Chicago Multifamily Market

The Chicago multifamily market can be characterized as being concerned, but trying to be hopeful and optimistic. Most clients are looking in 2009 to manage and optimize occupancy, as opposed to driving the rent roll up and increasing rental rates. A number of clients that manage larger portfolios have already sent out notices for spring renewals stating that there will be no rent increases. Certainly to the extent that different submarkets can absorb a rent increase, owners will seek to get them, but such increases will be modest. There is a growing concern about how correlated the apartment sector is to employment, and despite very good demographics for the rental market and despite the fact that there is an obvious and substantial reduction in home buying, both of which would benefit the rental market, the unemployment issue seems to be mitigating those gains.

In investment sales, Essex Realty Group is working primarily with three major groups of buyers at this time: first, there are a variety of lenders working to sell foreclosed conversion projects. Most of those properties, if not all, are reverting back to rental. The second group is developers that, in addition to their construction or conversion activities, have purchased income-producing properties to provide some diversification. Now that they need additional working capital to support their struggling development projects, and since it is much more difficult to refinance cash out of these investments, developers are selling rather than refinancing to raise capital. The third group of sellers that we seem to keep running into is the sellers that leave the market for everyday reasons; there are always owners that simply want to dispose of their property. Activity is equally divided among the three groups.

It is no secret that the lenders are scrutinizing acquisitions much more carefully. For assets that either have a high vacancy or substantial deferred maintenance, where there is a real need for capital improvement, the lenders are being particularly critical, and are either taking a pass entirely or making very low loan-to-value commitments. On the properties that are stabilized and in reasonably good condition, there are still ample lenders willing to loan at typically the 1.2 debt service coverage ratio, which in real dollars translates into 65 to 70 percent loan-to-value commitment. Most lenders are not giving 80 percent financing anymore; consequently, when you are looking at buying these deals – the third piece of the puzzle – buyers have to put more money down. And, because the loan-to-value ratios are lower and both the perceived and actual risk that buyers are taking on is higher, they expect a better cap rate now than they would have 12 months ago.

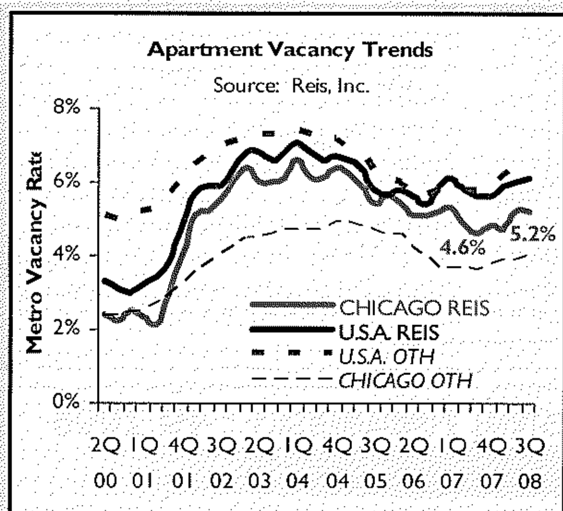
Between buyers and sellers, there is still a material spread between bid and ask for a variety of reasons. Over the last 8 to 10 years, as values were going up, sellers were inclined to be more aggressive, so there was a natural spread. They had to push the asking price upward to see where the market would go. Now that we are in a period of price erosion, sellers are slow to lower the prices and instead want to see what the market will conform to.

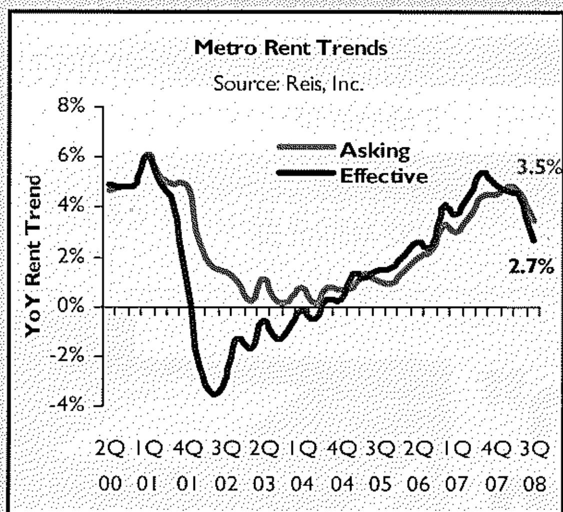
There has not been as much price erosion in Chicago's prime locations. Deals in those markets sold 3 years ago at a 5 percent cap rate. Implicit in a low cap rate is lower volatility. When buyers move to secondary and tertiary markets and properties, the values dropped off fairly steeply. Implicit in somebody buying at a 7.5 percent cap rate 2 or 3 years ago was greater volatility and risk, and now those investors are experiencing that volatility.

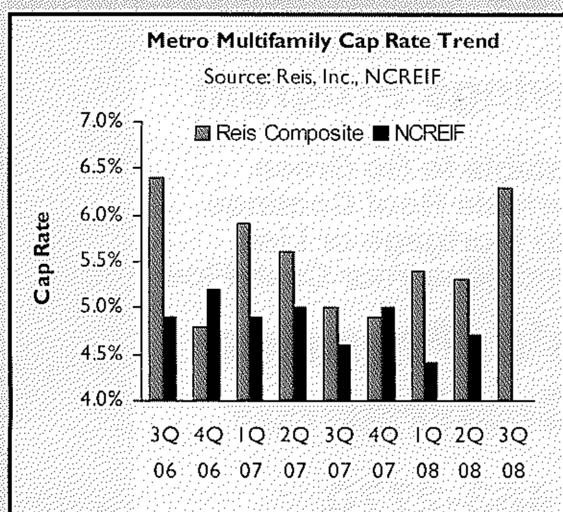
The velocity of transactions continued to be strong in the fourth quarter of last year. There was a fair amount of business, but a lot of it came from banks or developers. If the economy erodes further, or fails to stabilize, then there will likely be an increase in transaction velocity. If this occurs, several things will follow: First, cash flow from operations are going to suffer because of high vacancy. Whenever that happens, there is an increase in the number of transactions. Second, if the economy continues to erode further, many owners will opt to trade in bricks for cash, because they value or need the liquidity.

The Lincoln Park/Lakeview neighborhoods, as well the core suburban markets, have done well because there is a flight to quality, which often happens in an economic downturn. If an investor has some cash, and wants to place it somewhere safely, those are good areas in which to buy. Additionally, in some of the secondary or tertiary locations, like a Rogers Park, a South Shore or a Des Plaines-type of suburban location, investors can get much better pricing today buying there than they could have any time in the last couple of years. If someone is more opportunistic, those markets have received good interest as well.

— Douglas Imber is president of Chicago-based Essex Realty Group.







Courtesy of Red Capital Group

The Arboretum of South Barrington

Winnebago Energy Center
Landfill Gas to Energy

Citibank

Construction Managers
& General Contractors
since 1922.

Corporate
Healthcare
Retail
Institutional
Transportation
Industrial

www.ragnarbenson.com

250 S. Northwest Highway ~ Park Ridge, IL 60068
P 847-698-4900 ~ F 847-692-9320