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Twin Cities Multifamily Investment Stands Strong

The economic fallout related to the housing crisis has helped position multifamily assets as the number one preference for many investors in a number markets across the country. That is certainly holding true in Minneapolis and St. Paul, where strong demand for investment in multifamily assets continues. According to the National Multi Housing Council's (NMHC) October 31st Washington Update, apartments were rated the best investment opportunity in 2009. An excerpt from NMHC the article states:

"Our message about the long-term strength of the apartment sector was reinforced this week with the release of the annual Emerging Trends in Real Estate report by the Urban Land Institute and PricewaterhouseCoopers LLP. The report, which says that commercial real estate markets will bottom out in 2009 and flounder for much of 2010, singles out apartments as their number one "buy" recommendation. According to the industry experts surveyed for the research, commercial real estate faces its worst year since the 1991-1992 industry depression, with ongoing drops in property values, more delinquencies and foreclosures and crimped property cash flows.

However, the authors say that distress in the housing market is benefiting apartments and that moderate-income apartments in core urban markets near public transportation offer the best buy in the commercial real estate sector for the second year in a row. In its "Best Advice for 2009" section, the report recommends a return to basics approach in property management, staffing up asset managers and leasing pros, going green to cut energy expenses, buying or holding multifamily, purchasing distressed condos near public transportation and investing in Real Estate Investment Trusts, as they will lead the market's recovery. More information is available at <http://tinyurl.com/5gkssc>."

Strong multifamily fundamentals in the Twin Cities metro area have seen increased interest from institutional and private capital buyers looking for solid growth with historic steady increases in demand in a stable market. Third quarter numbers indicate the trend of lower vacancy rates. The current market wide vacancy rate in St. Paul is 3 percent, down from 4.3 percent a year ago, and 3.4 percent during the second quarter. Average rents are up 1.8 percent to \$876 year over year.. Metro wide, vacancy stands at 4 percent for the third quarter of 2008, with average rents at \$922, up 3.6 percent year over year.

Job loss in the Twin Cities was at 11,700 jobs for the third quarter. During that period, three market sectors had job gains: trade, transportation, and utilities with 1,200 jobs; information with 1,000 jobs; and education and health services with 4,600 jobs.

The crisis in the financial markets has positively impacted fundamentals in the Twin Cities multifamily market in three primary ways. First, declining housing values due to oversupply and tighter credit markets has decreased home ownership demand. Second, tighter underwriting criteria and equity requirements for construction loans have reduced the number of proposed units in the pipeline by approximately 50 percent. Third, the Twin Cities is experiencing effective economic rent growth and steady cap rates due to investor interest in the area and a relative lack of product on the market. These trends are functioning to strengthen fundamentals in an already strong and well performing market.



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Declining Values

According to the National Multi Housing Council (NMHC), there is an enormous excess of inventory of for-sale housing across the country. While the Twin Cities is not an exception to this oversupply, it has fared better than many markets, especially related to any significant threat from a "shadow market" due to over building in the for-sale housing and condo markets. The excess inventory in vacant condominium and for-sale single family homes combined with tighter underwriting standards are expected to keep home values down through 2009, making buyers wary of purchasing a new home in the near future and keeping them in the renter pool.

Construction Pipeline

The impact of tighter underwriting criteria and skittishness from lenders toward construction loans began to surface at the beginning of the third quarter. At the end of the second quarter, there were more than 1,700 new units in the pipeline for delivery by year-end 2009; today that number is closer to 700 units. This is due primarily to the hesitancy of traditional lenders to make construction loans, the lack of mezzanine debt available, and hesitancy on the part of private equity sources choosing to wait on the sidelines until there is more stability in capital markets.

Transaction Volume

Year to date cap rates for multifamily properties have remained stable because of the lack of investment-grade product on the market and continued investor demand. Cap rates for newer properties have ranged from 5 to 6 percent, 1990's vintage properties have averaged from 6 to min 6 percent cap rates, and pre-1980 properties have moved in to the mid 6 to low 7 percent cap rate range. Non- investment grade assets are trading at approximately 100 basis points higher.

What does this mean for local owners? Minneapolis and St. Paul will continue to be a supply-constrained market through 2009. Expect continued rent growth in the 3 to 5 percent range, and expect occupancy to remain above 95 percent for the foreseeable future. These strong fundamentals will drive demand for product, which will continue to outpace supply, and cap rates are expected to remain relatively flat, not withstanding further economic upheaval in global financial markets.



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