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Building boom depresses downtown apartment rents

By: Alby Gallun **February 13, 2014**

Rents at high-end downtown apartments slipped last year as demand failed to keep up with supply, an imbalance that could continue amid a building boom that shows few signs of abating.

Net rents at Class A apartment buildings in downtown Chicago fell to $2.51 per square foot last year, down 2.7 percent from 2012, according to Ron DeVries, vice president at Appraisal Research Counselors, a Chicago-based consulting firm. Many landlords are losing their pricing power amid competition from new high-rises with luxury amenities and fancy finishes.

The downtown market has weakened after three unusually strong years — Class A net rents rose 7.5 percent annually from 2009 to 2012 — powered by a shift in the housing market away from condominiums and into apartments. Many would-be buyers decided to rent, either because they were worried that condo prices would fall or because they couldn't get a mortgage.

Developers responded by building new downtown rental towers, completing about 2,700 units in 2013, the most in one year since at least 1999, according to Appraisal Research. They will add more than 2,000 apartments this year and possibly more than 4,000 in 2015, according to the firm. New buildings on track to open this year include **a 332-unit tower at 73 E. Lake St.** and **a 504-unit building at 111 W. Wacker Drive.**

While the new high-rises are leasing up, they are stealing tenants from older Class A buildings, where occupancies have dropped.

“They're the ones that are really paying the price,” Mr. DeVries said at a lunch presentation today at the Standard Club.

The downtown Class A occupancy rate was 92.6 percent in the fourth quarter, down from 94.6 percent a year earlier, according to Appraisal Research. Mr. DeVries expects occupancies to drop to around 90 percent over the next year or so as more developers complete projects.

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Yet the shift in the market is good news for tenants, who have more choice — and new leverage over landlords. To attract tenants, more landlords are relying on concessions, with many giving a month or two of free rent, Mr. DeVries said.

The question is whether demand will pick up enough to absorb all the new supply. Annual absorption, or the increase in the number of occupied apartments downtown, averaged 1,367 units over the past six years, according to Mr. DeVries. But developers are forecast to add an average of 3,054 units a year — more than double that amount — between 2013 and 2015.

An improving economy and job market could boost demand for apartments. Downtown landlords also could benefit as more companies move downtown from the suburbs, Mr. DeVries said. Motorola Mobility, for instance, is moving more than 2,000 jobs from north suburban Libertyville to the Merchandise Mart in River North, **a plan unchanged** by the recent news that Lenovo Group Ltd. is buying the business from Google Inc. **GoGo Inc.** also is moving to a new headquarters in the West Loop from Itasca.

The building boom has yet to depress rents at less-expensive buildings. Downtown Class B rents rose 1.35 percent last year, to $2.26 per square foot, according to Appraisal Research. But Mr. DeVries doesn't expect that to last, saying, “B's are going to start feeling pressure.

“At the end of the day, there's obviously a ripple effect,” he said.

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The reported average reduction calculates to $.067 sq. ft. or analogous to a vacancy/ rent loss of .027%. The unit mix, design/show of same , utility costs, location, "curb" appeal, building design etc. along with focused merchandising presentations (both media and on site) will more likely affect the ultimate absorption and turnover velocities of the respective properties. Frank Glickman

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