



By Wayne Williams

**Looking for recovery means looking at the different product classes.**

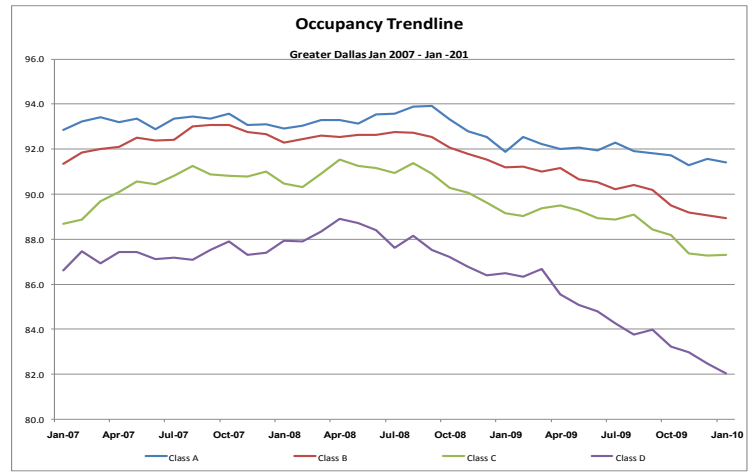
While the recession has affected virtually every multifamily product type and every product class in a significant way, there are some differences in the effects on the product classes that bear watching for signs of recovery.

Typically in a strong market the “rising tide lifts all boats”, however, in a weak market, different product classes will feel the effects in markedly different ways. As in our market, in a soft market one tends to find a lot of new product on the market at just the wrong time. This newer product is almost always “Class A” product.

Consequently in order for the Class A properties to maintain occupancy they must either slash prices or offer significant concessions. This in turn gives potential residents of Class B properties the opportunity to afford Class A properties, forcing Class B owners to increase concessions and so on down the chain of property classes. However, in this downturn we also have a significant amount of job loss and therefore residents that cannot qualify to live anywhere. At a certain point there is no point in lowering prices further to attract tenant. Therefore if we were to look for recovery we should see it first in the lower class properties that will “bottom out” and start to recover sooner. However it may not necessarily be the Class D properties that recover since higher class properties may still be deeply discounting and remain attractive for tenants once the recovery begins.

In analyzing occupancy for the last 3 years in stabilized properties (chart, top right), we find that not only are rents stratified for different class properties but occupancy levels are stratified as well. Ironically in the market as a whole there is no crossover in occupancy levels. Apparently Class A properties will discount enough to become attractive enough to residents to maintain their occupancy levels and class B properties will follow suit, etc. As one can see each level’s occupancy rate lowers at a faster rate than

the farther down the chain you go. From the time the recession formally started in the 4th quarter of 2007, all classes still gained in occupancy into 2008 but the Class C and D properties started to decline in the 2nd quarter of 2008 while Class B properties held steady and



Class A properties actually gained in occupancy into the 4th quarter of 2008. At that point each Class inexorably declined with the Class D properties declining at a much larger rate than the other classes falling to an average occupancy of 82% in January 2010.

Though the Class A properties have experienced a slight uptick in occupancy rates in the last few months this has been at the expense of rents and concessions.

In the last 3 years, from January 2007 to January 2010, effective rents have dropped in Class A stabilized properties from \$1003 per unit to \$991 (-1.1%) drop. In Class B properties effective rents dropped from \$715 to \$711 (-.6%). In Class C properties effective rents rose from \$600 to 614 per unit (+2.3%) and in Class D properties rents rose to \$573 per unit from \$557 in January 2007 (+2.9%). So while Class A and B properties struggled to maintain occupancy levels at the expense of Rents, Class C and D properties lost occupancy while modestly increasing rental rates just under inflation.

In fact, looking at quarterly absorption rates over the last 13 quarters (chart, below)

ones sees than in the last 6 quarters only class A and Class B properties have seen any net growth in one quarter and in the last 5 quarters only Class A properties have seen any positive quarterly absorption while Class B properties have had the worst performance in quarterly absorption rates.

In the coming months we will be looking hopefully for signs of recovery. Class C properties seem to have leveled off in their occupancy rates in the last few months without lowering rents. If we can see some growth in Occupancy in the Class D and Class C properties and see some rent stabilization in the Class A and Class B properties, that will be a positive sign that recovery is close. However some submarkets that are loaded up with newer Class A products such as the northern suburbs and uptown will still probably lag behind the other submarkets.

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