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Demand persists for southeastern Connecticut apartment properties as housing prices remain high

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Mounting job losses are expected to have a moderate impact on the southeastern Connecticut apartment market this year, although rental demand will persevere as the region's renter population remains locked in by high home prices. Southeastern Connecticut's concentration of financial services companies will hamper the ability of Hartford to recover from the current economic downturn quickly, which could negatively impact the local Class A market. Conversely, the life sciences industry is expected to help New Haven record a strong recovery, with continued growth in the healthcare sector supporting apartment demand. In New London, the presence two of the world's largest casinos will help preserve apartment demand for Class B/C assets in the area, with lower paid service workers. Likewise, pharmaceutical giant Pfizer will have a similar impact on Class A properties. Region wide, layoffs will accelerate in 2009, as 18,000 jobs are forecast to be cut marketwide, a 1.9% loss, after local businesses reduced payrolls by 6,900 positions in 2008. Through the first quarter, approximately 4,300 jobs have been trimmed.

Vacancy and rental rates will get a much needed assist from reduced development levels this year. While elevated land and construction costs have historically insulated the metro areas from overbuilding, developers are also responding to local economic uncertainty by slowing apartment deliveries in 2009. After approximately 700 units were delivered in 2008, less than 400 units are expected to come on line this year, an increase in inventory of less than 1%. The units will be located primarily in the Hartford area, with no completions scheduled for the New Haven or New London areas.

Region wide, after rising 30 basis points in the first quarter, vacancy will continue to increase through year end, finishing 2009 in the mid-to-upper 5% range. While this is about 150 basis points to 200 basis points higher than the average over the past eight years, it is still fairly strong. As a result of the jump in vacancy, asking rents are forecast to post a 2% to 3% drop this year to $978 per month, erasing a portion of the gains made over the past 12 months. These changes represent the first negative trends for the area in over a decade; however, the market in general remains reasonably fit in relation to most East Coast markets.

Hartford will continue to record losses within production, manufacturing and distribution companies in 2009, with vacancy forecast to finish the year at 6%, up 80 basis points from 2008, while rents are expected to fall 4.2% to $926 per month. A more stable pool of large employers, composed mostly of healthcare, government and higher education organizations, and no supply additions will mitigate rising vacancy and concessions in New Haven this year. A 2.2% addition to inventory in 2008 facilitated a 70 basis point jump in vacancy in the first quarter to a healthy 4.2%, but solid renter demand will stabilize vacancy, finishing the year at 4.5%, the lowest level in the region. Local rents are thus expected to remain flat in 2009 at approximately $1,100 per month.

Investors looking to the region have been faced with a shortage of quality for-sale product. Nonetheless, dollar volume was up 8% from the previous year in 2008, compared to a East Coast average dive of more than 50% and a U.S. average drop of approximately 40% for the same period. Regional per unit prices ended 2008 at an average of just over $98,000, up a solid 31% from the previous year, although cap rates once averaging in the high-6% to low-7% range were up above 7.5% for most transactions. Activity in New Haven and Middlesex counties actually rose 142%, thanks in part to solid fundamentals and positive near and long term economic prospects. Prices in the two counties lead the state in increases, posting a combined jump of 33% to an average of $105,000 per unit. Only one transaction was reported in New London County for both 2007 and 2008.

Preliminary data suggests that sales activity appears to be receding this year, as recessionary stresses have kept many buyers and sellers on the sidelines, while a lack of capital from national lenders has exacerbated the problem. Nonetheless, demand for assets with reasonable cash flow expectations persists, as do opportunities for such properties. Buyers of assets between $3 million and $7 million might consider looking to regional banks in Connecticut and New York for financing needs, as funds are available with spreads below that of most national lenders. While reduced investor demand for properties in lesser locations will continue, buyers are expected to target Class B/C apartments in top areas, which will likely result in a shift in pricing trends, causing cap rates to increase into the high 7% range.

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