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IMPORTANT FACTORS TO INCLUDE WHEN ANALYZING AN INVESTMENT IN

MULTIFAMILY PROPERTIES

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INTRODUCTION

Becoming a successful commercial real estate investor takes more than just becoming a property owner and managing the cash flow. It also involves gathering information for cost analysis and understanding the underlying profitability factors. It is therefore necessary to determine whether the targeted investment will be able to yield profitable returns and appreciation over time. Here is a list of the key metrics that you need to review before committing to a multifamily investment decision.

EMPLOYMENT GROWTH

One of the major drivers of commercial real estate demand is the employment growth rate, which directly impacts the growth of the population. As you analyze the multifamily investment market, it is important to understand some of the job creation trends, including whether there is a stable job market, the job fluctuation rate, stability of jobs, and whether there is volatility in the employment growth rate. In general, when there is a larger consumer market, the employment growth rate becomes stable due to many job creators.

The recent success in the multifamily investment market indicates that employment growth is a good predictor of the future real estate performance. As young people find jobs, they tend to move out of their childhood homes to rent or own apartments increasing household formation.

While considering this metric, some of the factors to keep in mind are:

- Jobs in healthcare, education, and government sectors tend to grow over time.
- Military jobs tend to fluctuate, depending on deployments and realignments.
- Both virtual service and manufacturing jobs have high volatility regardless of the economic growth rate.

When evaluating areas to invest in multifamily properties, observe the national unemployment rate and compare the state and local area for comparison.

POPULATION GROWTH

In a typical environment, population growth is influenced by favorable factors like affordable cost of living, low unemployment rates, access to industries, and business opportunities. This means that when people are migrating to an area, the multifamily investment market grows exponentially. Targeting an area that has higher popular growth will increase the likelihood of real estate boom because of the increased housing demand. Similarly, growth in population causes shortages in rentals, which means higher profits and better cash flow.

The trick to identifying the appropriate location for real estate investment is to consider steady population growth in the long-term. Such areas greatly influence multifamily pricing, rental rates, and new construction, unlike a top location for population growth for short-term. Areas with average and above-average growth rates are acceptable as long as they follow a positive trajectory with foreseeable future.

UNEMPLOYMENT RATE

The relationship between the unemployment rate and the cost of housing is very significant in analyzing the multifamily investment market. High risk of unemployment in an area reduces the willingness of the residents to rent high-priced apartments of purchase housing. This is particularly pronounced in families with volatile incomes, who are not able to purchase housing because of the potential losses in the future. However, there is also a negative relationship between homeownership and income uncertainty; with a high risk of being unemployed, few people would be willing to pay high rental prices or buy new homes. For investors in areas with higher unemployment Class B and C multifamily properties should be considered.

In general, it is important to look for a market that has a lower unemployment rate than the average US market rate. Areas with steady growth trends will be likely more favorable to the multifamily investment market compared to those with higher unemployment rates.

LOCAL REGULATIONS

The local regulations of an area can have a great impact on the commercial real estate market due to the resulting influence on property prices and demands. Some of the ways that a government can boost the real estate market are through deductions, tax credits, and subsidies. Being informed about such policies can help investors to determine possible supply and demand trends and future forecasts in the market.

An example of impact regulations have on the real estate market is the homebuyer's tax credit that was introduced by the US government in 2009. This tax incentive led to an increase in home purchases, with more than 900,000 people buying homes.

Multifamily construction is influenced by federal equal housing laws, local and state business practices, and landlord and tenant laws. With several voices impacting multifamily property, this can affect your allowable marketing activities, tax bills, tenant rights, and property living standards. Rental regulation policies, such as market caps or rent controls can negatively affect multifamily property valuations. While cities like New York have a history of regulating rents, other areas in California and Oregon have begun to institute them as well. Potential investors should do their research to see if the areas they are interested in are considering these types of government action.

Evictions also happen often in the real estate market, even in the case of a new Class A housing. The rates of evictions increase even more when we move down to Class D properties. It is important that you consider a market that provides favorable or neutral treatment to landlords in case of bad debt scenarios or evictions. In neutral states, evictions take 30 - 45 days and tenants are responsible for economic harm caused to the tenancy. However, some states may take up to 6 months for evictions, which may cause loss of rental income. Investors can obtain eviction reports from the seller or can obtain them through the recorder's office.

FACTORS TO INCLUDE IN MULTIFAMILY PROPERTY INVESTMENT

ECONOMIC TRENDS

The overall health of an area's economy influences the value of the real estate. This is always measured in terms of the economic indicators of the region, including employment data, the Gross Domestic Product, prices of goods, and manufacturing activities. However, it is important to note that the cyclicality of an economy has varying effect depending on the type of real estate. If a REIT, for instance, invests the bulk of its portfolio in hotels, it would be more affected by a depression compared to another one that primarily invests in office buildings or other property types. This is because the hotel industry is highly sensitive to a fragile economic environment.

Strong economies witness significant multifamily construction while metros with poor economics have few construction opportunities. When deciding on a multifamily investment market, consider key market trends such as steady employment growth, proximity to employment areas, accessibility, low crime rates, attractive retail sector, good schools, cultural attractions, and high population growth rate.

SUPPLY OF MULTIFAMILY PROPERTIES

Another important factor when evaluating multifamily properties to invest in is the supply in the target area. In areas with low construction of new properties, investors can often expect high demand for rental units. The total number of multifamily units available and the overall vacancy rate should always be taken into consideration when evaluating potential investments. More recently, developers have been focused on building Class A luxury apartments, resulting in lower vacancy rates for Class B and C properties.

QUALITY OF MULTIFAMILY PROPERTIES

When analyzing the multifamily investment market, it is important to determine the quality of a property you want to invest in. Real estate classification grade property based on physical and geographical characteristics. Below is a list of property classes that you should analyze:

Class A: This is the highest quality property in the real estate market. They are always new in the market, built within the past 10 years, with the latest amenities and accommodate high-income earners. Class A attracts high rent and is mostly found in the central business districts.

Class B: These are older properties that house lower-income renters compared to Class A. They are typically managed professionally and are well maintained. They are always seen as upgraded properties with updated amenities.

Class C: These properties are about 30 years old and are located in economically depressed areas. They are in need of renovation and are always located in the middle or low-income areas.

Class D: These types of properties are found in fringe markets and are more than 30 years old. They are always in need of extensive renovation and do not offer any amenity packages to tenants. Class D properties are always operationally challenging without management skills or experience.

FACTORS TO INCLUDE IN MULTIFAMILY PROPERTY INVESTMENT

DATA FROM INDUSTRY BENCHMARKS

Multifamily investors should always evaluate the financial metrics of any potential property. However, these numbers should always include an evaluation of the industry benchmarks compared to their targeted investment. The industry benchmarks listed below are created by the National Multifamily Housing Council:

NOI % of Revenue: Net Operating Income (NOI) expressed as a percent of Total Revenue. This includes revenue and expenses from property operations. Revenue includes rental income, rental losses and other income. Expenses include all property operating expenses generally covered by the following categories: payroll, administrative, marketing, operating and maintenance, utilities, taxes and insurance.

In Place Rent Per Square Foot: Average effective rent per occupied square foot for all in-place leases, including both new leases and renewals.

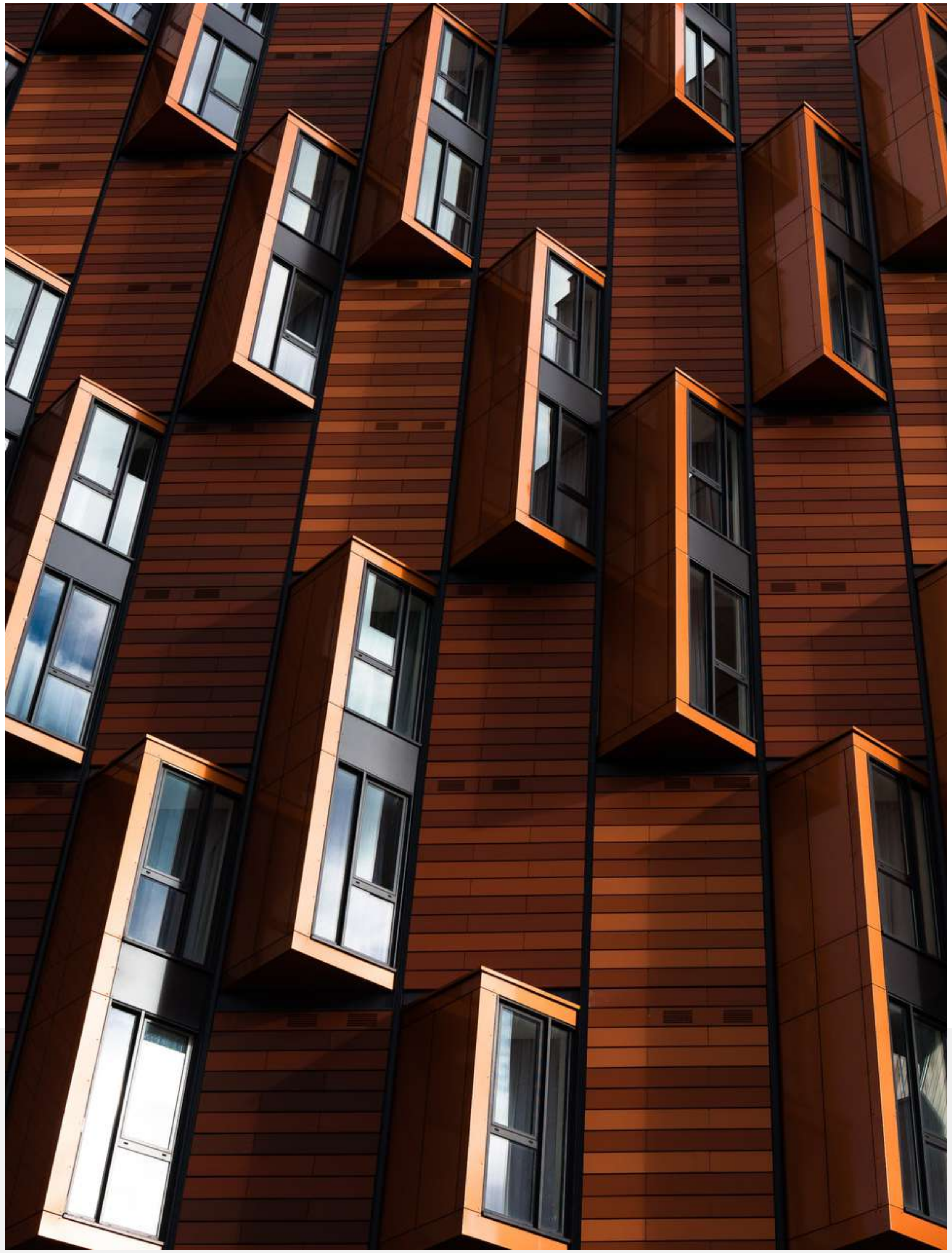
Rent Change - New Leases: Percent change in effective rent for a new lease on the same unit. Units vacant longer than 90 days are not included.

Rent Change - Renewals: Percent change in effective rent for a renewed lease on the same unit.

Renewal Conversion Rate: Number of leases that renewed divided by the number of expirations based on the lease end date. Expirations consider all leases that end during the period. This includes any leases that have terminations entered into the property management system. Early move outs, skips and evictions are counted as expirations based on the move out date. Month to months are included in the period once they either renew or give notice, based on the move out date.

CONCLUSION

Analyzing a multifamily investment market is very complex. Reviewing the above-listed metrics will help you evaluate the possible risks and profitability. It is clear that stable employment rates and steady population growth promise a lucrative investment market. Neutral local legislation and lower unemployment rates are favorable to real estate investment. A thorough analysis of these metrics will help you make clear and succinct decisions on your investment options.



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