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## Multifamily Cap Rates and Construction: Upward Trend for Both?

**LOS ANGELES, Dec. 15, 2011**— If you build it, will they come? Will it be profitable? With cap rates once again nearing record lows, many in the multifamily sector are turning their eyes toward development in an effort to garner greater yields. Cap rate compression and construction remain top of mind for respondents of Jones Lang LaSalle's Apartments Outlook 2012 Survey. The survey was completed by more than 150 private investors, real estate brokers, developers, REIT and institutional investors during the month of October. While most agree that multifamily remains the sector to watch, location is key.

"We're seeing a focus on coastal, gateway cities like Seattle, Portland, San Francisco and Washington, DC.—cities that have a strong focus on technology, biotech, life sciences and government as that's where the job growth is right now," said Seth Heikkila, Vice President, Jones Lang LaSalle. "But to move out that risk continuum, investors are requiring higher cap rates."

To view Seth Heikkila's Vlog, [click here](#).

With cap rates hovering around four percent in the most competitive markets, many are wondering if the apartment sector is in a bubble—and getting ready to burst. A majority of survey respondents, 34 percent agreed, conceding the numbers are already "over exuberant." Still, 22 percent say the market hasn't hit the bubble stage yet, while another 20 percent see that time coming in 2012.

"There's so much capital chasing too few deals—we call it "homeless capital," said Bill Montgomery, President, Acquisitions & Investment, Sares-Regis. "REITs have been buying all the core properties and pension funds have had a hard time competing. We're seeing money flowing into value add and development projects."

And so the great yield chase continues, and the construction pipeline—after years of inactivity—is finally heating up as well. Fifty-five percent of the survey respondents overwhelmingly say that's due to an increase in net operating incomes, while an equally impressive 49 percent say it's due to the availability of financing. However, 42 percent of respondents say the increase in development is directly due to developers lowering their return thresholds.<sup>1</sup>

To view Bill Montgomery's Vlog, [click here](#).

Added Montgomery, "There's a lot of interest in development right now. We just picked up a site in July that we closed on and we'll start in January—we have two more in the entitlement process, one

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<sup>1</sup> Numbers equal more than 100 percent due to respondents ability to check multiple answers

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approved and one that'll be approved by the end of the year. There's a lot of money interested in investing in those deals. The money's driving development... and there ultimately will be strong demand with the Gen Y and all the other things driving activity."

But with increased development, comes increased costs, at least when it comes to both mid-level and high-rise multifamily properties. Nearly two-thirds of survey respondents (63 percent) say the cost of construction for mid-rise properties rose by five percent this year over last, while another 29 percent say that number fell by five percent, and an equal number (25 percent) say the cost dropped by more than five percent. For high rises, the numbers are even more substantial. Nearly 70 percent of respondents say the cost of high-rise construction today versus a year ago has now risen by more than five percent, while 38 percent say that number fell by five percent and another 29 percent say that number fell by more than five percent. Garden-style development is the exception, however, with 61 percent of respondents saying the cost of construction today remains flat, while 46 percent say the cost has fallen by more than five percent, and another 33 percent say that number has fallen by just five percent.<sup>2</sup>

Tom Toomey, President and CEO of UDR, Inc. says, "We expect to see six million new renters over the next three or four year period. So why wouldn't you want to invest more, build more, redevelop more—just seems like a great time and the numbers are stacked up in our favor."

To view Tom Toomey's Vlog, [click here](#).

Jones Lang LaSalle Capital Markets is a full-service global provider of capital solutions for real estate investors and occupiers. The firm's in-depth local market and global investor knowledge delivers the best-in-class solutions for clients — whether a sale, financing, repositioning, advisory or recapitalization execution. In 2010 alone, Jones Lang LaSalle Capital Markets completed \$43 billion in investment sale and debt and equity transactions globally. The firm's dealmakers completed \$33 billion in global investment sales and buy-side transactions, equating to nearly \$140 million of investment trades completed every working day around the globe. In the United States, Jones Lang LaSalle grew its office broker volumes by 257 percent in 2010 and is quickly gaining market share across all property types. The firm's Capital Markets team comprises approximately 800 specialists, operating in 185 major markets worldwide.

### About Jones Lang LaSalle

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