

BOSTON MARKET HIGHLIGHT: BOSTON MULTIFAMILY MARKET

Where have all the cranes gone? The fallout in the credit market prompted by the sub-prime debacle, coupled with an oversupply of condo projects, has resulted in very few new multi-family projects making it off the drawing board; even despite sticky vacancies in the 5% range and a steady unemployment rate at 4.5%. Historically, many apartment projects have been constrained by high construction costs, high land costs, and thin development yields, which create the drive to build condos.

Are there signs of more apartment starts on the horizon? Rent appreciation has helped as many sub-markets are experiencing 3-5% growth. Unabsorbed condo projects, however will compete with rental stock, albeit, generally at the higher end of the market, making continued rent growth and absorption at the upper end of the rental market somewhat of a wild card. Both Harborview in the Charlestown Navy Yard and Longwood Towers in Brookline have recently announced their plans to convert their originally planned condo units into rentals. The cost structure for these projects is likely to be higher than what would have been incurred if they had originally been designed as rentals, i.e. acquisition cost

and/or construction cost (ex: hardwood floors, granite top counters, etc.). The real profit making opportunity on these projects will be deferred until later. On a positive note, once the condo market returns, these units should be ready for conversion with little need for significant improvements.

On the construction-side, with the trail-off of "Big Dig" construction and leveling of institutional work, there has been evidence of some relief in sub-contractor bid premiums. This too should help projects move off the drawing board. Land owners, historically are the last to recognize the cooling of values. This class has the philosophy, "when one product type falls out of favor, there's always an alternative use: retail, biotech, etc." It is interesting how the latest use usually surfaces as the new highest/best use! Two Financial Center's decision to move from residential to an office tower is a good case in point.

What can we take away from this? As with stocks and bonds, real estate investment money chases yield opportunities. To the extent one product type falls out of favor, it becomes overlooked until it gets back to a desirable yield. The multi-family development projects that will be able to make the jump from the planning phase to the construction phase will be

the projects that hit an acceptable yield level, generally 100 to 150 basis points higher than what a cap rate would be and are located in in-fill locations. Given the recent drop in interest rates, as well as, the momentum in rents, we may start to see more apartments on the rise.

Dennis Walsh is a senior director at Tremont Realty Capital in Boston.