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Cap Rates for Garden and High-Rise Apartments Have Converged. Now What?

Either garden-style apartments have more room to run or the price movement in high rises has been too fast.

By Erika Morphy | May 23, 2023

Historically garden apartments, usually found in the suburbs, have traded at a higher cap rate than mid/high-rise buildings, which typically can be found in urban areas.

The spread between the two categories began narrowing throughout 2022 and by March 2023, it became official: the two had converged at 5.1%.

For real estate investors this represents a buying opportunity if they are bold enough to make a bet on U.S. cities, says Aaron Jodka, Colliers' Research Director of Capital Markets. So far, investors haven't made this pivot yet, he tells GlobeSt.com, "but it is something we are closely monitoring."

"What I am arguing is that there is a pricing disconnect that either suggests that garden-style apartments have more room to run or that the price movement in urban markets has been too fast."

To understand the investment opportunity the convergence represents, it is helpful to understand why the convergence happened in the first place. For the last few years a lot of capital has been chasing the high growth Sunbelt markets, where garden-style apartments are very typical, driving down cap rates. The rise of interest rates set in motion pressure on pricing for all products but the momentum was more aggressive in the mid/high-rise space.

"Historically we have never seen that kind of convergence," Jodka says, likening it to the recent flip in urban and suburban office vacancy rates.

Jodka believes that the historical spread between garden-style apartments and mid/high-rise apartments will reappear and that garden apartments will be higher than the mid/high rise apartments.

"Urban markets are looking attractive right now," he says, and recent Census statistics show that people are returning to these metros. "I don't believe in the death of U.S. cities. There is too much of a 'there' there for them to fade away."

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