



Condo Craze Fades

By Gary Gately

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Little more than a year ago, potential condominium buyers lined up hundreds deep to preview condos planned in the Washington, D.C. metro area. Thousands would log on to the Internet to schedule a condo viewing. And a steady stream of developers, hoping to keep up with the high demand, converted apartment projects to condos. But the frenzy has cooled considerably, and now numerous projects are being converted back into apartments or canceled altogether.

“It's not like in 2004 and 2005, where you could build almost anything and people would buy it,” says William Rich, a vice president at Delta Associates, an Alexandria, Va.-based commercial real estate research firm. “Today, developers need to be more selective in their locations and more attuned to the target market they're trying to attract.”

Experts say the turnabout reflects factors including higher interest rates, an oversupply of condos, an extraordinarily tight local apartment market and high construction costs. They also point to would-be condo buyers waiting it out, renting until condo prices or mortgage rates fall. And while home builders have sought to lure buyers with incentives, these haven't worked as well in the condo market, where buyers pay not only high prices, but also hefty condo fees.

At the same time, the third-quarter apartment vacancy rate for the Washington metro area has fallen to 1.4%, the lowest in the nation, and rents have risen 7.5% in a year, compared with a typical increase of slightly less than 5%, Delta says.

Sales of condos in the third quarter of 2006, in the meantime, have dropped to the lowest level since the end of 2003, Delta reports. Researchers expect some 8,000 to 8,500 condos to sell by the end of the year, compared with 13,500 last year. Condo prices in the metro area rose only 1.8% in the past year, while remaining flat in Virginia and falling in the District of Columbia.

“There's a lot more condo projects in the market, so buyers have more places to choose from, and they're taking a longer period of time to purchase,” says Rich.

That stands in sharp contrast to the condo boom, when even those lacking experience in real estate hoped to cash in. “Everywhere you went, you heard waitresses and bartenders saying, ‘I'm going to buy a condo, quit my job and get into real estate,’” says Stacey Milam, senior investment associate at Marcus & Millichap Real Estate Investment Brokerage Co. “It's unrealistic. This game isn't easy. No game is with this much money involved.”

By August 2005, the condo market “just dropped off in the blink of an eye,” Milam says. “Now, consumers are just sitting on the sideline, being very patient.”

At the end of the third quarter, Delta reported, 24,813 condo units were for sale in actively marketed developments, with 80% of those under construction or already built. At this point, even with conversions to apartments removing condos from the pipeline, the market has swelled with about three years worth of condo inventory, meaning it would take developers at least three years to sell those units.

Sky is not falling

Nobody's calling it a condo bust just yet, but the softening market is evident in the number of condo projects that have been converted to apartments or canceled.

In the third quarter, 26 condo projects, with a total of 4,390 planned units, were removed from the pipeline, compared with just one project in the first quarter and seven in the second, Delta says. Of the 4,390 that had been planned for the third quarter, 2,277 switched to apartments, and 2,113 were canceled.

Of course, how properties fare varies in the Washington metro area, which comprises the District and surrounding counties: Montgomery, Prince George's, Anne Arundel, Howard and Frederick in Maryland and Arlington, Alexandria, Fairfax, Loudoun, Prince William and Stafford in Virginia.

For the metropolitan area, Delta says, new condo sales dropped to 1,331 units in the third quarter, the lowest since the fourth quarter of 2003.

Reconversions

Developers, who now have to worry about skittish buyers backing out of sales contracts more frequently, have responded to the slowdown by offering buyer incentives, such as assistance with closing costs as well as appliance upgrades, Rich says. If those strategies failed, many rethought their condo plans.

"I think almost every developer got caught up in a kind of condo craze," says Mark Coletta, a regional partner at Fairfield Residential LLC. "And then when the market turned, many developers needed to re-evaluate whether doing condominiums made sense, and I think a lot of them came to the conclusion that they did not, and now they're going back to apartments."

Dallas-based Fairfield, for example, had planned the 234-unit Columbia Village in Arlington County as condos and had planned to convert the 394-unit Bristol at Fairchase in Fair Oaks, Va., from apartments to condos. But this spring, the company decided to make both projects apartments. "Like everybody else, we had some deals that we thought could go condo when the market was red hot, and now we're going back to apartments," Coletta says.

Numerous projects in the Washington region have converted from condo to apartment. In Arlington, developer DSF Group of Boston had planned the 269-unit The Halstead as condos, but the market softened before DSF launched sales. Now, the developer plans to rent the units.

Finding balance

"We're not going to see many new condo developments," says Arthur Solomon, chairman and chief executive of DSF. "Already, you've seen a total stop in conversions from rentals to condos. That has ground to an absolute stop. Now we're seeing new construction starts will also grind down to a small number, which will then put the condo market back in balance."

Washington-based Monument Realty had purchased two apartment projects, the 574-unit Park Center in Alexandria in 2004, and the 256-unit The Prime in Arlington in 2005, with plans to convert both to condos. But the company decided to convert neither project to condos and to sell both for use as apartments, says Russell Hinds, an executive vice president at Monument.

The decision came after the pace of condo sales slowed and the apartment market strengthened, Hinds says. "What you saw was sort of a natural correction in the market," he says. As far back as 2003, some had been predicting such a correction, he says, adding, "Sure enough, that's happening." Hinds predicts the market will achieve equilibrium by the end of 2006 or in early 2007.

Jobs cushion the blow

Coletta and other developers characterize the condo market as a slowdown. Yet sales have remained strong in some places, including three condo projects Fairfield is marketing in the metro area, Coletta says.

"Job growth has been strong, and it is predicted to stay strong," says Coletta. "That just bodes well in general for the housing market. If [interest] rates start to come down, I think you'll see the condo market start to make a modest rebound." In 2005, the city added 72,000 jobs, bringing the total new jobs since 2000 to 270,000.

Greater Washington's population is expected to grow by 8.5% from 2000 to 2010, or three times the projected growth for New York City, twice that of Chicago, and four times San Francisco, reports the Greater Washington Initiative, a regional marketing organization.

Despite the heated pace of job and population growth, most developers and real estate experts agree the red-hot pace of the condo market over the past four to five years couldn't sustain itself. "The pace it was before was just extraordinary; it was out of control how busy it was," says Gerard DiRuggiero, a broker and managing member of the real estate brokerage Urban Land Co., based in Washington.

When the Floridian condos opened in Northwest D.C. in July 2005, Urban Land sold 30 units in a single day, DiRuggiero says. Another 20 condos sold there in the few weeks after opening. "People were buying like that because they were expecting the prices to go up, so they wanted to get in," he says. "Now, the buyer doesn't have that sense. So why buy now?"

Investors, DiRuggiero says, have pulled out of the condo market, slowing much of the speculative buying that fueled the market and drove prices higher. "The demand for condos is lower than it's been, and the rental market is hot right now, so it's just an investment decision of where you make more money," he notes.

Apartment demand

So far, builders making the shift to apartments have avoided flooding the market, and analysts say they haven't seen negative effects as a result of condos transforming to apartments.

Dennis W. Russo, a partner at the New York-based real estate law firm Herrick, Feinstein, says real estate investment trusts, pension funds and insurance companies have started buying properties that had planned to convert to condos but instead will remain apartments.

“What’s happening is saturation of the market,” Russo says. “Prices are not going up any more, and basically you can’t absorb all that property.” But REITS, pension funds and insurance companies are satisfied with prices they pay and a return of about 4% on the investments, he says.

“From an apartment standpoint, there has been no letup at all,” says Grant Montgomery, a vice president of Delta. “People are looking for apartments. If you have a project coming out of the ground or delivering in the next six months, it’s a particularly good time to be doing apartments.” Strong job growth also has helped fuel demand for apartments, Montgomery says. But the apartment market still could suffer.

“If we have a concentration of [condos change] to apartments, that could negatively impact the apartment market by increasing the supply,” Montgomery says. “We don’t want to flood the apartment market with supply. It could happen. I don’t think we foresee it, but I think we have to have a close watch on that.”

Gary Gately is a Baltimore-based writer.

WASHINGTON, D.C. - BY THE NUMBERS

METRO POPULATION:

6 million

Source: Greater Washington Initiative

UNEMPLOYMENT RATE: 3.4%

Source: Greater Washington Initiative

LARGEST EMPLOYERS:

1. Northrop Grumman
20,600 employees
2. Verizon Communications Inc.
16,000 employees
3. Science Applications International Corp.
15,810 employees
4. Lockheed Martin
15,700 employees

Source: Greater Washington Initiative

METRO AREA VITAL SIGNS

Office:

6.6% vacancy, 2Q 2006

7.5% vacancy, 2Q 2005

\$36.65 rent per sq. ft., 2Q 2006
\$34.92 rent per sq. ft., 2Q 2005

Source: Reis Inc.

Multifamily:

3.9% vacancy, 2Q 2006
4.6% vacancy, 2Q 2005
\$1,212 effective rent, 2Q 2006
\$1,162 effective rent, 2Q 2005

Source: Reis Inc.

Retail:

5.2% vacancy, 3Q 2006
4.6% vacancy, 3Q 2005
\$22.85 rent per sq. ft., 3Q 2006
\$21.58 rent per sq. ft., 3Q 2005

Source: Marcus & Millichap

Industrial:

7.86% vacancy (Va.), 3Q 2006
7.37% vacancy (Va.), 3Q 2005
9.66% vacancy (Md.), 3Q 2006
9.16% vacancy (Md.), 3Q 2005
\$10.85 rent per sq. ft. (Va.), 3Q 2006
\$10.52 rent per sq. ft. (Va.), 3Q 2005
\$8.61 rent per sq. ft. (Md.), 3Q 2006
\$9.17 rent per sq. ft. (Md.), 3Q 2005

Source: CB Richard Ellis

Hotel:

70.4% occupancy, 3Q 2006
73.4% occupancy, 3Q 2005
\$140.36 average daily rate, 3Q 2006
\$130.48 average daily rate, 3Q 2005

Source: Smith Travel Research

MAJOR PROJECTS:

Arcola Center, a mixed-use development on approximately 400 acres in the Dulles International Airport area of Loudoun County, Va. The project is planned for up to 2.1 million sq. ft. of office and commercial space, up to 1.1 million sq. ft. of retail space and about 80 acres of high-density housing. Also included in the plan are two hotels and a civic/cultural tourism and educational destination centered around a restored slave quarters dating from the early 1800s. The entire community will be linked via pedestrian pathways.

Cost: \$1 billion

Developer: Buchanan Partners

Completion: 2008