nerej CELEBRATING 55 YEARS

Revenues push higher despite increased vacancy in southwestern Connecticut market

November 19, 2008 - Connecticut

Cooling economic conditions continue to dampen residential demand in the southwestern Connecticut market amidst a late-year upswing in construction activity. Indeed, local apartment operators are bracing for the largest quarterly inventory expansion in three years during the fourth quarter. Approximately 70% of this year's deliveries are slated for Fairfield County. While vacancy in Lower Fairfield County is expected to remain in check, occupancy levels will drop further in Bridgeport submarket, after owners significantly raised rents at the expense of increased vacancy earlier in the year. In contrast, there has been minimal new development in New Haven County, which has supported revenue gains in most submarkets. Owners in New Haven Harborside are expected to record the most significant improvements in operating fundamentals, as the area's Class A asking rents have attracted renters from Fairfield County's more expensive Class B/C properties. Fortunately for leasing activity marketwide, construction is forecast to be subdued in 2009.

Since the third quarter of 2007, multifamily builders have completed 750 units in the metro, expanding total market-rate stock by 1.7%. Nearly 300 apartments were delivered in the preceding 12-month period. Approximately 570 units are expected to come online during the next six months; however, the lack of construction financing will begin to narrow the pipeline in the second quarter of 2009. The Bridgeport submarket will lead the metro in apartment development in 2008. Builders are on pace to complete roughly 480 units, which will expand the local inventory by 4.8%. Developers are forecast to deliver more than 1,000 apartment units this year, compared with 425 rentals in 2007. During the past five years, completions have averaged 440 units annually.

Since the third quarter of 2007, the combination of accelerating apartment development activity and cooling demand has pushed vacancy up 120 basis points to 4.9%. Year to date, however, vacancy has only increased 20 basis points. Although demand for Class A rentals remains healthy, absorption has been affected by job losses, with top-tier vacancy rising 10 basis points to 3.5% in the past year. Aggressive asking rent growth in the Class B/C sector has come at the expense of occupancy levels during the last 12 months, especially in the Bridgeport submarket. Marketwide, lower-tier vacancy has climbed 230 basis points to 6.2% during that period. The elevated pace of construction activity and cooling residential demand as a result of employment losses will increase vacancy 100 basis points to 5.1% in 2008.

Asking rents appreciated 3.5% year over year to end the third quarter at $1,602 per month. Meanwhile, owners were able to raise effective rents 3.3% to $1,560 per month. Class B/C apartment owners have begun to close the large gap between upper and lower-tier rents during the past year. During that period, Class B/C asking rents have advanced 3.8% to $1,284 per month, while Class A rents have increased 3.1% $1,990 per month. In the last 12 months, slower but still-resilient rental demand has allowed owners to achieve healthy effective rent growth, consequently offsetting occupancy increases and pushing gross revenues 2% higher. Asking and effective rents are forecast to advance 3.3% and 3.1% this year to $1,617 per month and $1,574 per month, respectively.

Through the third quarter, for the state of Connecticut, 1,422 multifamily units have traded for $181.84 million, compared to 1,417 units for $115.7 million in 2007 and 1,404 units for $94.72 million in 2006. Supported by resilient demand for Class A buildings, the median price has appreciated 22% to $87,750 per unit in the last year. During that period, the median prices in Fairfield and New Haven Counties were $171,400 per unit and $69,800 per unit, respectively. The prevalence of Class A transactions over the past year has compressed cap rates from between 10 basis points and 20 basis points to the low-6% to low-7% range. Excellent demographics and incomes will preserve apartment property values through the economic downturn. Although investors' confidence in Class A assets will linger, well-located urban and suburban Class B/C assets proximate to CBDs and universities are expected to attract an increased number of buyers.

Deal flow has declined in both counties due to constrained capital markets; however, the slowdown has been more pronounced in New Haven County during the past 12 months. During that span, apartment price appreciation in the county has fallen short of the pace recorded in Fairfield County. Nevertheless, many investors have found opportunities in New Haven County. Buyers have been particularly bullish on repositioning opportunities in assets with fewer than 20 units north of the New Haven core.

Steve Witten is a vice president, investments and senior director of Marcus & Millichap Real Estate Investment Services' National Multi Housing Group, New Haven, Conn.