Multifamily Target Market Selection Criteria

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Investing in multifamily real estate can be an exciting and lucrative experience. However, as with anything, multifamily real estate investing comes with its own risk. While conducting due diligence of the property is extremely important, it is equally (and maybe even more) important to make a comprehensive analysis of that particular real estate market.

How to Select a Target Market

Selecting a target market is important for a myriad of reasons. If your target market is ill-defined, your market may be too broad, which will make it challenging to identify good deals. Likewise, it will be incredibly difficult to acquire the level of understanding required to make informed investment choices. On the other hand, you'll have issues discovering adequate offers that satisfy your investment requirements if it is too small. It's generally best to narrow down your search to specific submarkets within a Metropolitan Statistical Area (MSA). For newer investors, it's also good to look at your current market or others you are somewhat familiar with – this helps with another critical aspect of multifamily investing: building your multifamily investment team.

Ultimately, selecting good target markets boil down to a few key themes:

- People
- Jobs
- Money/Economy
- Real Estate Market Cycle
- Crime
- Types of businesses in the general area

Population and Population Growth

When choosing a market, you want to pick a market that is big enough (generally over 200,000 population) that you have a good pool of interested buyers and renters. Likewise, picking an area where corporations are looking to move their headquarters to or expand operations is a good indicator that there will be an influx of workers. In general, you will also want to focus on markets with above average population growth trends. A decline may be an indicator that this is not a good market to invest in.

Unemployment, Job Growth, And Unemployment Rate

Specifically, you should look at the unemployment figures over the last five years. To do this appropriately, you should look at the Census.gov website under the “Selected Economic Characteristics” information table to figure out the percentage for the city for the last 5 years. A low, stagnant rate is acceptable. A high and/or increasing rate is undesirable and should be a red flag to reconsider your investment in that market.

To truly get an understanding of the job growth in a specific location, you can compare it to the national one-year job growth rate to get an idea of how your target area holds up.

Job Diversity

Analyzing the job diversity in a specific market goes hand in hand with analyzing the unemployment and job growth of an area. Overall, it is better to avoid cities and areas that are dominated by one or a few industries, particularly those heavily vulnerable to economic cycles. The rise and fall of cities like Detroit are a great example of what happens when a city is dependent on one industry. As such, look for cities with more jobs in various industries, healthcare, finance, education, and business services.

Leisure and Hospitality is another vulnerable industry; we know hotels and airlines are cyclical businesses: they make money in the good times, but lose money in recessions.

On the contrary, jobs in the tech sectors arguably are the exact opposite; meaning that they are less vulnerable to economic cycles by nature. Excitingly, rundown buildings in emerging tech cities are being transformed by techpreneurs. Likewise, there is an increase in hubs and co-working spaces for digital technology-related businesses.

At the same time, tech workers are typically young and looking for affordable homes and workspaces to rent. Notably, this demographic is seeking to renovate rundown properties in up-and-coming areas, which increases market value. For example, Tampa is emerging as a top city in the tech and IT industry. Specifically, the city has a goal of raising the profile of its metro area as an emerging tech hub. When Tampa was invited to be a Google Fiber city, Tampa’s value in the tech industry predictably increased. Additionally, Companies like Citi, Verizon, and WellCare are hiring in Tampa and local IT talent can expect to make a median salary of $79,553 a year.

Median Household Income

Housing is the top expense for the majority of individuals and families. Therefore, the median household income (MHI) is an important figure that helps determine which markets are sustainable in the long run. When calculating the MHI, focus on a one-mile radius to understand the true demographics on a potential investment opportunity. Average MHI across a 10-mile area, for example, could return a completely different tenant profile and family income. As such, when doing an MHI analysis, it is especially important to focus on neighborhoods in no more than a two-mile radius. Lastly, evaluate the MHI trend. Specifically, are the numbers rising, declining, or staying stable over the last two to five years.

Macroeconomic Trends

This usually goes hand in hand with employment trends, but focusing on markets with leading GDP growth is worth highlighting as well. As the saying goes: a rising tide lifts all boats. A good property in a location with a stagnant economy requires operational excellence, with a low margin for error. An average operator and property in a booming economy could perform just as well, if not better.

Landlord-Tenant Laws

Evictions and bad tenants come with the territory when owning multifamily properties. As such, when evaluating multifamily properties, it is important to review the landlord-tenant laws in your target market to see what impact those laws may have on the eviction process. Remember, evictions typically mean lost rent and legal costs for landlords. Moreover, Investors must focus on state laws along with the rules and regulations in each local county. Notably, sometimes, cities have stricter rules and regulations apart from state-wide laws, so it’s important to pay attention to those as well.

Some things to consider include, but are not limited to, whether the tenant can withhold rent for repairs issues, how much notice a landlord has to give to evict a tenant, the amount of deposit that can be held, the landlord’s duty to mitigate damages, and the overall financial risks landlords can be responsible for.

For example, Massachusetts is commonly known for permitting tenants to sue landlords for money for neglecting to provide full services. This is true, even if the tenant has arrears and isn’t paying their rent. Also, cities like New York City, are notoriously known for prolonged and costly eviction proceedings, which frequently take longer than a year and sometimes two years.

On the contrary, states like Texas, Indiana, Florida, and Georgia have some of the best laws that favor landlords. In landlord friendly states, the average eviction proceeding takes around 30-45 days to complete.

Other Considerations

Below are a few additional considerations.

Real Estate Market Cycle

It is best to understand where an area is in the real estate market cycle, which are different than overall economic cycles and can be local to an MSA. The four phases are: Recovery, Expansion, Hyper Supply, and Recession. It is best to invest in markets coming out of recovery and into the expansion phase.

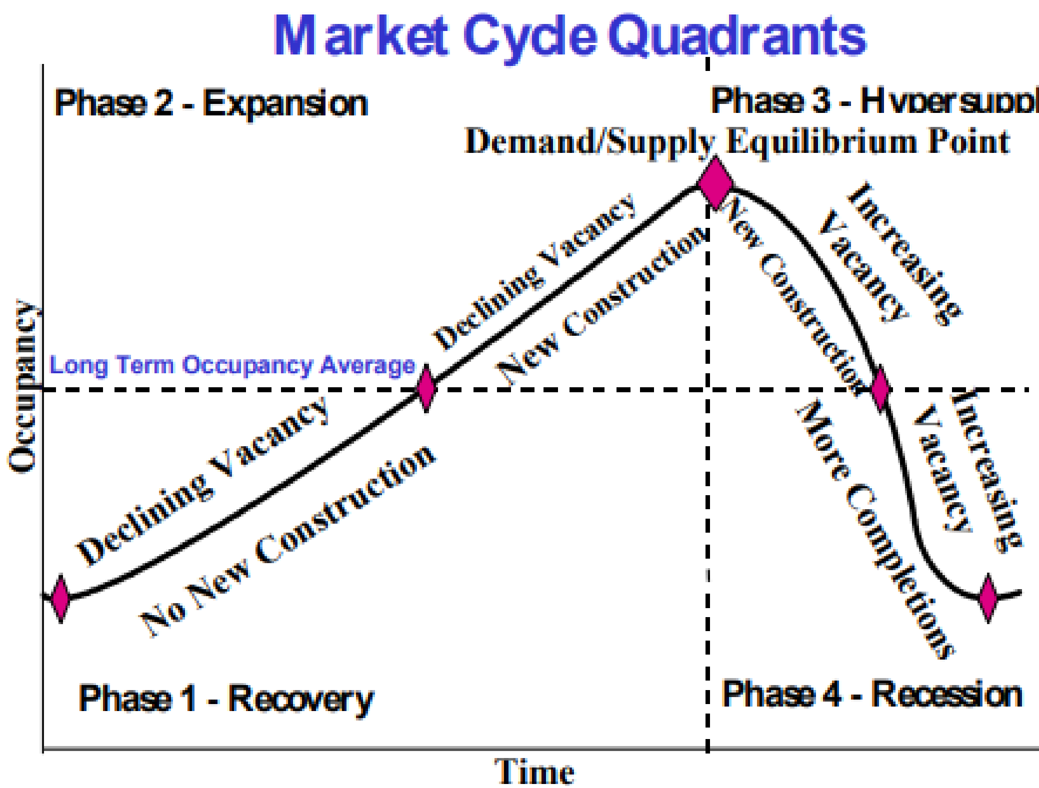

Image from: http://realestate.wharton.upenn.edu/wp-content/uploads/2017/03/388.pdf

Crime

Typically, there is a correlation between the criminal activity in a neighborhood and the delinquency rates of the renters living in that neighborhood. Fortunately, an easy search on the internet about the property and surrounding area can let you know about recent crime activity and if there is anything to be worried about.

Furthermore, when you physically go to view properties, you should be very observant. Look for things such as bars on windows, unkempt landscaping, trash in streets, etc. Likewise, observe the type of vehicles you see in the parking area and what conditions they are in. Also, be mindful of the activity during the time of day. For example, do more residents appear to be at work or home midday?

Likewise, you can draw conclusions about the local market by looking at what kind of stores are located in the area. Large retail companies, stores, and restaurants do a lot of research prior to devoting themselves to opening new stores in the area, and as such, you can use this information to guesstimate the local demographics. For example, if you see a Starbucks or Whole Foods in the location, you can assume that there is an adequate affluent population in that area that is willing to pay for these higher-end stores. On the contrary, if you observe a concentration of discount stores, pawn shops, and bail bonds businesses, the opposite is probably true.

Overall, your understanding of the target markets that you are considering investing in can make or break your investment success. As such, doing the appropriate due diligence will reduce the chance of expensive mistakes and likewise increase your chances of success.

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