

# e-merging directions

timely research on current commercial real estate topics

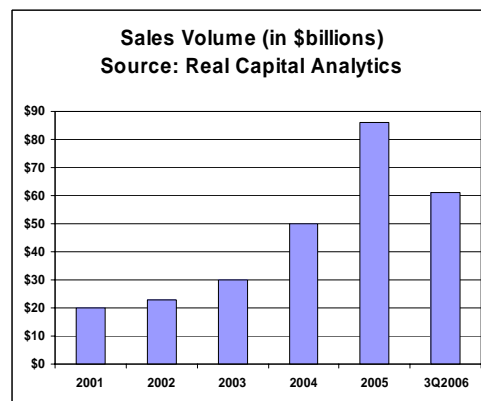
## Rental Apartments Gain Favor Among Investors

Apartments continue to be a preferred product type among investors due to the combination of improving rental and vacancy fundamentals, increased influx of capital, favorable demographic trends, and job growth. A key contributing factor to the improved rental and vacancy statistics is the one thing most investors don't like, higher interest rates. But with the rise of interest rates in the past couple of years, would-be buyers have moved back into the rental pool.

### Apartment Sales

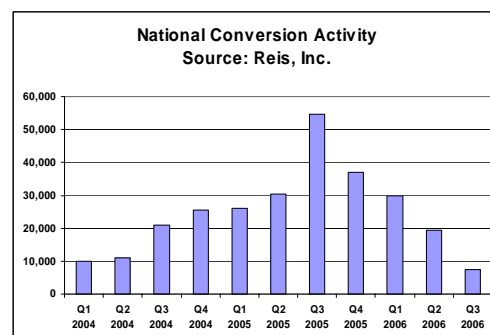
Apartment sales, like most commercial real estate products, have seen an increase in velocity the past couple of years. There are several key contributors to this phenomenon: marginal stock performance, increased influx of capital, easy credit, and real estate becoming more of an accepted asset class for institutional and private equity investors as they seek to diversify their portfolios.

As depicted in the graph on the right, apartment sales volume has continually increased each of the past four years, and it appears the trend will continue in 2006 and 2007. Even if it does not exceed the record for sales volume set in 2005, it has already reached twice the volume of 2003, and has exceeded 2004.



### Condo Conversions

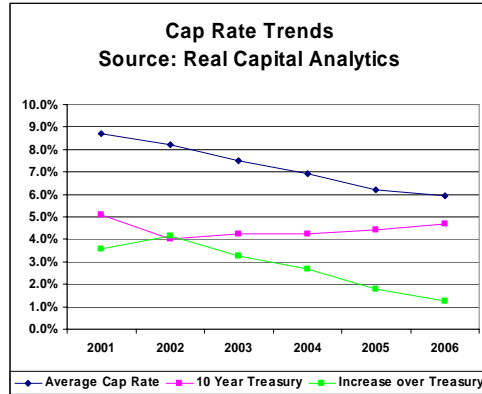
The trend in recent years has been to convert current apartment buildings to condos. The owners could do the conversion, removing renters and making "home owners" out of "existing" tenants, which are the younger generation wanting to take advantage of low mortgage rates and urban living.



This trend has at least seen a dramatic slowdown in many markets and has come to an abrupt end in most markets. Proposed condo conversion projects have fallen from 55,000 units in third quarter of 2005 to a little more than 7,000 units for the same quarter in 2006 - a thirteen percent drop from one year ago. The beginning of the "broken condo" opportunities foretells what will be coming to market in the next year.

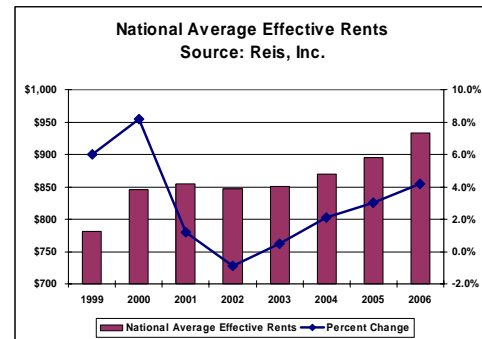
### Capitalization Rates

As the capitalization rates have decreased the past few years, investment prices have risen. Compare this rate with the 10 year treasury, which is considered to be a no-risk investment. Subtract the value of the 10 year treasury from the cap rate to calculate the additional rate of return for the risk of investment. The increase of cap rates over treasuries was over 4% in 2002 and is now just above 1%. This indicates that investors see multi-family assets as solid investments.



### Apartment Rents

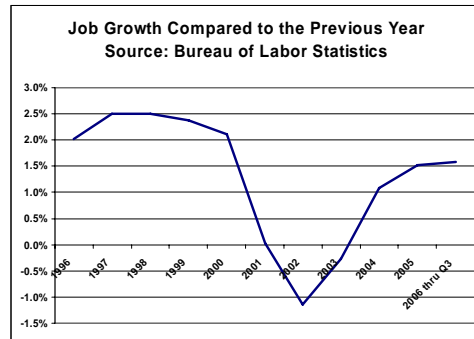
Good news for apartment owners and investors is that the effective rental rates have continued to rise as concessions are burning off. The national average effective rents have increased steadily the past three years by about two to four percent each year. This is in contrast to the less than one percent increases of the prior three years. The small increases and decrease can be attributed to low interest rates during that time period. The steadily increasing trend is expected to continue in the near future as interest rates rise, slowly removing more potential homebuyers from the market and keeping vacancy rates low.



## Job Growth

The improvement in the job market is supporting household formation, creating active renters of young adults. Aside from a couple of years at the early part of this century, job growth has been positive. In fact, recent trends indicate job growth has been positive and will continue its upward trend.

In all, apartments continue to be an attractive investment. Expected increases in interest rates, asking rents, lower vacancies, concessions burning off, and increased job growth all add to the attractiveness of multi family properties as an investment. With the slowdown in condo conversions and compression of cap rates, investors should anticipate continued competition for assets, particularly Class A assets, as sales volume continues to remain high for the next twelve months.



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