TOP 3 REASONS WHY YOU NEED TO INVEST IN MULTIFAMILY REAL ESTATE DURING TIMES OF INFLATION

Anything good in the financial news?

The recent 40-year-high consumer price index (CPI) increase of 7.5% has cash-rich investors running for cover.

Why? Because their stacks of cash just became 7.5% less valuable. Welcome to inflation.

People think that hoarding cash is the safest form of "investment," but in times of high inflation the opposite is true. Yes, your savings account balance never goes down. (It barely goes up, but hey, up is better than down).

But because the cash is becoming less valuable, that balance has less buying power. In other words, hoarding cash in times of inflation is the only investment strategy guaranteed to make you poorer.

There's a reason money is pouring into multifamily real estate right now, even though prices are higher than they were a few years ago.

Why? Because smart investors know that multifamily real estate is an excellent hedge against inflation – that is, a way to protect their wealth from the ravages of inflation – for three critical reasons:

1.Real Estate Values Tend to Increase in Times of Inflation

Let's go back to Inflation 101. Money gains or loses value for the same reason anything gains or loses value – supply and demand.

If the government prints or borrows a lot of money (see: stimulus, rescue, recovery, and infrastructure bills passed in the wake of COVID-19), more money in circulation means greater supply. Something that is easy to get is inherently worth less. (Not "worthless," worth less.)

The "printing money" situation gets a lot of ink, but the demand side is important too. If goods and services are in high demand – say, in an environment of increased consumer demand like we have experienced during the COVID-19 lockdowns, and then again with the reopenings – materials and labor become scarce. You have to pay more to buy things, or pay a higher wage to tempt someone to work for you. Costs rise, and a dollar doesn't go nearly as far as it did before. Inflation wins again.

One of the costs that rise during periods of inflation is the cost of real estate. This is why investors don't hesitate to pay higher prices than they did a few years ago – because inflation of the currency makes those price increases look flat, or even like a decrease in value.

Moreover, if we can expect to see more inflation in our immediate future, those prices may soar even higher. And even if the value flatlines, it's better than holding on to cash and having less buying power every year due to inflation.

2. Apartment Rents Tend to Increase in Times of Inflation

Another cost that tends to go up in times of inflation is apartment rent. Inflation can have this effect on all types of commercial property rent, but the effect on apartment rent is particularly reliable and predictable.

Why? Because the demand is stable. Regardless of the performance of the dollar, people need a place to live.

Apartments also tend to have shorter leases than office, industrial, or retail property. Those other commercial leases can run five years, ten years, or even longer. Apartment leases, by contrast, rarely exceed a year. Why does this matter? Whenever a lease renews, it's a chance to renegotiate the rent. Or, it's a chance to swap out one tenant with a new tenant. The result – apartment complexes can enjoy a faster, more steady increase in the revenue from its rent roll.

Of course, this assumes no external factors. If people are moving out of a market instead of moving in, the demand for apartments will decrease because fewer people need a place to live. That's why it's important to carefully choose your market. Look for population growth, job growth… not declines or recession.

Suffice it to say, if you pick your market right, you can expect to see market rents increase due to inflation.

I know what you're thinking – "More rent means more net operating income (NOI)! And due to the income method of real estate valuation (cap rates and so on) that means my property will become even more valuable!"

Yes … and no. See, NOI isn't just gross rents collected. It's gross income minus operating expenses. And inflation will push the price of those expenses up as well. Insurance, contract labor, appliances and materials … they all get more expensive due to inflation. So maybe your NOI increases … maybe it doesn't.

Maybe it stays flat.

But even if you can't count on an effective increase of your NOI, you may be able to expect more cash flow, as #3 will demonstrate.

3. Inflation Makes Real Estate Debt Worth Less

I mentioned above that while rents may increase during inflationary cycles, costs increase as well.

But one thing that probably doesn't increase is your mortgage payments.

Most apartment complexes are financed with fixed-interest loans with fixed installment payments. Many of them are highly leveraged, too – 50%, 75%, even 80% loan-to-value (LTV) or even more.

Because your mortgage payment doesn't increase, those rent increases can produce more cash flow, even if your other costs increase.

But it gets even better. Another thing that doesn't increase is the loan balance. That's a liability on your balance sheet … but inflation does something magical to that liability.

Even as your property gets more valuable, the declining value of the currency makes that debt less valuable.

After all, if you borrowed $1 million and the currency inflates 7.5%, your lender can't turn around and say "Well now you owe us $1.075 million." Nope, the lender is stuck with that same fixed balance.

The fact that multifamily real estate is eligible for excellent financing – high LTV, high amortization, with fixed payments – makes this debt-debasement effect particularly noticeable.

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As you can see, multifamily real estate has all the makings of an excellent life raft during periods of high inflation, like the one we find ourselves in. Your asset increases in value, your cash flow increases, and your liabilities become less valuable. It's the definition of win-win-win.