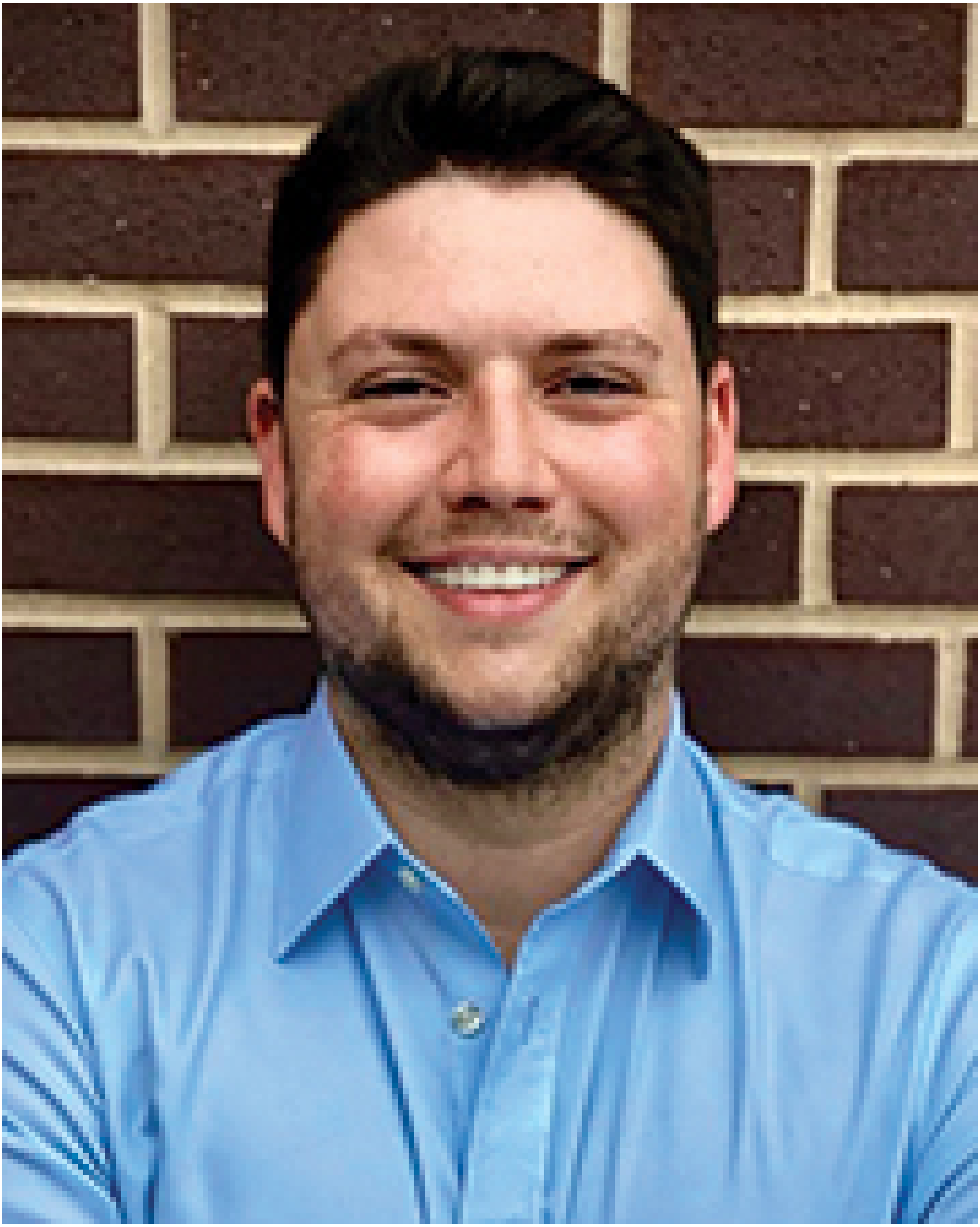
nyrej EST 1989

Why multifamily garden style vs. high rise during COVID-19? - by Marc Hershberg, Jared Isaac and Brian Shorr

September 22, 2020 - Spotlights



Marc Hershberg

Jared Isaac

Since the onset of the COVID-19, residents of cities have begun to move outwards from urban cores to surrounding suburban areas for two primary reasons. First, densely populated and overcrowded cities serve as primary targets and hotspots for future outbreaks, as illustrated by how large, urban metropolises have fared during the current pandemic. Second, the proven long-term viability of the work-from-home (WFH) eliminates the need for employees and employers to work and live in the city.

These trends of outmigration will have a significant impact on the real estate markets in both urban cores and their rural/suburban areas. As the WFH model continues to gain traction and persist into the future, the need for office space in all real estate markets (read: cities and suburban areas) will drop. Similarly, the need for retail stores in all real estate markets may also drop, especially given the success and ease of online shopping and e-commerce. Furthermore, as city-dwellers move outward residential real estate in cities will drop. This will be met by an increase in residential real estate in surrounding suburban and rural communities. As such, residential landscape of urban cores and their surrounding suburban and rural areas will change as a result of the pandemic.

We believe that investors looking to grow their wealth and reap steady, long-term returns should shift their investments from high-rise apartment complexes to investment into multifamily garden style communities. Though both types of real estate offer investors passive income and enjoy the same tax benefits, multifamily garden-style real estate has historically been “the most resilient property sector to recessions."1

Specifically, in both the 2001 and 2008 recessions, multifamily garden style rents declined at a much less steep pace than office rents and industrial rents, implying that collections and occupancy rates remained strong, even in times of economic distress. Moreover, after these recessions, multifamily rents grew at considerably higher rates than office rents and industrial rents.

Moreover, high-rise apartment complexes are often overcrowded and cramped. Therefore, the need for privacy, physical space, and social distance may soon render high-rise apartments a relic of the past. Even if cities do regain their pre-pandemic value, occupancy restrictions will limit the number of residents permitted to live in high-rise apartments, thereby reducing these assets' ability to produce income and generate revenue. In other words, what is typically an investment property's primary revenue stream will fall to the wayside. Thus, investments into high-rise apartments will not yield the historically steady cash flow and stable returns as they did before the pandemic. Furthermore, with no need to renovate and maintain these assets, they may depreciate in value, further hindering their ability to generate income.

However, multifamily garden-style apartments, which are more spacious and less congested than their high-rise counterparts, serve as a stronger and more secure investment for a number of key reasons. First, "Mid-rise buildings are a reasonably cost-effective solution for developers, [and] by creating more units per square foot of land, investors will see a more substantial financial return."2 Second, unlike high-rise apartments which have more floors, multiple elevator units, and more electrical wiring, multifamily garden-style communities require less upkeep, and therefore face less maintenance expenses. The profitability of multifamily garden-style communities lends itself to being a greater investment vehicle long term than their high-rise counterparts.

While urban core high-rise buildings often entice larger real estate investors, who can hold properties with huge overhead for a long time, most investors who are looking for stable cash-flowing investments should look to multifamily investments that offer a stronger and safer outlook.

1 Multifamily Most Resilient Property Sector to Recessions | US Multifamily Research Brief

2 https://www.reonomy.com/blog/post/types-of-apartment-buildings

Marc Hershberg is CEO, Jared Isaac is senior associate and Brian Shorr is an analyst at Topaz Capital Group LLC, New York, N.Y.