



What Lies Ahead For Puget Sound Apartment Owners?



SUHRCO manages a diverse portfolio of commercial and multifamily residential properties in the Puget Sound region. Established in 1973, the company employs more than 300 experienced professionals dedicated to meeting the management, leasing and brokerage needs of building owners, tenants, and condominium/homeowner association boards and owners.

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Third Quarter Update –By: James C. Palzer, CPM®

One could compare the last two years of the real estate market to the last two year run for the Seattle Mariners. It's been pretty tough going. Frankly, I think we're all getting a little sick and tired of the doom and gloom. Is there ANY good news? We think so. Here is a round-up of some positive signs for a market recovery and continuing challenges to ponder over as we head into fall. (A multi-family real estate "hot stove league" if you will.)

Improvement in Multi-Housing Market Trends

In early September, the *Multi-Family Housing News* reported that in the beginning of 2010, the greater Puget Sound rental market has seen marked improvement; occupancy has increased, rents have remained steady and concessions are disappearing. Consider these figures:

- The Puget Sound Region's vacancy dropped from 7.2% in the fall of 2009 to a respectable 5% coming into the winter. According to Patty Dupre and Mike Scott of *Dupre + Scott*, vacancies will continue this downward trend through 2014 and settle in at about 2.8%.
- Rents seemed to have bottomed out this summer. We've recently seen up to 2% increases in rents on the same unit once the unit is re-rented. In September 2008, average rents were at a high of \$995 before dropping 5.6% to an average of \$940 in March 2010. By September 2010, rents crept up to about \$950 (still a 4.5% decrease from September 2008). The forecast through 2014 suggests that rents will increase by about 5.75% a year (\$55) for an increase of about 23% (\$220) between now and the end of 2014.
- About 10% of the regions rental communities were using concessions in September 2009. Then, communities using concessions activity spiked upwards to about 60% in March 2010 and dropped to about 36% in September of 2010.
- Translated to concession dollars, concessions averaged a low of \$400 in March 2007, then jumped to \$750 by September 2009 and then have steadily decreased to an average of \$655 by September 2010.
- Net Operating Income (NOI) is anticipated to increase by about 8.5% annually or 34% between now and the end of 2014.

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Construction Slow Down/ Job Growth Fuel Recovery

Meanwhile, a dramatic slowdown in apartment construction, combined with job recovery may help spur further increases in occupancy and rents.

Apartment construction estimates for King, Pierce and Snohomish counties on development of 20 units and larger has all but stopped. There are roughly 217,201 market rate apartments with communities of 20 units and larger in King, Pierce, and Snohomish Counties. Current estimates show less than 2,000 units planned to be built or finished between now and the end of 2011 and less than 3,000 units for 2012. That is only 2.5% potential new units being added to the current Puget Sound inventory over the next 28 months. And, we need to keep in mind that rumors suggest many of these properties will not even be built.

In addition, demographic changes will bode well for increasing occupancy and rents. Approximately 34,000 more homeowners and renters between ages 20 to 34 will enter the marketplace through 2012. Employment opportunities are also on the rise. Projections indicate there will be approximately 71,000 new jobs in Snohomish, Pierce and King Counties over the next two years. What makes us different from other parts of the country? Some say it's our diverse economy including employment in healthcare, biotechnology, aerospace and the information technology sectors. This broad range of employment opportunities has served us well.

The Other Side of the Fence

There are a lot of positive indicators. Logically thinking, one could easily conclude that owners of apartments are seeing an end to their woes and are finally stepping out of the woods to a brighter day. And, with little new construction in multi-family, it seems to be a "no brainer" for investors with cash available to look at apartments as a pretty safe bet. Well, not so fast.

- Apartment sales volumes have dropped dramatically. From 2005 to 2007, the average tri-county sales volume of 5 units or more averaged about \$2.74 billion. Comparatively, from early 2009 through September of 2010, sales volume has been a dismal \$400 million. That's an 85% decrease in sales volume or about \$2.34 billion!
- Price per unit on sales in 2008 averaged \$125,000. But the 2010 average per unit on sales is \$106,000 representing a decrease of \$19,000 per unit or a whopping 16.2%.
- Capitalization rates in 2007 averaged about 4.75% compared to the 2010 average of 6.4% or an increase of 34.7%.

CASE STUDY: Shorewood Heights

The last two years have kept most investors who refinanced or purchased their multi-family properties in 2006, 2007 and 2008 doing whatever they could to cover their operating costs and debt and not lose their properties.

In some cases, investors simply could not stop the hemorrhaging nor continue to feed cash into an already flailing investment. A recent sale demonstrates that some investors have had enough and are throwing in the towel.

*Shorewood Heights Apartments is a 38 building, 645-unit community with Lake Washington views, built on Mercer Island in 1948. Purchased in December 2005 for \$140.5 million (\$217,787 a unit), the Shorewood property sold in September 2010 for \$109.9 million (\$170,430 a unit). **This is a loss of \$30.5 million (\$47,357 a unit) or 21.7% of the original purchase price.***

Investors with cash in hand are swooping in and picking up financially troubled properties at about \$0.80 on the dollar compared to what the properties fetched in 2005 through 2007 (see sidebar.) Downtown Seattle and core Eastside locations like Bellevue/Redmond show strong investment opportunities, according to Hendricks & Partners, and secondary markets such as Renton/Kent have good economic indicators and less competition. Hendricks & Partners reports that it received over 25 offers on the last two deals it marketed on the Eastside and 15 offers on a deal in downtown Seattle.

(more)

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Additionally, home and condominium foreclosures will continue to see an increase into the foreseeable future and apartment rentals will continue to compete with reduced sales prices in entry-level home and condominium purchases. For example, current mortgage payment estimates in Snohomish, Pierce and King Counties are \$925, \$825 and \$1,125 respectively. King County condominium mortgage rate premiums for 2010 average \$1,125 compared to a slightly higher average on a 2BR/2BA apartment rent of \$1,225. Mortgage rates in 2007 were about 6.75% compared to September 2010 rates of about 4.7%, a decrease of over 30%, which makes ownership more affordable for many who are also potential renters.

Still, the meltdown of the housing market may scare many potential buyers from purchasing homes. A recent article in *Time Magazine* titled "The Case Against Home Ownership" suggests homeownership has let Americans down. For generations, we believed that owning a home was an axiomatic good. But today, the dark side of

homeownership is now all too apparent: foreclosures and walkaways, neighborhoods plagued by abandoned properties and plummeting home values, a nation in which families have \$6 trillion less in housing wealth than they did just three years ago. This isn't good news for new homeowners or those people wanting to get into home ownership. Conversely, it's good news for apartment owners and investors who could and will benefit from those who are now skeptical about purchasing a home.

So as Autumn moves into the Puget Sound, two things are certain. One, the Mariners will not compete in the World Series again this year, and, more positively, the multi-family housing market is showing signs of a slow but steady recovery. If you're like me, you can't wait for the spring when it might be possible to hear once again from Mariner Hall of Fame Announcer Dave Niehaus, "*It's swung on and belted! Get out the mustard and the rye bread, Grandma! It's Grand Salami Time!*" As they say, hope springs eternal for baseball fans, and in our case, real estate professionals as well.

If you would like more information about how current trends in multi-family housing affect your property, please contact Jim Palzer CPM®, at 425-460-3139 or jimp@suhrco.com.