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Investments lag with apartment rentals

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Sales of apartment complexes to investors continued well into 2008 even as sales of other income properties dropped.

Now, apartment sales also have slowed. Steve Fender, president of Verity Property Management Inc., Boise, said he's aware of one Boise-area apartment sale in the works, to an out-of-state investor completing a tax deferred exchange.

"As for straight sales, traditional lender-financed, the most recent I'm aware of closed in July," he said. A lender backed away from the planned sale of a 12-unit apartment property recently, less than a week before the deal's expected closing date, he said, adding that deals involving smaller complexes can encounter more problems because cash flow takes a big hit with each new vacancy.

Lenders, in response to market uncertainty, require that investors put in more of their own money – sometimes up to half of the deal's total value for conventional financing, he said.

Many banks own too many foreclosed single-family residences already, said Fender, a retired real estate attorney. They are reluctant in the down economy to run the risk of having to foreclose on a multi-family residential property "because of the attendant issues including managing the tenant base, collecting the rents, and the legal obligation to maintain the individual units in a habitable condition.

"As banks have come under increased scrutiny to keep homeowners out of foreclosure, there is less money to loan on multi-family apartment buildings," he said. Insurance companies, pension plans and other non-banks tend to fund apartment purchases involving large dollar amounts, he noted.

The apartment segment is seeing more investor purchase and sale activity than retail, industrial and office properties nationwide, said Jack Harty, principal in Boise commercial mortgage brokerage Harty Capital.

"Sellers are still reluctant to lower their prices, but the world has changed and they're going to have to," he said. Apartment values should come down in view of continued job losses and uncertainty about the supply of tenants, he said.

Deals for less than $3 million traditionally go to banks or Wall Street finance sources, Harty said. Insurance companies, pension plans, Fannie Mae and Freddie Mac, fund the bigger deals. Fannie is the Federal National Mortgage Association. Freddie is the Federal Home Loan Mortgage Corp. Both are government-sponsored enterprises.

"Fannie, Freddie, insurance companies and Wall Street conduits all were making apartment loans two years ago at very favorable rates," he said. Since then, conduits, insurance companies and pension funds are much less active but Fannie and Freddie – which the U.S. government rescued last fall – continue to provide long-term (post-construction) financing for qualifying apartment deals.

Harty said Fannie and Freddie "are providing good financing for well-performing properties. They are pretty risk-averse right now."

Fannie Mae and Freddie Mac share risk with another lender and the apartment owner. The loans usually tend to require less equity from the owner compared to smaller deals financed solely by a lender, he said.

Although smaller, bank-financed deals are not always higher-risk than larger-value deals, "they are almost always more expensive," he said. They cost more to produce, and involve more overhead as a percentage of the total loan.

On smaller deals, apartment investors have many fewer financing choices compared to two years ago, and the lenders are being more cautious, Harty said.

Fender said Boise-area apartment values in three to five years should be "back to where they were prior to the implosion." In the long term, he said, apartments will continue to be popular as investments for reasons including that most investors are familiar with them, investors can boost occupancy in tough times by adjusting rents, and investors can monitor the property's physical condition while a property manager tracks financial performance.