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BRIGHT SPOT: Apartment Reports Upbeat Amid Housing Downturn

Fannie and Freddie Are White Knights For Borrowers While Housing Woes Help Investors By Keeping Tenants From Wandering Off

Home sales may be slow, but folks still need a place to live -- and apartment operators are among a narrow band of investors that have reaped benefits from the single-family housing downturn, if not from the credit crunch that has followed.

Year-over-year apartment growth has slowed due to the softening job market and increasing supply, but market conditions for most multifamily owners and developers remain relatively stable. Renters -- by choice or not -- are keeping occupancy high at most properties by staying put rather than venturing out to buy homes, analysts say. Apartment investors are saving on interest by taking advantage of lower-cost floating-rate debt provided by government-backed Fannie Mae and Freddie Mac lenders, helping shore up sales transaction volume compared with activity in the office, industrial and retail markets.

Those factors have congealed into a rosier-than-expected outlook for apartment results by executives of publicly traded apartment REITs during fourth-quarter earnings calls with investors over the last few days -- catching some on Wall Street a bit by surprise.

"The general tone and guidance ranges were a bit stronger than we anticipated," Citibank’s Craig Melcher said in a Feb. 8 research report. "[However] the apartments are not out of the woods yet, and we expect the tone on [investor] calls in the next few quarters will deteriorate if the job losses that were experienced in January continue for the next few months and a recession materializes."

The latest quarterly survey by the National Multi Housing Council released last week shows the ongoing financial market turmoil and its spillover into the broader economy are having a double-edged effect on the apartment sector. Although sales are down historically and equity is less available, the housing and mortgage market downturn are bolstering demand for rental units.

"The apartment industry is clearly benefiting from the downturn in the for-sale housing industry," said NMHC Chief Economist Mark Obrinsky. "Overall, the apartment industry remains healthy at this point due to continuing strong fundamentals and the fact that apartment firms did not overbuild in the latest economic cycle."

Almost 80% of Multi Housing Council respondents indicated that tightening mortgage credit has reduced the outflow of renters into homeownership, according to the survey. Although that’s only a small rise from 75% in October, more than one-third of those surveyed described the number of renters staying put in apartments as "big," up from 22% in October and 18% in July.

Home ownership rates have dropped 150 basis points since the peak, creating more than 1.5 million renters, while some economists think the rate could drop another 200 basis points before it's over, Camden Properties (NYSE: CPT) Chairman/CEO Rick Campo told shareholders.

"On the other hand, job growth continues to slow, with 2008 projected to decline about 50% to 265,000 jobs created. But the real wild card here is that shadow supply of single-family homes and what effect they will have on multifamily demand. The answer to that question will unfold during 2008."

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One factor countering the dour outlook of other real estate categories is the relative availability of multifamily financing. With the tightening of loan underwriting standards across the industry, government-sponsored enterprises (GSEs) Freddie Mac and Fannie Mae and have become everybody's favorite dance partner at the commercial mortgage ball. While CMBS and CDO outflows were tanking in 2007, Fannie and Freddie agency lenders posted record loan volumes last year, according to the Mortgage Industry Association.

"Fannie and Freddie are providing a lot of capital to the multi-family market and I have not heard of buyers having any difficult arranging financing from either agency,"David Robertson, executive vice president with Aimco's capital division, told investors.

With the ability to finance deals at 5% to 5.5%, agency financing has propped up apartment transaction volumes, according to Citigroup's Melcher. Although buyers are not able to leverage deals as tightly as a year ago, debt of 60% to 80% is still available through the GSEs.

"The market for apartment financing remains very strong right now in terms of volume," according to Brian Kochan with Deutsche Bank Berkshire Mortgage, a Fannie/Freddie DUS lender in Bethesda, MD. "Rates range between 5.25% and 5.75% for 5-year and 10-year money, partial interest-only is still available for fully levered deals and term I/O is available for low levered deals."

Residential REITs yielded 5.3% on average as of Dec. 31, higher than the 4.9% average yield for all equity REITs, S&P noted.

However, cap rates for multifamily assets will continue to adjust upward as conventional buyers and lenders focus on debt service coverage when underwriting new acquisitions, said Jason K. Check, who heads up acquisitions for TPG Residential in San Juan Capistrano, CA.

"Sellers will be forced to adjust expectations as short-term debt issued during or prior to 2006 is required to be refinanced and portfolios are rebalanced to provide operating companies with much needed capital to continue operations," Check said.

"Notwithstanding the reductions in the value of the single family homes that we read so much about nearly every day, it's a simple fact that the premium and the cost to own a home versus the cost to rent is bigger today in nearly all of our markets than it was five years ago," Equity Residential Chairman/CEO David J. Neithercut said. "So it's no surprise that we continue to like our business and the markets in which we operate. They delivered for us in '07. We expect them to deliver for us in '08 and beyond."

As always, however, analysts acknowledge there are some important "what ifs" going forward. The financial crisis continues to put a crimp in overall apartment sales and capital availability. The S&P Residential REITs Index was down 27.9% in 2007, compared with a gain of 3.6% for the larger S&P Composite 1500 Index.

Meanwhile, the blade of the housing crisis and its growing unsold or foreclosed inventory could swing back and cut apartment owners, analysts said.

S&P REIT analyst Royal Shepard said empty and unsold single-family homes and condominiums will eventually compete with apartments for renters in the so-called "shadow" rental market in some areas especially hard-hit by the housing crisis, including South Florida, Las Vegas and Southern California.

But so far, "while [unsold houses and condos] may attract some apartment renters, the lowest homeownership rate in 5 1/2 years seems to have increased demand for apartment residences," the Multi Housing Council's Obrinsky said.

Still, demographics remain on the side of apartment providers long term. S&P expects the decline in single -family housing starts to bottom out this year. By 2009, a renewed wave of young echo boomers and new immigrants entering the workforce and housing market should drive down average multifamily vacancies

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from 9.9% in 2005 to 9.2% nationally next year, according to S&P.

Here are some snapshots and color from select apartment earnings reports and conference calls over the last week compiled CoStar Advisor:

Apartment Investment and Management Co. (NYSE: AIV) announced fourth-quarter FFO in line with Wall Street consensus. Aimco's same-store NOI was 2.9%, falling short of expectations, due mainly to higher expenses. The company’s capital division provided a lift, however, adding 28 cents to after-tax FFO compared with the company prediction of 16 cents. The company, which is in the middle of a major portfolio pruning and asset redevelopment program, is reportedly planning to sell $1.5 billion in property.

Aimco reported new lease rent growth in excess of 5% in Dallas, Houston, and Denver, while new lease rents declined in Phoenix, New England, Orlando, Tampa and South Florida, a trend expected to continue through 2008. Aimco also expects Orange County, CA, and Northern Virginia to face pressure due to new supply.

"The bottom line is that external forecasters tell us that 2008 will be a tough year but so far, first quarter revenue is consistent with guidance and our operating platform is healthy across a wide range of metrics," said Executive Vice President Jeffrey W. Adler.

AvalonBay Communities, Inc. (NYSE: AVB) reported lower-than-expected quarterly FFO because of a write off related to an expense for abandoned projects. Fourth-quarter FFO rose to $89.6 million, or $1.14 per share, compared with $79.9 million, or $1.05 per share, in the year-earlier period. Analysts were expecting FFO of $1.19 per share, while the company forecast $1.16 to $1.20 per share.

"Despite the likely weak economic environment and the volatility in the capital markets that are expected this year, we are still able to project growth and operating FFO of over 13% for 2008," Avalon Bay Chairman/CEO Bryce Blair told investors.

Colonial Properties Trust(NYSE: CLP) reaffirmed FFO in the range of $2.15 to $2.25 per share, but now anticipates a 2008 profit between $1.20 and $1.50 per share, up from its prior estimate of $1.15 to $1.45 per share. The boost is based on lower development spending, reduced costs and higher apartment sales. The Street expected FFO of $2.14 per share.

Camden Property Trust (NYSE: CPT) reported FFO of 94 cents per share versus the consensus estimate of 92 cents due to lower expenses, higher interest income and equity in joint ventures. Management provided 2008 guidance of $3.60-$3.80, compared with a consensus of $3.80. The growth markets of Denver and Charlotte showed the strongest revenue while Tampa, Orlando and Phoenix, markets with an oversupply of housing, reported negative revenue growth.

Equity Residential (NYSE: EQR) reported better-than expected fourth-quarter results and forecast full-year FFO greater than Wall Street's prediction. FFO rose to $193.8 million, or 67 cents a share, from $154.5 million, or 49 cents per share in the prior year, beating both the consensus FFO of 60 cents per share and the company's forecast of 59 cents to 62 cents per share.

EQR sold $173 million of assets in the fourth quarter, but due to the disparity between real asset pricing and our share price, the company essentially shut down its acquisition business in the fourth quarter, acquiring only two assets for $67 million, Neithercut said.

"We do continue to see transactions taking place out there, though in limited number compared to past years. I’ll tell you that our guys are underwriting deals, they are keeping their noses in their markets, and it’s clear there continues to be investor demand for multifamily assets, and there continues to be availability of financing for assets in all markets, with Freddie and Fannie very much open for business and looking to book loans."

Post Properties Inc. (NYSE: PPS) reported a 71.7% increase in FFO and stronger occupancy during the

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fourth quarter. Executives also announced during that they have suspended efforts to sell properties in most markets while they consider a $2 billion buyout bid from the company's founder.

(Senior Editor Mark Heschmeyer contributed to this report)

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