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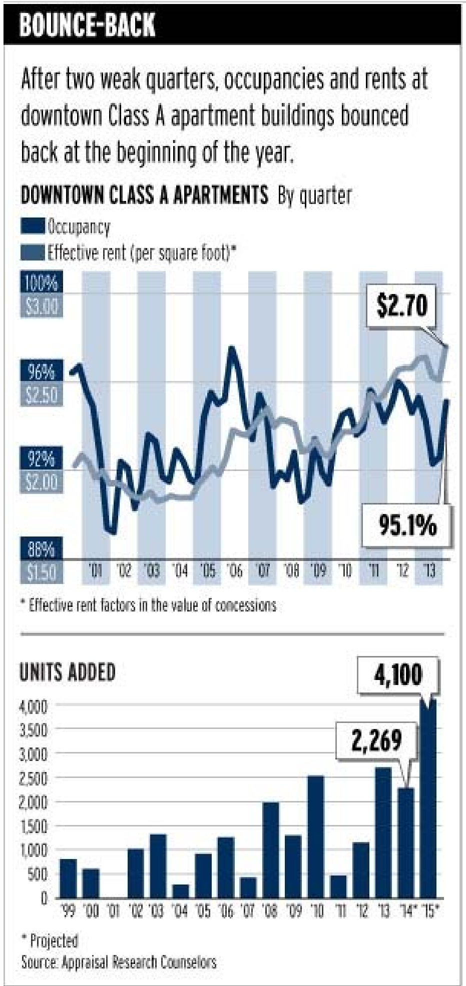
Downtown apartment market 'on fire' in first quarter

By Alby Gallun



Downtown landlords worried about a potential apartment glut can breathe easier, at least for a little while.

Demand for apartments surged in the first quarter, boosting rents and occupancies at high-end downtown buildings after **worrisome declines** in the previous two quarters, according to a report from Appraisal Research Counselors, a Chicago-based consulting firm.

The report suggests that the downtown market so far is holding up amid the biggest apartment building boom in decades.

Effective rents at top-tier Class A buildings rose to a record high of $2.70 per square foot, up 7.6 percent from fourth-quarter 2013 and 2.7 percent from a year earlier, according to the report. Effective rents include the impact of concessions such as free rent.

“The market was on fire,” said Appraisal Research Vice President Ron DeVries. “It was pretty spectacular.”

The downtown Class A occupancy rate rose to 95.1 percent in the first quarter, up from 92.6 percent in the fourth quarter but down from 95.3 percent a year earlier. The most stunning statistic was net absorption, or the change in the number of leased apartments in the quarter. Net absorption totaled 1,013 units, the biggest quarterly figure since at least 2011, according to Appraisal Research.

The market “came on faster and heavier than anyone expected,” Mr. DeVries said. He expected absorption of about 500 units in the quarter.

RENTS UP…

Yet the good news for landlords is bad news for tenants, who have endured big rent increases over the past four years. The average Class A downtown apartment rent is nearly 30 percent higher than it was in late 2009, according to Appraisal Research.

Apartments have been the hottest real estate sector since the crash, as more people have favored renting over owning and some who would like to buy no longer can because it's harder to get a mortgage. The downtown market has been especially strong, and many landlords believe it has staying power because of strong job growth in the tech sector and the trend of companies such as **Motorola Mobility** moving their offices downtown from the suburbs.

“Downtown is getting more than its fair share of the jobs,” Mr. DeVries said. “Therefore, it's creating more housing demand.”

…BUT SO IS SUPPLY

The problem is that developers are piling into the market, fueling concerns about **an oversupply.** Developers completed 2,695 apartments in downtown Chicago last year and are on track to finish another 2,269 this year and 4,100 in 2015, according to Appraisal Research.

Add it all up, and that's a 33 percent increase in apartment supply in just three years. And that doesn't include 2016, when Mr. DeVries expects developers to add another 4,000 units downtown, provided they can obtain construction financing.

If landlords can rent about 1,000 units a quarter, the supply increase wouldn't be a concern. But don't expect a repeat of the first quarter: Downtown absorption averaged about 1,400 apartments from 2009 to 2013—four very good years for landlords—so demand would have to more than double to get to that level.

Mr. DeVries expects absorption this year to exceed 2,000 units but doesn't see it going over 3,000.

“We've never hit 3,000 for apartments,” he said. “For the balance of 2014, we're looking pretty good. Starting in 2015 and 2016, that's where we're going to see big numbers on the supply side."

JOBS WILL DRIVE DEMAND

For now, it's a great time to be an apartment developer. Five weeks after opening its leasing center at **OneEleven,** a 504-unit tower at 111 W. Wacker Drive, Related Midwest already has leased 100 units in the new building, said Curt Bailey, president of Chicago-based Related.

"As long as it's in the right location, we feel it's a very good time to be opening up a building in Chicago," he said.

Mr. Bailey thinks downtown job growth will fuel demand for apartments, saying 40 percent of renters in another Related building, at 500 N. Lake Shore Drive, are people who moved to Chicago for jobs.

"We've always been confident that if the jobs came, we'd be fine," he said.

Landlords are fine right now. Mr. DeVries expects Class A rents to rise 2 to 3 percent this year.

Owners of less-expensive Class B apartments are thriving, too. Effective Class B rents hit an all-time high of $2.35 a square foot in the first quarter, up 4 percent from fourth-quarter 2013 and 1.3 percent from a year earlier, according to the Appraisal Research report. But the Class B occupancy rate fell to 92.6 percent, down from 93.0 percent in the fourth quarter and 95.3 percent a year earlier.

"Obviously, one quarter doesn't make the market," Mr. DeVries said, "but it's certainly a good sign of where we're headed this year."

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