

MULTI-HOUSING NEWS

Market Report: Bright Spots

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Even though the weather in Seattle, Portland and the Bay Area is often marked by foggy, overcast skies, the multifamily forecast for these three areas remains sunny. In fact, San Francisco, San Jose, Seattle and Portland all made MHN's list of "10 Hot Prospects for 2008" (see MHN's Dec. 2007 issue). Job growth in these markets, while slowing slightly, continues to outpace the national average, powered in particular by the technology sectors.

The Seattle area is now enjoying the most diverse economy it's ever had, with major employers ranging from Boeing to Microsoft, Amazon and Google, according to Tom Parsons, senior vice president and general manager of Opus Northwest LLC, based in Seattle. And Nike is also beefing up its staffing levels in the Portland metro area. In-migration continues in all three areas, but the high cost of single-family housing and stricter lending standards are expected to keep more people in rental housing.

Occupancy in both the Seattle MSA (metropolitan statistical area) and Portland multifamily sectors is high, at 95.9 and 96.2 percent, respectively, but each is down one percentage point from the first quarter of 2007, according to Greg Willett, vice president of research and analysis for M/PF Yieldstar. "It is a competitive leasing environment," says Parsons, who oversees both the Seattle and Portland offices.

At the same time, rent growth has been strong but is likewise subsiding slightly. Seattle saw rents rise 8 percent in the last year, while Portland reported 5 percent gains, says Willett. In the previous year, Parsons adds, rent growth in Seattle had been in double digits, at around 12 percent.

As in many places, condo conversions took a lot of rental product off the market, notes Greg Wendelken, vice president and regional manager of the Seattle office of Marcus & Millichap, and with condo development dominating, not many apartment communities were built in the past several years in these high barrier-to-entry markets.

Now, Seattle is seeing a big upturn in construction on the apartment side. This year, 7,400 apartments are under construction, "helping to get inventory back up to where it had been," says



Willet. "Last year, 6,200 apartment units were underway but that number was only 3,400 in 2007 and just 2,300 in 2006. Furthermore," Willett adds, "We haven't seen meaningful deliveries yet. Still, occupancy is tight and economic growth is strong."

"Nine thousand apartment units in Seattle are in the hopper so we'll see how many actually get built," adds Wendelken. "2007 was the first year where we actually had negative absorption of apartments," he reports.

Many condos continue to come online in downtown Seattle and in the nearby suburb of Bellevue. A number of major employers, such as Microsoft, Expedia and Eddie Bauer, have recently expanded their operations in Bellevue. In fact, Willett points out, for a suburban area, Bellevue "is going very vertical."

Plus, green is a big concern. For example, the 42- and 43-story Bellevue Towers, being developed by a Portland, Ore. company, Gerding Edlen Development, are aiming for LEED (Leadership in Energy and Environmental Design) Gold.

Recycling of construction waste is standard, notes Parsons. These municipalities are focused on a wide variety of environmental issues. And in keeping with concerns about air quality, some of the developer's new buildings will ban smoking within their confines.

Downtown living continues to grow in popularity for both young professionals and empty nesters in all these areas, and previously suburban communities are seeing more multifamily development. In Seattle, the interest in downtown living is expected to provide sufficient demand for apartment properties in core growth areas, including the downtown/Capitol Hill, Queen Anne and Belltown as well as North Seattle submarkets.

However, the condo market has softened here, too, notes Wendelken. "We built a lot of condos and at some point, supply just outstrips demand, especially in the suburbs.

"Historically, for the last 40 years in Seattle, the last five or six years in each decade are pretty strong, but the first three or four years of every decade tend to start out slow," recalls Wendelken. "Prices are still going up but not as much—we're in the beginning of our breather, from a value standpoint," says Wendelken. "Now, and for the next couple of years, people will have to buy with a longer-term outlook, unless they do a value-add deal."

"We're still very bullish on this market, but now, people have to price a building correctly, and have to consider that you're selling an income stream," says Wendelken. "People will have to figure out how they actually make money on this building, rather than just buying it because it's going up in value. We can't sell any more negative leverage like we used to. That'll be good—it'll kind of cleanse the market. A lot of buyers and brokers who shouldn't have been in the market will probably get out."

While the velocity of sales is now way down, Wendelken notes that some property owners are still interested in selling because they believe that no matter who's elected president in November, capital gains taxes will go up.

The condo market softened in Portland before Seattle, according to Parsons. He attributes that to the fact that it was fueled more by investors. Furthermore, in the last 18 months, Portland actually delivered more condos than Seattle, which is three times larger. However, Parsons expects demand will again outpace availability by 2010.

Opus, for example, had entitled a property in Portland on a high-profile site as a condominium but "saw the handwriting on the wall" back in late 2006 and re-designed the floorplate and unit mix into a rental. This became a 330-unit community called The Ladd.

"The big problem in Seattle and the adjoining Bellevue suburb is that the delivery costs to consumers have gotten so high." While there has been a stabilization in construction costs, Parsons notes, prices remain expensive. Costs have declined only in one type of multifamily building: the five-over-one urban wood product. And neither Seattle nor Portland is a development-friendly area—it takes a long time for a project to be approved, he points out.

Opus currently has high rises under construction in both downtown Seattle and Portland that are aiming for LEED Silver ratings. Fifteen Twenty-One Second Avenue, comprised of 143 condominiums in a 38-floor glass tower, will be the first "tall and slender" residential tower under Seattle's new zoning, which encourages density and environmentally conscious living. Park, a mixed-use, 101-unit apartment building in Portland's historic Alphabet District, will incorporate historic design features that enhance the surrounding community while seeking LEED Silver certification.

San Jose/Silicon Valley/Peninsula

In San Jose, rent growth is up 8.4 percent, Willett reports, with occupancy at 96.2 percent, which again is down about a percentage point from the same period a year ago.

Builders are expected to complete 1,020 apartment units in San Jose this year, boosting inventory by just 0.9 percent, according to Marcus & Millichap research. Deliveries totaled 670 units in 2007.

Silicon Valley's multifamily market remains healthy and strong, though it is seeing a lull in terms of rent growth during the past three months after strong growth in the past 18 months, adds Bruce Dorfman, one of the principals of Thompson|Dorfman Partners LLC, based in Mill Valley, Calif. There is no oversupply of apartments and, in fact, there is still a decline in the amount of Class A apartment inventory due to condo conversions and construction.

While much of this firm's work is in the luxury condo sector, Thompson|Dorfman have also been involved in several small-scale workforce housing projects specifically designed for public school teachers. In order to attract and retain teachers in districts with prohibitively high housing costs, a subsidiary of Thompson|Dorfman has built housing for both the Santa Clara Unified School District and the San Mateo Community College District on surplus land already owned by these districts. In fact, it has just broken ground for the second phase of Casa del Maestro, which will consist of a three-story building with 30 units in San Mateo, and plans to start another 60 units elsewhere in the fall. Target rents for teachers are 50 percent or less of the market rate.

The for-sale market on the Peninsula continues to move product, Dorfman reports. In fact, the developer just entitled a 1,600-unit project in north San Jose. Three different architecture firms will be designing the six buildings in this walkable community, which is located near a light rail station, a five-acre park and the Guadeloupe River. The 32-acre development will include both rentals and condos.