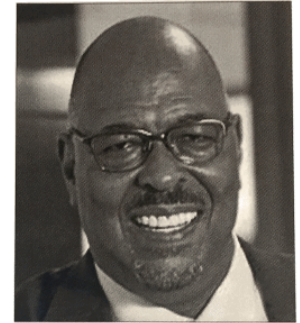


Micro-Units vs. Family Units

What investors need to understand about affordable housing.



By Daryl Carter

Much of the focus of the apartment industry today is on serving the growing millennial market — primarily single residents between the ages of 18 and 34. Certainly, considerable demand exists in this market niche. But the investment community as a whole is largely ignoring a tremendous opportunity: the demand for large, family apartment units.

The world may see micro-units as the latest fad in hip living, but both money and a social impact can be made by providing families throughout the United States with quality, well-sized homes they can afford.

As CEO of Avanath Capital Management, my favorite task, without question, is walking our communities with my on-site colleagues to gain a better understanding of our residents and their needs and, more important, their aspirations. And as I walk our properties, I see families and older residents. Avanath owns and manages Low Income Housing Tax Credit, Section 8 and other affordable apartment communities in major urban and suburban markets, such as Brooklyn, N.Y.; Los Angeles; Orlando; Sacramento; San Francisco; and Washington, D.C. Our residents make \$25,000 to \$70,000 per year. Most of our properties have three-bedroom apartments, and several have four-bedroom units.

Our specific experience with three- and four-bedroom units indicates the following trends.

Large-unit properties experience minimal turnover. Our three- and four-bedroom apartments are in the highest demand and have the lowest turnover. We have several properties at full occupancy, with waiting lists. A high percentage of people on our waiting lists want larger apartments. By investing in assets with little to no turnover, we maintain consistency in our

cash flow, bolstering strong risk-adjusted returns for our investors.

Families are changing. Although the demand for larger units is primarily from families, the term “family” can have a variety of configurations: a married couple with children, a single parent with children, an unmarried couple with children, a multigenerational family, etc., many of which are shown on the television show *Modern Family*. By offering a product that meets the needs of modern families that represent a diverse base of the population, we maintain strong profitability through sustained high demand.

Baby boomers prefer large units. Larger units are desired by older couples who are downsizing from homeownership. These moves are motivated primarily by financial reasons, though lifestyle considerations also play a part, particularly the elimination of home maintenance. The extra bedroom or two can accommodate visits from children and grandchildren. By providing housing that meets the needs of baby boomers, we can attract a tremendous base of long-term renters, resulting in ongoing consistent returns.

Family properties don't need the fluff. Communities with larger units that attract families demand different amenities than properties with small units. While many of the new, micro-unit buildings have espresso machines and yoga rooms, the residents in family communities are partial to outdoor grilling areas, dog-washing stations, pet parks and children's play areas. By focusing on reasonable amenities that attract families and baby boomers for long-term living, an investor can maintain both quality and demand with minimal capital investment.

Large-unit properties near work and schools are prospering. The location-location-location rule still applies to apartment communities that target families. Close proximity to employment and transportation is as important for family rentals as it is for rental properties targeting single millennials. Another important consideration for family rental properties is proximity to quality schools. Although there is considerable demand in downtown/urban city centers, certain suburban locations with superior schools are highly attractive to families that rent. By investing in large-unit properties near employment and schools, investors ensure residents are positioned to live in their communities for long periods of time, further contributing to consistency in returns.

“An imbalance is present in the supply of larger apartments for families versus the demand for larger apartment units.”

Large-unit properties prepare renters for homeownership. Larger affordable units appear to be one of the “stepping stones” to homeownership. A multigenerational family with multiple wage earners that is paying 35 percent of its income or less on a rental can build the savings to buy a home — certainly where the home prices are within the FHA limits, which can provide for 95 percent or more in financing. Single millennial residents paying 40 percent or more of their incomes in market-rate apartments have little opportunity to amass enough savings to enter the for-sale market. By offering housing that supports a next step of homeownership, large-unit apartment investors are supporting the overall economic condition in our country, in addition to helping many to achieve their own American dream.

The strong demand for larger, family rentals is supported by key market statistics provided by the National Multifamily Housing Council, including:

- 9.6 million households, or 22 percent of total rental households, are headed by a person age 30 or younger. By contrast, a whopping 19 million households, or 44 percent of the total rental households, are headed by a person age 45 or older.
- More than half of U.S. rental households consist of married couples, couples with children, domestic partners, blended families, generational families or other quasi-family configurations, while only 48 percent of these households consist of unmarried singles.
- The total stock of multifamily rental housing in the United States comprises 18.4 million units; however, only 1.6 million units are three-bedroom or larger.

This means large-unit properties represent only 8.6 percent of the total multifamily apartment inventory.

Clearly an imbalance is present in the supply of larger apartments for families versus the demand for larger apartment units. This imbalance is fueling rising rents and maintaining unprecedented high occupancies of larger units. The demand for larger rental units is fueling strong demand for single-family rentals, as well.

Investors and developers are responding to the demand from single, millennial renters by building micro-units and adult dorms. But the overwhelming demand from families is not being widely addressed. So how does a shrewd investor capitalize on the demand for affordable family rentals? Here are some of the strategies investors can employ:

- **Convert from C to B.** Many of the properties built in the 1960s and 1970s have larger floor plans but are “out of favor” with core institutional investors. Investors can acquire these class C vintage properties and upgrade them into affordable class B properties.
- **Seek out small buildings.** In many dense urban neighborhoods, the older properties with large apartment units are found in smaller buildings, very often with only 10 to 50 apartment units. These buildings can be assembled into portfolios and renovated to accommodate larger families.
- **Invest in older communities that support an active lifestyle.** Properties that target residents 55 years and older are not our parents’ senior communities. Most 55-plus communities today comprise active seniors, many of whom are still in the workforce. Most have vibrant social lives and pursue a multitude of activities and hobbies. When I visit one of our seniors’ communities, the gym is often filled with residents working out and checking their Fitbits.

In conclusion, today’s families need affordable housing more than ever before. As family formation continues to evolve and include new combinations of blended families and multigenerational members, the need for larger rental units will grow. In addition, a significant number of active baby boomers are in need of safe, quality and affordable rentals.

Investors and developers who take note of this demand and work to meet it will reap benefits by way of investment yields and social impact. Affordable micro-units and dormitories are one small solution to the affordable housing crisis, but there is a larger solution that still needs to be addressed. ■

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