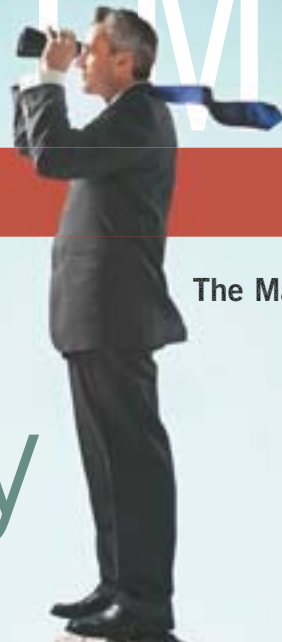


# COMMERCIAL INVESTMENT



## Real Estate

The Magazine of the **CCIM** Institute

### Multifamily FOCUS

Where's that  
**deluxe**  
apartment  
in the sky?

How Green  
Is Your  
Building?

Retail SOS:  
Save Your  
Shopping  
Center

CCIMs  
Deliver  
the Deals



# Multifamily Moves on Up

Buyers start looking for that deluxe investment

The national multifamily investment market may have turned a corner in 2009, at least in terms of investor demand. Dollar volume of the sector's closed transactions hit an all-time low of \$2.06 billion in the first quarter of 2009 but ticked up to approximately \$3 billion or more in the remaining quarters of the year, according to Real Capital Analytics, a New York-based research firm.

Anecdotal evidence suggests that volume will climb in 2010 as a groundswell of bidding activity begins to result in completed transactions. Although distressed assets are catching headlines and offer lower prices, brokers say investors are competing for high-quality multifamily properties with low vacancy rates. That suggests that pricing is bottoming out, says Dan Fasulo, RCA's managing director.

"For the few good assets that are available, we're seeing 20 to 30 bidders," Fasulo says.

"With that type of underlying demand, I can't see a scenario where prices fall from where they are now."

At Marcus & Millichap Real Estate Investment Services, multifamily deal volume is rebounding from a 38 percent drop in 2009, according to Linwood Thompson, M&M's managing director.

"We've done twice as much business in the last four months as we did in the previous nine months," says Thompson, who also directs the company's national multihousing group. "In 2010 velocity is probably going to increase 25 percent to 30 percent marketwide."

## Bid Wars Redux

Throughout the U.S., investors are showing renewed interest in executing multifamily deals, as evidenced by the number of bids for stabilized assets. Late last year, M&M received 40 offers on a three-asset

C.J. Burton/Veer



in the sky.

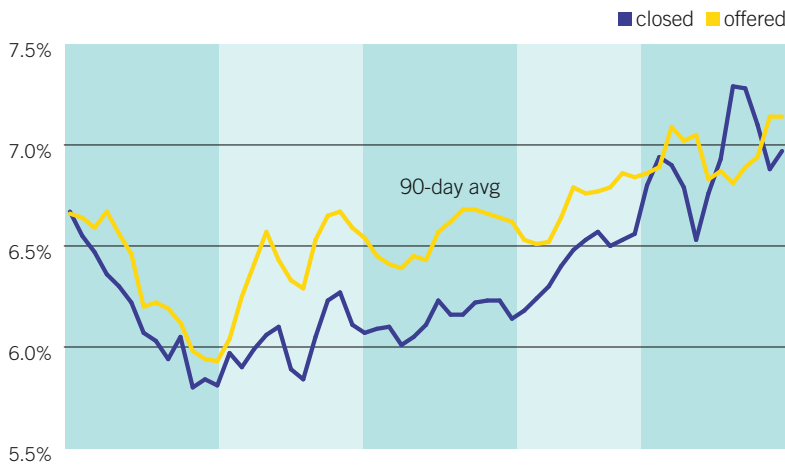
by Matt Hudgins

# MULTIFAMILY

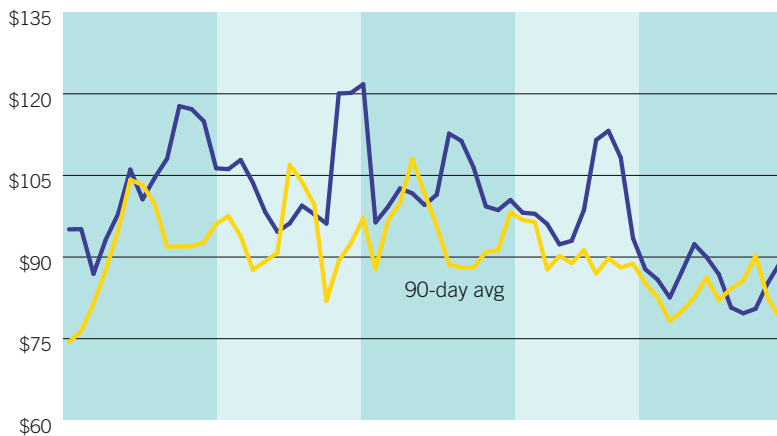
## BY THE NUMBERS

through November 2009

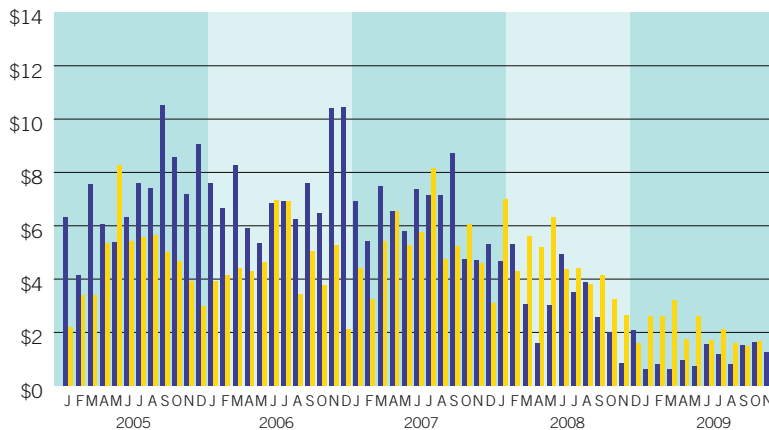
### Average cap rate



### Average price per unit in thousands



### Volume in billions



Source: Real Capital Analytics

apartment portfolio in Florida. And in January, an apartment property in San Antonio that included an assumable loan garnered 50 offers, Thompson says. “The number of offers that we receive on deals is up dramatically.”

In other markets CCIMs also report a surge in serious buyers. Phoenix’s economy suffered as its housing industry imploded, yet buyers there are scrambling to buy cash-flowing apartments, says Brad Miner, CCIM, an associate in CB Richard Ellis’ debt and equity finance group in Phoenix. Thirty-four apartment complexes with 100 or more units traded during 2009, double 2008’s total, Miner says. Distressed deals accounted for about half of last year’s volume.

On a recent multifamily listing, some 200 investors and brokers requested copies of the offering documents. “The buyer interest is mostly from private investors,” he says.

Thompson sees the run-up in buyer inquiries and bids as a sign that investors are growing optimistic. “That’s a function of the belief that the market is at or near bottom, so they’re thinking about how to get themselves positioned for the next up-cycle.”

## Hotbeds Warming Up

In a few rare markets — San Francisco, Washington, D.C., and Boston — competition to buy healthy multifamily assets is actually reversing the trend toward higher capitalization rates or initial annual returns on an acquisition, Thompson says. “If that continues, some sellers will feel like this is the time to move.”

Those markets are atypical, however. The bar for what constitutes a hot market is



Older properties in high-demand locations are often good investments.



Well-appointed common areas featuring pool tables, flat-screen TVs, and other high-end amenities are standard in today's student-housing properties.

## APARTMENT EXPERTS FOLLOW THE MONEY

Government-sponsored enterprises Fannie Mae and Freddie Mac have been a lifeline for multifamily investors, providing liquidity that is sadly missing outside of the apartment realm. "That has softened the amount of value decreases in the sector," says Dan Fasulo, managing director at research firm Real Capital Analytics. "For prime multifamily, we're not seeing the type of 40 percent to 60 percent declines in value that we are seeing in the office, retail, and hotel sectors."

CCIMs say the U.S. Department of Housing and Urban Development's loan programs may soon overshadow Fannie and Freddie as the darlings of multifamily borrowers. Those programs, insured by the Federal Housing Administration, include 223(f) loans, which can be used to refinance assets, and 221(d)(4) loans for new construction.

Loan-to-value ratios can be as high as 90 percent of construction costs and typically amortize over the 40-year term of the loan, says Jeff Siebold, CCIM, an appraiser and owner of Siebold Group in Taswell Beach, N.C. "This is not about subsidized housing; it is about market-rate apartments," Siebold says. "Some of the nicest class A or B properties that you see very well might have a 221(d)(4) loan as part of their program."

Government-backed loans won't work for every project, in part because they are limited to stabilized properties, according to Brad Miner, CCIM, a CB Richard Ellis associate in Phoenix.

Brokers say cash transactions also are mushrooming. Wealthy individuals concerned about inflation are increasingly interested in multifamily as a conservative investment vehicle, says Robert Vallera, CCIM, principal of Commercial Realty Advisors in La Jolla, Calif. Vallera contends that many investors worry U.S. fiscal policy will soon fuel rapid inflation. "I have closed more all-cash apartment transactions with private investors in the past year than in my prior 25 years of apartment brokerage combined," he says.

In a year when the U.S. dollar is weak in comparison with many other currencies, foreign investors are expected to be an expanding source of capital. To establish contacts and help promote properties, Stanley Ching, CCIM, owner of 2020 International Real Estate LLC in Pearl City, Hawaii, is organizing a trade show that will take place either in Hong Kong or mainland China this June. "Hawaii real estate will be the primary focus, especially the multifamily sector."

understandably lower today. Many investors now value stability and steady returns over appreciation potential and are ready to pay for that consistency.

Portland, Ore., is a magnet for conservative investors, according to Tom Davies, CCIM, vice president for apartment investment sales at Norris & Stevens. Although current prices suggest a 17 percent drop in Portland's apartment values since 2008, appreciation averaged 9.5 percent annually for the preceding decade, so "values have not dropped that much," he says.

At more than 93 percent, occupancy rates are near their typical equilibrium of 95 percent. In fact, the 8,000-unit apartment portfolio that Davies' company manages grew net operating income in 2009 from the previous year. "Portland has always been a little more stable than other markets on the West Coast," he says.

Apartment fundamentals in San Diego County, Calif., have proved more resilient than in past recessions, according to Robert Vallera, CCIM, principal of Commercial Realty Advisors in La Jolla, Calif. Asset values are down about 25 percent since 2005, but vacancy rates have moved up just 200 basis points to about 5 percent since 2007. Vallera attributes that relative stability to the near-universal impact of the job crisis.

"During the prolonged recession of the 1990s, many coastal California residents relocated to lower-cost cities in the Southwest, such as Las Vegas and Phoenix," Vallera explains. "This recession's deep national scope has prevented the unemployed from being able to easily flee inland in pursuit of better employment opportunities."

San Diego's economy is more diversified today than it was in the

1990s, Vallera says, but unemployment still has doubled to more than 10.1 percent in the past three years. Vacancy and concessions have combined to reduce rental income by about 10 percent.

As in Portland, San Diego's physical and legal barriers have protected residential markets from oversupply everywhere except in the central business district. Inland California markets with low barriers to entry — including the Inland Empire, and the Imperial and San Joaquin Valley areas — are languishing under high vacancy and home foreclosure rates brought on by overbuilding. "An ample supply of inexpensive foreclosed homes for sale now has tilted the rent vs. own equation to the detriment of apartment owners in these inland markets," Vallera says.

# BIG VALUE

DECLINES in median multifamily sales price per unit

| MSA                              | 2007      | 2008      | 2009      |
|----------------------------------|-----------|-----------|-----------|
| Charlotte, N.C.                  | \$62,292  | \$69,063  | \$30,172  |
| San Jose, Calif.                 | \$155,833 | \$169,348 | \$131,250 |
| Washington, D.C.                 | \$121,250 | \$94,000  | \$86,857  |
| Riverside-San Bernardino, Calif. | \$103,958 | \$90,455  | \$69,598  |
| Orlando, Fla.                    | \$69,129  | \$67,222  | \$41,667  |

Source: Marcus & Millichap

## Hot Pockets

Local economic factors count for much more these days, leading to pockets of investment potential in many smaller markets. Jeff Siebold, CCIM, appraiser and owner of Siebold Group in Taswell Beach, N.C., has identified several hot spots for apartment development based upon growth planned by major employers. Apartment demand in Mobile, Ala., has heated up in the wake of a new steel plant announced last year. Military base realignment promises to boost housing needs in Fayetteville and Jacksonville, N.C., to serve

Fort Bragg and Camp Lejeune respectively. Planned automotive plants will create thousands of apartment renters in West Point, Ga., Chattanooga, Tenn., and Tupelo, Miss.

Edward Martin, CCIM, owner of MLC Properties in Atlanta, finds even smaller pockets of opportunity by buying what he calls “B and C properties in A locations.” His company recently purchased the note on one such asset and is currently going through the

foreclosure process to take ownership. In return for getting a delinquent loan off its books, the bank that sold the note is paying for the bankruptcy procedure. “I’m not interested in being a note holder at all and told the bank so,” he says.

Commercial real estate experts who can identify the lucrative needles in their local-market haystacks will be the best performers in the years ahead, Fasulo predicts. “2010 is going to be all about understanding the dynamics of your local market, even down to block by block, asset by asset,” he says. “Investors are going to have to fight to make great returns.”

## STUDENT HOUSING MAKES THE GRADE

CCIMs seeking a multifamily niche with plenty of demand from both investors and renters need look no further than student housing. Cap rates for student housing increased 50 basis points in 2009, while the average price rose 5 percent. Both measures outperformed those for traditional apartments, according to Marcus & Millichap’s 2010 national multifamily report.

Consider the University of South Carolina campus in Columbia, S.C., where private developers have added more than 1,900 student-housing units since 2007. Despite the increase in product, occupancy remains around 97 percent, says appraiser Michael Dodds, CCIM, managing director at Integra Realty Resources in Columbia. “The university works well with developers and actively refers potential tenants to the off-campus developments.”

In 2008 alone, four complexes totaling more than 800 units sold at prices ranging from \$97,000 to \$152,000 per unit in Columbia. Projects include both new construction and renovations, such as Philadelphia Management’s conversion of the historic Olympia and Granby Mills into student complexes with four-bedroom units as large as 2,800 sf.

Student housing often reflects class A finishes and amenities, a characteristic that tends to place those assets out of many private investors’ price range, says LyLy Fisher, CCIM, owner of Fisher & Co. Real Estate in Austin, Texas. Prices of \$30 million to \$40 million for a single complex are common.

Still, Fisher finds it easier to line up investors for student

housing than for conventional multifamily deals. “I have a waiting list of investors who are ready, willing, and able to pursue student-housing projects,” she says.

Local banks that understand the university and market are a good source of leverage for campus-oriented multifamily projects, according to Ken Etterman, CCIM, managing principal at Redfish Advisors in Asheville, N.C. Etterman’s company recently obtained construction loans on three separate student-housing projects for a total of \$45 million in financing.

Rental demand and cash flow are seldom problems in this niche, so the deciding factor on qualifying for most loans in the sector is equity. Etterman says borrowers should be prepared to plunk down 20 percent to 30 percent of the project price in cash.

Investors need educating before attempting student-housing projects. Renters today expect one bathroom per bedroom, with two-bedroom, two-bath and three-bedroom, three-bath units preferred, Etterman says. The difficulty of adding bathrooms to older, four-two units make rehabbing many properties impractical, so a rehabilitation may require teardown and replacement.

Property management also is a key to a success, experts say. “These projects are not successful if they are managed as traditional multifamily properties,” Etterman says. “They require a higher level of management and oversight, so it’s probably wise to involve a third-party manager with a focus on student housing.”

## U.S. HOUSEHOLD FORMATION (IN THOUSANDS)

| Household types | 1999           | 2000           | 2001           | 2002           | 2003           | 2004           | 2005           | 2006           | 2007           | 2008           | 2009           |
|-----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Married no kids | 28,428         | 28,809         | 28,942         | 29,699         | 30,150         | 30,652         | 30,595         | 30,920         | 31,570         | 31,849         | 32,562         |
| Married w/kids  | 26,342         | 26,502         | 26,661         | 27,048         | 27,170         | 27,067         | 27,515         | 27,257         | 27,375         | 26,520         | 26,556         |
| Other           | 22,515         | 22,676         | 23,004         | 23,787         | 24,548         | 24,710         | 25,186         | 25,771         | 25,964         | 26,282         | 26,430         |
| Single          | 26,606         | 26,724         | 27,820         | 28,775         | 29,431         | 29,586         | 29,859         | 30,453         | 31,132         | 32,167         | 31,657         |
| <b>Total</b>    | <b>103,890</b> | <b>104,711</b> | <b>106,427</b> | <b>109,309</b> | <b>111,299</b> | <b>112,015</b> | <b>113,155</b> | <b>114,401</b> | <b>116,041</b> | <b>116,819</b> | <b>117,205</b> |

Source: National Multi Housing Council

This positive but slow trend accounts for lingering vacancy problems despite a falloff in multifamily construction.

## Distress: Gold Mine or Mine Field?

Failed residential condominiums are a fertile field for distressed opportunities, but the risks are high, according to John W. Stone, CCIM, director of multifamily investments at Colliers Arnold Commercial Real Estate Services in Clearwater, Fla. If the subject property has even a few units that have sold to individual investors, then condo laws can impose severe restrictions on what a buyer can do with the rest of the property. In addition, debt financing is nearly impossible to obtain for broken condo projects, so buyers should prepare for all-cash closings.

Units built to be condos tend to be larger than apartments, and that means rental rates need to be higher per unit to cover the cost of the property. Association fees and taxes for each unit may run \$1,000 per month, so usually the only viable option is to liquidate the condo units, Stone says. For apartments converted to condos, the size and value of individual units is usually smaller, so those properties are more readily operated as apartments to help offset the investor's expenses during a hold period. While investors may convert the entire property to for-rent, ultimately the best returns for these assets come from selling the units as condos once demand has recovered.

Timing is critical. "This is a very high-risk business," Stone says. "If you're off by even a year with what it takes to unload these units, your yield could be dramatically affected."

Investor Andrew Mittler, CCIM, principal at Optimal Properties in Austin, Texas, has acquired a range of assets from banks and distressed sellers. His team looks for assets suffering from poor management, which provides additional upside potential via rehabilitation and better operations.

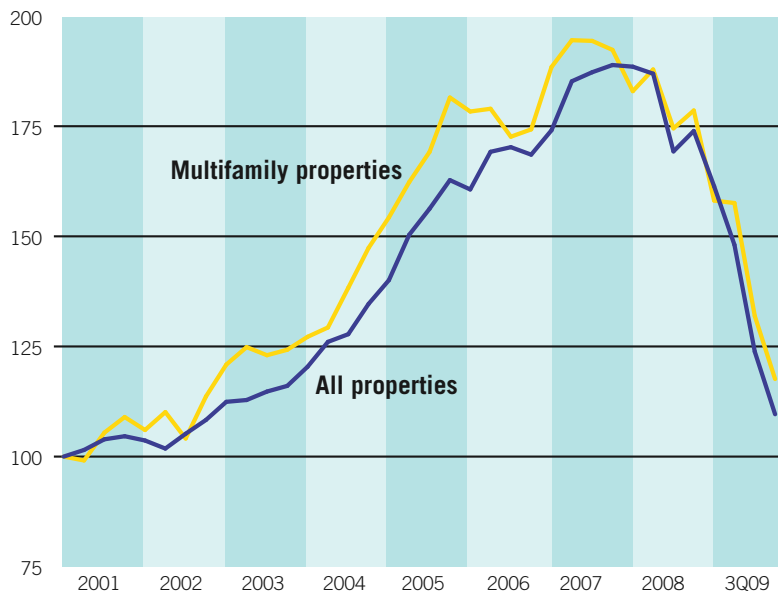
All of a CCIM's training comes into play in working with distressed assets, Mittler says, from valuing properties and financial instruments to projecting cash flows and performing other analyses. "This is the time when people who can fix problems ought to be buying properties," he says. "If you're a beginner, you've got to tread really lightly."

**Matt Hudgins** is a freelance writer based in Austin, Texas.



The Galery at NoHo Commons in Los Angeles sold for \$96 million in September 2009. In 2007 it sold for close to \$140 million.

## MULTIFAMILY HOLDS ITS OWN



In the past decade, multifamily prices have peaked higher and retained their values better than commercial properties in general.

Source: Moody's/REAL National All Property Type Aggregate Index