The Four Economic Multifamily Market Phases

Investing in multifamily real estate is a constant learning experience; however, as you become more experienced, you learn how to evaluate each multifamily market phase more quickly. It should go without saying that you can invest in multifamily real estate when the market is up, but should you invest when the market is down?

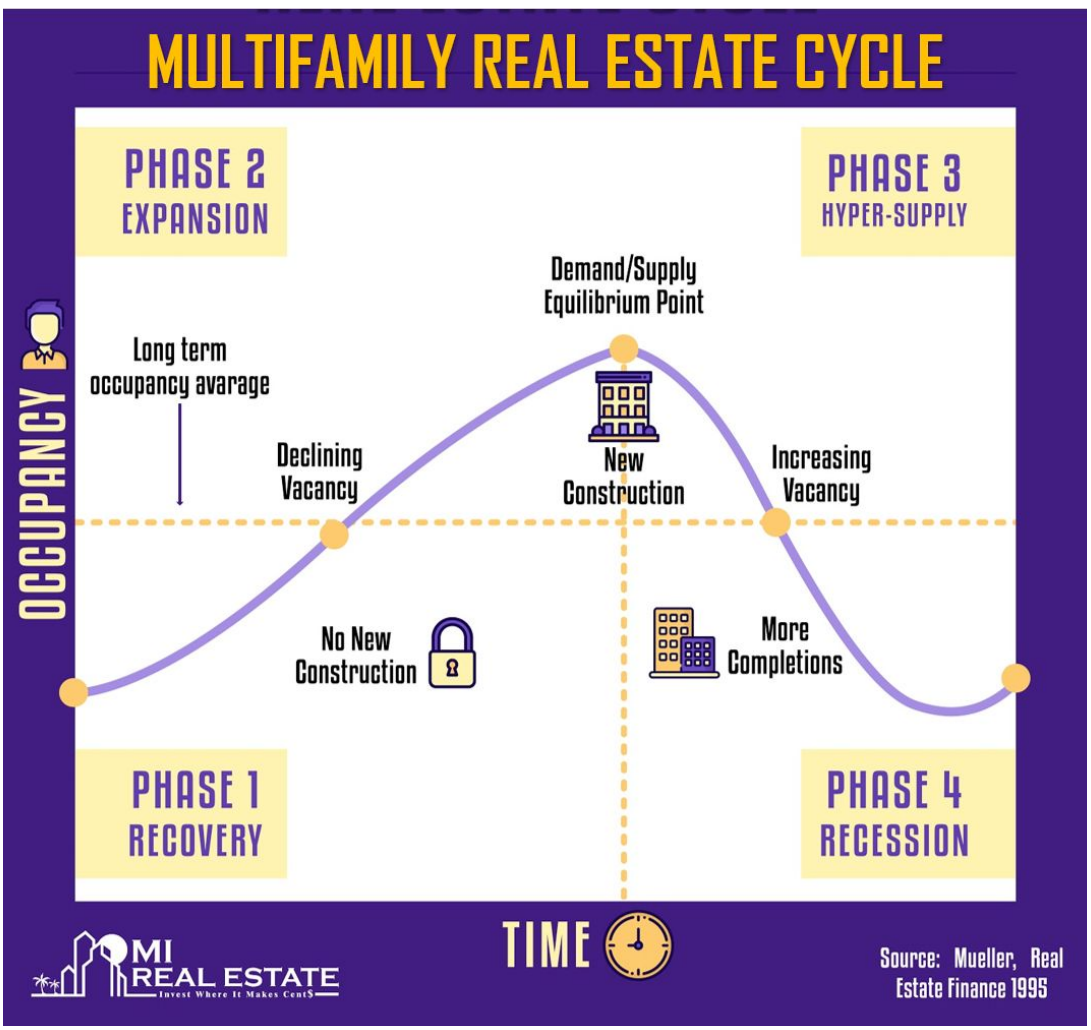
As a serious real estate investor, you should know that multifamily apartment buildings are approximately 25% of the total U.S. real estate market. As such, you must educate yourself about the various real estate phases in both your target and existing multifamily markets. Savvy real estate investors keep their eye on the real estate phrases to recognize and take advantage of various investment opportunities and risks.

Similar to the economy in general, there are four phases to the real estate cycle-- recovery, expansion, hyper supply, and recession. Typically, the cycle repeats in waves. As explained below, the multifamily real estate sector is considered one of the most “defensive” areas of real estate. Therefore, it's possible to invest successfully throughout all phases of the multifamily market cycle.

What Can Real Estate Investors Learn from Each Multifamily Market Phase?

Having a general understanding of a multifamily cycle's phases can assist you in making sound investment decisions. Taking a close look at the real estate market and examining the current conditions can tell investors a lot about potential investment opportunities as well as the risk that may develop during each cycle. Specifically, determining what phase the market is in enables you to make some predictions on how much return you can expect with each potential real estate investment. Likewise, you can make predictions on just how long you will hold onto certain investments in your portfolio and develop a general exit strategy and plan capital improvement projects.

Below, we will discuss the four economic phases of the Multifamily Real Estate Investing Cycle.



THE RECOVERY PHASE

During the recovery phase, typically, there is little to no new construction and construction job rates in most markets are slowly decreasing. While it is true that the average multifamily property will have steady occupancy rates even during the recovery phase, some property owners may have difficulty keeping their properties occupied at a high occupancy rate (95+%). Moreover, there are several other signs that the market is in the recovery phase.

Typically, rent growth hovers near the inflation rate, rather than increasing substantially.

Businesses in the area are starting to generate new growth and hire new employees, which will subsequently produce higher demand for housing in those job markets.

In general, during the recovery phase, cash buyers can do quite well. Likewise, sellers are in a much better position to sell, as well. This is a terrific time for experienced investors to hold on to assets until the expansion phase. Cash is king during the recovery phase. Especially because it may be tough for average investors to obtain financing

An investor may have high operating expenses in this phase due to high vacancy rates in their buildings. However, investors may also have the ability to buy more quickly and find better investment deals compared with other economic phases. At the tail end of this phase, the real estate market is primed for additional growth and development.

THE EXPANSION PHASE

At the peak of the expansion multifamily market phase, supply and demand are balanced. The expansion phase is a great time for investors who can purchase properties at a discounted price, hold, and renovate the properties so that they can sell at a premium in the upcoming years.

Rent increases. The market is peak performance for owners. Increasing rental rates tend to support new buildings and redevelopment of existing properties.

Declining vacancy rates. There are fewer available apartments and housing when the market is expanding. As such, many apartment owners may find it easier to keep their buildings close to 100% occupied.

Unemployment Declines. Local employers have more openings, and fewer people in the area struggle with joblessness, which is a plus for the multifamily real estate market.

Overall, the growth phase is both a seller’s market and a buyer’s market: sellers will gain from selling at greater rates than the recovery period. In contrast, buyers will value having the ability to buy multifamily houses in a growing market.

HYPER SUPPLY PHASE

The next phase in the multifamily market phase is hyper supply: a period when the marketplace experiences an oversupply of rental properties. New buildings and construction are still feasible; however, the market or neighborhood is oversaturated. More than likely, an area is oversaturated if the following is occurring.

Jobs are increasing. It may be harder to discover renters for properties, particularly those in popular locations. In general, properties will remain vacant longer.

Declining rent prices. The price of the lease might continue to grow. However, it won't grow as fast as it can be in the other phases.

Instead of new structures filling quickly, they might take longer to lease-up or rent to 90% occupancy. The supply is increasing, making it a tenant's market, rather than a landlord's market. During this phase, smart property owners and managers start focusing on renter retention and how to keep their existing renters, rather than concentrating on how to bring in new ones.

Likewise, during the majority of the hyper supply phase, it's a seller's market as many buyers don't recognize the oversupply until late in this phase and sellers won't budge on pricing until buyers stop buying.

RECESSION

Typically, during this multifamily market phase, the real estate market is saturated with supply, outweighing demand. Consequently, developers start little to no new construction projects during a recession. You will also probably see interest rates increase. In most instances, your vacancy rate may also increase. This is partially spearheaded by the fact that most renters have a choice of available properties on the market.

Additionally, during a recession, there is typically negative rent growth, and rental rates grow substantially slower than the current inflation rate.

This phase is most definitely a buyer's market and, therefore, a good time for investors to purchase distressed properties. Overall, this is arguably the best phase for investors with significant cash reserves who can afford to renovate and reposition their properties in preparation for the expansion phase.

THE VERDICT

Multifamily apartment buildings tend to be less susceptible to financial cycles, considering that everyone needs somewhere to live. This is true even though a down economy may trigger substantial job losses in some markets. In general, the verdict is that investors can invest successfully throughout each multifamily market phase. Especially if they fully appreciate the pros and cons of each phase.