How to Invest in Todays Challenging Multi-Family Market

By Barry Saywitz, President, The Saywitz Company

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While today's real estate market continues to be robust with significant activity, plenty of capital chasing deals and limited inventory, there are still challenges, risks, and pitfalls in investing in today's multi-family real estate market. Commercial real estate markets around the country continue to move forward at a rapid pace and the multi-family industry in most major markets around the country, especially throughout California, continues to be one of the most vibrant and exciting sectors of commercial real estate.

With the housing market continuing on an upward slope, home prices rising and interest rates ticking up, it makes the ability for homeownership much more difficult to achieve. If you combine this with the fact that baby boomers are selling their homes to take retirement money and profits without purchasing a new home and the fact that millennials continue to prefer to rent versus seeking homeownership, this demand for the rental market continues to push apartment rents to an all-time high. The increase in rents obviously drives values for apartment buildings and multi-family properties and makes them an extremely desirable investment vehicle.

With a limited number of quality properties for sale and significant available capital, there are numerous buyers chasing every deal. The average sale time of a property has decreased dramatically and the terms of the transaction and the timeframes for the buyer to perform have also been adjusted. There is no question that this is a seller's market. For the buyer, there are several risks to be aware of in today's market.

Experts believe that is currently difficult to acquire and finance a property with a cap rate that is lower than the interest rate unless there is significant upside in rents. However, many multi-family properties are being sold at extremely low cap rates with the promise to the buyer that they can come in and immediately raise rents. The fallacy in this scenario is that one can, in a tight market, raise rents nominally without push back from existing tenants. However, to raise rents significantly, the buyer will need to invest capital and remodel the property and/or the units. Also, the buyer will need to turnover a significant portion of the tenant mix as those that are there may not be able to afford the new rents or may not appreciate the significant rent increase or see value in paying more for something unless they receive improvements to their unit.

Additionally, when a buyer decides to remodel the property or raise rents, there is downtime involved from turnover. This downtime is also typically not factored into the marketing packages by sellers and brokers but must be accounted for in the overall return. With interest rates on the rise, those investors that did acquire properties in the last few years were able to lock in an extremely low interest rate. However, in the coming years, when those loans roll from fixed rate to adjustable or reset at the future rate, there is no question that the mortgage will increase and if rents do not continue to increase at the same pace, they will see their returns diminish.

As we all know, real estate value does not go up forever and it is a cycle. Many experts believe that we are in the 9^{th} inning of this nine-inning real estate cycle and for those who are currently investing may be overpaying and in serious danger of a market adjustment and/or interest rate increase, which would negatively affect the overall return and the value of the property.

Nonetheless, there are a certain number of foreign investors that are looking to acquire property in the U.S. with foreign money. In California and the West Coast, there is a significant number of Asian investors. Those individuals and entities are trying to move their funds out of their native country and onto U.S. soil. They are typically not as concerned about returns or cap rates and are more focused on placing the funds and buying a piece of real estate. Additionally, there is a significant amount of overseas investment from Europe and the Middle East who also typically have little regard for returns and are looking to simply diversify and turn their cash into real estate investments. It is difficult for the average investor, who is looking for a reasonable return, to compete with these types of buyers. In many instances, these buyers are paying cash and do not have financing contingencies and are less concerned with nominal inefficiencies or deferred maintenance at the property.

With all of that said, there is still money to be made in the multi-family market. There are still properties that have significant upside in rents and for the savvy and careful investor there are still plenty of opportunities. However, for those who believe that they are going to buy property and sell it in a few years and hopefully make a profit, they need to be wary of interest rates and rent growth. In addition, if the market should flatten or turn, these investors/property owners will be in significant trouble. Additionally, for those unsophisticated investors who do not have professional management and attempt to manage their properties on their own in today's market, will have little trouble renting units but when the market softens, these are the first properties that run into problems. The short answer is that the multi-family market continues to be robust, continues to be an excellent opportunity for investment, but investors should be cautious. The investor that offers a sound investment strategy will be successful in both the short-term and the long-term.

Barry Saywitz is President of The Saywitz Company, a national commercial real estate brokerage, investment, consulting and Management Company headquartered in Newport Beach, California. The Saywitz Company owns, manages and maintains a portfolio of more than 75 multi-family properties throughout Southern California. Addition information on The Saywitz Company can be found at www.saywitz.com.