

# Spokane-Kootenai Real Estate Research Committee

Multifamily and Condominium Markets

2019 Real Estate Market Forum

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Washington Center for Real Estate Research

University of Washington

[realestate.washington.edu](http://realestate.washington.edu)

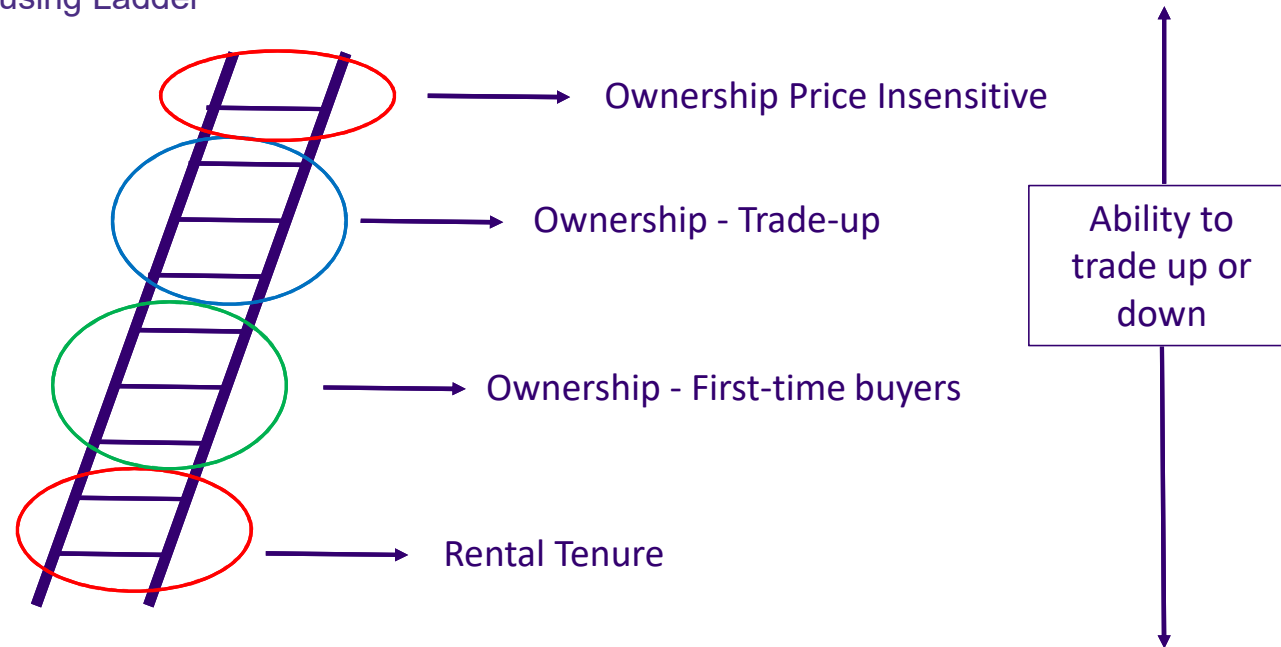
February 21<sup>st</sup> 2019

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# Basics of urban housing markets

## > Housing Ladder

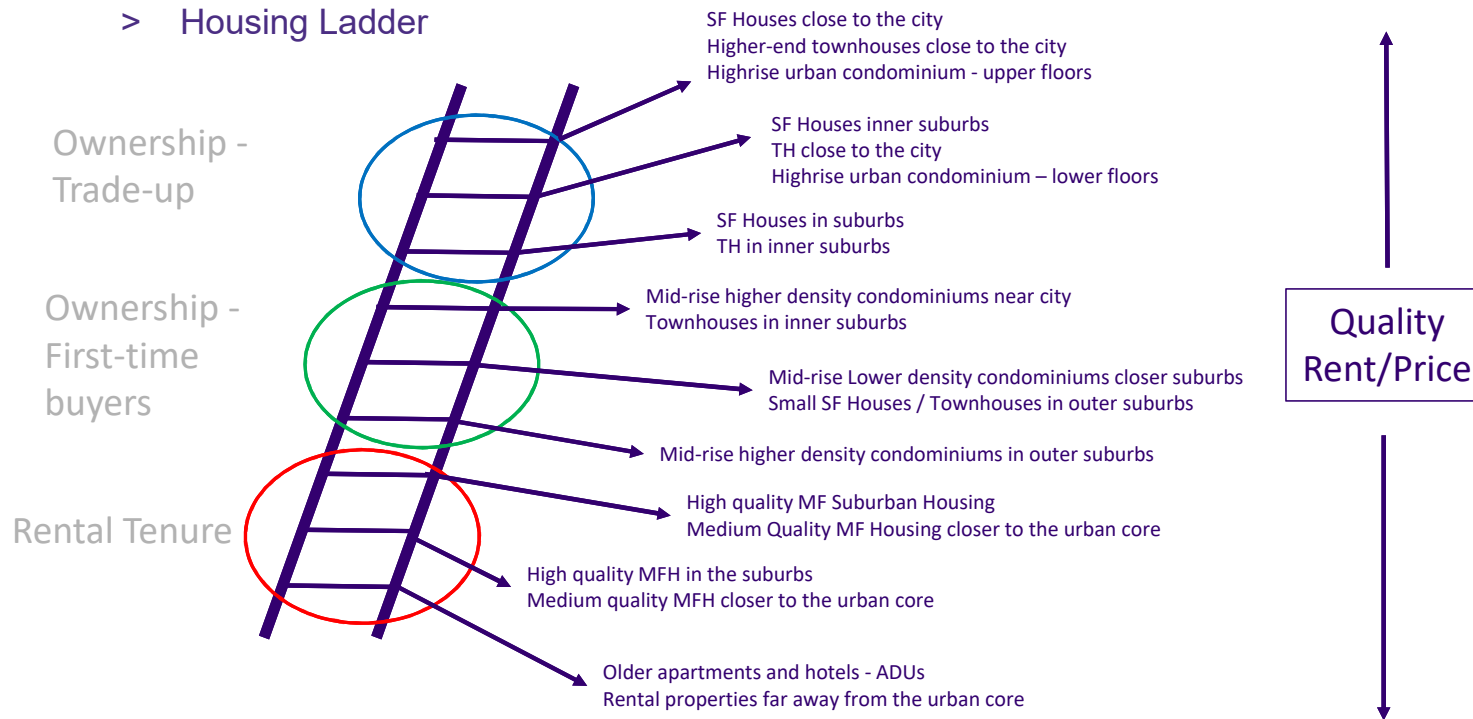


You should see movement between different housing types and tenures



# Basics of urban housing markets

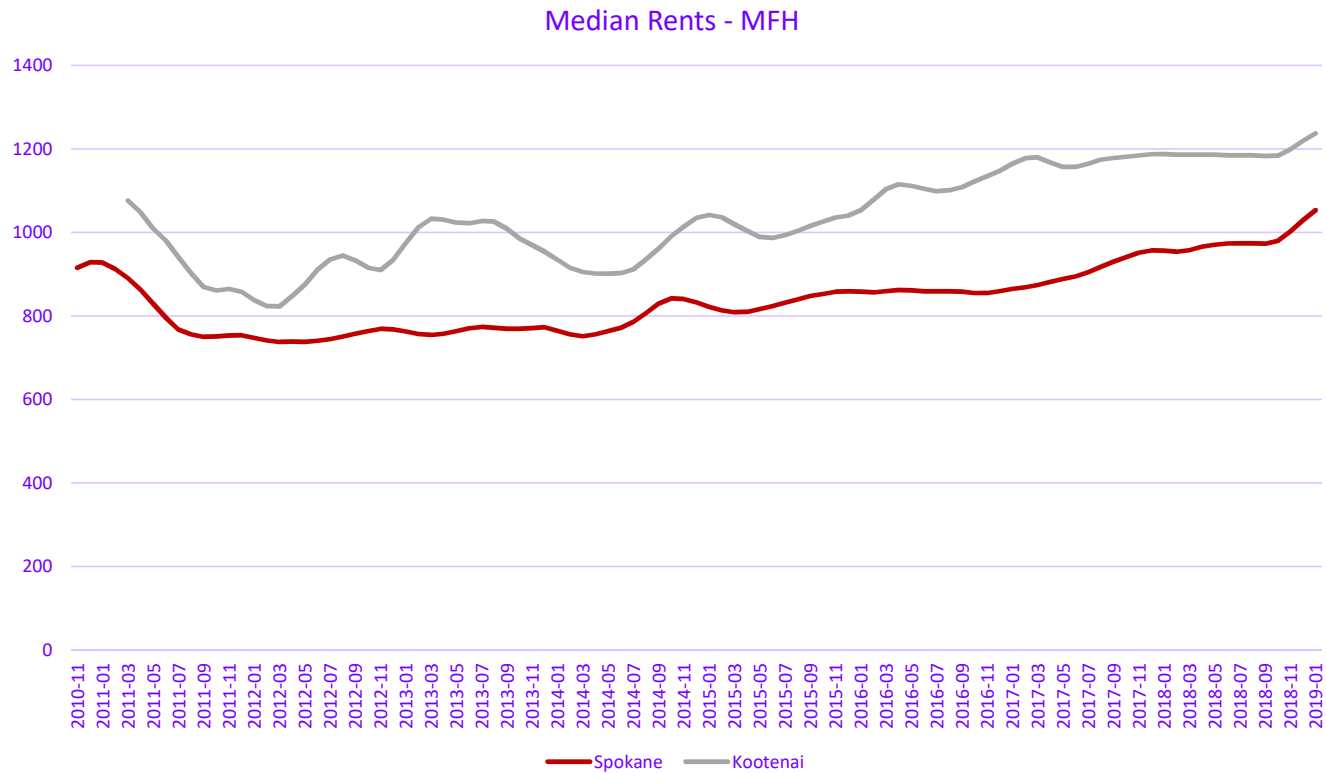
## > Housing Ladder



Each rung on the ladder represents a particular submarket



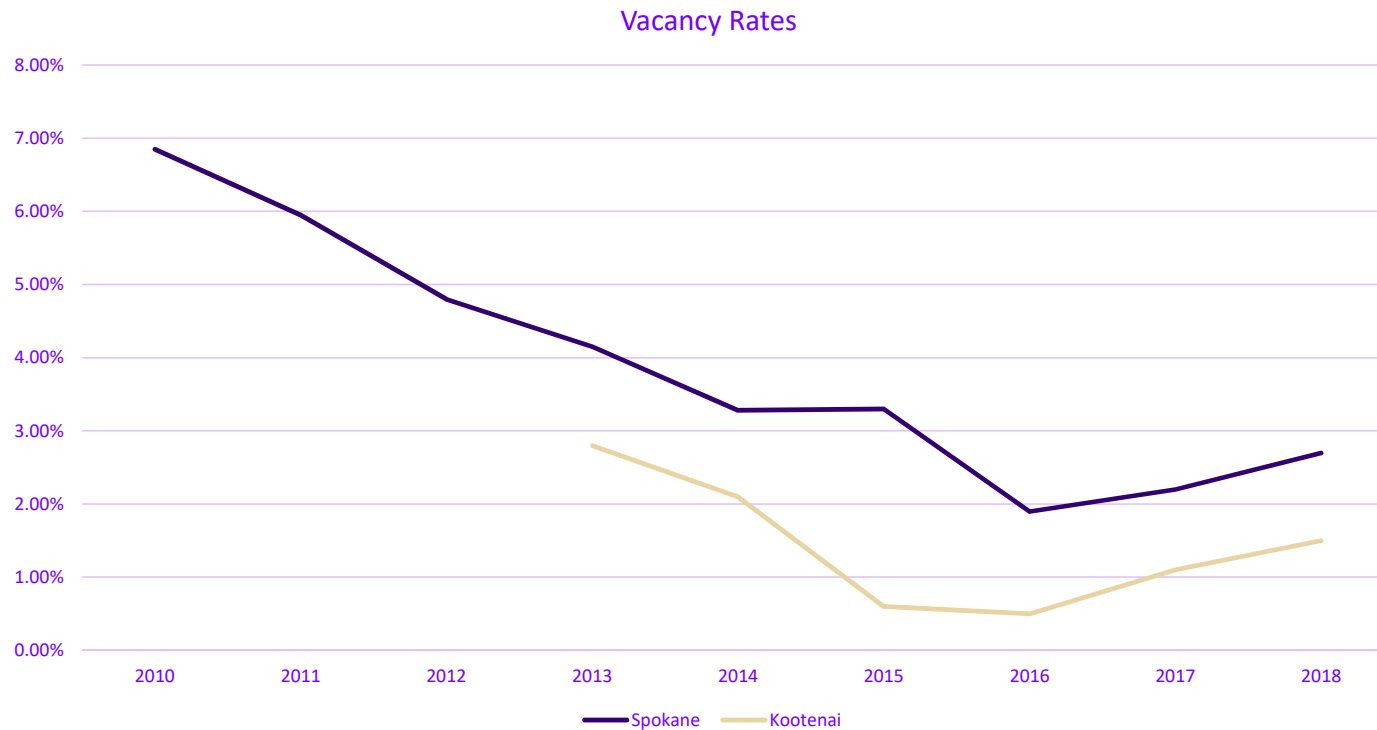
# Multifamily Rents in Selected Areas



Source: Zillow, WCRER



# Vacancy Rates



Source: WCRER





# Spokane Investment Statistics

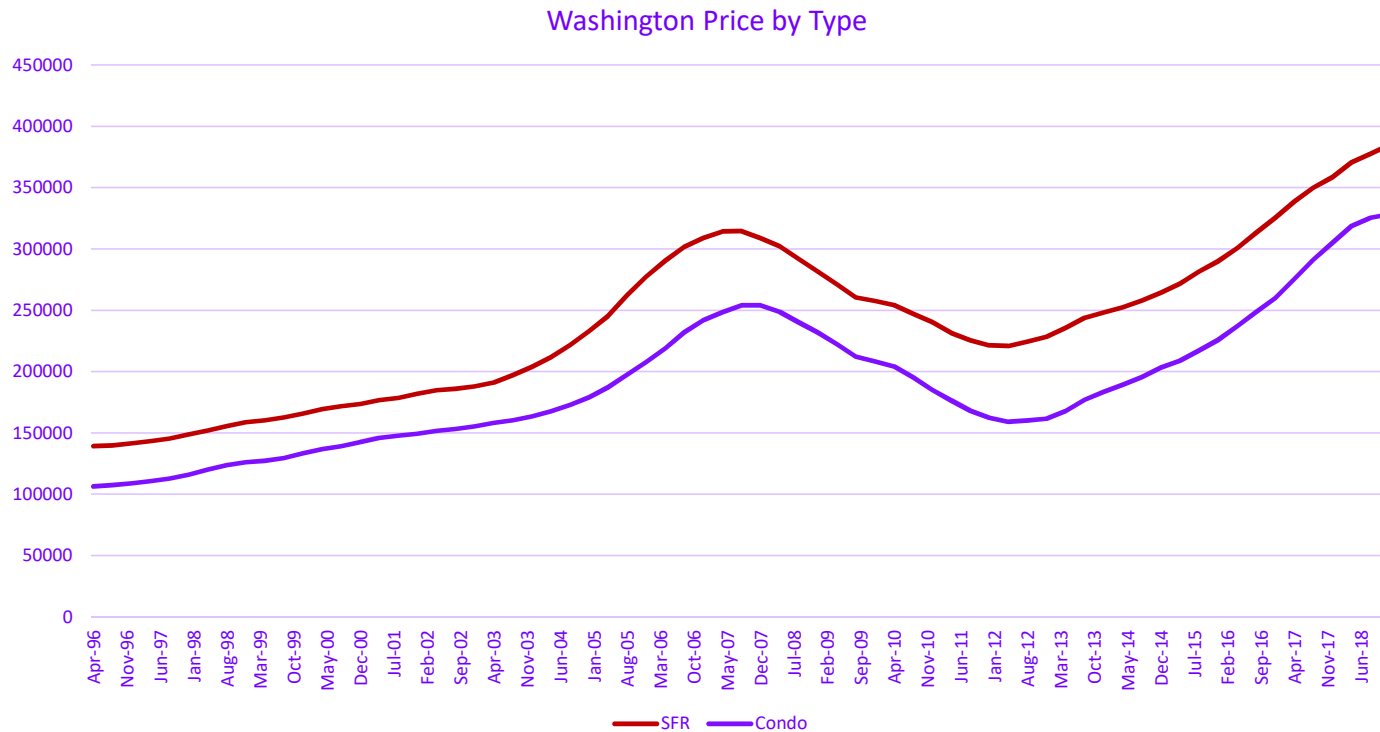
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- > Consistent compression on Cap Rates
  - Between 6-7.5% across classes, sub 6 for New/Prime in Spokane
  - Between 5.5 and 7% in Kootenai, close to 5 for prime
- > Per door prices have doubled since 2011
  - One deal at \$177,000 per door
- > Current Cost of borrowing on MFH is still low:
  - 4.90% for a 10/30
- > Evidence that many buyers are from Seattle and Portland
  - Cap rates are closer to 5% and lower for newer deals

Source: WCRER



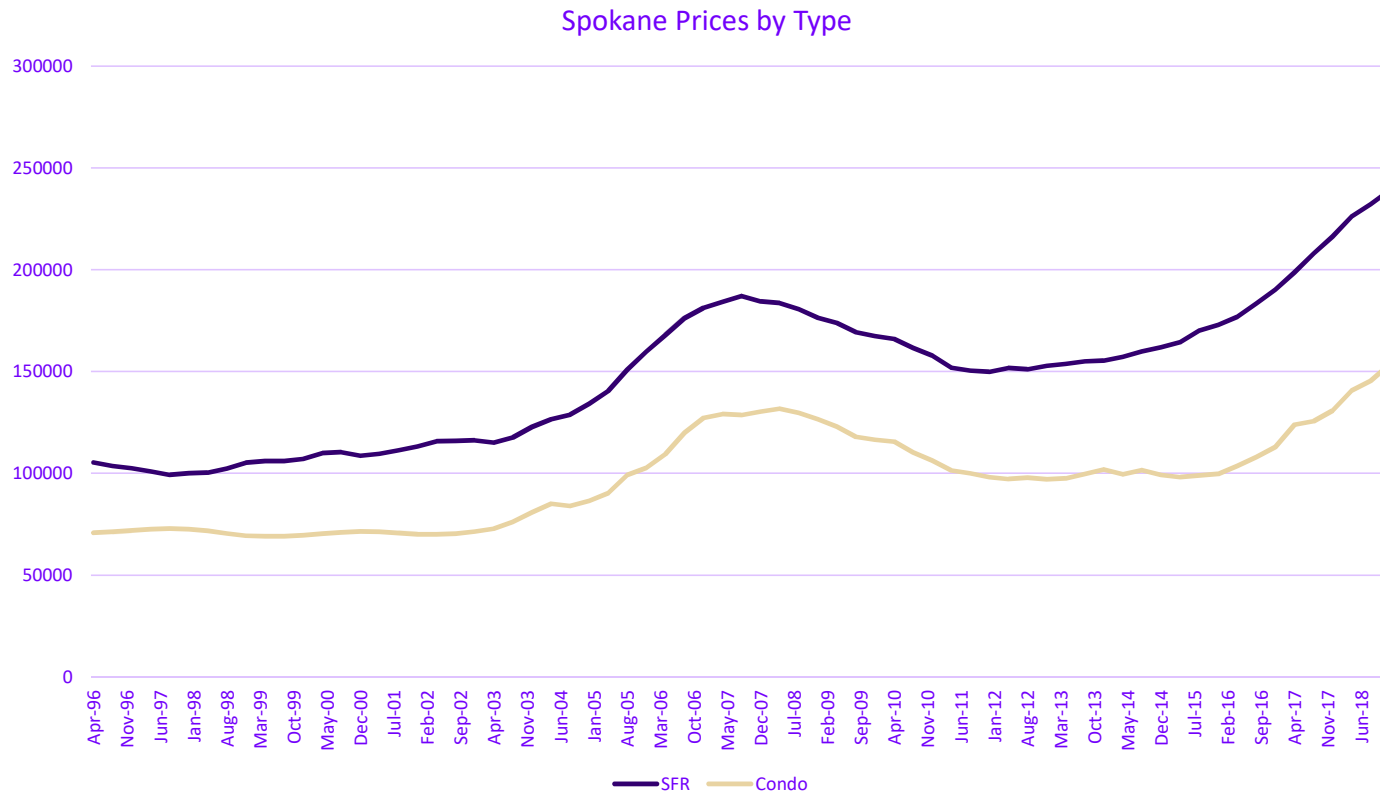
# Washington Housing Market



Source: WCRER, NWMLS, RMLS, Zillow



# Spokane Area Housing Market

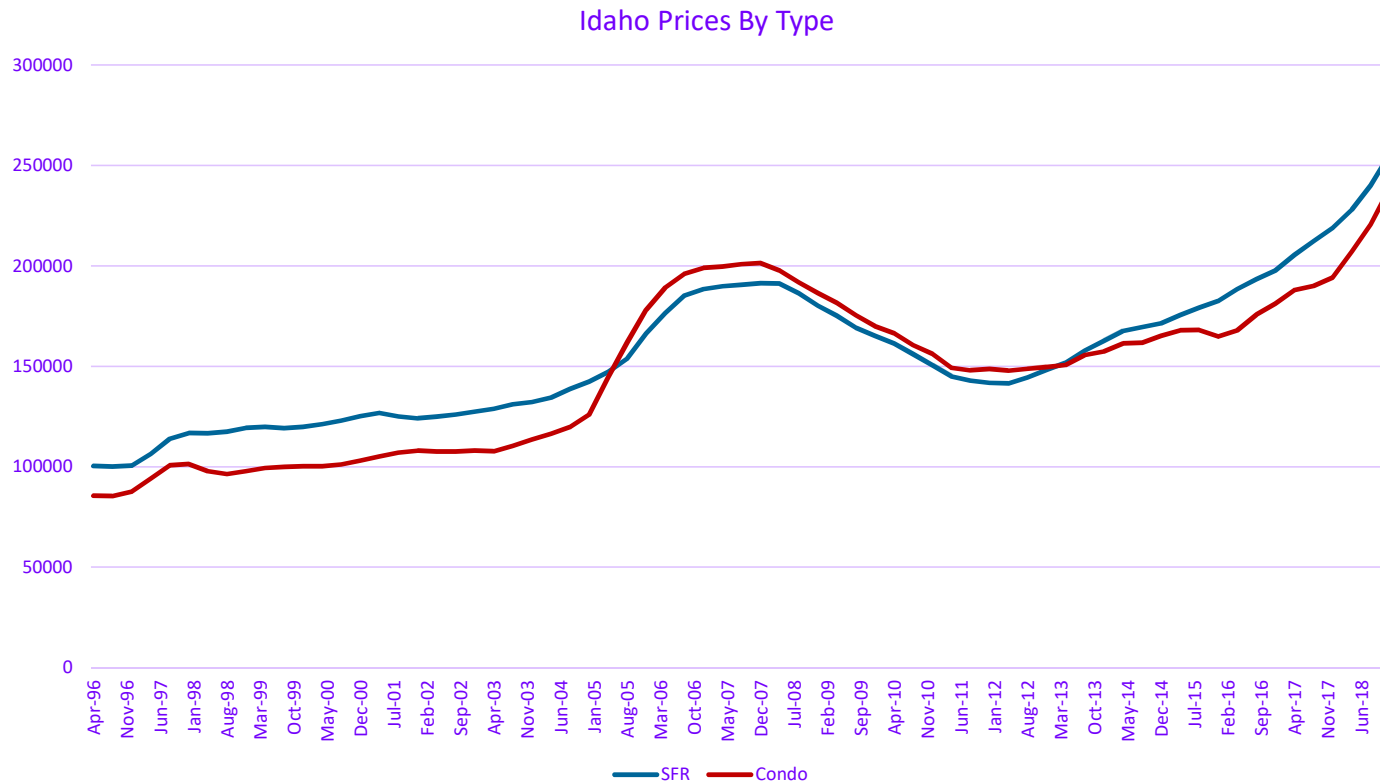


Source: Zillow, WCRER





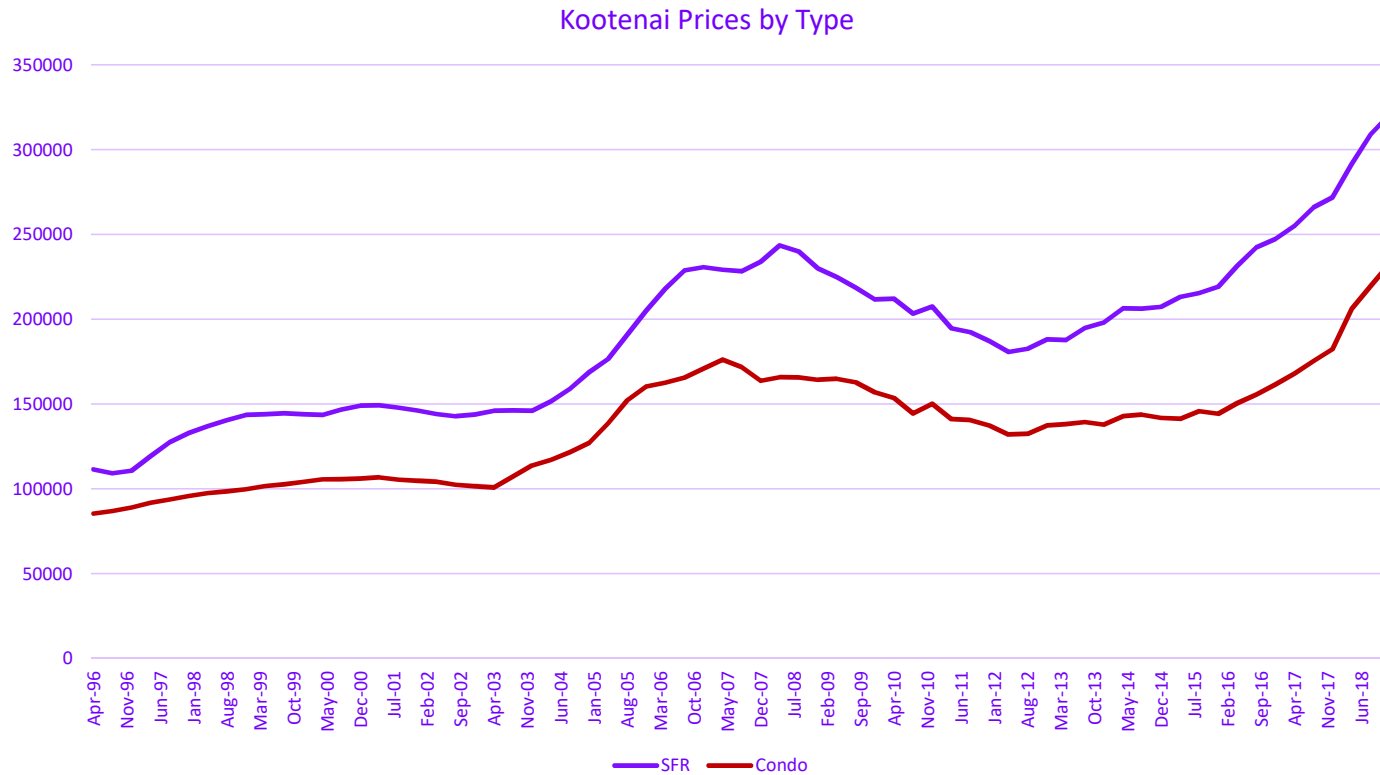
# Idaho Housing Market



Source: WCRER, Zillow



# Kootenai Housing Market



Source: Zillow, WCRER



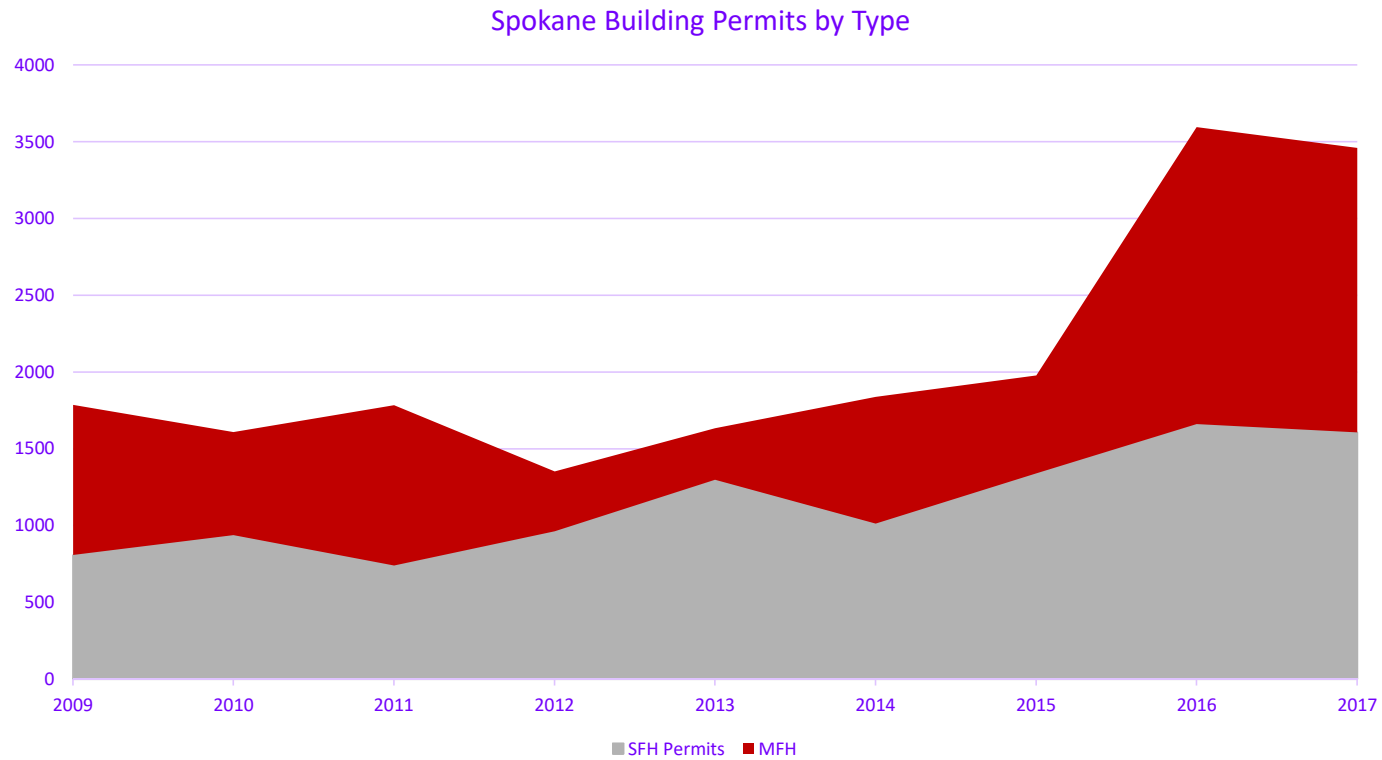
# What should we expect on supply?

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- > Developers respond to prices and rents
  - If they believe that prices or rents will be high enough when the development is completed, they will build.
  - At this stage of a mature cycle, we would expect to see balanced development across several housing types and tenure
  - Is that happening?



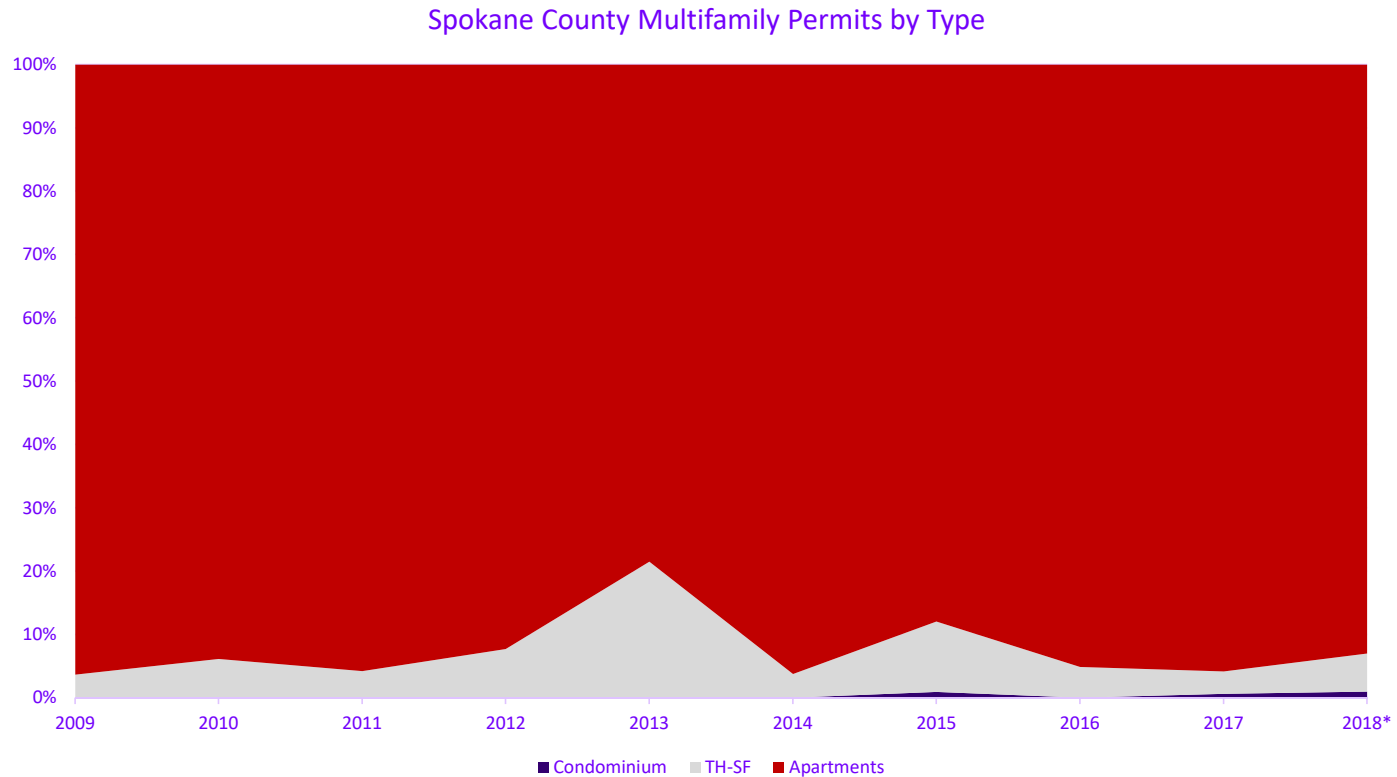
# Building Permits by Type



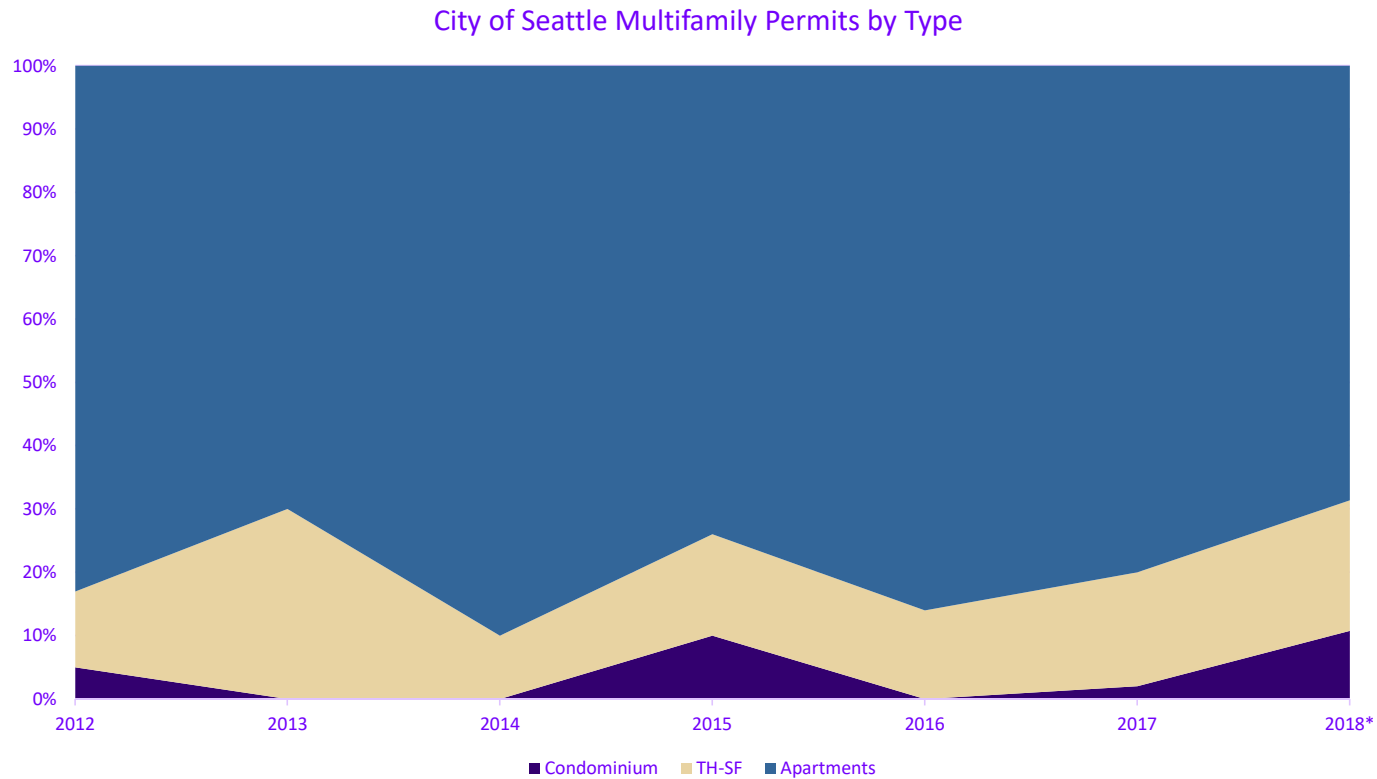
Source: US Census Bureau, WCRER



# MFH Activity by Type – Select Markets



# MFH Activity by Type – Select Markets



# Supply Dynamics

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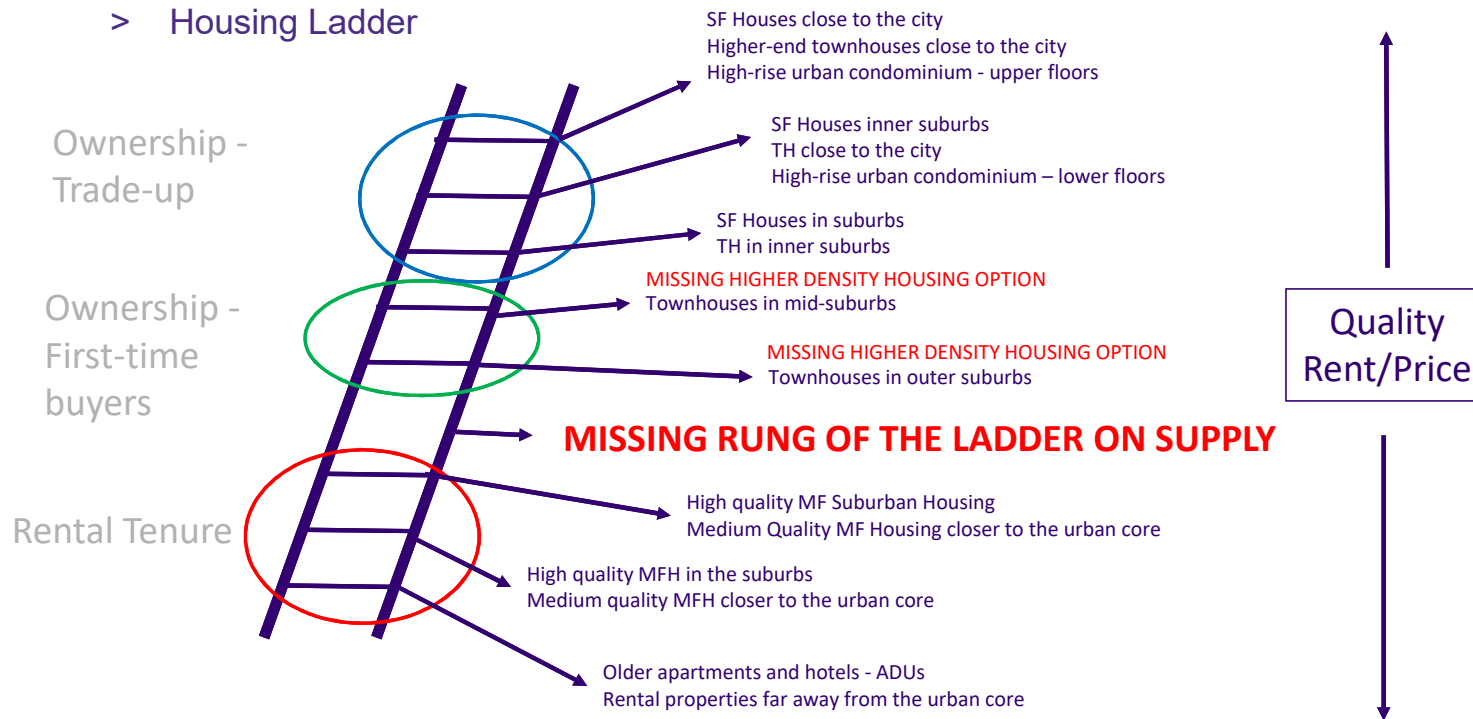
- > Clear imbalances in the types of housing supply being delivered
- > This has implications for the entire housing market, especially in relation to housing tenure (and subsequent retail patterns)
- > Many of the current housing market problems can be attributed to the lack of supply in key submarkets
- > Serious implications for urban form, retail performance and commercial real estate demand
  - Downtown redevelopment and University District
- > Nature abhors a vacuum





## Current Supply Dynamics

### > Housing Ladder



Vacuum between rental tenures and first time buyers  
This is called the MISSING MIDDLE



# Nature abhors a vacuum

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- > Rents go up to meet the space left in the demand on the housing ladder
  - As rents go up, the bottom rungs of the ladder get higher
  - New construction in apartments intensifies as rents increase
  - Older properties are redeveloped and gentrified
  - The result is increased homelessness as the most vulnerable cannot pay higher rent
- > Trade down opportunities are available in Spokane
  - Older people in cities are staying in houses longer
  - Velocity of housing goes down in urban areas
  - People cash out and move to Spokane into lower density single level townhomes
  - First time buyers have few options to move up
- > Only effective form of rent control is a 30 year fixed rate mortgage
  - Increasingly difficult for first time buyers to make the transition



# Development Risk and Liability

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- > No uncertainty!
  - Under current regime, the probability of lawsuit appears to be 100% for mid-rise and high-rise developments
  - Extends the time of the development process well beyond completion
  - Brand and reputational issues
- > Contractor Issues
  - Multifamily contractors cannot walk away either!
  - Contract exclusions to prohibit conversion within liability period?
- > Development Lending Issues
  - Banks worry about having to extend credit to developers for liability
- > Buyer Issues
  - FHA Guidelines - approval
  - Fannie and Freddie limitations
  - Bank issues on lending to buyers while litigation is pending



# Economics

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## > Condominium Development:

- Higher end of the market offers higher profit margins and less risk as prices continue rise (buyers less price sensitive)
- Prices must rise substantially before developers will take increased cost risk in first-time buyer markets – especially suburban areas
- Based upon the evidence provided, prices will need to increase more in order to attract developers into the condominium market

## > Commercial Market Implications

- Retail follows offices (industrial) and residential
- Higher retail rents follow homeownership as the dominant tenure



# Tax Changes and REITs

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- > Change in tax rate to investors from 39.6% to 29.6%
  - Represents significant decrease
- > REITs care about cash flow
  - Capital value growth and sale of the asset can create problems
  - With lack of condos, REITs have had the field to themselves in multifamily
  - Apartment have always been attractive to REITs
- > Tax changes will affect REITs
  - But not for a while
  - Will lead to more investment in REITs
  - Place pressure on earning expectations



# Tax Changes and REITs

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- > Tax changes should not make it more attractive for REITs to sell assets
  - It should make it easier for them to try and turn around riskier assets, such as retail
  - Absolute vs. nominal returns expectations among investors
  - Cap Rate compression and the search for yield
  - Allows for higher levels of capital expenditure and strengthens the case redevelopment
- > Plenty of credit to finance redevelopment for REITs
- > Lagged market impacts on investment
  - 2017-18 changes will not impact market greatly for at least a year, likely two or three in terms of rents and prices



## Commercial Implications for Spokane

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- > Likely continued higher demand for smaller sized condominium (or single level townhouse) developments
- > Current housing demand being met by the apartment market
  - Drag on retail spending patterns and the ability to have strong prime retail centers
  - Possible oversupply emerging in apartments?
- > Opportunities for REITs to take advantage
  - Can take risks and partner with housing developers rather than just build apartments
- > Legal frameworks need to change to allow more condo development in high density areas (downtown Spokane)





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THANK YOU



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