

Posted on July 18, 2013

## Macro Units: What to Do When Gen Y Grows Up

With construction costs rising, some high-rise projects are now less costly than their wood-frame counterparts.

By LINSEY ISAACA

When the downtown development 3232 Georgia Ave in Washington, D.C. preleased its 69 units this year, the property was almost entirely filled up in less than three months. That's not surprising when you consider the ample closet space and amenities the property offered, all at an affordable price.

Best of all, the units are large, representing a trend that's taken Washington, D.C. by storm: Developers are increasing the square footage of their units, bucking the national "micro unit" trend.

More surprising than how spacious the building's units are, however, is how quickly its two- and three-bedroom apartments leased up. By early June, they were the first to go. And the developers, Neighborhood Development Corp. and Mi Casa, Inc.

aren't alone in their choice of unit size, and unit mix.

"In the past few years, the trend was to have a real high percentage of one-bedroom units because it seemed like the market was young professionals



who wanted them," says Rob Blalock, vice president and division manager at Birmingham, Al.-based construction firm Brasfield & Gorrie. "It used to seem that one-bedrooms were the first to go, and they'd have a harder time selling the two-bedrooms. Now, that's switched."

Plenty of new developments have stuck to a 70 percent one-bedroom, 30 percent two-bedroom plan. But as some developers see larger units leasing more quickly, many are now slowly tacking on a decent number of three-bedrooms to cater to brimming families, and, in some situations, roommates. In Atlanta, Blalock has dealt with many clients the past two years who wished they'd added more two- and three-bedroom units to buildings that are now accumulating some long-term vacancies.

"I think the one thing that's consistent is that, typically, you have a longer duration of tenants who stay in [the larger] units by nature of the type of tenant who's there," says Pete Martay, chief acquisitions officer at Chicago-based Pangea Properties.

### MACRO VERSUS MICRO

Developers are trending toward larger units for a number of reasons.

"There are times when [a micro unit] works and it's very interesting," says Daniel Gehman of Chicago-based architecture firm Harley Ellis Devereaux. "[But then] you start to realize the nuances from doing a whole building full of them."

For one, micro units are more expensive to build, chiefly because they require multiple kitchens and bathrooms with less living space to distribute the cost.

"Maybe in a location where you're on top of a college campus, you

might be able to justify micro units, particularly if you have a really rich, vibrant, walkable city," Gehman says.

And by walkable, Gehman means restaurants and shops should be within three blocks. Because if the location isn't right, developers will have trouble filling micro units when the next downturn comes around.

### GEN Y GROWS UP

For a long time, the micro-unit trend was aimed at young professionals, a bevy of Gen Y renters who preferred smaller spaces, or more accurately, smaller rents. But they're beginning to behave just like their parents, and in L.A., in particular, developers are trying to anticipate their next move.

Gen Y's preference for walkable communities (not to mention the large amount of student debt that many of them carry into their careers) means that many will delay suburban home ownership. Even the small percentage of Gen Yers who are ready to buy aren't expected to retreat to the suburbs and purchase large homes.

"While a renter will rent a 380-square-foot micro unit, he or she will not be going to buy a 380-square-foot condo," says Manny Gonzalez, principal at Irvine, Calif.-based KTGY. "There's no exit strategy like you have on a two- or three-bedroom unit that will openly get converted into a condominium."

By increasing the square footage of a unit—about 950 square feet for a two-bedroom, and around 1,150 for a three-bedroom—developers can set themselves up for a condo conversion in four or five years. Plenty of two-bedroom plans now include a dual master bath, offering similar closet space in both bedrooms to appeal to roommates.

"Selected developers in selected markets, we're seeing them finance projects as a rental but [retain] possible conversion of the property into a condo," says Mark Humphreys, CEO of Dallas-based Humphreys & Partners Architects. "If you're building a project to sell to an institution, you can get much more money by converting it into a condo."

It has to be in the back of the mind of any developer doing an urban project today, Humphreys says.

### THE MAGIC FORMULA?

Despite the growing popularity of larger units, the move to build them is very market specific. And condo conversion can be quite expensive depending on the amount of time lost between the cash flow coming from renters and transitioning the building to appeal to buyers. For some developers, larger units might represent a larger risk.

"In some markets, you hear our developer clientele saying they're completely leased in their small, one-bedrooms," Humphreys says. "They're struggling on their twos."

Market trends will determine how much rent developers can get per square foot. In high-barrier coastal markets, where land is expensive, for example, developers have to fit as many units on a property as they can, says Gonzalez, and two- and three-bedroom units won't allow for enough affordability to keep the building full.

And smaller units help a project pencil out in other ways: Building 1.5 parking spaces for each one-bedroom keeps garage costs down for developers as opposed to building as many as three spaces for a three-bedroom.

But there's a lack of market research about the macro unit trend, particularly in the Southeast, where Blalock says he was surprised to learn there's demand for three-bedrooms.

"Developers are really grappling with this issue," Blalock says. "What's the right formula, what's going to be popular? They're all dying for market reports on what's leasing the fastest, so that on their next project they can kind of read the tea leaves and see that three-bedrooms are going to be really popular."