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10 Reasons to Pour Money Into Multifamily

Market trends play in favor of apartment investments

In the past few years, multifamily has been the shining star among the various commercial property types. Backed by growing investor interest and lender appetite, money has poured into this sector in response to increasing demand for apartment living. The resulting investments have created opportunities for commercial mortgage brokers in almost every market across the nation.

The apartment market seems to be continuing unabated. This past second quarter, the national multifamily vacancy rate remained unchanged at 4.3 percent while asking and effective rents grew by 0.6 percent and 0.7 percent, respectively, according to Reis.

Looking ahead, the apartment sector is expected to remain strong, even if growth isn't at the same pace seen in the past few years. Still, there are many reasons to expect investors to continue pouring money into apartment buildings.

There are 10 trends in today's market that support the stability and strength of the multifamily sector. These trends likely have been attracting investors and creating business opportunities for commercial mortgage brokers, and they are expected to continue to place multifamily among the most attractive asset types for investors.

By following the dynamics that influence financing and demand for apartments, brokers can position themselves for multifamily deals in their markets. Here is a look at the 10 trends that play in favor of apartment properties.

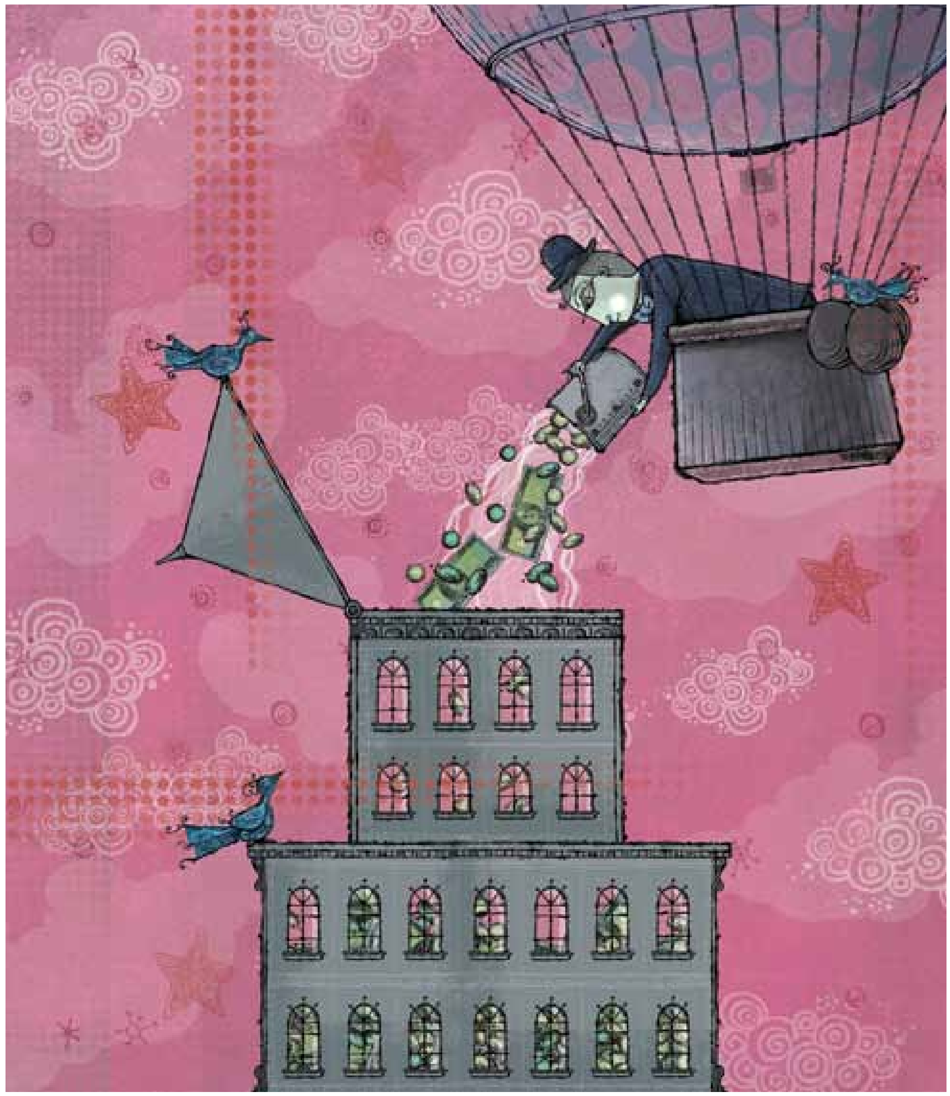

Illustration: Dennis Wunsch

1. Funding sources

More nongovernmental money seems to be available for apartment buildings than for single-family homes. Many people perceive nongovernmental funding sources — such as private money, pension funds, credit unions, small- to mid-sized community banks, etc. — to be easier to qualify for than government loans.

2. Demand

Everybody needs a place to live. Since the credit crisis in 2007, people have been hit with lower wages, higher unemployment, restricted access to credit, higher gasoline prices and so forth. As a result, more Americans have scaled back their lifestyles and chosen to move into affordable apartment units.

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3. Shadow inventory

When more foreclosed homes hit the market, more homeowners will be forced to become renters. By some estimates, the country's shadow inventory — homes that have been delinquent for more than 90 days — was at 2.99 million loans this past second quarter, although it should be noted that this was well below its 2010 peak of 5.5 million loans.

4. Low cap rates

Apartment buildings typically are valued based on their income and expenses more than just about any other major factor. To determine capitalization rates, take the property's net operating income (NOI), and divide it by the typical cap rate for the region. At lower cap rates, apartment buildings' values increase. At higher cap rates, the perceived risk of investment increases.

In the past few years, many apartment buildings might have been sold at prices calculated by using cap rates ranging between 7 percent and 10 percent. Prime apartment buildings in large cities like Los Angeles, San Francisco, Boston and New York have been selling at cap rates in the range of 3 percent to 4 percent or higher. The lower the cap rates are, the higher the sales prices will be for the sellers — and the larger the qualifying loan amounts will be for the buyers.

5. Bankers' appetite

Multifamily deals have been the most popular asset class for conventional bank lenders. Generally, they are perceived to be easier to underwrite and approve than most other types of real estate. For commercial mortgage brokers, this popularity means the availability of a reliable funding source from conventional lenders.

6. Attraction

For many potential apartment renters, city life is more attractive than living in the suburbs. With high gas prices, many people can't afford long commutes and tend to move closer to the big cities, where jobs, larger educational institutions and recreation facilities are concentrated.

7. Management

Multifamily projects are easier to manage than multiple rental properties scattered around town. Many apartment owners hire on-site property managers to deal with daily issues such as maintenance and rent collection. With efficient on-site or off-site property managers, building owners can focus on their yields instead of dealing with property or tenant problems.

8. Cash flow

Once the existing mortgage is paid off, monthly cash flows become significant. Free and clear apartment buildings provide consistent monthly cash flows, which can, in a way, turn into one's personal pension fund.

9. Lower rates

With today's still relatively low mortgage rates, the monthly cash flows of apartment properties are even more positive. In the past, apartment mortgage rates hovered between 6 percent and 10 percent or higher — along with interest rates. In recent years, mortgage rates for apartment buildings have ranged between 3 percent and 4 percent, however. Obviously, lower rates translate into higher net monthly cash flows. In addition, improved monthly cash flows and annual NOI numbers only can improve overall property values.

10. Appreciation

Multifamily properties' income increases naturally along with increasing rents. Although much of the rent increase may be governed by market dynamics, efficient management and response to tenants' needs and maintenance requests can help increase existing rental rates on a fairly consistent basis — if the overall occupancy rates remain as relatively high as they have been in recent years.

With the increase in the monthly net cash flow, property owners get more options to potentially pay off existing mortgage balances sooner. As rents and NOI numbers increase each and every subsequent year, then buildings' values will increase even further in the future.

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With multifamily-investment prospects remaining strong, commercial mortgage brokers should keep their eye on potential deals in their markets. They must, however, stay current with the status of the various properties around their markets and develop connections with real estate agents and other market professionals who specialize in apartment building investments. By doing so, they will be sure to capitalize on the opportunities offered by a thriving multifamily sector. ●

Reprinted from *Scotsman Guide* Commercial Edition and scotsmanguide.com, October 2013