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Construction accelerates, vacancies edge higher in Connecticut apartment market

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As we begin the second half of 2013, economic growth across the region over the past 18 months has been a major catalyst in making New Haven and Fairfield counties magnets for apartment renters. Nearly 5,400 workers were added to payrolls in the region in 2012, contributing to net absorption of more than 1,000 apartments over that time.

This year, employment is on track to continue this expansion with additional hiring through the remainder of the year, on track to double last year's number of new jobs. In fact, total employment in the two counties will expand 1.5% in 2013 with the addition of 11,500 jobs.

In addition to the other sectors growing over the past year, professional and business services and manufacturing and construction will increase payrolls by year end. Over the past four quarters, the leisure and hospitality sector was the largest job creator, producing 1,200 new positions, followed by trade, transportation and utilities with 1,070 positions.

As a result of the jobs growth, apartment developers are eager to place cornerstones for new residences, and have increased construction in Fairfield and New Haven counties. Developers will deliver 1,370 units in Fairfield County by year end, accounting for all of the construction in the market. More than 600 units will come online in Stamford alone. Last year, 493 units were delivered in the market.

Though vacancy has decreased dramatically from the height of the recession to slightly above the current U.S. average, demand for new units will fall short, lifting vacancy temporarily. Vacancy will increase 30 basis points to 4.8% in 2013 as the number of units coming online more than doubles. Still, the vacancy rate remains below the U.S. average of 5%, and in time, the new units will be absorbed as the region continues to grow and gain additional commuter and lifestyle residents.

Employees will migrate to New Haven and Fairfield counties to take advantage of reasonable rents, particularly at new luxury apartments. The absorption of new luxury apartments will help push up effective market rents 1.8% to $1,610 per month by year end. Overall, effective rents inched up 0.3% in 2012. Local property owners' restraint in raising rents rapidly will keep vacancies low, particularly at complexes near major transportation routes and commuter rail stations.

Employment growth, combined with escalating housing costs in other markets, aided leasing in the second quarter of 2013. Though projected completions this year are higher than last year's total, vacancy generally remains below 5%, and unfulfilled demand for rental housing persists. The majority of the 2,660 planned units coming online in the area will be in Fairfield County with about half coming to market this year.

Undiminished appetites among institutions and large investors for new properties offers developers a potential exit strategy, though a broad range of properties are changing hands in the market. As buyer interest grows, more owners are bringing properties to the market and assets are trading in the high-5 to 6% cap rate range. Initial yields in outlying areas typically run about 50 basis points higher, while Fairfield County properties offer first-year yields generally ranging from 6.5% to 7.5% for non-institutional assets.

In recent weeks, the Fed's suggestion that the central bank could begin to scale back its aggressive bond-buying program later this year was misinterpreted by the markets, which have been hyper-sensitive to any material changes in monetary liquidity. This caused a rapid sell-off in the bond market, pushing the 10-Year Treasury yield from 1.66% in early May to 2.6% on June 25th. Mortgage rates jumped considerably. The situation has been exacerbated by widening spreads spurred by market volatility. In this instance, increasing interest rates are not related to real estate fundamentals. We anticipate rates to settle, if not even come in a bit as the initial market hyper-sensitivity eases.

In the apartment investment sales market, volume rose nearly 37% over the past 12 months. The median price of properties sold over the past year in the region was $75,000 per unit, or 38% higher than the median price in the prior annual period. The outlook includes expectations for additional performance improvements and a stronger local economy that will sustain a high volume of transactions in the market through 2014, when the Federal Reserve could raise interest rates.

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