Opportunities And Challenges In The U.S. Multifamily Market

CHAPTER 4:
THE ECONOMICS OF BUILD-TO-RENT PROJECTS

AUGUST 12, 2024 | JASON D. BEAKLEY, CERTIFIED GENERAL APPRAISER

The build-to-rent (BTR) sector has emerged as a significant force in the multifamily housing market, offering a unique investment opportunity for developers and investors. BTR projects involve the construction of purpose-built rental communities designed specifically for the rental market, rather than traditional apartment complexes or single-family homes intended for sale. As this sector continues to gain momentum, it's crucial to understand the economic factors driving its growth and the financial considerations involved in these projects.

The Rise of the Build-to-Rent Sector

The BTR sector has experienced a surge in popularity in recent years, driven by several key factors:

1. **Demographic Shifts:** The increasing preference for rental living, particularly among millennials and empty nesters, has fueled demand for high-quality, amenity-rich rental communities.
2. **Affordability Challenges:** Rising home prices and tighter lending standards have made homeownership less attainable for many households, leading them to seek rental options.
3. **Institutional Investment:** Institutional investors, such as real estate investment trusts (REITs) and private equity firms, have recognized the potential of the BTR sector and have allocated significant capital to these projects.
4. **Supply Constraints:** In many markets, the supply of traditional multifamily housing has struggled to keep pace with demand, creating opportunities for BTR developments to fill the gap.

The Economics of Build-to-Rent Projects

BTR projects offer unique economic advantages and considerations for developers and investors:

1. **Operational Efficiencies:** BTR communities are designed and built specifically for rental operations, allowing for greater operational efficiencies compared to traditional apartment complexes. These efficiencies can include centralized management, streamlined maintenance, and optimized amenity offerings, potentially leading to lower operating costs and higher net operating income (NOI).
2. **Longer Hold Periods:** Unlike traditional multifamily developments, which are often sold within a few years of stabilization, BTR projects are typically held for longer periods by institutional investors. This longer hold period can provide more stable cash flows and the potential for greater appreciation over time.
3. **Economies of Scale:** Many BTR projects are developed as part of larger, master-planned communities, allowing for economies of scale in construction, marketing, and operations. This can result in cost savings and increased operational efficiencies.
4. **Amenity Offerings:** BTR communities often feature extensive amenity packages, including pools, fitness centers, co-working spaces, and community areas. These amenities can command higher rents and attract tenants seeking a more lifestyle-oriented living experience.
5. **Financing Considerations:** BTR projects may require different financing structures compared to traditional multifamily developments. Institutional investors and lenders may have specific underwriting criteria and risk assessments for these projects, which can impact the availability and terms of financing.

Challenges and Risks

While the BTR sector presents significant opportunities, it is not without its challenges and risks:

1. **Construction Costs:** The rising costs of labor and materials can impact the financial viability of BTR projects, particularly in markets with high land and development costs.
2. **Market Saturation:** As the BTR sector continues to grow, there is a risk of oversupply in certain markets, which could lead to increased competition and pressure on rents and occupancy rates.

3. **Regulatory Environment:** Local zoning regulations, permitting processes, and housing policies can impact the feasibility and profitability of BTR projects in certain markets.

4. **Tenant Retention:** While BTR communities are designed for long-term rental living, tenant turnover can still be a challenge, impacting occupancy rates and operating costs.

5. **Economic Cycles:** Like any real estate investment, BTR projects are subject to the broader economic cycles and market conditions, which can impact demand, rents, and property values.

Conclusion

The build-to-rent sector represents a significant opportunity for developers and investors in the multifamily housing market. By understanding the unique economics, advantages, and challenges of these projects, industry professionals can make informed decisions and capitalize on the growing demand for high-quality rental communities. As we continue this blog series, we'll explore additional strategies and best practices for successful BTR development and investment, ensuring long-term profitability and sustainable growth in this dynamic sector.[1][2][3][4][5]

Citations:

[1] https://www.realpage.com/analytics/forecasting-2024s-top-apartment-markets/
[2] https://www.suburbsfinder.com.au/resources/how-to-make-use-of-supply-and-demand-indicators-when-it-comes-to-investing-property/
[3] https://learn.saylor.org/mod/book/view.php?chapterid=8773&id=31636
[4] https://www.mashvisor.com/blog/determine-rental-demand-buying/
[5] https://wilkinsoncorporation.com/resources-investment-articles/category/investment/2024-multifamily-investing-outlook/

Jeason D. Beakley
CERTIFIED GENERAL APPRAISER
Director
+1-480-440-2842 Ext. 09
jbeakley@fourcv.com
www.fourcv.com