Jun. 22, 2012

Lighthouse Market

By Philip Shea, Associate Editor

As the U.S. enters a phase of renewed and considerably vigorous multifamily expansion, one region shining bright among the others is the cradle of the nation itself. New England, and in particular the Boston metro area, has emerged as a prime location for rental growth—with a positive employment outlook and continued single-family woes in the forecast.

Michael Liu, vice president and principal at The Architectural Team, says the market has seen very healthy growth over the past year and that investors and developers from across the country are paying attention.

“There’s been a tremendous expansion in the planning and development of multifamily rental housing,” says Liu. “My perception over the past year-and-a-half or so is that the national players and institutional multi-housing developers have taken an increasingly dominant role in the marketplace, which seems to be of an ever-greater proportion of the work compared with the small local multifamily developers.”

According to Liu, the dominance of these national players has led to an increase in larger development projects, as opposed to the smaller boutique projects typically favored by local developers.

David Cary, managing director at Integra Realty Resources in Boston, emphasizes the expanding urbanization near the Boston metro area and the gravity shift toward renting due to continued financial barriers to homeownership.

“People are wanting to live more in Boston and the city itself, so that’s been a good thing for the city,” says Cary. “For the suburbs, I think you’re looking at people not being able to afford the down payment for homes, and that’s fueled the occupancy numbers and rents increasing and so forth.”

Cary adds that while rental rates continue to move up in Boston and outlying areas, other parts of New England such as Connecticut—while not necessarily performing poorly—remain somewhat flat. “I think the rental rates have been more stagnant there [in Connecticut],” says Cary. “You haven’t seen the increases that you’ve seen in the Boston metro area.”

Indeed, Marcus & Millichap’s Q2 2012 Apartment Research Report for Boston showed rents increasing over 8 percent in the past three years, this while home prices were flat and new apartment construction fell below existing permits for development. Meanwhile, rental rates in the New Haven, Conn. metro area rose by 3.6 percent, while vacancies remained low at 3.5 percent.

Todd Tremblay, senior associate at Marcus & Millichap, highlights this strong showing in the Boston market while emphasizing single-family lethargy and lack of multifamily construction.

"Vacancy has continued to decrease and is close to zero in core markets such as the Boston/Cambridge area," says Tremblay. "The sales for residential homes remain sluggish, and supply of new construction apartment units remains below historic norms, driving the increase in overall rents and decreasing vacancy."

Where the money is

While multifamily across the region is performing well, different asset classes have varied concentrations of investment activity—as is often the case. David Cary of Integra says top-of-the-line assets currently make up the strongest corner of the market, with cap rates being a prime indicator.

"I would say the A market is very strong," says Cary. "The core A properties are probably performing the best, followed by the B. The real tertiary markets and secondary market-type properties are a little bit flatter. Cap rates are not decreasing as much as they are in the A and the B."

Todd Tremblay at Marcus & Millichap agrees with this observation and explains why cap rates—especially for Class A—are trending so low, and the effect that this is having on less equipped investors in the region.

"Quality A-class apartments continues to be one of the most sought after asset classes in the marketplace," says Tremblay. "High demand, lack of supply and low interest rates are driving the compression of cap rates. Class B and C properties are seeing the effects of this as investors who are unable to purchase Class A properties are forced to consider B and C properties."

Cary echoes the point that Class A properties in the region have considerable barriers, but iterates that good opportunities for investment exist with respect to lower-tier products.

"I think that a lot of people are finding it very hard to compete," says Cary. "It's reached a point now where it's tough for people to be in that market—you've got to pay so high for the good quality stuff. I would guess that [they're focusing on] the value-added stuff, the more secondary locations, Class B, Class C, that you can turn around a bit and upgrade a bit."

Liu at The Architectural Team points out a dynamic beyond asset class that is serving as a selling distinction in the current market, creating a focal point to which investors might have to pay attention in the near future.

"Part of it is that there has been such an escalation in amenity, and there comes a point where there's diminishing returns," says Liu. "You can't ratchet the bar much higher and maintain any kind of control over construction costs."

The road ahead

Going forward, the positive trends in the New England region are expected to continue, as is the consolidation of Bostonites to the city's core. As the cost of commuting to downtown from outlying suburbs—which reach as far as New Hampshire—hits unprecedented heights, urban multifamily is expected to see a profound resurgence.

"You only need gasoline prices to go up $1 or $1.50 per gallon before they cannot live where they were living before, and that is going to drive a consolidation of population around where they work," says Liu. "That, in combination with the insecurity of job situations in the new order, is going to favor rentals over homeownership except at the highest income levels."

David Cary says he's observed a gradual evolution of his city into a denser and more cosmopolitan metropolis, with more growth in the forecast that will solidify its standing as a prime hub of the East Coast.

"Boston continues to evolve into a little bit more of a 24/7 type city, and you've got more people wanting to live in the city," says Cary. "There's a tremendous number of units expected to come online in the next two to three years."

Also, Cary notes that the city's chief assets, as compared to other key metros, will make it a major job center as the economy continues to recover and expand.

"Boston benefits from the mix that it's got," says Cary. "The higher education—you've got Harvard, MIT, BCB—you've got a tremendous number of colleges and universities, which provide new start-up companies. And as they start to grow and the economy improves, I think that's what will continue to drive the multifamily market."

Liu states that while the overall picture for Boston looks good, there are still numerous areas for improvement in terms of amenities and public transportation—which can have a tremendous impact on the apartment industry.

"We have lost a lot of that infrastructure," says Liu. "It's fine to say that you've got 150 or 350 units on top of some station, but if that station does not take someone to within walking distance, or to a bus that will take them within walking distance of where they've got to go, there's still that."

However, this is not to say that Boston is behind other major metros in terms of public transit. As Liu states, "there are plenty of cities across the country that have virtually no public transportation—no rail or light-rail system." The city of Boston has had an extensive subway system in operation since 1964.

Todd Tremblay at Marcus & Millichap iterates that the region's economic situation continues to look up as the key factor of job growth shows no sign of waning, no doubt bolstering the multifamily sector for some time to come.

"Employment remains strong in Massachusetts relative to the rest of the country," says Tremblay. "Massachusetts employment features diversification across many sectors. Job growth will contribute to the increasing demand for residential units."

Tags: market report

RELATED POSTS
MARKET SNAPSHOT: Demand in Charlotte Remains Strong as Population Surges

MARKET SNAPSHOT: Alabama Apartments Garner Interest from Multiple Buyers

WEB FEATURE: Global Market Report – Europe

New Dawn

NYC and N.J. Returning to Pre-Recession Levels