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Navigating thru the headwinds - Greater Boston's multi-family and retail investment sales markets

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Multi-Family

Apartment fundamentals have been the most stable asset class throughout this economic downturn. The combination of declining household credit quality, rising residential foreclosures, and tougher mortgage standards are providing a boost to the renter pool and helping offset the impact of shadow renters on vacancy.

Limited deliveries of new multi-family units should keep vacancy fairly stable in Boston throughout 2009.Â Approximately 2,100 apartments are scheduled to be completed this year, following the delivery of 3,300 units in 2008. However, the metro's high concentration of professional and financial jobs makes it vulnerable to the economic downturn. In 2009, payrolls are expected to decline by 46,000 positions, or 1.9 %. Last year, 27,800 jobs were eliminated. Developers are responding to weaker demand and slowing multi-family construction activity.Â

Despite a major drop in sales activity from the peak (down 50% nationally), apartment properties are trading and being financed, thanks largely to agency lenders and local/regional banks. Capital remains available, particularly for high-quality assets, although borrowing requirements and underwriting have adjusted to additional risk in the market.Â DCR's have increased to 1.25% - 1.3%, with down payment requirements increasing to 25 - 35 % Â

Investment trends in the Boston apartment market will likely diverge in 2009; demand for stable assets in core markets will remain strong, supporting current values, while properties in tertiary areas will face challenges. While average cap rates are approximately 7.5% throughout the metro area, investors will pay a premium for stabilized properties in premier submarkets such as Brookline, Cambridge/Somerville, Allston/Brighton; these assets are expected to trade at cap rates in the low to mid 6 range. Spreads will continue widening further by quality of product and market. The majority of the core apartment owners have balanced leverage and relatively healthy operations. Distressed properties will continue to emerge from tertiary areas, dominated by high leverage, weak operations, and maturing loans. More than ever, a fresh look at each property's hold, refinance or sell strategy is warranted, given the recent market volatility.Â

Retail

Cooling economic growth and the housing downturn are weighing heavily on retailers throughout the U.S. Declines in consumer confidence and retail sales growth are resulting in store closures for both local/national merchants. Large national chains are continuing to halt expansion plans into 2009.Â The ICSC statistical model projects 148,000 stores to shutter in 2008 with an additional 73,000 during the first half of 2009.

Over the past six months, single tenant inventory in New England has significantly increased while transactional velocity is down over 50%. Investors, now more than ever, have many options to place capital across all of the major product types. Owners/developers who need to sell are facing constant price adjustments necessary to clear the market. The new construction pipeline in New England will continue to trade well into 2009.

Since July, cap rates for single-tenant assets with strong credit have released 50 - 75 basis points with non-credit moving 100 - 250 basis points. Investors are more than ever scrutinizing the corporate balance sheets, analyzing unit sales, and paying significant attention to the location of the asset. In addition, investors looking for single tenant/multi tenant assets are favoring retailers that sell necessities, including wholesale clubs, drugstores, discount stores and grocery stores.

Tighter lending standards and slower economic growth will encourage many owners to comb through their retail portfolios, selling underperforming properties that fall outside of their core strategy and re-deploy the equity in assets that offer better returns.

Debt

The cost and availability of capital remain top concerns for investors as illiquidity in capital markets continues to drag down investment real estate sales. Most investors are not optimistic that access to capital will improve anytime soon. In addition, investors believe that the cost of capital will be more expensive a year from now. Mortgage spreads have already increased and are likely to remain volatile as risk is re-priced.

The greater Boston market will offer great opportunities for cash and low leverage buyers with strong lender relationships. We look forward to helping private and institutional clients navigate in 2009.

Bob Horvath is senior associate at Marcus & Millichap, Waltham, Mass.