A Closer Look:

End of Year Rental Market:

An Outlook for Property Managers

Thanks to upticks in housing and employment, the second half of 2010 looks promising for the rental real estate market. Here's what property managers need to know about the prospects for recovery in the multifamily and commercial segments.

For many economists, housing isn't just an economic indicator. When the housing bubble burst, the global economy ruptured right behind it. Because housing foretold the start of the recession, some predict it also will foretell the start of the recovery. Unfortunately, however, two years after it began, the recession continues to be reality.

Although housing can't foresee the economic future, it can help property managers forecast it. Like a weather forecast, an economic one isn't always correct, but it can predict a probable story. And for property managers, that story is a happy one going into the second half of 2010, according to the National Association of Realtors® (NAR). In March, pending home sales—an early indicator of actual home sales—had increased for the second consecutive month, NAR reported, suggesting that a "surge of home sales is unfolding" for the spring and summer home buying season.

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Just how beneficial depends on what kind of properties you own and where they're located. Generally speaking, however, what's good for housing also is good for rentals, which for property managers means that the economic downturn could turn into an industry upswing.

Employment is everything

Of course, housing isn't the only dataset that impacts rentals. In order to plan their transition from recession to recovery, property managers also must consider other principle economic drivers—in particular, employment.

"Unemployment is the single biggest economic factor impacting the rental market. When money gets tight, people double up with roommates or family, leaving more rental inventory vacant," says Rent.com president Peggy Abkemeier. "Unemployment is not likely to gain any real ground until capital begins flowing again to small businesses, and larger businesses increase their hiring efforts, and it's difficult to pinpoint when that will be."

Abkemeier says markets function based on the collective human sentiment, and that can be difficult to predict given the length and depth of this recession. "While there may be some pockets of rental market recovery, we believe that the rental market, at large, will continue to struggle until there are clear signs of a recovery in employment across the board," she says. "As jobs return and Americans go back to work, they will come back to the rental market."

Luckily, the nation's employment picture seems to be improving. According to the country's latest jobs data, released in May, unemployment was 9.9 percent in April—still high, but down from 10.1 percent last fall—while total employment was up by 290,000 jobs.

Also promising, according to NAR, are trends in: real gross domestic product (GDP) which the NAR predicts will grow 3.1 percent in 2010 and 2.8 percent in 2011, after a 2.4 percent drop in 2009; real disposable income, which NAR predicts will grow by 0.6 percent in 2010 and 2.9 percent in 2011; and consumer confidence, which NAR expects to rise 12 percent each year from 45 in 2009 to 57 in 2010 and 69 in 2011.

Multifamily has muscle

Buoyed by gains in employment and consumer confidence, the strongest rental market sector in the latter half of 2010 will be multifamily, according to Ratiu, who cites the following NAR data points:

- **Vacancy:** NAR expects multifamily vacancy rates, which were 7.4 percent in 2009, to fall to 6.8 percent in 2010 and 6.2 percent in 2011.
- **Net absorption:** NAR forecasts a positive net absorption rate—an indicator of increasing demand—of approximately 145,700 units in 2010 and 214,500 units in 2011, both up from 105,500 in 2009.
- **Rent growth:** Although it expects a 1.5 percent decline in

America's— Best and Worst— Rental Markets

According to National Association of Realtors® (NAR) economist George Ratiu, local rental markets are linked inextricably with local economies. The strongest rental markets are in cities with diverse economies, he says, while the weakest are in cities that depend largely on a single industry for employment. Regionally, the strongest markets are in areas where unemployment is lowest, while the weakest are where unemployment is highest due to declines in manufacturing, tourism and other major economic engines.

Top 10 U.S. Rental Markets*	Bottom 10 U.S. Rental Markets**
1. San Jose, Calif.	1. Phoenix
2. Pittsburgh	2. Jacksonville, Fla.
3. Washington, D.C.	3. Houston
4. Boston	4. Dallas
5. Newark, N.J.	5. Atlanta
6. San Diego	6. Indianapolis
7. Seattle	7. Fort Worth, Texas
8. Orange County, Calif.	8. Tucson, Ariz.
9. Portland	9. Las Vegas
10. Fort Lauderdale, Fla.	10. Cincinnati

*Based on the lowest multifamily vacancy rates, according to NAR.
**Based on the highest multifamily vacancy rates, according to NAR.

"Based on our forecast, we expect demand for rental space to increase in 2010 as well as 2011," Ratiu says. ***"We're expecting anywhere from a 35 percent to 40 percent increase in demand, which should lead to a drop in vacancy."***

multifamily rents this year, NAR predicts a 1.2 percent growth in rents next year, which bodes well for 2012 and 2013.

- **Household formation:** Based on household formation data from the U.S. Census Bureau, the 10-year average of new households being formed has been 1.3 million per year. According to NAR, household formation dropped to 772,000 in 2008 and only 398,000 in 2009. That number, it predicts, will return to pre-recession levels sometime in 2010 or 2011.

"Based on our forecast, we expect demand for rental space to increase in 2010 as well as 2011," Ratiu says. "We're expecting anywhere from a 35 percent to 40 percent increase in demand, which should lead to a drop in vacancy."

The commercial rut continues

Although the multifamily market appears to be rebounding, the commercial sector continues to struggle, according to Ratiu, and will keep on struggling even as the rest of the economy improves, due largely to a glut of supply and a lack of capital.

"Because of the nature of commercial construction—there were still a lot of projects in the pipeline when the recession started—you still had a lot of new office buildings coming on line the latter half of 2009, which bumped up vacancy rates considerably," Ratiu says. "Then, on the investment side, capital from banks has dried up."

According to NAR, too much competition and too little financing has impacted:

- **Vacancy:** NAR expects office vacancy rates to rise from 16.9 percent in the first quarter of this year to 17.6 percent in the first quarter of 2011; industrial vacancy rates to rise from 14.3 percent in 2010 to 14.8 percent in 2011; and retail vacancy rates to rise from 12.6 percent in 2010 to 12.8 percent in the first quarter 2011—and should hold at that level for most of next year.
- **Net absorption:** For 2010, NAR forecasts a negative net absorption rate of approximately 25 million square feet for office space, 90 million square feet for industrial space and 4 million square feet for retail space—a trend that it predicts will reverse across all three sectors with positive net absorption in 2011.
- **Rent growth:** NAR predicts a 2.3 percent decline in office rents this year, a 6.3 percent decline in industrial rents and a 1.5 percent decline in retail rents, with smaller but continued declines forecasted for 2011.

"The commercial market is still struggling with very weak fundamentals," Ratiu says. "Traditionally, commercial real estate tends to lag the broader economy by a year to a year and a half; assuming the recovery in housing is in late 2010, early 2011, expect the recovery in commercial real estate to happen in 2012 or 2013."