Adding Multifamily to your Portfolio of Investments as a Way to Grow Your Passive Income

Multifamily real estate is a strategic and widely held asset class of commercial real estate. Once viewed as a residential asset, multifamily real estate is now a primary class of its own, with the other three being retail, office and industrial. As the population has grown over the last three decades, there has been an increasing need for apartment complexes and other multifamily properties, which has led this class to become a segment in its own right.

Not surprisingly, the multifamily asset class has become increasingly attractive to investors because of its distinct and unique benefits. Instead of having rental units spread out across multiple locations, an investor can have a large number of units under one roof, making management far easier. It also tends to be easier to add value and revenue streams to a multifamily family property than a single or two-family home, and although there are no guarantees, a multifamily tends to stand a better chance of holding its value than smaller homes.

Naturally, there are aspects of this commercial real estate class that differ from other commercial asset types, including asset classes within the category itself, the drivers behind demand for multifamily units, and the impact of renter demographics on that demand. Before you invest in multifamily real estate, it pays to learn more about these aspects, so you are making the most informed investment decision possible.

Asset Classes Explained

The multifamily category is a wide asset class spanning a vast spectrum of properties that, technically speaking, includes any building that has two or more housing units that are adjacent horizontally or vertically. This asset class is also represented by its shared physical systems, such as amenities, utilities, heating, cooling, roofs and walls. A multifamily can include apartment, condominium or townhouse projects, but apartments are often the focus when it comes to investments.

In the industry, multifamily properties are graded as Class A, B, C or D, and this is determined using criteria such as quality, amenities, rent, location, age and other factors.

• Class A multifamily properties are the highest rate tier of buildings. These tend to be located in suburban neighborhoods, although the increasing attractiveness of city living to renters has led to more Class A properties in urban settings. These are properties that are almost comparable to a resort, with amenities such as fitness centers, eateries, outdoor areas for cooking and social gatherings, and more. Often commanding the highest rents in the area, a Class A property is often considered a "best in class" asset.

• Class B multifamily properties are a step down from Class A in terms of building quality, location and amenities. These buildings are well-maintained and will often have the term “workforce housing” associated with it as it is often intended to offer a viable housing solution to median wage earners. These buildings may or may not have updates.

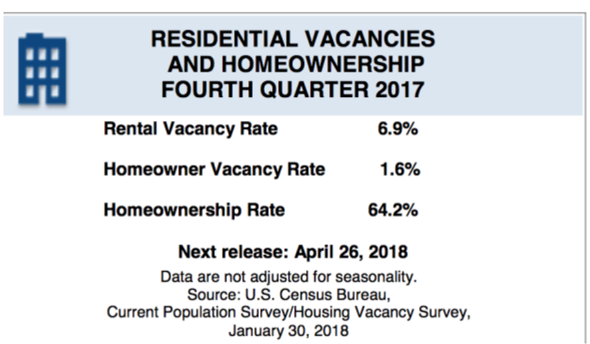
• Class C multifamily properties are a step below Class B in terms of not only building quality and amenities, but the workforce attracted, as these are generally blue-collar and low-to-moderate income tenants. These properties are older, with outdated designs, finishes and/or building systems, or they may desperately need renovations and maintenance. In some cases, a Class C property has the potential to become Class B or A depending on what it needs and where it is located.

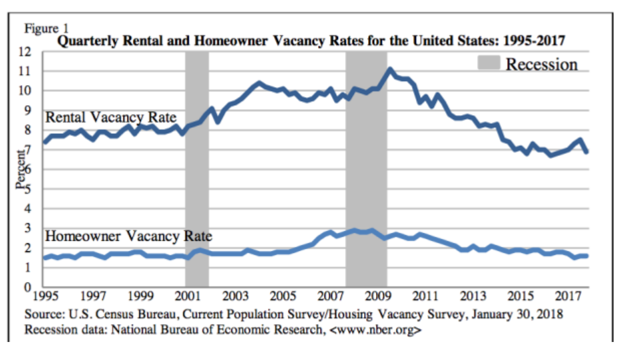
• Class D multifamily properties are the lowest rating in the building tier. A Class D property will have lower rents, bare-bones functionality and are typically in lower socioeconomic areas and neighborhoods deemed unsafe due to high crime. These properties are much older, with outdated designs, finishes and/or building systems. Class D properties do not have the potential to become Class C or B.

Apartment properties are also available in different shapes and sizes, from high-rise and dense urban buildings to resort-style complexes in a suburban area. A low-rise or garden-style building is two to four stories high, while a mid-rise has five to nine stories. A high-rise has at least ten stories.

The Drivers of Demand

To start exploring the drivers behind multifamily demand in the US, it pays to consider how many households are renters and how many are owners. According to a recent report from the US Census Bureau, the homeownership rate is 62.4 percent of all households, which is among the lowest levels seen in the past two decades. The rental vacancy rate is 6.9 percent, while the homeowner vacancy rate is 1.6 percent.



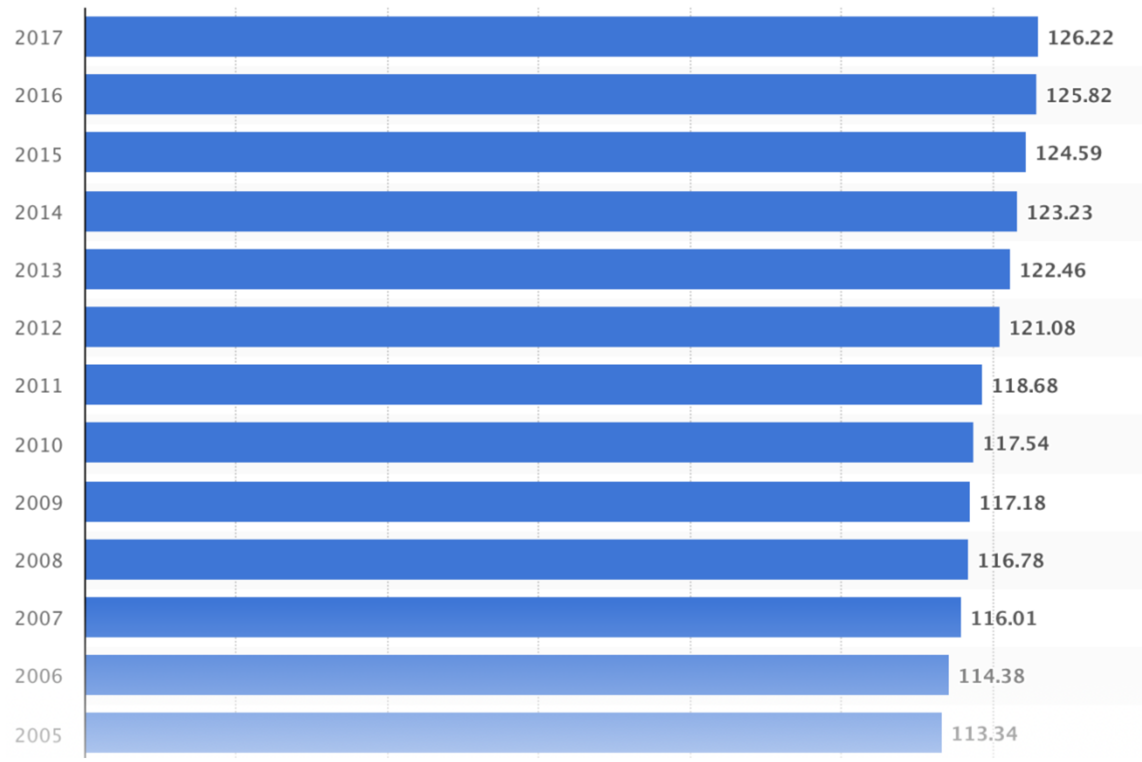


Source: US Census - QUARTERLY RESIDENTIAL VACANCIES AND HOMEOWNERSHIP, FOURTH QUARTER 2017
To see the full report, use this link: https://www.census.gov/housing/hvs/files/currenthvspress.pdf)

Drivers of demand will boost or reduce the total number of households in the US, change the percentage of owners versus renters, or both. While there are many factors that contribute to the demand for multifamily properties, the key drivers are growth in population, growth of rental households, growth of jobs, and ownership costs. These factors also influence and interplay with each other, as explained below.

The total number of households grows along with the population, although not as quickly. This, in turn, creates a demand for living space. According to Statista, there were 126.22 million households in the US in 2017. This is an increase of just under half a million households from 2016 to 2017, and up 1.6 million households from 2015.

Number of households in the U.S. from 1960 to 2017 (in millions)



Source: Statista - Number of households in the U.S. from 1960 to 2017 (in millions)
To see the full graph use the following link: (https://www.statista.com/statistics/183635/number-of-households-in-the-us/)

After the Great Recession, homeownership fell from 69 percent to the 62.4 percent level seen now. The combination of people being unable to afford their homes, jobs lost and a tighter availability of credit all contributed to this decrease in homeowners. With this shift, when total households are held at a constant, there are more renter households at the expense of owner households. With the total number of households increasing, however, there are potentially millions of people being added each year who need a rental space.

Household growth and job growth tend to correlate, as people can afford to get a place of their own when they have a job. Growth of jobs does help grow total US households, but it often grows it via renters because the people who mainly benefit from more jobs are often renters and not owners. Fannie Mae recently illustrated this trend in its Home Story feature, which highlighted four cities that saw job growth boost rents and rental activity in the area (http://www.thehomestory.com/four-cities-where-growth-is-increasing-rental-demand-and-rents/).

The final driver of demand is cost of ownership. When real estate prices are on the high end, they act as a deterrent to home buyers because they make buying a home more difficult to afford. It also becomes harder for people to qualify for mortgages. When a market has expensive housing stock, the percentage of renters tends to increase. This is not surprising; when the comparative cost of owning versus renting shifts, it sparks demand for the slightly cheaper option. It's not unusual to see a renter percentage increase and an ownership percentage decrease when there are rapid spikes in real estate values in a given area, particularly when those spikes are outpacing wage growth. When the cost of buying a home goes up but wages are stagnant or grow very slowly in comparison, people simply become unable to afford homeownership.

Today's Demographics

The growing popularity of renting is partly influenced by demographic trends. The choices and behaviors of the various demographics have a direct impact on multifamily trends. While there's always the possibility of deviation among the members of a particular demographic, the members do tend to share certain behaviors and attributes in large numbers.

One key renter demographic is the millennial generation, encompassing people born mainly between 1985 and 2004. This is a large portion of adults now in their 20s, a time of life when many people rent instead of owning because they are leaving their parents' home for the first time and embarking on their professional careers. Overall, this group is putting off marriage, having kids and moving to a suburb to buy a house until later in life, and this effect is expanding the year-over-year pool of renters.

This group also has a larger load of student debt compared to earlier generations, making it more challenging for them to buy their first home because they are contending with debt as soon as they leave college. A survey carried out by the National Association of Realtors® in conjunction with the nonprofit SALT® found that of the 3,230 student loan borrowers polled, 71 percent responded that their student loans were preventing them from buying a home (https://www.nar.realtor/newsroom/71-percent-believe-student-debt-delays-homeownership).

Of course, millennials are not the only ones drifting toward multifamily. As covered by the Chicago Tribune, older renters, or "empty nesters", are increasingly downsizing and trading their homes for smaller and more low-maintenance apartments and townhomes. Both of these demographics have been drawn to city centers, which is creating a stronger demand for condo and apartment rentals in and near bustling business districts and central downtown areas across various US markets.

These demographic trends have also increased the number of rentals across all income, age and household categories. Millennials, for example, have increased the total number of under-30 renters by close to one million over the last ten years, while those from Generation X (people born between 1965 and 1984) have added around three million people to the group of renters in their 30s and 40s, despite the population in this range of ages decreasing. The biggest increase has been seen in the number of renters in their 50s and 60s, which has seen a jump of just over 4 million. The growth reflects the baby boomer renters (those born between 1946 and 1964) aging and the drop in homeownership across this generation. Households in their 20s still account for the biggest single share, but households 30 and up are now making up half of the total rental market.

Tenure by Age of Householder

Age Distribution	People in Rental Housing	Share	People in Owner-Occupied Housing	Share
Under 30 Years Old	9,545,700	21.81%	2,879,293	3.83%
30 to 44 Years Old	14,409,218	32.93%	15,854,130	21.11%
45 to 64 Years Old	13,200,382	30.17%	33,108,686	44.08%
65 Years and Older	6,602,227	15.09%	23,260,416	30.97%
Total	**43,757,528**	**100%**	**75,102,528**	**100%**

Source: NMHC tabulations of 2016 American Community Survey. Updated 10/2016. Note: Does not include non-housing units.

As with any other real estate categories and asset classes, multifamily properties come with their own set of unique risk factors and complications for investors to consider. However, from a risk analysis and investment perspective, this category of commercial real estate assets is often held as the safest of all the classes of commercial real estate. This is mainly because this class has higher-than-average occupancy rates and lower price volatility than the other classes do.

Apartments tend to have a wider debt capital availability and lower capital cost, and during times of economic downturn, this asset class tends to perform better than others. When economic times are tough, people still need places to live, but they may not need the businesses spaces found in the office, industrial and retail classes. In fact, these classes may suffer when the financial outlook is bleak, particularly in the retail class. In addition, when the economy dives, it may force people out of their homes and into the rental market.

Despite the relative stability that the multifamily real estate class provides investors and its continuing potential for growth, it's still always wise to do as much research into a multifamily asset as possible.

When you have a handle on all the angles, a firm grasp of the market and its associated aspects, terms and characteristics, you will be a more informed investor over the short term and in the long run.

Our motto *"We Buy Only Where We Would Live"* identifies our properties as management friendly, well maintained and simply great places to live.

REI Women, LLC would like to help you either get started on your journey with finding the right investment, or help you extend your current portfolio of investments, using multifamily properties. If you would like to learn more, please reach out to us.

How can you get involved in investing in multifamily properties?

1. DIY or
2. Partner or work with a multifamily real estate investment company that matches you up with the right opportunity for you.

- REI Women recognizes as one of our investors' your needs differ, and we are always only a phone call away.

- We pride ourselves in taking a personal approach to accommodating investor requirements.

- We commit to ensuring each investor is kept up-to-date on each of their investments.

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