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Marcus & Millichap Apartment Research Market Outlook: Low interest rates lure institutions back to the market

May 12, 2011 - Spotlights

Limited construction activity and a surge in payrolls this year will propel improvements in Boston apartment operations ahead of most of the nation. Deliveries will drop to the lowest level in more than a decade during 2011, boosting the performance of existing complexes, particularly as job growth accelerates. Employers will elevate head counts to near pre-recession levels. Large job gains in the professional and business services and financial activities sectors, especially, will ignite renter demand for Class A units. Core submarkets like Central City/Back Bay/Beacon Hill will receive the most leasing activity as residents move closer to major employers in the Financial District. As a result, the submarket's vacancy rate will plunge 110 basis points this year, surpassing the metrowide decrease. Apartment properties in the suburbs will also demonstrate improvements through 2011, though, with employment gains in the goods and services industry fueling strong absorption of lower-tier units in areas such as the North Shore/Merrimack River Valley, where blue-collar jobs comprise a significant portion of the work force.

Investment activity will increase this year as institutional investors move off the sidelines to take advantage of the low cost of capital and properties trading below replacement cost. The growing presence of these buyers in the market should entice owners to unload assets at attractive yields, particularly in Suffolk County, where cap rates among Class A properties containing 200-plus units dipped into the low-6% range last year. Private, in-state buyers will also step up their activity, focusing on outlying areas such as the Mystic River North/Rte. 128 submarket for properties listed below \$5 million, especially those along major transportation routes like state Rte. 99 and U.S. 1. These experienced local investors will seek to purchase low to mid-tier assets with deferred maintenance; these properties currently trade with first-year yields 110 basis points above the market average. Additional investment opportunities will emerge east of I-93 in the South Shore/Rte. 128 submarket, where operations continue to stabilize and the median price in apartment deals has dropped nearly 20% since 2006.

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APARTMENT FORECAST

Employment: Boston employers will expand payrolls by 2% this year by adding 49,000 jobs, the largest annual increase in more than a decade. During 2010, metro head counts expanded by 37,000 positions.

Construction: Apartment construction output will slow to 285 units in 2011, expanding inventory by just 0.1%, well below the 10-year average of 2,800 units annually. In 2010, builders completed more than 1,040 apartment units.

Vacancy: Supported by decreased building activity and positive net absorption of 2,050 units this

year, the metrowide vacancy rate will drop 90 basis points to 4.2%, well below pre-recession levels. In 2010, vacancy plummeted 130 basis points.

Rents: Asking rents will reach a historical high in 2011, advancing 3.5% to \$1,772 per month. Effective rents will increase 4.5% to \$1,694 per month as leasing incentives dip to an eight-year low of 16 days of free rent.

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