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Long term apartment fundamentals remain strong in Connecticut

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Apartment fundamentals have been the most stable of any investment property sector throughout the economic downturn. Supply-constrained markets in Connecticut with solid economic drivers during the past few years entered the downturn with low vacancy and are well positioned to weather the economic storm. The return of households to the rental market after temporary homeownership, the emergence of echo-boomer renters and a significant drop in new supply pipelines will ultimately lead to several years of strong rent growth. The challenge will be getting through 2009, which will require exceptional tenant retention, aggressive marketing at the property level and an unwavering focus on operations.

Job market struggles in the New Haven market will persist through 2009, yet low housing affordability and a reduced pace of apartment construction are expected to keep apartment vacancy fairly tight. Although contraction of the professional and business services and financial activities sectors will slacken top-tier rental demand this year, Class A properties in the New Haven Harborside submarket should perform well due to the area's relatively affordable rents when compared to Fairfield County. The greatest strains in the market are expected in tertiary submarkets such as Naugatuck/Waterbury, where rent gains will moderate and vacancy should creep higher as renters begin to double up. Elevated land and construction costs have historically insulated the metro area from overbuilding, and developers are responding to local economic uncertainty by slowing apartment deliveries in 2009 and in the years to come.

Multifamily investment activity in Connecticut is expected to gain some additional momentum this year after a surprisingly strong 2008. Last year, investors' fears of the added risks associated with lower-tier assets limited transactions to mostly Class A and B+ properties in the state's urban areas. While reduced investor demand for properties in secondary and tertiary locations will continue, buyers are expected to target Class B/C apartments in stable CBD markets. Buyers will likely target lower-tier properties in the New Haven core, Hamden and the Fairfield/Bridgeport/Trumbull triangle, where students represent a consistent pool of renters. Fewer Class A transactions and the presence of low-leverage opportunistic buyer funds will likely result in a shift in pricing trends, causing cap rates to increase to the mid 7% to 8% range.

Apartment properties are trading and being financed in the region, thanks largely to agency lenders and still-active local and regional commercial banks. Through the third quarter of 2008, 4,990 apartment units traded in Connecticut for $703,307,000. This compares to 2007 in which 6,247 units sold for $891,958,998. Year-end sales data will be available soon, and it will be interesting to see how the fourth quarter of 2008 faired. Average per-unit sales value through Q3 of 2008 was $140,943, which compared favorably to $142,782 per unit for the year ending 2007. The current apartment transaction climate, defined by various degrees of price declines, should be distinguished from the sector's long-term intrinsic value. Properties that must be sold in today's environment clearly require discounting from previous years' values in order to clear the market. On the other hand, owners without a compelling need for an immediate sale, the majority of whom report healthy operations, are positioned to hang on through the downturn. If however, an owner is contemplating a sale in the foreseeable future (within two to four years), there could be no better time to sell as we expect yield criterion to continue trending up. More than ever, a fresh look at each property's hold, refinance or sell strategy is warranted, given the recent market volatility.

Investors must differentiate distressed properties from the rest of the marketplace, which remains extremely healthy compared to historical standards and other real property sectors.

Connecticut multifamily owners with reasonable leverage and relatively healthy operations are expected too comprise the majority of the marketplace in 2009. These investors will continue to ride out the downturn and will be rewarded by several key factors that point to long-term value. The significant decline in new construction now taking hold, combined with renter demographics similar in scope to the baby boom wave as they entered peak renting years, will be the main drivers of value creation. While we expect 2009 to continue to be a tough year for commercial investment real estate, multi- family is certainly the preferred product type for institutional and private investors with its promise of delivering stable, solid returns, particularly in the supply-constrained New England markets.

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