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Pent-up demand to attract private, institutional investors to Connecticut multifamily assets

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Apartment property fundamentals should stabilize this year after absorbing the demand shock of 2009. Tepid job creation and elevated unemployment will hamper renter household formation through most of 2010, delaying a more noteworthy improvement in apartment demand. National unemployment in the prime renter age cohort of 20 to 34-year-olds started the year more than 200 basis points above the overall rate and at the highest level on record since the early 1980s. Additional challenges to an apartment recovery in 2010 include competition from shadow rentals and the extended first-time homebuyer tax credit. By some estimates, the latter has already resulted in 350,000 home sales that would not have occurred otherwise. The extended forecast for the apartment sector remains bright, supported by a pullback in construction and permitting, burn-off of excess housing inventory, receding homeownership rates, and favorable demographics.

This year's slow rebound in hiring, particularly in the professional and business services and trade, transportation and utilities sectors, will continue to dampen apartment fundamentals in southwestern Connecticut. Nevertheless, modest historical rent increases and average inventory growth of just 1.1% annually over the past five years have led to pent-up renter demand in many submarkets. In New Haven Harborside and North Haven/Wallingford/Meriden, for example, slight vacancy improvements are projected to persist in 2010, which should allow rent reductions in these areas to taper off by mid year. Alternately, owners in Fairfield County will continue to rely on concessions due to elevated rents. The largest rent cuts have already occurred in the county, and modest job creation will cause rent discounts to ease further as the year progresses. Construction will increase to an uncharacteristic high of 500 units in 2010. Completions will be limited to the New Haven core, however, where vacancy is the tightest in the metro area and unoccupied units fill quickly.

By the numbers, employment growth in New Haven is forecast to lag the national average. Employers are forecast to increase head counts in the New Haven metro area by 1,600 positions in 2010, or 0.2%, after shedding 26,700 jobs last year. Construction output is expected to increase to 500 units this year, following the completion of 280 apartments in 2009. In 2010, limited job growth and the delivery of new stock will contribute to raising vacancy 30 basis points to a still-healthy 4.8%. Vacancy increased 40 basis points last year. Asking rents will decline 1.6% to \$1,497 per month this year, while effective rents will dip 2.5% to \$1,405 per month. In 2009, asking and effective rents fell 4.5% and 6.2%, respectively. Class A rents in the downtown core New Haven market will be negatively impacted as the 360 State St. project comes online with 500 new units in spring of this year.

Continuing an investment trend that began during the second half of 2009, sales velocity in New Haven will accelerate in 2010, though the number of sales will remain well below peak levels. Buyers will be most active in New Haven and lower Fairfield County due to their historically strong

rental demand and large concentrations of employers. Investment activity also will increase in the Wallingford/Meriden submarket, given the resiliency of area operating fundamentals through even the worst of the recession. In Bridgeport, expectations for still-soft rent and vacancy trends will likely limit an upswing in buying activity this year, though the possibility of cap rates nearing 9% will maintain some investor interest.

Apartment development in the years leading up to the recession fell short of historical norms, and tight credit markets have since cleared many planned projects from the pipeline. In 2009, multifamily permitting declined 60% from the previous year, and construction deferrals doubled. The lull in development will provide owners time to fill vacant units ahead of the next construction cycle, which is unlikely to reach meaningful levels until 2012-2013. Furthermore, apartment owners stand to benefit from echo boomers transitioning into their prime renting years, with the number of 20 to 34-year-olds projected to rise by approximately 5 million individuals in the next 10 years.

Looking ahead, a lack of distressed properties and increased activity from both private and institutional investors will keep the spread between cap rates and agency lending rates tight in 2010. In lower Fairfield County, however, persistent buyer interest and the low availability of for-sale top-tier properties may underpin slight cap rate compression. While we expect at least the first half of 2010 to continue to be a tough year for investment real estate both nationally and regionally, multifamily is certainly the preferred product type for institutional and private investors delivering stable, solid returns, particularly in the supply-constrained Connecticut markets.

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