

Multifamily

Market-Rate Multifamily

By Jennifer Caterino



Cyan/PDX

THA Architecture and GBD Architects

Portland, Ore.

This 16-story building in downtown Portland is certified LEED Gold. It appeals to Generation Y renters by compensating for small units (many are less than 550 square feet) with attractive communal areas such as a "living room" and a park for residents.

It wasn't all that long ago that developers were scrambling to convert apartments to condominiums and architects were vying for the chance to design luxury residential projects. Today, after the bust and as the nation inches toward economic recovery, the development focus is on market-rate apartments, while financing for condominiums remains largely elusive.

The nation's apartment vacancy rate dropped to an average of 7.7 percent in the third quarter of 2010, according to the Commercial Real Estate/Multifamily Finance Quarterly Data Book issued by the Mortgage Bankers Association (MBA). The rate had dipped as low as 5.7 percent in late 2006 before gradually increasing to a 30-year

high of 8.4 percent in fourth-quarter 2009. The MBA also reported that the economy grew at a seasonally adjusted annual rate of 2.5 percent in the third quarter, marking the fifth straight quarter of positive growth.

Manny Gonzalez, AIA, a principal of KTGy Group based in the firm's Santa Monica, Calif., office, thinks that market fundamentals combined with the nation's demographics have the potential to trigger more multifamily development. "All it takes is for the job market to come back, and it could create a frenzy in the [apartment] market in two to three years," Gonzalez says.

Renter Nation

Expected to lead the apartment market's recovery are the so-called Echo Boomers. Also dubbed the Millennials and Generation Y, this group is estimated to total from 60 to 77 million Americans. Whether it's because they are disillusioned by the housing crisis, lack job security, can't qualify for a mortgage, or prefer the mobility, this group is being hailed as the next renter nation.

"Historically, 64 to 65 percent of people owned homes," says Jack Hannum, vice president in Transwestern's Phoenix Investment Services Group and a specialist in large multifamily properties. "In 2004, that number increased to 69 percent; now, it's trending back to a 65 percent net rate. That represents a significant number of people shifting back to the rental pool."

According to Michael D. Binette, AIA, vice president and principal in charge of construction for the Architectural Team in Chelsea, Mass., there has been a psychological change in the mindset toward rental apartments. "It's becoming a lifestyle choice rather than a stepping stone," he says.

While some of these people are becoming renters out of necessity, Hannum says that the flexibility that comes with a lease appeals to many Echo Boomers. He sees the next wave of multifamily projects, coming on line in roughly two years, as poised to capture the would-be renters who doubled up with a roommate or moved home with their parents when the economy grew shaky. "There is not the same fear in the markets as two years ago. We consider these temporary living situations that will only happen as long as they have to," he says.

Small Place, Big Lifestyle

In Boston, the Architectural Team is reconfiguring a project it first began in 2001. The Kensington was set to go forward as a 30-story residential tower in 2005, but the ensuing economic turmoil put that project on hold, along with many others across the country.

Now its developer, the Kensington Investment Co., is tracking for a July 2013 opening, says Mark J. Rosenshein, a senior project manager with the Architectural Team. Once a mix of luxury condos and market-rate rentals with an affordable component, the project is now strictly market-rate rental units.

But the building's composition isn't the only thing that has changed. Using the same building area, the new configuration will yield 383 units—76 more than in the original scheme. Rosenshein says that shrinking the units (what were once one-bedroom condos averaging 1,000 square feet are now 800-square-foot rentals, for example) allowed for the unit increase.

"Generation Y doesn't care if the unit is smaller," says Alan P. Mark, president of San Franciscobased Mark Company, which specializes in project turnarounds. "They consider the home to be the bedroom, the living room, and the surrounding amenities."

"We are designing a lot smaller," says KTGy principal Rohit Anand, AIA, who is based in the firm's Tysons Corner, Va., office. What might have been a 950-square-foot apartment a couple of years ago now measures 800 square feet. Though units are getting smaller, the size of amenity areas that house club rooms, fitness centers,

pools, and the like is consistent with older product, Anand says; these areas can extend as much as 5,000 square feet in a 200-unit building.

What has changed is how an amenity package is programmed. Today's projects emphasize open, connected spaces, and many of the newer amenities are on par with what has traditionally been included in hospitality projects, Anand says.

Deven Morganstern, a marketing agent for Cyan/PDX in downtown Portland, Ore., attributes that project's success in part to the communal "living room" areas and adjacent resident-only park. As of early January, the 352-unit apartment building boasted a 90 percent occupancy rate. Designed by a joint venture of THA Architecture and GDB Architects, the 16-story project is largely composed of compact studio, one-bedroom, and two-bedroom apartments, many under 550 square feet.

From Granite to Green

While granite countertops, flat-screen televisions, and stainless steel appliances will make their way into many market-rate residential projects, Gonzalez says that the level of finishes will vary from developer to developer. "It's more important to be urban and cool than high-end and grand," he says. "For example, instead of a sliding shower door, you can do a rounded bar with a curtain and create a W Hotel kind of feel."

Sustainability looks to be the wild card when it comes to the Echo Boomers' apartment wish list. "This generation is more focused on the impact of its carbon footprint," Binette says. "They won't pay more for it, but if they have the choice of two buildings with the same rent, they'll pick the more sustainable one."

Anand and Gonzalez agree that Echo Boomers are hesitant to pay substantial rent increases for a green apartment, but sustainability efforts have garnered different levels of success in different markets.

In Phoenix, for example, where spaces for social interaction are a key tenant amenity, Hannum doesn't currently see a building's carbon footprint playing a primary role in attracting tenants. But Morganstern says sustainability has been a draw for the LEED Gold-certified Cyan/PDX. Even with rents that exceed downtown Portland's average, he reports that 65 to 75 percent of residents are renewing leases compared with the industry average of 35 percent. In addition to a green roof and various energy-saving measures, the building offers residents access to bikes and is sited near transit.

Housing Shortages

The dearth of new multifamily construction is expected to result in diminished stock and possibly a housing shortage if demand outpaces supply. The National Association of Home Builders (NAHB) estimates that about 300,000 multifamily units need to be added each year to meet ongoing demand. "We retire 100,000 apartment units annually" to obsolescence or condo conversion, Gonzalez says.

Nationally, the MBA reports that multifamily permits in structures with five units or more fell to 94,000 in November on a seasonally adjusted rate, the lowest level in the past 12 months. In the same period, the number of multifamily starts dropped to 72,000, and completions fell to 73,000. Compare that to 2007, when the multifamily sector recorded 359,000 permits, 277,000 starts, and 253,000 completions.

Alan Mark predicts that San Francisco's condo inventory will dwindle to fewer than 500 new units by early 2012, based on the current development pipeline. "There were 165 units permitted during Q3, none of which we believe to be market-rate condos," he says. In Phoenix, Hannum echoes Mark's concerns. "Apartment developers in Phoenix want to get going, but they are still struggling" to get financing, he says. Hannum expects Phoenix will experience a housing shortage in 2013 or 2014 as population and employment grow.

For 2011, the NAHB forecasts 133,000 multifamily construction starts. At the same time, Jones Lang LaSalle's 2011 Multifamily Investment Survey indicates rising investor interest in the product type. Compared with 90 percent a year earlier, 93 percent of respondents predict that their investment allocation into multifamily product will increase in 2011. The Southwest and Northwest are the two regions that stand out for potential investment, according to the survey.

For now, condo developments are far and few between, as lenders have remained reluctant to finance projects. But don't count out another condo-conversion craze in a couple of years, Anand says, before evoking a familiar industry idiom: "We're in a 10-year business, but we have a five-year memory."