

Need to Jump-Start Your Commercial Real Estate Portfolio?

Try Apartment Properties — their future appears bright!

By Craig Lieberman

No matter what the government may be telling us, it is pretty obvious that the economy hasn't rebounded, stabilized, or shown any real signs of growth. Like any economic cycle, disastrous or otherwise, certain sectors are doing well and investment opportunities are available. Bankruptcy lawyers and buying foreclosed homes are two examples that come to mind.

So you've ruled out law school, what about buying up foreclosed homes? Yes, if lucky, you can be one of the fortunate investors that have beat out the masses who have been vying for the same properties. Lending has tightened up a bit and banks are a bit more cautious about to whom they will lend, so the timeline is a little longer. However, once you take possession, it is difficult to know for sure whether you will make a profit on that quick flip. Oh, you're going to rent it out? Good luck on being able to cover the carrying costs associated with ownership while you are forced to clean up and repair beat-up foreclosed houses you are trying to ready for sale.

Apartment buildings are the best real estate investment option, particularly in today's economy. First, there will always be a need for housing. Second, there will always be people who prefer renting to homeownership or those who simply can't afford to buy their own home. And, most important, as rents rise over the next few years for reasons alluded to below, values will tend to rise, giving way to increased equity or net worth.

Let's look at three key questions to further investigate if the time is right for investing in apartment buildings.

Is this a good time to buy apartment buildings?

A singular look at low interest rates gives a resounding "Yes!" to the question "Is this a good time to buy apartment buildings?" Let's broaden the decision-making scope to include other economic factors along with some demographics.

In a classic example of "supply and demand economics," the multifamily sector has seen a continued decline in vacancy rates which is expected to last for several years. The negligible supply of new apartment units coming on line over the last 18 months due to stalled or postponed projects caused by the almost impossible financing environment; in fact, there were only 99,000 apartment permits and construction starts nationally over the last year compared to the average of 146,000 units. Meanwhile, demand for rentals is, and will continue to be, only getting stronger. This disequilibrium between supply and demand is expected to

give the "upper hand" to landlords vis-à-vis the tenant population. As the vacancy rate is stabilized and not increasing, rental rates will begin to creep up as has been the case.

Echo Boomers, the demographic born to Baby Boomers between 1982 and 1995, will lead the demand for apartment rentals for the foreseeable future. There are an estimated 70 million Echo Boomers. Additionally, renters between the ages of 20 to 34 will expand by 3.2 million over the next two years. The very high unemployment rate doesn't discriminate between Echo Boomers, Gen Xers, or Baby Boomers -- the unemployed are more likely to rent than own homes.

Lastly, it's no secret that homeownership has declined from 2006 to today. The decline, 69 percent to 66.9 percent, has resulted in almost 2.5 million households possibly needing a home to rent. The housing crisis has altered the American dream of home ownership -- the lore of striking it rich with equity growing housing has been eroded in the perception of the public. Though home ownership is still a goal for more than the majority of Americans, according to a survey conducted by Fannie Mae, over 25 percent of the renters polled said they will wait longer to make their dream a reality. Additionally, almost 80 percent of the survey participants stated that renting "has been a positive experience for them and their families."

What kind of financing is available for apartments?

Here is some good news: money is available and lenders are looking for borrowers. Today's favorable capital market conditions include government-sponsored enterprises (GSEs). According to the Federal Housing Finance Agency, GSEs, which include Freddie Mac, Fannie Mae, and HUD, provided financing for over 80 percent of loans in 2008 and 64 percent in 2009. Today, the GSEs have low fixed-rate financing for apartment buildings.

To get a little more technical about it, for a seven- to 10-year term GSE loan-to-values range from 70- to 80-percent. Over the 10-year Treasury yield, interest rates range from 180 to 220 basis points. Ratios for debt service coverage (the ratio of net operating income to the annual debt service) are 1.25 to 1.35, and mortgages for apartment properties are lower than other commercial property sectors -- about 120 to 150 basis points lower.

What is the forecast for apartment sales in 2011?

It is a rosy forecast for apartment sales in 2011. As rental demand is tightly tied to job growth, the apartment sector will benefit from declining homeownership and a limited supply of new apartment housing. According to Moody's www.economy.com, the labor market should recover by 2014. As a positive consequence, vacancy rates are projected to decline and rents are expected to increase. The national vacancy rate dropped from 7.8 percent to 7.1 percent over the third quarter, 2010 -- one of the

largest recorded drops. The declining rate should continue for at least another three years because supply will not be able to keep up with demand. Increased rental rates is a natural consequence of stronger occupancy rates; industry experts reported an increase in rents for the same third quarter, making it the second quarter in a row showing rent increases. The increases were 0.5 percent and 0.6 percent for the second and third quarters, respectively. Asking and effective rents are anticipated to keep increasing through 2014, coinciding with the projected more robust jobs growth.

The foregoing is a sure sign that the multifamily/apartment property sector is strong and getting stronger. Not only is the sector benefiting from declining homeownership and stalled construction, but there is also a new demographic wave that is maturing into apartment renters. Today's economy may not be the best market for the average investor or investment. Apartment properties, however, offer better than average returns through good times and bad. There is really no good reason not to invest in them.

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