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buffalo spotlight

2006 Buffalo apartment market: Building prices surge, paralleling decline in long term interest rates

bh Brian Heine



Licensed real estate broker

Climbing apartment prices continue to attract sellers in the Buffalo apartment market eager to take advantage of historically high valuation levels and cash out accumulated equity. Buyers continue to take advantage of the area's stable apartment occupancy and steady long term mortgage interest rates. 2005 sales totaled near 1,600 units for investment grade complexes in Erie and Niagara Counties. The majority of

the sales occurred in the Buffalo suburbs and prices rose to an average \$37,500 per apartment, a 13.6% increase over 2004. Buyers range from local property development firms adding to their portfolio to New York City and California investors engaging in 1031 tax deferred exchange transactions or looking for portfolio diversification. 2005 average prices in the city of Buffalo remained unchanged over 2004 at \$25,000 per unit as did those in suburban Niagara County at \$30,000.

Buffalo area apartment occupancy has ranged in the 90% to 95% range for the last decade with yearly rent growth near 3%. Bellwether REIT Home Properties 1,600 unit suburban portfolio saw 91% occupancy in 2005 with average monthly rent of \$1.01 per s/f, a 1.6% increase over



University Village at Sweethome, Amherst, N.Y.

2004. Low vacancy alone is not enough, management must ensure that rent levels are at market price

and increased yearly to compensate for the inevitable increases in property taxes and utility costs. High

occupancy and steadily increasing rents are the keys to successful leveraged real estate investments and these two factors represent the appeal of apartment investments over other classes of commercial real estate such as office and industrial properties. The banks recognize this and have responded by offering higher loan to value ratios and in some cases allowing secondary financing or mezzanine loans in their underwriting for apartment mortgages. This trend should continue as most forecasters see only modest increases in long term interest rates through the remainder of 2006.

New supply remains limited, hampered by the recent price increases in building materials due to Katrina and higher oil prices. The major project to open in 2005 was the 269 unit University Village at Sweethome in Amherst, an off-campus privately owned student housing complex. The \$36 million complex was developed by American Campus Communities, a Texas-based REIT. The units will be readily absorbed as the shortage of student housing at the State University at Buffalo Amherst Campus has tightened the overall vacancy in Amherst.

First year cap rates for well located and professionally managed suburban properties remain in the 8% range. The best opportunities remain in identifying turnaround opportunities where those investors with better understanding of local market economics are able to raise the net operating income of a property and hence the property value in a short time period. What really counts is not just the going in cap rate but the total return over the projected ownership period. In this market a local builder was able to purchase the Park View Apartments in Attica and after a one year renovation program funded with the complex's cash flow and rent increases aimed at bringing rents closer to marker was able to sell the property for 27% over the purchase price from one year earlier. Properties can still be bought well under replacement cost even after accounting for the renovation costs. In the city of Buffalo, Landhouse Millicent Group purchased 120 units and after complete renovation using only private funding is offering two bedroom townhouses at a very competitive \$595 monthly rent.

Apartment building prices have surged in recent years, paralleling the decline in long term interest rates. The increase in apartment property values going forward will be related to increases in net operating income due to tighter management and expense control and real increases in rental income.

Brian Heine is a licensed real estate broker in Buffalo, N.Y.



F O R S A L E

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Brian Heine
Exclusive Broker

(716) 884-4437
b.heine@verizon.net