

Apt. Sales Fall Amid Markets Turmoil

By Keat Foong, Executive Editor

New York—The apartment investment sales market since the financial crisis occurred in mid-September has frozen as apartment buyers and sellers face deep uncertainty over the future of the nation's—indeed, the global—economic condition.

“The apartment investment market is pretty much at a standstill,” acknowledges Michael Katz, co-CEO of Sterling American Properties.

Even before October, apartment sales volume in the third quarter through September had already fallen 58 percent compared to a year ago, according

Additionally, high-leverage players, who formed the bulk of buyers in the past, have also dropped out, she explained. “Previously, about 80 percent of apartment investment sales buyers were interested in long-term holds. These buyers are still there, but they normally constitute only 20 percent of the market,” she explains.

On the other hand, about 80 percent of deals have, in recent years, been done by 20 percent of buyers. These are the higher leverage buyers who are now out of the market as they can no longer find the financing they need.

Cap rates are rising

In this environment, cap rates have increased, though probably not nearly enough for many interested buyers. Through September, the weighted average cap rate for apartments was 6.1 percent, up 31 basis points from a year ago, according to Real Capital Analytics.

Wallace says that apartment cap rates have risen in markets she covers by about 25 to 50 basis points for Class A apartment properties, 50 to 100 basis points for Class B assets, and as much as 150 to 200 basis points for Class C assets.

Adding to the dearth of buyers, a lot of potential sellers have also exited the market. “We have pulled everything off the market. Nothing is for sale,” says Katz, of Sterling American Properties. Katz points out that most of the company's properties have long-term debt at good leverage that precludes the pressure to sell.

However, Katz says that his company is still seeking buying opportunities at this time. “We are looking to buy.” The company has the cash, and would factor its equity contributions into the purchase prices as necessary. “We put in money ourselves as a part of the purchase price. Instead of 30 to 35 percent, we put in 40 percent, no problem,” says Katz.

In the past year, Sterling has made acquisitions in the Inland Empire in California; Phoenix; Tampa, Fla.; Ann Arbor, Mich.; and New York.

Similarly, Michael Stewart, CEO of Pacific Property Assets, an investment firm that focuses on markets in California and Arizona, says his company is looking to purchase apartments. “We are actively

buying properties,” he says, adding that the company currently has five acquisitions in escrow.

Pacific Property Assets is targeting apartments of “Class D to Class C-plus” quality in “Class D-plus to Class B” locations, in markets such as Long Beach and Riverside, Calif. and the Phoenix metro area.

Pacific Property Assets is a long-term holder, says Stewart. “We buy and retain our properties indefinitely.” The company looks to renovate properties and hopes to get returns above 20 percent on its investments. On most of its transactions today, it is assuming the existing mortgages, though there is also one deal that is being financed via HUD 221 FHA insurance, Stewart says.

“There are not a lot of Class A properties on the market. The institutions have pulled off the properties,” Stewart comments. “The REITs know they are in a tough sales market.”

In the current environment, Wallace says buyers with one- to three-year time frames should not be in the market, and owners who need to be out need to be selling now. However, she argues that investors with horizons of five years or longer should be making investments today. “This year, the property may be \$30 million, and next year, \$26 million. Does it matter? Not if you are not selling it.”

Wallace says that now is a good time to buy in desirable but previously difficult to enter markets. “Southern California has always been a very tight market. It is very difficult to get projects in the well-located core. This is an opportunity to come in when no one else is buying, especially if you are a long-term holder.”

Rehabs focus on curb appeal

As far as rehabilitation, Tom Breneke, president of Guardian Management LLC, advises that developers should curtail the amount of rehabilitation completed. In this market, he cautions, renters may prefer to have a lower level of finishes in their apartments and pay less rent, rather than to pay higher rent for more bells and whistles.

“Renters are not paying what they used to for rehabs. Two years ago, prospective residents might pay for the renovation. But today, they're opting for better value. If the carpet is five years old, that's



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Pictured: Wyndham Park, Beaverton, Ore., acquired and rehabbed by Guardian Management LLC

to numbers from Real Capital Analytics. The company reports that less than half of the \$10 billion in commercial real estate transactions in contract set to close at the beginning of September 2008 actually did close.

The drop in apartment investment sales volume is attributed to a combination of negative sentiment and uncertainty; lack of bank financing; the death of conduit financing; tougher LTV and DSC requirements from Fannie Mae and Freddie Mac; and a continuing gap between buyer and seller expectations.

By November, Kitty Wallace, senior vice president at Sperry Van Ness, said that multi-housing deals had dropped 70 to 80 percent in her markets. Wallace says a lot of core buyers such as institutional investors and pensions advisors are out of the market because their high-yield requirements cannot now be met.

okay. They prefer to have the lower rent," he says. "We see companies installing items such as granite counters and stainless steel appliances. Thirty to 40 units into the rehab, it is hard to cut back on these."

Breneke says that spending on rehab may be reduced 10 to 20 percent, by, for example, installing white appliances instead of stainless-steel ones. Rents can be increased today by maybe \$15 for every \$1,000 spent rather than \$20 for every \$1,000 spent, he says.

Breneke also advises that developers should look hard at the large-ticket items, such as the roof and

HVAC systems—to make sure they are intact when considering an acquisition. "You want a solid environment." He opines that the rehab should also be executed from "the outside in." Compromises can be made on the inside, he suggests, "but the curb appeal should look its best."

Katz, of Sterling American Properties, calls for the industry to remain calm. "This is just to remind everyone that we have been through this before.

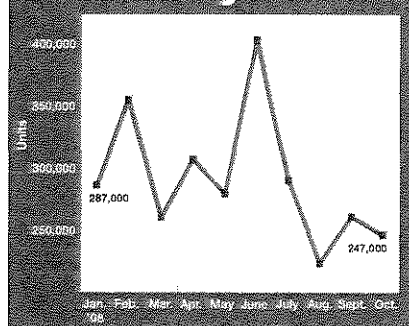
The key is not to panic. You'll come out of it. Everyone does. So, you'll have a smaller vacation, and one car instead of two. The key is to keep your head up, and not get depressed." He said owners also "came back" from the recession of the late 1980s and early 1990s. **MRN**

To comment on this article, e-mail Keat Foong at kfoong@multi-housingnews.com

NAHB ONLINE

Limited Range

Multifamily Starts



Multifamily Starts: Starts are down to 247,000 units (seasonally adjusted annual rate), but that's not the low for the past 12 months, surprisingly enough. Last December, the starts rate was at 211,000 units. The numbers have been all over the map since then, but they seem likely to stay in the mid-to-low 200,000-unit range for the immediate future. NAHB's forecast for multifamily starts shows the numbers stalled in that range through 2009, with an upturn beginning in early 2010. That upturn, however, isn't projected to move much beyond the 250,000 mark.

Commentary and Data Supplied by Dean Crist, Senior Economist, National Association of Home Builders (NAHB)

To comment, contact kfoong@multi-housingnews.com.

Complete series of charts and commentary from NAHB, on Starts, Rent Changes, Interest Rates and Building Materials Prices, www.multi-housingnews.com/marketdata

Community Investment Mezzanine Fund, LP

FannieMae | RCG Longview



\$8,000,000

**CI Mod Rehab
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secured by
an Apartment Complex
comprised of
406 Units

located in
**the La Mesa area
of San Diego, CA**

and subject to
\$33,000,000

**of Senior
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We provide flexible financing options for the rehabilitation and preservation of affordable multi family housing nation wide.

The Community Investment Mezzanine Fund, LP together with Fannie Mae's "DUS" product provides a one-stop financing solution for multi-family properties with moderate to significant rehabilitation needs by combining a permanent DUS loan with a temporary mezzanine loan.

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