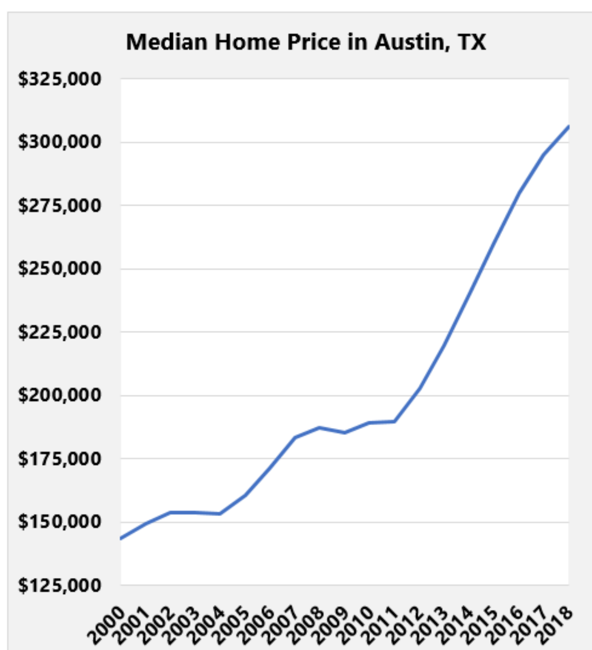
Investment Considerations: The Interplay Between Single and Multi-family Housing

In July, the National Association of Realtors reported that pending home sales were down 0.7% month-over-month, and 2.3% year-over-year. This was the seventh straight month of year-over-year declines.

There were two major reasons for the decline in home sales. First, supply constraints continued to push prices higher, as the average price for a single-family home in the U.S. rose from $258,100 in July 2017 to $269,900 in July 2018, an increase of 4.5%. Alongside the gain in prices, there was also an increase in interest rates, as Freddie Mac reports the rate on a 30-year fixed rate mortgage increased from 3.97% to 4.53% over the same 12-month period.

While this may indicate there is trouble on the horizon for the single-family home market, we do not believe it portends the same for the multi-family market.

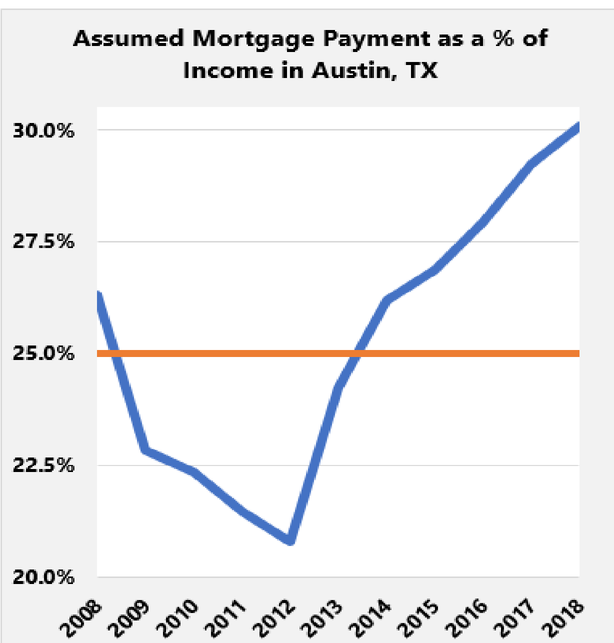
For example, consider an area like Austin, TX, where PIA currently has a multi-family development. We reviewed housing data and income in Austin beginning in 2000 and evaluated how affordable a single-family home would be to potential first-time homebuyers in the area. As shown in the chart below, the Austin area is a useful guide because its home values did not see wild swings in prices following the Great Recession, which makes comparing affordability more applicable.



Source: Real Estate Center, Texas A&M University

Using data from HUD and the Real Estate Center at Texas A&M, we created an affordability index for the Austin market. We assumed a first-time home buyer earns 80% of the median area income, purchases a house that is 80% of the median home price, puts 10% down on a standard 30-year mortgage at the average mortgage rate in the U.S., and pays 0.5% of the home value in PMI during the first year. We assumed a payment equaling 25% of a person's income is considered affordable.

As you can see in the chart below, for most of the last decade, homes in Austin were considered generally affordable for first-time homebuyers. In 2012, our hypothetical first-time homebuyer would expect to pay roughly 20% of their income towards a new home. Now in 2018, the same hypothetical buyer would have to pay more than 30% of their income for a comparable home.



While the median income in the area rose from $42,500 in 2012 to $48,200 in 2018, because of the double impact of rising home prices and interest rates, the income required to purchase a median-priced home rose from $35,300 to $58,000. Put simply, many potential homebuyers have been priced out in a very short period of time.

We analyze this data because we feel it is important to consider the single-family market when making a decision on multi-family housing in a particular area.

In this instance, Austin has seen a large influx of new multi-family development, and both occupancy and effective rent growth has begun to level off, cooling investor sentiment about the prospects in the city. However, when one considers the rapid increase in home prices and interest rates, coupled with continued population growth, it is clear that many of Austin's residents will continue to rent because of the high price of ownership. Like all diligent investment underwriting, commercial real estate requires a careful review of all of the relevant market factors prior to making an investment decision.

> *"Commercial real estate investment requires a thorough understanding of myriad factors beyond the simple supply and demand of a given property type in an area."*
> – Chris Boggs, President

www.piainc.net
(804) 644-4474
901 East Byrd Street, Suite 150
Richmond, VA 23219
PIA Property Investment Advisors, Inc.