

MULTIFAMILY MARATHON

In Boston, high barriers to entry and strong employment have created a winning multifamily market.

By Jaime Lackey

If there were a championship for multifamily market fundamentals, Boston landlords would be standing on the podium,” says Brandon Beatty, senior analyst at Tremont Realty Capital.

Fundamentally, the Boston multifamily market fared well throughout the recession, says Travis D’Amato, vice president with CB Richard Ellis/New England. “Average occupancy never dipped below 94 percent [in the metro Boston area].”

Beatty notes, “Landlords were able to buy occupancy with only minor concessions at the trough of the recession. Historically, the vacancy rate in Boston has ranged from 2.5 to 8 percent. Today it is hovering at 4 percent.”

Indeed, both occupancy rates and rents have returned to pre-recession levels – and are beginning to exceed these levels, D’Amato notes. Before the downturn, the area’s average rental rate peaked at \$1,500 per month in fall of 2007, and bottomed out at \$1,450 in early 2009. The current average rent is now approaching \$1,550 per month.

Some submarkets, like Cambridge and Brookline, are enjoying 98 to 99 percent occupancy and extremely high rent growth, D’Amato notes.

“The Mass Pike, Route 90, and Interstate 93 North Submarkets are

doing well, with occupancy rates of 93 to 94 percent or higher,” he adds.

Not many Boston properties are listed for sale, but when a property is on the market, the competition is enormous, D’Amato says. “In particular, there is an overwhelming amount of capital looking for core properties inside Route 128.”

“Cap rates today are lower than they were in 2007,” he notes. “In 2007, they were around 5 percent, or just under 5, for Class A properties. In 2008 and 2009, there were a few transactions and the cap rates climbed to almost 6. Today, cap rates for Boston apartments are in the low 4s.”

If demand is so high, why is no one selling? “There are a lot of private owners in Boston, and they tend to hold properties for the long term,” D’Amato says. “Boston didn’t see much new construction until 2003 and 2004. From 2003 to 2008, there was a boom in institutional building. Before that it was all private owners. If there were more institutional owners, there would be more turnover as institutions tend to have 5-year hold periods.”

Furthermore, D’Amato explains, “Everyone wants to own multifamily in Boston. It is second only to D.C. Because there are so few properties listed for sale in Boston, owners want to hold on to the properties they have. If they were to sell, what would they buy?”

The few sales transactions that have taken place in the last year have included some impressive numbers. In May, TIAA CREF purchased Rivers Edge The Residences in Medford, a 222-unit property, from Criterion, which developed the property in 2008, for \$80 million or \$360,000 per unit. In December 2010, JP Morgan purchased Park Lane Seaport in the Boston Seaport district for \$193 million or \$417,000 per unit. Cornerstone sold the 465-unit property, which was built in 2006. In September 2010, UDR purchased Garrison Square, a 160-unit property located in the heart of the Back Bay, for \$98 million or \$612,000 per unit. Archon sold the historic property, which was renovated just before the sale.

“The Park Lane transaction was a sub-5 cap rate,” Beatty notes. “This type of dynamic speaks to developers.”

While there were practically no land sales from 2008 through 2010, D’Amato and Beatty see that market coming back significantly. D’Amato notes that land values are not where they were at their peak – and developers can build to a 6 percent cap rate.

According to D’Amato, there are a few projects currently under way. In the Back Bay area, Avalon is building a 188-unit tower at Prudential Center, with occupancy scheduled in just under 2 years. Just behind the Ritz in Downtown Cross-

ing, Millennium Partners is building a 224-unit property set to open in about 2 years. Along the border of Chinatown, National Development is building The Kensington, a 250-unit project.

While development is picking up, there are still strong barriers to entry. There are only 2,200 units in various stages of the approval process throughout metro Boston, Beatty adds.

“In the next year, we will see significant rent growth and more projects starting construction – though we won’t see a construction boom equal to that of 2006 and 2007,” D’Amato predicts. “Cap rates will continue to stay low, especially for core properties. And the lack of core properties for sale will continue to drive cap rate compression for suburban product. In short, the Boston multifamily market will continue to be very strong through 2012.”

Beatty agrees. “In Boston, apartment supply is constantly chasing demand, the barriers to entry are very high with a 1- to 3-year approval process, and unemployment is lower than the national average. These factors indicate that the Boston multifamily market will continue to outperform apartment markets around the nation.”

He predicts that lenders will return to the market with more competitive terms for construction loans in the next year due to the high demand and activity in investment sales. In particular, small for-sale condo units that appeal to first-time homebuyers (for whom financing is readily available) and high-end projects that appeal to cash buyers stand to benefit from increased lending on new construction.

While Beatty does not foresee major risk in the market, he does note that investors should watch for potential negative impacts from cuts in healthcare spending and college loan programs. Healthcare and education are large employment

drivers in the city, and Boston has the highest percentage of college students of any major U.S. city. In all, though, he says the only true negative in the market is simply the lack of assets for sale.