BUILDING DESIGN +CONSTRUCTION

Rental Renaissance, The Rebirth of the Apartment Market

Across much of the U.S., apartment rents are rising, vacancy rates are falling. In just about every major urban area, new multifamily rental projects and major renovations are coming online. It may be too soon to pronounce the rental market fully recovered, but the trend is promising.

By Peter Fabris, Contributing Editor
January 03, 2012

Gables 5th Street Commons, a four-story, 138-unit mixed-use apartment complex by developer Gables Residential, near the University of Texas at Austin. Building Team members: Looney Ricks Kiss (architect), Gables Construction (GC), Basharkham Engineering (MEP), Viewtech Inc. (SE), Bury + Partners (CE), and Kevin Sloan (landscape architect).

The Great Recession that began in 2008 essentially killed the entire U.S. housing market. New housing construction of any kind was pretty much stopped in its tracks. And while new single-family and condominium housing construction has continued to be dormant, the last 18 months or so have seen a resurgence in the multifamily rental market—in part due to the collapse of the single-family and condo markets. "The occupancy rate in the apartment sector was 91.8% at the end of 2009," notes Greg Willett, vice president of research and analysis, MPF Research, Carrolton, Texas. "By the third quarter of 2010, the occupancy rate was up to 94.8%."

Foreclosures forced many former homeowners into apartments, a trend that shows no sign of improving any time soon. "Home ownership has dropped by a couple of percentage points and is still falling," says Mark Obrinsky, vice president of research and chief economist for the National Multi Housing Council, Washington, D.C. "Rental vacancy rates are now back to the normal range."

The precipitous drop in housing values has spooked some consumers who likely would have taken on a mortgage before the recession. “You now have the new phenomenon of renters-by-choice who have lost faith in the wisdom of owning,” says Michael Liu, AIA, NCARB, vice president and principal with the Architectural Team, a Boston-based design firm specializing in multifamily housing. With little reason for optimism in the near term for housing values to appreciate significantly, the rental market will continue to benefit from these renters-by-choice.

Demographics are also fueling the rental recovery. “The U.S. population is growing,” says NMHC’s Obrinsky. “There are many developed countries where that is not true.” Specifically, a segment of the population coveted by multifamily rental developers—the so-called “echo-boomers”—is itself booming. “Working in our favor is the growth of the 25- to 34-year-old population, who have a higher propensity to rent,” says John Christie, senior director for investor relations and research with Avalon Bay, a national rental housing operator and developer.

APARTMENT FINANCING GREATLY IMPROVED

In the last year or two, the capital spigot has opened for rental projects, first in a few select markets like Washington, D.C., and New York, then in urban areas in most of the country. “If you want to build apartments, there are plenty of people willing to lend to you,” says Avalon Bay’s Christie. “Interest rates are down, and there is a lot of money available, particularly for larger companies like REITs.” Smaller developers may still face a “more selective lending environment,” he adds.

After sitting on the sidelines for a couple of years, insurance companies and other large investors that historically have funded multifamily projects have jumped back in the game, and the intensity of their interest is picking up. “In the last few months in particular, debt availability has outpaced equity,” says Matt Trammell, vice president of finance for Wood Partners, a national multifamily developer based in Atlanta. “People really like this space.”

Despite the recent flurry of activity in rental construction, however, the overall supply of rental housing hasn’t increased much in recent years. “We are at the low point for deliveries because there were so few starts in 2009 and 2010,” says Willett. Starts increased substantially in the past year, though, with about 160,000 new units in development. According to Obrinsky, “We are running about twice the level of the trough, but still well below the levels of 1998-2007,” when pre-recession starts ran 300,000-350,000 annually.

With continued strong demand, we may be at the beginning of a modest surge in multifamily rental construction. Low rental vacancy rates are likely to continue for the next couple of years, says Willett. Many developers seem to agree, and are planning accordingly. “We expect a boom in starts in 2012 and into 2013, then the market will stabilize,” says Trammell. “It won’t be boom and bust.”

While the current revival in apartment construction is a welcome relief from the generally bad news in the housing market, don’t expect a return to the good old days before the recession. Markets would have to tighten significantly more to reach those levels, says Obrinsky. One cause for concern: Most renters are not seeing more disposable dollars in their paychecks. “Rents are going up, but incomes are not,” Willett says. At some point, he says, it will become increasingly difficult to keep units occupied.

SOUNDS GREAT, BUT WHERE IS THE GROWTH?

In general, most of the action on new and major rehab projects is in urban areas, particularly near the urban core. That’s because the sweet spot of the rental market—young professionals—often choose to live in areas that offer lots of amenities—cafés, restaurants, nightspots, and other neighborhood attractions.

Every metro region's rental market suffered a drastic downturn during the recession with the exception of the Washington, D.C., area. "Unemployment in D.C. never went above 6.5%," notes Wood Partners' Trammell. As a result, it was the one market that saw continued investment, though the pace has slackened recently as increased supply created during the recession is being absorbed. "The Northeast overall didn't get hit as hard as other areas," Trammell notes.

Austin, Texas, Boston, the Bay Area of Northern California, and Seattle—urban areas with science-and-technology-based economies—have been leading the recovery, Christie says. In the second half of 2011, the action has picked up noticeably in many other areas, including parts of the Sunbelt from the Carolinas to Texas to a wider swath of the West Coast.

Still lagging are Las Vegas, Orlando, and Atlanta, though the latter is starting to show faint signs of life, Trammell says, mostly because so few units have come online in recent years. "Even in Atlanta, which has a lot of suburban sprawl, the preference is to be downtown," he says. "Capital still wants to be in projects in urban core settings where employment growth and job security tend to be on the higher end of the job scale."

In Boston, Kensington Investment Company recently broke ground on The Kensington, a 381-unit, 27-story glass-and-stone tower in the Hub's Downtown Crossing neighborhood. The project embodies the qualities of the current wave of rental projects. "The demographic we are targeting is the 25- to 40-year-old professional who works downtown," says Ralph Cole, the developer's executive vice president.

The site is right in the city's rejuvenated theater district. "Three theaters in the neighborhood have won National Restoration Awards," Cole points out. The area is also close to the downtown financial district and Chinatown with easy access to several subway lines. Local amenities and attractions will help draw medical school students, financial professionals, and some empty nesters, Cole says.

Proximity to light rail can also help turn a downtown site into a real winner. Houston House, a recently renovated apartment complex, is close to a light rail line that connects to the Texas city's huge medical center, which employs 100,000. Despite a substantial rent increase after a major renovation, vacancies filled quickly, says Larry Hill, owner of local development firm Sumar Realty.

Phoenix presents an interesting case study, Trammel says. "The housing market got beat up there as much as any city outside of Las Vegas," he says. "But rental rates have recently risen by 8% to 10%." The single-family home and condo markets' misfortunes have been the rental market's gain in just about every market save Las Vegas, which is still experiencing declining rents.

Depending on the strength of a region's job market, some select suburban locations, particularly those located near mass transit, may be attractive sites for development. "As you go further out from the city, you have different submarkets," says Cole. In such cases, he says, the apartment market has to be viewed on a community-by-community basis.

TIGHTER SPACES, DAZZLING COMMON AREAS

Most new projects include smaller units than similar multifamily starts of past decades. In the 1980s and early '90s, there was a tendency to build more two-bedroom units, because young professionals then were apt to share an apartment with a roommate, says the Architectural Team's Liu. "Now the trend is to have smaller spaces with a heavier mix of one-bedroom and studio units," he says.

Trammell says units in his firm's new projects typically run 700 to 800 square feet in size, compared to the 900-sf units of the 1990s. Today's young city dwellers don't seem to mind smaller spaces. With WiFi networks at the local Starbucks or college library, work and study can take place outside of the apartment. And, he says, the target clientele doesn't want to stay home when they can take advantage of the theaters, restaurants, nightclubs, and other attractions within a short walk.

Apartment units in projects more distant from downtown areas, where land prices and labor costs are usually lower than in cities, likely will be somewhat larger than those in the urban core.

In order to attract the desirable professional class, many developers are trying to outdo the competition with common-area amenities. For example, Boston's Kensington project will include a heated pool, fitness center, and function and media rooms for people to gather together. Houston House features a full-length indoor basketball court and an outdoor rooftop pool area with attractive views of the downtown.

Another factor that is shaping today's apartment design is the upscale residential experience many tenants had in college. "New university housing overtly imitates luxury housing," Liu points out. Apartment seekers accustomed to resort-style pool areas, lounges, and other common areas they enjoyed in their college years are going to expect them in their après-university lifestyle facilities.

Technological advances are also influencing apartment design. Since most tenants will have their own laptops, iPads, or other devices, new projects are unlikely to have business centers equipped with computers, as was the case 10 years ago. With WiFi throughout the building a common feature, those who need a quiet space in which to work can usually find a lounge or small room with a table for perching their laptops. Trammell points to a recent Texas development that included iPod docking stations connected to built-in wall speakers—a relatively low-cost feature that proved very popular with tenants and therefore might be included in future projects.

One new phenomenon specific to adaptive reuse projects, according to Liu, is the "internal bedroom"—yes, a room with no windows. To compensate for the windowless environment, designs may employ translucent walls or walls that do not go from floor to ceiling. In some cases, clerestory windows may be used to bring natural light and a sense of openness into the room, Liu says. This design feature, which originated in New York City loft projects, is becoming more widely accepted.

Post-recession economics are also shaping developers' interior design choices. Before the recession, granite counters, stainless steel appliances, and other high-end finishes may have been de rigueur, but today some developers opt for less expensive alternatives. "People seem less willing to pay extra for bells and whistles like granite countertops," says Avalon Bay's Christie. Wood Partners' Trammell says his firm uses granite on some projects, laminate on others: "We make those decisions on a property-by-property basis."

As the ranks of successful renters-by-choice has grown, some high-end developments are creating social calendars with planned activities such as yoga, master swims, in-house movie nights in the media room, and special events such as dinners for community members at local restaurants. Catering to young, single professionals, these activities add to the appeal of the rental lifestyle and encourage loyalty to the development itself. It's a smart strategy to attract and retain the target market.

If the rent-by-choice option continues to be a popular lifestyle choice, prospects for new rental development may be even brighter than current estimates. Ultimately, though, the pace of new and rehab apartment construction will depend more on growth in the job market, the pace of home sales, and the state of single-family home and condo values. For the next few years at least, the apartment sector will be the standout in an otherwise static residential market.

Kensington: The Ups and Downs of a Downtown Tower Project

The 27-story Kensington apartment tower that broke ground in October will fill a gaping hole in Boston's Downtown Crossing neighborhood. Taking more than 20 years from inception to groundbreaking, the project illustrates the challenges of developing a major rental project in a congested urban setting.

Property acquisition began in the late 1980s. The site originally consisted of six separate lots and buildings, some privately owned, and other lots or alleys owned by the city or public agencies. "Some smaller lots were not for sale originally, or had their ownership interests tied up in estate settlements," says Ralph Cole, executive vice president for Kensington Investment Company. It took the developer until the late 1990s to get all the lots in its hands.

Next came an arduous permitting process. Some owners of abutting properties opposed Kensington's Planned Development Area zoning designation, particularly the proposed demolition of a vacant building that had once housed the Gaiety Theatre; the old burlesque playhouse that had been deemed insufficiently architecturally significant by various preservation commissions. "That challenge consumed a year and went all the way to the Massachusetts Supreme Judicial Court," where Kensington prevailed, says Cole.

In 2005, with the lawsuit out of the way, Kensington worked with the Boston Redevelopment Authority to have the parcels the BRA had taken by eminent domain cleared of any title blemishes so that all the lots could be consolidated under one deed. Just as that process was finally being resolved, however, the project hit another roadblock: construction material prices shot through the roof, making the project financially unviable. The apartment tower was put on hold for another couple of years, until construction prices came back to earth in 2008-2009. By then, with the collapse of the condominium market, the project, originally conceived as a mixed condo/rental building, had to be reborn as an all-rental property.

Should the Boston condo market rebound in the near future, some units could be converted to condominium ownership, says Cole. To hedge its bets, the developer is building the Kensington to what Cole calls "condo-level quality."