

Multi-family Investment Drops, But Fundamentals Remain Resilient

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The economic recession is negatively impacting all aspects of the real estate market. The combination of decreased demand and a frozen credit market is pushing up vacancy rates and depressing rent growth in most commercial markets. In the residential sector, mortgage delinquencies and foreclosures are still increasing. While existing-home sales rose in December of last year, resales are still lower than a year ago. As banks and other lenders await the shake-out from an economic stimulus package, credit is tight, and many potential first-time homebuyers are still on the sidelines, continuing to rent apartments.

As a result, the multi-family market is maintaining resiliency. Below we take a look at the state of the multi-family market in the fourth quarter of 2008.

Market Fundamentals

While the demand for apartment space was down compared with that in the third quarter, it is still a positive 12 million square feet. The number of completions remained relatively high, despite a slight drop in the third quarter of 2008. In addition, conversion of condominium projects into apartments continued to contribute to the completion figures. Consequently, the national vacancy rate stood at 6.1 percent in the fourth quarter of 2008, up 30 basis points from the previous quarter. **In response, rent growth in the multi-family sector was virtually flat. For the fourth quarter of 2008, rents were up a mere 0.6 percent.**

Regionally, the market trends were mixed. While there were several markets with lower availability, they are not geographically concentrated. At the top of the list for lowest availability is San Diego CA, with a vacancy rate of 3.5 percent. It is followed by Newark NJ (3.6%) and Boston MA (4.2%). Rounding the top-five list are Pittsburgh, San Francisco and San Jose, all three recording vacancy rates of 4.3 percent in the fourth quarter. **At the other end of the availability spectrum, there are markets like Jacksonville FL (9.9%), Phoenix AZ (9.4%), Orlando FL (8.5%), Houston TX (8.3%), and Atlanta, GA (8.2%) which posted higher availabilities.**

Investment Trends

The credit crunch that became more acute in the third quarter of 2008 pushed investment in multi-family properties down to 2001 levels. The volume of significant apartment sales dropped 61.7 percent in 2008, to \$37.6 billion. For the fourth quarter of 2008, the volume of sales was down 87.5 percent compared with the fourth quarter of 2007. Disappearing credit and a considerable pricing gap between buyers and sellers contributed to the major decline.

Cap rates for the multi-family sector increased throughout 2008, with a spike during the last quarter of the year. Cap rates rose from 6.1 percent in January 2008 to 7.1 percent by December 2008. For the fourth quarter of 2008, cap rates for apartments registered 6.8 percent.

The total number of properties trading hands experienced a continual decline during 2008. In the first quarter of 2008 there were just slightly more than 700 properties traded, in the second only about 550.

The third quarter saw that figure decline to 462. However, during the fourth quarter, slightly less than 300 units exchanged hands, a 72.0 percent decline from the fourth quarter of 2007.

The average price per unit, while generally volatile on a year-over-year basis, also moved downward in the fourth quarter. **While the average price per unit hovered around \$100,000 for 2008, it closed the fourth quarter at slightly less than \$90,000.**

Outlook

Looking ahead at 2009, the multi-family sector is likely to remain resilient, especially in comparison with the other commercial sectors. The fundamentals are weakening, but by the end of 2009, the vacancy rate is expected to be 6.5 percent, while rent growth for the year is expected to be 1.8 percent.

Meanwhile, ***investment in apartments is likely to be comparatively stronger***. During 2008, the number of apartment properties changing hands declined 49.2 percent, the lowest rate of any commercial property category. ***But the number of multi-family investments declined less than all other commercial sectors, except industrial. The figures paint a similar picture for the volume of sales in apartments which, at \$37.3 billion, is the second highest among all commercial real estate sectors. The main issue likely to continue impacting the multi-family sector is the availability of financial credit and investors' confidence in the markets.***