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Secondary Markets Attract Yield, Rehab Buyers

Even REITs, including Home Properties and Grubb & Ellis, are eyeing Class B and C assets.

By:

[Chris Wood](#)



The 80-unit Southridge Apartments in Pomona, Calif. is part of a three, B Class property portfolio purchased by Raintree Partners.

Credit: Raintree Partners

While large institutional buyers and REITs continue to duke it out in the core and core-plus apartment acquisition space, deal flow in Class B assets is beginning to improve. Smaller buyers looking to generate cash flow and returns on value-add opportunities are turning away from the compressed mid-4 percent cap rates of core deals and eyeing mid-range transactions.

On Aug. 6, Laguna Nigel, Calif.-based Raintree Partners completed a three-property portfolio acquisition for \$30.6 million that includes multifamily communities in Claremont and Pomona, Calif., and is finding additional opportunities in several southern California submarkets without having to bear the burden of aggressive Class A pricing.

“Obviously the hot asset classes that have significant sums of money chasing them are the more core and core-plus properties, and the REITs, as well as a few institutional groups, are very aggressive in that space,” says Raintree director of acquisitions Aaron Hancock. “The REIT cost of capital is very difficult to compete with on core assets, so we are looking to where we can find sections of the market where we can compete against other players at higher yields.”

Buying Up the Bs

Hancock says typical buyers on Class B assets are cash-flow driven, private buyers, and while there remains competition for product in the marketplace, prices are more conservatively underwritten to current cash flow yields, which means they have not seen severe cap rate compression.

“Buyers in the B space are pricing assets to generate cash flow yields that they find attractive compared to institutional buyers who are underwriting significantly aggressive rent growth over the next 16 months based on what they are already seeing in their portfolio,” Hancock says.

Hancock continues, saying the combination of rehab opportunity and the spread between cap-rate and agency debt is making deals such as the latest Raintree portfolio acquisition all the more attractive to smaller regional firms, particularly when they don’t have to venture far from traditional markets to close transactions. “It’s not like we’re out in the Central Valley chasing yield,” Hancock says. “And the agency debt that we are able to put on those assets is the same debt that we would be able to put on a Class A institutional asset, and we are still getting pretty attractive cash flow.”

REITs Join In

Not all secondary market buyers are small, regional players, however. While most REITs remain exclusively focused on high-barrier-to entry markets, Rochester, N.Y.-based Home Properties is looking for value-add opportunities across the Northeast, even if those opportunities are just now coming online.

Looking for B and C asset first-year cap rates from 5.9 percent to 6.5 percent, Home examined more than \$700 million worth of deals in 2009, and has already studied about \$500 million worth of properties as of mid-July. To date in 2010, the REIT has only acquired three properties, most recently buying Annapolis Roads Apartments in Annapolis, Md., for \$32.5 million.

“In our space, there’s less competition for a B or C asset than there is for an A asset,” says Home executive vice president and CFO David Gardner. “We’re seeing much more in the pipeline, [including] opportunities to buy properties that are accretive out of the box, and we’re not sure how long those opportunities are going to be there.”

In an 8K report filed Aug. 20 with the U.S. Securities and Exchange Commission, the Santa Ana, Calif.-based non-traded Grubb & Ellis Apartment REIT indicated that it is also making a Class B market play, entering into discussions with Oakton, Va.-based value-add apartment operator Mission Residential to acquire a portfolio of 15 properties for \$276.4 million. That deal has yet to be finalized.

—Additional reporting by Jerry Ascierto

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