BUSINESS

Low vacancy rates make it tough for Twin Cities apartment renters

The vacancy rate remains low in much of the metro, but the average cost is not.

By Jim Buchta (http://www.startribune.com/jim-buchta/10644536/) Star Tribune

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Developers are flooding the Twin Cities with new apartments, but it remains one of the most competitive markets in the nation for renters.

“I don’t think rental companies are desperate yet,” said Susan Cevette, who last week moved into a two-bedroom, two-bathroom apartment at the Rafter, a 26-story apartment tower that just opened at 333 E. Hennepin Av. in northeast Minneapolis.

Cevette, a small-business owner who wanted to downsize from a townhouse in the Bryn Mawr neighborhood, said she wanted to be in an area where she could more quickly walk to a grocery store and other essentials. There was no shortage of choices, she said, but none was a bargain.

“There were plenty of options as long as I was willing to pay the price,” she said.

JEFF WHEELER – STAR TRIBUNE

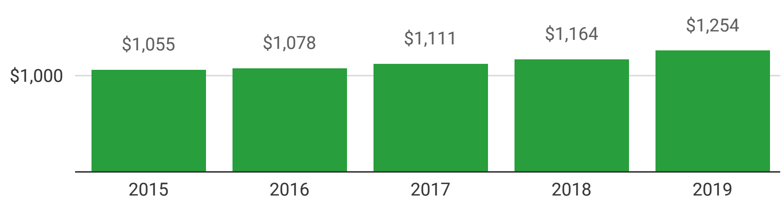
Nicholas Nicome helped his mother, Susan Cevette, move into the Rafter, a new apartment building in northeast Minneapolis.

With the average vacancy rate throughout the seven-county metro at just 2.3%, the average monthly rent is now at an unprecedented $1,254 — a nearly 8% increase over last year, according to a midyear report from Marquette Advisors.

Though apartments are filling as quickly as they are built in most of the metro, renters in parts of Minneapolis and St. Paul now have an abundance of options and more are on the way. In downtown Minneapolis, for example, the average vacancy rate increased slightly last quarter to nearly 5%, and in downtown St. Paul the vacancy rate was a metro-high of 7%, according to the report, which surveys nearly 150,000 rentals in buildings with more than 10 units. (Income-restricted rentals aren’t included in the survey.)

Twin Cities apartment market

Average rents and vacancy rates and average in the Twin Cities metro area rose in the second quarter of 2019.



Get the data • Created with Datawrapper

“Supply and demand remain in check for the metro,” said Brent Wittenberg, vice president at Marquette’s Twin Cities office.

The Twin Cities is in the midst of a decadelong rental construction boom driven by changing demographics, steady job growth and a shortage of houses that are affordable to entry-level buyers. In just six years developers have built nearly 25,000 apartments across the metro and an additional 13,000 are slated to be built over the next two years, according to Marquette Advisors.

Until recently, those developers have focused on downtown Minneapolis and adjacent neighborhoods, but with parts of the city reaching saturation, attention is shifting to the suburbs, where the vacancy rate is as low as 1 to 2%.

Developers are also investing in areas along the periphery of both downtowns including northeast Minneapolis, where Mortenson is still putting the finishing touches on the Rafter. Though the building officially opened last week, leasing began earlier this year, said Brent Webb, development manager for Mortenson.

To differentiate the building from others that recently opened or are under construction, Webb outfitted the Rafter with art and architectural details by local artists.

Since the Rafter started preleasing in January, Webb said, more than 40 units are occupied and another 40 are leased. So far, Webb said, micro-studios at 417 to 442 square feet are the most popular to renters, along with two-bedroom, two-bathroom corner apartments like the one that Cevette recently rented. Monthly rents for the two-bedroom, two-bath units range from $2,575 to $3,935.

Vacancy rate, second quarter of each year

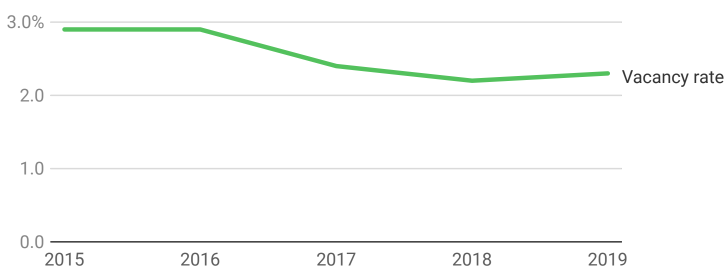


Chart: Jim Foster, Star Tribune • Source: Marquette Advisors • Get the data • Created with Datawrapper

Though Cevette wasn't offered any discounts or concessions, they are popping up at various buildings around the metro, especially in areas where there are several new buildings competing against one another and during the least popular rental times, especially fall and winter.

Wittenberg said that Marquette expects about 6,400 total new market-rate units to hit the market by the end of the year, most them during the last half of the year. Smaller, boutique-style buildings on infill lots are becoming increasingly common.

"We see demand from older millennials, Gen X and empty nesters who want to be urban, but not necessarily downtown, and many who prefer a somewhat smaller building," he said.

Wittenberg said there are about 13,000 units in the pipeline for the next two years, coinciding with growing concerns about a possible recession and a recent weakness in the state's job market that could eventually reduce demand for rentals.

"This hasn't materialized yet," said Wittenberg.

While job creation has clearly slowed, he said, there's still a strong migration trend to the Twin Cities metro area from more expensive cities.

"With low unemployment locally, businesses are recruiting new hires from outside our market, and they are showing a strong tendency to rent when they get here," he said.

According to a recent survey of the 60 U.S. metro areas by Yardi Matrix, a national real estate research firm, the average vacancy rate in the Twin Cities metro at the end of June was 3% — the lowest in the nation. The average rent increase, however, was only slightly above the national average at 4%.

Mary Bujold, president of Twin Cities-based Maxfield Research and Consulting, and other market watchers say that as supply increases and absorption rates in some submarkets slow, concessions might blunt the pain of rising rents over the next 12 to 18 months.

And while developers haven't yet started bailing on proposed projects, incremental changes are underway. Lenders are being more cautious and developers are facing steep increases in construction costs that "keep coming in higher than anyone is prepared for," she said.

In particular, the industry has been struggling with the impact of tariffs and the rising cost of commodities, including concrete and steel. Finished products also cost more. The latest Bureau of Labor Statistics report shows that during July, plumbing fixtures and fittings cost 6.5% more than last year and the price of furnaces and heaters was up 11%.

Those challenges are forcing some developers to re-evaluate their projects. Though Bader Development received approval to build two 26-story apartment towers with more than 700 units near Bde Maka Ska, formerly called Lake Calhoun, in south Minneapolis, last week it asked the city to reconfigure the project with the same number of units in just one tower to reduce construction costs.

Bujold said that despite a growing number of challenges, cheap borrowing costs will fuel more apartment construction as long as lenders are willing to lend.

“That concerns me a little about supply overheating the market,” she said.

Jim Buchta has covered real estate for the Star Tribune for several years. He also has covered energy, small business, consumer affairs and travel.

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