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REGIONAL MARKETS: US **MULTI-FAMILY** The multi-family sector has been so popular some investors are looking further afield. **Stephanie Schwartz-Driver** reports

Stepping out of the gateway

Liquidity is always on the minds of investors, but moving into secondary cities is not a concern on this front, according to Jack Kennedy, president at CK Property Management, another firm following a similar strategy. "Many European investors are willing to look at only gateway cities, because they believe that is where the liquidity is. But we have a very vibrant brokerage market. Everything sells, and at around the same pace.

"The type of property I'm interested in is a little older, around 10 years old, with around 300 units, in solid locations based on schools, demographics, average income, and single-home valuations."

Kennedy looks specifically for "growth corridors" outside cities, "off the beaten path but places that people want to live." CK Property is interested in Phoenix, Seattle, Portland, Nashville, Houston (last year the fastest growing city in the country), or other cities with similar growth potential.

The company upgrades countertops, appliances, flooring, and lighting. "If we can make fairly modest improvements, we can drive up value," Kennedy says. Under this business model, based on the cost of debt, first-year cash flow can range from 6% to 7% or even greater.

This is the essence of a value-add strategy, according to Kennedy. "It is purely a function of increasing the income. If I'm increasing the net income, I'm increasing the value of the property – suddenly my loan-to-value (LTV) metric goes down. If I'm driving up the cash flow, I'm boosting net operating income."

Kennedy points out that it would be hard to realise the benefit of this business model if the focus was limited to core, not only because of the price of the property but also because of the cost of the debt. He deploys only moderate leverage, and will not go over 55% LTV.

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One key to this strategy is the fact that, typically, American multi-family leases are only one year long. This means that Kennedy does not need to shut a building down to do the renovations, and he aims to acquire buildings that are 90–95% leased already. Instead, they do seven to 10 units a month, each unit taking around two weeks to renovate. Staged renovations also reduce risk, he points out. "Because we do the work in stages, we can always pause if the market turns down," he explains.

Kennedy maintains that demographics suggest continuing strong fundamentals for the multi-family sector nationally. There are some 80 million "echo boomers coming to the housing market in the next 10 years, and most will start out as renters," he says. "We fully expect people will get back into home buying, but they will have to put more money down, which will delay the process and effect some people's capabilities."

Although these kinds of investments are outside the normal geographic focus of foreign investors, Kennedy believes they represent good opportunities for international diversification. "Multi-family is not a big sector in Europe, but investors understand the historical long-term attractiveness of the sector.

In Kennedy's view, the biggest obstacle to increased interest from international investors, particularly Europeans, is that they are not familiar with the structural dynamics of US multi-family. For example, typically short lease terms, often seen as a risk factor, are a benefit for repositioning properties; and US apartment complexes, with hundreds of units, portfolios become more efficient because of economies of scale.