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As attitudes toward homeownership shift, apartment sector set to flourish

January 19, 2012 - Connecticut

The U.S. apartment sector recorded strong absorption gains and higher occupancy rates in 2011 as it continued to its marathon-like recovery. Tight supply conditions exist, especially in metros with high barriers to entry. The national vacancy rate declined 120 basis points over the year to 5.4%. Effective monthly rents nationwide posted healthy annualized gains of 4.0%. Foreclosures in the single-family market, the inability of most Americans to meet mortgage financing requirements and households choosing rental housing for lifestyle reasons or employment mobility contributed to a net rise in apartments nationwide, totaling an annualized 900,000 in 2011. In addition, the 20-34-year-old age cohort captured approximately 70% of job gains recorded in 2011, stimulating new household creation.

Multifamily sales activity surged through the first three quarters of 2011, characterized by portfolio sales, a return to pre-bubble sales volumes and a narrowing differential between core and value-add yields. A significant shift in transactions to secondary and tertiary markets compressed cap rates for Class B and value-add properties to the 7.5% range, while core properties settled below 6%. The number of offerings in October spiked to the highest level since 2007, yet the fourth quarter marked a moderate slowdown in apartment property sales. Economic uncertainty played a role, but deal fatigue, rich pricing, and macro concerns caused investors in the top-tier segment to pull back in late 2011. However, many risk-tolerant investors view this as an opportunity, so it should not result in a major market slowdown.

In New Haven and Fairfield Counties, there was also a surge in demand for rentals and a growing movement among local residents away from homeownership, as in virtually every other market in the country. Because of the region's proximity to Boston and New York, along with its modestly expanding economy, it will remain a prime market for investors in 2012. The notable growth of Yale University and its affiliated medical facilities has spurred a major redevelopment project linking the downtown core to the Medical District. The Downtown Crossing Project will transform Rte. 34 and generate transit-oriented development that includes retail, residential and medical space. In Fairfield County, meanwhile, high demand will persist for Class A units in areas such as Greenwich. Stamford, in particular, is home to one of the busiest Amtrak stations in the country and its access to I-95 enhances its appeal for commuters. The city also hosts many large-scale businesses that support white-collar jobs. In 2012, NBC Sports will join the area's collection of companies that already includes RBS Greenwich Capital and General RE, contributing to demand for top-tier apartments. Supply growth in the area is accelerating, however, and may place upward pressure on the vacancy rate.

Investment activity in the New Haven-Fairfield area will remain steady, as buyer demand will go unfilled in 2012. An aggressive buyer pool illustrates the desirability of assets in the area, while the

low sales volume reflects long-term hold strategies favored by most owners. Property owners are hesitant to sell performing assets despite cap rates in the 6% range in downtown New Haven. Investors seeking higher yields, meanwhile, can consider smaller suburban communities, where cap rates are 50 basis points higher. In Fairfield County, listings typically offer first-year yields 50 to 100 basis points above first-year returns recorded in New York City, and will garner significant interest from regional buyers.

Financial conditions improved throughout 2011. GDP and employment growth rose, shoring up property performance and revenue streams. Loan delinquencies receded from their cyclical peaks and values firmed across most commercial property types, aided by the low cost of debt and positive spread between cap rates and interest rates. The multifamily sector was the only property type with strengthening loan performance on a national level.

In 2012, fundamentals and a favorable spread against Treasuries will promote multifamily development in many parts of the U.S., including Connecticut. Fannie and Freddie will remain the chief suppliers of apartment loans in an increasingly crowded field of providers. Accommodative monetary policy will keep interest rates low for several years. Expect life companies and commercial banks to grow market share by pursuing assets with good credit features and stabilized revenue. Sellers will bring more properties to market, capitalizing on strong investor demand, easing bidding wars. Capital will migrate to secondary markets and value-added investments. Sales volume will rise as risk tolerance expands and capital becomes more fluid.

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