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Multi-family Housing More Renters in the Recession?

by Howard Riell

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The multi-family segment has taken a pounding along with the rest of the real estate industry. But the good news, say those who know, is that the worst is probably over, and the climb - slow but steady - back to recovery has already

begun.

Multi-family properties remain a good investment, although investors hoping to scoop them up for a song may well be disappointed. Rents are stabilizing, and more Nevadans are renting thanks to still-high unemployment and all the foreclosures, as well as other bad experiences they've had with home ownership.

"As the Las Vegas resort industry starts showing signs of recovery, we expect the local apartment market to improve," says John Restrepo of Restrepo Consulting Group LLC in Las Vegas. Leisure and hospitality sector stabilization will at some point re-ignite hiring, he believes, "and the resort industry traditionally was a major provider of renters. That said, there is an abundance of single-family homes for rent, which indicates that the apartment market recovery will be sporadic, with some submarkets and products doing better than others. Relative pricing will be the key."

Like the region's other real estate markets, the apartment market has been "severely affected by the recession's impacts on the job market," Restrepo notes. "Many complexes currently listed for sale have extremely elevated vacancies along with a great deal of deferred repairs. This has resulted in bank cautiousness in lending on apartment projects."

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“I’m not sure any of us knew it would be quite this bad,” says David Krantz, vice president of real estate services for RMI Management, a homeowner association management firm. “I think some of it was that we didn’t want to believe it would be this bad, but it is, so you deal with reality.”

“You have a high foreclosure rate in the majority of multi-family units -- what we’re seeing is anywhere from to 30%, sometimes higher, delinquency rate in our multi-family community associations,” says Heather Herrod, RMI’s Vice President of Business Development. “That is challenging to manage.” Beyond that, she adds, turnover among unit owners is another problem. “Therefore we have to continue to communicate and educate them on what it means to be part of a homeowners association.”

At the very least, the economic turmoil that hampered the segment’s growth “appears to be bottoming out,” suggests Pat Sauter, senior vice president for NAI Global, a network of independent commercial real estate firms. “The declines in rents and concessions seem to have stopped.” The reason? “I think the unemployment somewhat stabilizing has been the main reason. When it comes to everybody who lost a job or has had to double up in an apartment or move back home, I think that has happened, it’s behind us; we’re not seeing a lot of that continuing on.”

“Overall we’re starting to see some stabilization with multi-family,” suggests Evan Griffith, an associate with the National Multi Housing Group (NMHG) of Marcus & Millichap in Las Vegas. Over the last year or two, he points out, “Obviously rents have decreased across the board. People who are getting forced out of their homes still feel comfortable renting. We’ve been seeing especially the occupancy in a lot of the multi-family properties starting to stabilize over the last 12 months in Las Vegas, with some sub-markets doing better than others.” The same applies to Reno, he adds. “There is not as much product, so overall we’re definitely seeing some stabilization in occupancy and rents.”

Number-One Investment

On a national level and throughout Nevada, multi-family is “still the number-one investment with regards to real estate,” says Sauter. “It seems to have stabilized, and in other parts of the country is recovering faster than other segments based off of shorter-term leases. That means you will realize the growth in this segment faster than if you’re in retail or office, where you’re on five-year leases or longer.”

Sauter suggests that rather than look at the segment in terms of geography, one should judge according to quality of properties. “The better quality the asset the more demand there is for that product from investors here locally and on a nationwide basis. In terms of location, Las Vegas is a better target than Reno, and within Las Vegas the nicer suburbs of Summerlin, Green Valley and the southwest are definitely better locations in terms of what investors are looking for.”

What people get wrong about the multi-family segment, Sauter insists, is the notion “that properties are out there to steal; that they can come in and buy stuff for prices that are below realistic expectations. That is not the case.”

“We’re seeing a more stable environment,” adds Art Carll, NAI’s managing director. “We’re

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being able to justify some better numbers than what the expectation of out-of-town investors might have for the multi-family market.”

Multi-family is still a good investment, Griffith believes too. “There is a huge buyer demand out there for multi-family right now. Fundamentally we’re seeing that a lot of investors are still bullish on the segment; with interest rates as low as they are they’re still able to get a nice spread.”

As for bank foreclosures and the high number of delinquencies -- homeowners who are failing to pay their homeowners association dues - “the highest percentage is in multi-family condominium conversion units,” says Herrod. “Because of a high delinquency rate turnover, bank-ownership comes into play, and then you get a new owner.”

Another issue, says Krantz, is that banks will not lend money on any of these properties for resale. “If there’s over 50% who are not owner-occupied, which is almost every complex out there, the banks - as they have tightened credit -- have simply put in a rule that says, We will not lend on a property that is in that kind of situation. If your delinquency on collecting HOA dues is over 15%, the banks will not loan money on that kind of property.”

Thus, Krantz continues, the only person who can go in and buy the property at that point in time is a cash buyer, which makes sense. “It’s a good buy because they’re buying a two-bedroom unit for \$50,000 or \$60,000. The rents for the same are \$700 or \$800, so their cap rate, the return on their investment, is quite good.” A complication is that the appreciation will most likely lag behind as improvement in the market in general takes place. “But if you can buy a unit for \$50,000, five years of rental proceeds is going to pay for it. Now you own it free and clear.”

What it will take for banks to change this lending policy, Krantz is convinced, is mostly time, possibly as much as four years or more. “I’m not sure we’re ever going to get as loose as we were before, which really is what caused the problem. You could go in and simply state income. All these hybrid loans that they were shoehorning people into really caused a problem.” Those days may well be gone forever, he adds. But one way or another, credit has to loosen up in order for the economy and the housing market to come back.

The Coming Months

In 2011, Sauter predicts, Nevada will see “very slow” improvement in occupancies, and a slow reduction in the concessions being offered. “Also, probably a pretty good uptick in the number of transactions due to lenders allowing a few more properties to hit the market and be sold.”

The Las Vegas apartment projects traded at deep discounts in 2009 and 2010. As a result, Restrepo recounts, many lenders were uncertain about foreclosing on distressed properties. As the economy slowly improves apartment operations “should start stabilizing (and) attracting investors to Las Vegas, assuming interest rates remain low and the price gap between buyers and sellers closes.”

Restrepo and his associates believe that renting will grow in prominence because of increasing difficulty in obtaining financing for home purchases, as well as the recognition by lenders that they should not have lent to many buyers. “And by many consumers that they should not have bought homes during the boom, because they fundamentally did not qualify.”

Restrepo cites data showing that the apartment vacancy rate in Las Vegas dropped to just over 10% in 2010, nearly one percentage point from 2009. “This was the first year-over-year rise in the last four years. Our data also show that monthly asking rents for apartments dropped about 2 percent to around \$800, making many apartment rentals more attractive vis-à-vis single family rentals.”

Apartment conversions, says Restrepo, “have gone the way of “Manhattanizing” Las Vegas. That’s to say, what have been converted have been converted. We don’t expect to see any large-scale conversions in Las Vegas in our life times.”

“There are no condo conversions,” notes Corbin Seti, a vice president with RMI Management. “There are documents recorded on the land. They can’t just switch like that. That came and went.” Adds Herrod, “They will never convert to apartments because it would take every one of those 200, 300, 400 or more homeowners to actually agree to sell their units to one entity.”

In Las Vegas, Sauter points out, “every condo conversion that did not sell out completely has reverted back to rentals. I don’t know of any projects that are continuing to sell units.” The reason is a lack of financing, plus the fact that the retail pricing of a converted condo is extremely low.

For the year ahead, Herrod anticipates an uptick in building, but “just slightly. Those builders are not going to be constructing multi-family units. In fact, I don’t think there’s one developer in this town that has it on their forecast for even up to three years. They’re not going anywhere near a multi-family plan.”

The challenge for builders, Krantz suggests, is that the REO (Real Estate Owners, a property in possession of a lender as a result of a foreclosure or forfeiture) foreclosure homes are “all being sold for under replacement cost. And until that number rises up to where a building can even compete it’s just beyond a challenge for these guys to even think they can get into that market.”

Those who are a bit more savvy are looking further down the road “and seeing that there is not too much in the construction pipeline,” Griffith points out. “With not too many deals getting done in 2008 and 2009 and a lot of people stashing cash and building up capital they’re looking longterm - five, seven, 10 years out - and realizing that there are not too many developments being planned or future rent growth anticipated.” Basically, what there is is what we’ve got.

Many in the industry feel there is a paradigm shift going on, Griffith explains. “With the housing downturn there are some people who are a bit gun shy about purchasing a house. Maybe they’ve had a bad experience.”

Over the past year, NMHG’s management has seen the number of transactions involving sales of multi-family apartment complexes double compared to the preceding 12-month period. “We expect a further increase in transactions in 2011,” Griffith says. He also expects more bank-owned product to be released this year, as well as more short sales. Another doubling, he adds, is “possible; I think it’s definitely possible.”

Krantz counts Las Vegas as among the worst areas in the state for the multi-family segment. “Our unemployment is high and our foreclosure rates are higher than anywhere else. I mean, the only other place you would even look at as far as density is Reno, and they did not get hit nearly as hard as we did.” Unemployment, of course, is a prime culprit.

“With unemployment and (lingering) uncertainty those are folks who can’t afford to buy, or

afford to rent for that matter,” Krantz says. Even for those with a job, he adds, “there is a lot of uncertainty: ‘Am I going to have a job next month? Am I going to have a job next year?’ There is this real bunker mentality. These guys hunker down, they double up, move in with friends, move in with family, and no one really is going to move or budge until they know their future is going to be better.”

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