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'Belle of the Ball'

With renter demand rising and new supply extremely limited, apartments are investment darlings.

Housing prices are hitting decade-long lows, new jobs are being created at an anemic rate and economists are now talking about the real possibility of a double-dip recession. Yet things are looking up for the multifamily marketplace

Apartment vacancies are dramatically down this year while rents are rising — up by double-digit percentages in some markets. Transactions are heating up as investors appear willing to pay stunning prices, often at capitalization rates of 5%, for choice properties.

With little new inventory slated to enter the market this year, most observers haven't been so ebullient on the outlook for the sector's fundamentals since at least 2006.

"Multifamily is hot again," declares Dan Fasulo, managing director of Real Capital Analytics in New York, which tracks the industry. "All the ingredients are there to support a positive picture for investors. It's a difficult challenge, still, to get a mortgage on a house."

'Compelling' fundamentals

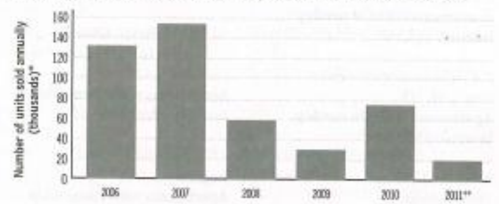
Meanwhile, the huge echo boom generation is moving into the prime age group for renters (mid-20s to mid-30s). That's swelling the rental pool at the same time that new construction has waned.

Paula Poskon, an analyst with brokerage firm Robert W. Baird & Co. in Milwaukee who covers most of the apartment REITs, is trumpeting the sector to her clients. "The fundamentals in this sector are extremely compelling," she says.

"There is this huge demographic wave of young people coming into the apartment market and no new supply for them," adds Poskon. "A lot of companies cut back on their investment in development during the recession."

INVESTOR APPETITE FOR APARTMENTS GROWS

The number of apartment units sold in the U.S. in 2010 rose 148% over 2009 levels as real estate fundamentals improved. The health of the economy will determine if that trend continues.



* based on sales $5 million and above ** year-to-date through April

Source: Reis

At the end of 2009, according to researcher Reis, apartments peaked at an 8% vacancy rate, a modern record. By the first quarter this year, that vacancy had narrowed to 6.2%.

Meanwhile, the firm is forecasting that rents will increase about 4.4% this year, way above the annual average of 3.2% for the past three decades.

Victor Calanog, chief economist at Reis, predicts that vacancies will nosedive all the way to 5.5% by the end of this year, followed by an aggressive 5% run-up in rents in 2012.

"In 2010, many landlords were hesitant to raise rents when vacancies were still running 7% and more," says Calanog. "But now they'll be prepared to really jack up their rates. The good times should roll through at least 2012 in the apartment sector. Of all real estate sectors lately, this is the belle of the ball."

The outlook may dim a bit by 2013, forecasters say, only because new construction deliveries will kick in by then. In 2011, Reis is forecasting that new apartment deliveries in the top 50 U.S. cities will total a meager 33,000 — a post-World War II record low.

Reis predicts new construction will amp up to 75,000 units next year and 125,000 units by 2013, still well below the 30-year average of 143,000.

In the trenches

Active builders include REITs such as AvalonBay Communities, which delivered three new apartment communities early this year totaling nearly 900 units, at a cost of $234 million.

John Christie, the company's senior director of investor relations, says that AvalonBay expects to start construction on another 2,500 units, at a cost of $850 million, in the second half of this year.

The company also has a $1 billion fund for acquiring assets. Overall, it currently has 55,000 units in 16 markets.

"We're getting rent increases averaging 7% this year," says Christie. "That's the best rent gains we've had since 2006."

Christina Aragon, director of strategy and consumer insight at Santa Monica, Calif.-based Rent.com, notes that during the recession young people had either returned home to live with their parents or were doubling up with friends.

"That's all reversing now," she says. "People feel a bit better about their employment, and they're moving back out into the rental market."

— H. Lee Murphy