

# Recipe in the making for tight apartment supply

Clients often ask our firm if the Albuquerque apartment market is overheated. We believe that the market is hot rather than "overheated." This article will review the ingredients that form of our local markets housing recipe.



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## Demand

Historical job growth for the city has created 1,100 units of apartment demand each year. A strong workforce, high quality of living, and economic incentives are likely to put upward pressure on forecasted job growth, increasing the demand for multifamily units to 1,300 units per year.

## Supply (or constraints on supply)

Ten years ago, a development client would come to town, and ask, "What can I build an apartment on?" Although apartment land was plentiful and priced attractively, strong demand for single-family housing coupled with better profit percentages saw acre after acre being down-zoned from medium density (12 to 24 units per acre) or high density (24 to 99 units per acre) to low density usage (4 to 6 units per acre).

In the late 1990s, as the apartment market shot across the equilibrium point (the balance point between demand and supply, at which rents neither go up nor down) and rents started to rise to the point where new multifamily construction was financially feasible, the private sector was locked out by government restrictions.

Like a neglected kitchen, these came in three forms:

1. Stale milk with a predictable smell. A zoning process that empowered the few or one over the needs of the many, led to zone change refusals, or even worse, an approval followed by a death of a thousand paper cuts, otherwise known as the appeal process.

2. Enter front left burner. The Planned Growth Strategy, whose intent, while noble, has led to the adoption of a plan that limits growth outside the existing service area in Albuquerque, thereby pushing growth out another 15 to 60 miles from metropolitan Albuquerque.

3. On the back burner: For over a decade, the impact fees have increased with great regularity. The process for determining them still lacks transparency and they are difficult to calculate in advance.

The end result?

An apartment oven that once used to bring new apartments to market at the rate of thousands of units per year, has been turned down to a number that is lucky to reach the hundreds of new units per year.

## Occupancy

As the number of potential new multifamily residents exceeds the supply of

available apartment units by a factor 2 to 1, these residents move into the existing vacant housing inventory (now numbering just shy of 80,000 units) and raise the occupancy by 1 percent each year.

## Rents

In the mid 2000s, the occupancy rate crossed Albuquerque's equilibrium point of 94 percent, shifting the rental pendulum to the landlord's favor, allowing for increases in rents, and the shifting of some formerly-based landlord expenses, such as the cost of water, to the tenant.

Based on current demand and supply trends in the marketplace, Albuquerque's rental market is set to repeat the trend witnessed in the early 1990s when the market's rents rose at 10 percent per year from a monthly rate of \$.49 per square foot to \$.74 per square foot. Following the same trend, the average rent today could exceed the highest rent in the city (\$1.15 per square foot) before the decade closes.

## Construction costs

A couple of years ago, I spent a considerable amount of time in China and watched the city of Beijing put more square footage under construction than the entire western United States.

In a globally integrated world, these building trends are felt thousands of miles away — China continues to gobble up natural resources from oil to steel, raising the cost of construction here.

Add to this rising labor costs from a shortage of construction workers, the bottom line is construction costs 25 percent higher than five years ago. The hurdle to make a development profitable increases at the same rate, raising the gap between existing rents and rents necessary to financially support new housing.

## Affordability

All of this sets the stage for the next affordable housing crisis. The last time rents boiled over at an annual rate of 10 percent per year, incomes were increasing a fifth as fast. Annual housing expenses that outstrip annual income leads to a housing burden, as Albuquerqueans reallocate their budgets from necessary items like health insurance, education or even entertainment to housing, straining the welfare system or decreasing the flow of dollars in our community.

## Bubble or Steam?

For a bubble to exist, an irrational exuberance needs to be demonstrated in the market. Based on past bubbles, those were based on untrue speculation, unrealistic tax benefit, or the belief that there is one more person who will come through the door and pay even more.

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