



CAPITAL Insight



Apartments, an Attractive Real Estate Investment

by: *Peter Austin, Senior Vice President, Welsh Capital*

Someone recently asked where I would invest \$1 million in commercial real estate. I first thanked them because with reasonable leverage I could buy a large enough asset to hire a professional management company, like Welsh. Then I told them that my answer would depend upon the market and explained that it continues to be difficult to purchase well priced assets. That said, my answer came quickly, "Apartments!" There are two reasons: the demographics support continued demand for rental housing, and mortgages are easier to find.

The U.S. Census Bureau predicts that over the next ten years there will

be 15 million new households in the U.S. This will be partially due to the "unbundling" of doubled-up households and job growth that may spur new household formation, in addition to the reemployment of teens, who experienced the largest percentage of unemployment during the recession (27.6 percent).

If the renter versus ownership percentage remains unchanged, at 35 percent and 65 percent respectively, demand would increase by 525,000 new rental units per year. In recent years, multi-family housing starts have not even come close to meeting this demand and they are not expected to rise

in the near term. The U.S. Census Bureau reported 554,000 single and multi-family housing starts in 2009. If the supply does not begin to rise to meet demand, the market will heat up, driving higher occupancy and rental rates, thus creating better returns for investors.

Year-over-year sales volume has increased in the office, apartment, and hotel sectors, both in terms of dollar volume and number of properties. According to Real Capital Analytics, sales of significant apartment properties totaled \$1.3 billion in May, an encouraging 62 percent increase over May 2009 activity, while deal size also increased with

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New Apartment Listings for Sale

Langdon Lake Apartments

\$1,350,000
7.50% cap rate
24 units on Langdon Lake
Mound, MN

The Antonoff Apartments

\$910,000
7.50% cap rate
18 units - classic
Midtown - Minneapolis

Uptown Apartments

\$395,000
7.20% cap rate
6 units - class
32xx Hennepin

Wedge Apartments

\$569,000
7.20% cap rate
5 units - classic
24xx Dupont

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Recent Financings

Como Lake Apartments St. Paul, MN Apartments - \$678,750	Taylor Park Apartments Sheboygan, WI Apartments - \$3,550,000	505 King Street LaCrosse, WI Office - \$3,160,000
Dinkytown Shoppes Minneapolis, MN Retail - \$1,650,000	Calhoun Park Terrace Minneapolis, MN Apartments - \$720,000	Crossroads Plaza Chanhassen, MN Retail - \$2,318,000
2020 Cliff Road Eagan, MN Retail - \$1,102,000	KGP Logistics New Century, KS Industrial - \$6,875,000	Waters I Eagan, MN Office - \$7,106,250
University Apartments Minneapolis, MN Apartments - \$1,000,000	Centennial Plaza Blaine, MN Apartments - \$2,100,000	Crystal Lake Estates Robbinsdale, MN Apartments - \$1,057,500
Park 'n Go Bloomington, MN Other - \$6,675,000	3401 Nevada Ave N New Hope, MN Office/Warehouse - \$1,809,000	Cahill Road Edina, MN Industrial - \$1,200,000
Granite Ridge Brooklyn Park, MN Apartments - \$4,500,000	WSI Sale Leaseback Fond duLac, WI Industrial - \$2,295,000	Birchwood North Branch, MN Apartments - \$1,500,000
Franklin II Franklin, WI Industrial - \$4,950,272	BridgePoint S. St. Paul, MN Industrial/Mixed Use - \$1,585,189	Block Apartments Minneapolis, MN Apartments - \$900,000
Corner Shops Maplewood, MN Retail - \$2,750,000	316 Larpenteur Maplewood, MN Apartments - \$864,000	PaR Systems Shoreview, MN Industrial - \$4,350,000



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38 percent more properties trading. New offerings have also accelerated; reaching \$53.3 billion, which is 49.5 percent of last year's total and more than double year-to-date closings.

According to the National Mortgage Banker's Quarterly Data Book, the average range of capitalization rates for the four basic property types (apartments, industrial, office and retail), from 2005 through the first quarter of 2010, range from a low of 6.4 percent to a high of 7.8 percent, or a difference of 1.4 percent. This data is based on average sales in excess of \$5 million. Apartment capitalization rates changed the least, from a low of 5.8 percent in 4th Quarter 2005 to a high of 7.2 percent in the 4th Quarter 2009. The current average capitalization rate for apartments is 6.8 percent, which is the lowest amongst the four property

types. Retail is highest, at 8.3 percent.

Why do capitalization rates matter? A lender will lend on today's value hoping that at loan maturity the value will be enough to justify a sale or refinance, allowing for repayment of the loan. Lenders look more favorably at stable asset classes, like apartments, and are more willing to lend on them. More lenders currently exist for apartments than any other asset class, creating competition and driving down interest rates. Historically, apartments have commanded the highest leverage levels. These higher leverage levels coupled with lower interest rates potentially drive a better rate of return on this asset class.

Distressed apartment properties are being reclaimed by lenders at a

rapid pace, as are other asset classes, but few are currently being re-sold to investors. Lenders have acquired \$10 billion of significant commercial property so far in 2010, while they have only disposed of \$2.6 billion, which means their property portfolios have increased far more than any of the traditional investor groups. Most of them are waiting for the economy to turnaround before selling these assets, so it will become an interesting sector to watch. Sales of distressed apartments only accounted for 23 percent of all apartment sales of \$2.5 million and greater this year.

Welsh Capital has financed over 16,830 apartment units in 306 projects with a transactional value in excess of \$446 million. We know apartments and we are here to assist you in financing them.

Transaction of the Quarter - Taylor Park Senior Apartments



Welsh Capital recently arranged a \$3.55 million construction renovation-permanent loan for Taylor Park Senior Apartments, an affordable housing project in Sheboygan, Wis.

The borrower, an affiliate of St. Paul, MN-based Real Estate Equities, intends to renovate the vacant six-story apartment building at the northwest quadrant of Erie Ave. and 29th St. The property will feature 42 low-in-

come senior housing units when construction is completed. The project is being developed using low-income housing tax credits (LIHTC's).

The permanent portion of the loan is non-recourse, has a fixed 17.5-year interest rate and a 30-year amortization. Welsh arranged the financing with a local bank within its network.

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EXPERT ADVICE, UNPRECEDENTED ACCESS, POWERFUL ADVANTAGES.

Our Commercial Loan Group can make a big difference in the successful closing of your investment financing. At Welsh Capital, we're financing specialists. Unlike a local bank, we have extensive real estate experience and a variety of local and national funding options which provide our clients with a powerful advantage.

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