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Residential Real Estate Focus

Oversaturated: Greater Washington's glut of apartments

Our rental market is about to get oversaturated. So why are developers still breaking ground? Everyone seems to agree it's just a matter of time, but there's disagreement about how bad the pain will be.

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Local developers will deliver some 31,000 apartment units in the next three years. Those apartments need tenants. Tenants need jobs. And despite the Washington area's seeming recovery from the worst recession in many decades, unemployment rates are double that of the mid-2000s — especially in the suburbs.

Are we headed for a rude awakening?

"We're going to end up with a glut of apartments in the Washington area because the job growth and population numbers won't support it," said Steve Silverman, director of Montgomery County's Department of Economic Development. "It's just a question of when, not a question of if."

There are 31,334 apartment units in the pipeline in D.C., Montgomery, Prince George's, Fairfax, Arlington, Loudoun and Prince William counties and Alexandria, according to data provided by Delta Associates.

Of those, 25,486 are under construction or being marketed now, and the rest are expected to come online within 36 months.

Among the largest inventories, the District's NoMa and H Street NE areas have 2,515 units leasing now, while the Rosslyn-Ballston corridor in Arlington has 2,598. D.C.'s Columbia Heights and Shaw areas have 1,918.

The market is beginning to feel the effects of the new units, Delta reports. Rent declines were registered in the second half of 2012 in certain oversupplied submarkets.

Still, as Delta reported in its year-end report, "the market seemed to discount the threat of overbuilding." The pipeline has more than doubled since 2009.

The region is expected to add 1.7 million new residents by 2040, according to the **Metropolitan Washington Council of Governments**, and many of those will be young workers seeking multifamily housing. But growth in the short term may be tempered by financial crises such as the federal government's sequestration cuts, which threaten to slash job opportunities.

Builders remain confident.

Kettler Inc., for example, has four projects under way across the region, including 450 K St. NW and a 30-story Tysons Corner high-rise, that total 1,453 units. Two more Kettler projects, in Crystal City and in Bethesda, are scheduled to break ground by the end of the year, and 1,200 more units in unannounced projects may be started by early 2015.

"We believe strongly that for a variety of demographic and economic reasons that there's going to be more demand for multifamily as a proportion of the overall market than there has been historically," said Bob Kettler, the company's chairman.

Kettler said he is "fully aware of what's under construction" and a round of oversupply may be coming, but it doesn't worry him. He has been through these cycles before.

"We're swamped," Kettler said. "We think we're going to blend in, and we think we have enough muscle actually to weather any supply imbalance that may exist over the next year or two."

At the close of 2012, apartments were leasing at 18 units per building per month for projects leasing for the first time, according to Delta. The long-term average since 1996 is 17 units per month.

"We're holding up, but we'll see if we keep that momentum as we add new projects," said Grant Montgomery, director of Delta's apartment practice. "The question will be, when do we reach a tipping point or do we reach a tipping point?"

And how will we know? Concessions — a month or two of free rent, maybe free parking — will creep up, driving net rents down. That last happened in 2009 and 2001, but the driver then was recession — a lack of jobs and demand. This time, it's too many units.

"Developers need to adjust to reality and a more competitive market," Montgomery said. "That's one of the reasons we're going into this potential bubble. We emerged from the recession sooner. Our development pipeline picked back up. We're moving through that process sooner. We're a harbinger of what may occur nationally."

The Washington area is no longer the hottest job market in the country, as it was just a few years ago, said Lisa Sturtevant, deputy director of **George Mason University's** Center for Regional Analysis. Actually, it is in the bottom half of U.S. metro areas.

Builders responded to the population boom of 2009 and 2010. Now growth has slowed, at roughly the time the units are delivering.

"The demand that we saw a few years ago, I can't see that being as strong this year, next year and the year after next," Sturtevant said. "In some places there is a potential for oversupply of certain kinds of rental housing, high-end rental housing, in the District especially."

The demand for more affordable multifamily housing, meanwhile, will remain strong — but that's not what developers are building. Citing the 2010 American Community Survey, the Center for Regional Analysis reported last year that 49 percent of the region's apartment residents pay at least 30 percent of their monthly income on rent. The burden skyrockets to 82.8 percent for residents earning less than $50,000.

Builders are reacting to a changing market — but not by building apartments in the less expensive suburbs. They're building smaller units— the average size of a unit in Kettler's 450 K St. NW will be about 600 square feet — to meet the demands of a younger workforce that want to live in an urban area.

"They're trying to balance the price point of the renter with the lifestyle and location al preferences of the demographic," Montgomery said. "The price point has typically been a garden, but the locational preference of the 25-year-old is a transit-oriented, more dense location than it has been in the past. Developers have tried to thread that needle by building smaller units."

Expect the building boom to continue even as the region is saturated in new apartments because multifamily housing is just about the only thing lenders feel safe about right now, with office space at a virtual standstill, Silverman said.

"I think at some point the bubble will burst," he said. "Remember, it's presumably got to be driven by jobs. These kids who are moving out of their parents' basements and moving into these high-rise apartment buildings presumably have jobs."

Michael Blum, a principal of Arlington's **Insight Property Group LLC**, said he is a "big believer in the overall market," though his company is "definitely shying away from certain submarkets," namely the Red Line corridor in Montgomery County, Tysons and NoMa. It's simply a matter of oversupply, he said.

Insight will deliver one project, the 67-unit Grayson Flats in Arlington, next week and recently broke ground on two others, one at the Huntington Metro station and another in Silver Spring, totaling 617 units.

"We're pretty confident on those two largely because of the micro locations and our basis," Blum said. "We have a very competitive basis, the total cost per unit will be considerably lower than most of the competition."

He added, "Our motto is focus and sustained growth through various cycles of the economy and real estate market. Block and tackle."

Building boom: More than 31,000 apartment units are in the pipeline locally, a number that has more than doubled since 2009 as developers are able to get financing for multifamily units easier than for office space.

Place	Under construction/marketing	Planned with likely delivery within 36 m
District	8,274	1,589
Montgomery County	4,427	1,485
Fairfax County	4,145	932
Arlington County	3,266	492
Prince William County	2,072	301
Alexandria	1,816	501
Prince George's County	1,486	548
Frederick County	203	32

SOURCE: Delta Associates

Michael Neibauer covers economic development, chambers of commerce, transportation and politics.