



NEW JERSEY

The Business of New Jersey Real Estate: Timely Information, Trusted Analysis and Valuable Resources Online

Last updated: October 5, 2009 10:57am

Apartment REITs Set to Rebound

By Ken Schapiro



To say that looking for bright spots in the current real estate market is a challenge is probably the greatest understatement of the recession. However, the sun is definitely rising on Real Estate Investment Trusts for apartment buildings.

Apartment REITs continue to benefit in this real estate correction because the number of renters and the duration of their stay has increased. Owning a home remains unaffordable for many people, as the unemployment rate has remained lofty for quite some time and lending standards have tightened. Additionally, rising unemployment means less office space is needed, which is obviously not good for office REITs. The weaker economy also means lower consumer spending, which is certainly a negative for retail REITs. From the investors' perspective, apartment REITs continue to be viewed as a relatively safer segment within the broader REIT industry because of comparatively stronger balance sheets.

Demographics favor the apartment market in a very big way. The children of baby boomers are going to need somewhere to live very soon, which will be a shot in the arm for the apartment market. After the smoke from the housing bust clears, home ownership will be down from the peaks seen earlier in the decade. Additionally, current and future renters are very unlikely to make a quick departure from the apartment market as financing for potential homeowners will continue to be difficult to come by post-recession.

Cash is king in the current market as obligations come due and apartment REITs have an important advantage over their retail and office brethren when it comes to meeting obligations. Apartment REITs

can use their buildings as collateral to borrow from Freddie Mac and Fannie Mae, providing access to 7-to-10-year debt at 5.5%, which is approximately a 2% discount over the borrowing options available to commercial and retail REITs.

Many publicly-traded REITs have issued new equity since March to address funding issues that they are facing over the next three years. Making equity available has been the key advantage that REITs have over other property owners that have not been able to raise capital. REITs have raised an impressive \$13 billion since March, but they will likely need to go back to the markets to take advantage of undervalued real estate opportunities.

Apartment REITs with strong balance sheets and access to capital will thrive in this environment. Condor Capital recently initiated a strong position for our investors with AvalonBay Communities, an Alexandria, VA company that is very well-positioned for success in the current downtrend.

AvalonBay's focus on luxury apartments in urban regions, including the greater New York City area, protects it from excessive competition. This emphasis on upscale, high-rise apartments also provides a barrier-to-entry advantage since construction is the most expensive. Additionally, landlords operating luxury apartments have the benefit of making greater concessions to keep price-sensitive tenants from leaving.

AvalonBay's strong balance sheet and large capacity on its bank line put it in an excellent financial position, especially when compared to the majority of its peers. The company has the flexibility to refinance should unforeseen challenges arise and should be in a comfortable position to complete all ongoing construction projects without external financing.

Apartment REITs like Avalon Bay that are well-capitalized with liquid assets to meet maturing debt will do very well over the next few years and will be very attractive for patient, long-term investors.

Ken Schapiro is president of Condor Capital, an SEC-registered investment firm based in Martinsville that manages over \$500 million in portfolio assets.