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Capital Area's Apartment Boom Could Fizzle

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WASHINGTON—The construction cranes that have crowded this city's skyline for the past few years were symbols of its red-hot apartment market. But now, the sight of them could be an ominous sign of overbuilding.

This year alone, developers are expected to deliver more than 15,000 new apartment units in the greater metro area, with 11,000 more expected in 2014. That is well above the more than 6,000 units delivered, on average, each year during the prior decade, according to research firm Delta Associates.

Construction cranes line K Street, one of the areas where several apartment complexes are being built.
Lexey Swall for The Wall Street Journal

Developers flocked to the nation's capital after the financial crisis, based in part on the area's longtime reputation as being recession-resistant, due to the high number of federal employees, as well as contractors and consultants that cater to the government. Unlike private enterprises, which tend to trim their workforces during economic downturns, the federal government usually keeps its employees during good times and bad.

The new supply of rentals is coming just as the sequester—a package of $85 billion in cuts to defense and domestic programs that went into effect earlier this month—threatens to drag on the area's recovery by reducing spending and eliminating jobs. While the exact number of jobs lost remains to be seen, estimates range from hundreds of thousands to one million or more.

Federal spending accounts for about one-fifth of the economic output of the District of Columbia, Maryland and Virginia, according to the Pew Center on the States, a nonpartisan research group.

Now, an oversupply of new apartments is taking hold. The growth in rental prices is slowing, developers are canceling or scaling back projects, and more landlords are concentrating on lower-priced rental units to compete with the glut of high-priced apartments expected to hit the market over the next three years.

"Washington is a temptress. It's a trap. The historic stability of the area induces both financiers and developers to move forward with projects that they might hesitate to build in almost any other market," said Anirban Basu, chief executive of economic consultancy Sage Policy Group Inc. "At some point there simply are not enough warm bodies to fill all the units that they're building."

To be sure, Washington remains one of the nation's most educated and affluent markets, and many developers expect government jobs to drive demand for apartments for years to come. That's why some developers say they aren't worried.

"Long term, all of the new D C. supply will do just fine," said Jeffrey Friedman, chief executive of Associated Estates Realty Corp. , which has purchased almost 2,000 Washington-area units in the past few years and has a community under development in nearby Bethesda, Md.

But many developers who have recently completed projects have focused on so-called Class A apartment buildings, filled with pricey amenities such as outdoor kitchens and fancy gyms, which developers hope will translate into higher monthly rents. Hot submarkets include NoMa, which is north of the U.S. Capitol and boasts a new Metro stop, and the Roslyn-Ballston corridor in Arlington, Va., a walkable community filled with young residents

While landlords managed a 1.9% increase in rent prices last year—down from 2010's 7.8% incline—this year could show the first drop since 2009, Delta reports. The vacancy rate for these high-end apartments could jump from the current 4 2% to 5.9% in 2014, according to Delta.

Camden Property Trust, a Houston-based company with nearly 6,000 units in the Washington area, didn't pursue building three apartment communities in the suburbs because it was jittery about all the new supply, said Chief Executive Ric Campo. While the firm currently has two projects under development, he said, "we have definitely slowed our pipeline."

Other operators have focused on building less-expensive apartments. AvalonBay Communities Inc., a large national landlord, just opened its first property designed under its AVA brand geared to younger renters, on a site in Washington's rapidly gentrifying H Street area. The original site of AVA H Street had zoning approval for an eight-story, 180-unit building, which would require a concrete and steel frame. But AvalonBay decided to build a shorter, smaller building with a wooden frame to keep costs—and by extension, rents—low.

At "every new [upscale] deal that gets built, everyone's adding the latest thing they can dream up as an amenity, and that just gets more expensive," said Jonathan Cox, a senior vice president with AvalonBay. "We priced this project from day one, between $250 and $350 [a month] lower in every unit type than our competitors."

Profit-eroding concessions have picked up at these new amenity-filled communities, as landlords compete for tenants. In 2012, the average concession for new apartments was 8% of the monthly rent, up from 5% in 2011, Delta reports

Eric Suissa, director of sales at rental brokerage DC Apartment Co., said more apartment buildings in the city are disguising rent reductions as free first months of rent, waived move-in fees or other perks. "You'd be hard-pressed to find a building that has not reduced rents," he said. "They're offering parking spaces and washer-dryers so people will sign the lease instead of shopping around."

Kimber Watson, a 24-year-old event planner, was until recently paying $2,195 per month to rent a 500-square-foot studio in downtown Washington. Seeking a larger space, she recently moved into a one-bedroom loft apartment where she pays $1,990, and was able to negotiate with her landlord to reduce her move-in fee from one month's rent to $250.

"They told me the unit had been on the market for longer than they hoped it would be," Ms Watson says.

"I told them I'm really interested in the apartment, so what kind of deal can you give me?"

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