

Single Family Home Vs. Multi Family

Time and time again I have seen realtors pushing buyers around, mainly the property buyers who purchase multi-family investments. For some reason, many realtors seem to think that those investments are much more significant regarding a Single Family Home. Obviously it depends on the price, but in general, the costs of multi-family properties have been increasing so much that the numbers just don't make sense anymore.

As a general rule of thumb, I am firmly convinced that an SFH (single family home) is a much better investment than a multifamily. The only exception to this rule is if the multi-family is bought at such an "interesting" price, and with a much higher cap rate than the SFH.

Let's analyze this:

1. Duplexes have a higher vacancy rate

- The vacancy is one of the most critical concepts of real estate investing. If you are not aware of the right vacancy, you will end up entirely out-of-pocket and go into a real estate investment blind.
- All salesmen will try to pitch you a great investment and will probably try to challenge your ability to interpret the vacancy rate.
- When you're dealing with a duplex, you are taking a higher risk, because the risk of an empty house is higher, at least double when compared to the single family home. Indeed, you will be dealing with two tenants and not only one.
- You have another added risk; Assuming that you're buying property below market value, you will most

likely be dealing with a lower income tenant than the SFH.

- Usually, the rent of a duplex unit is 25/30% lower than the SFH of a similar size. This means you are dealing with a more complicated tenant, your risk of not collecting the rent is higher.
 - So, you not only have double vacancy risk, but you also have a lower income tenant to deal with.
 - If you calculate a vacancy of 10% as a standard vacancy, a duplex in the same area should be at least 25/30%, considering double the risk and adding the extra percentage of risk dealing with a more troubled type of tenant.
- As you can see already, you need to have an amazing gross amount to still stand up with a reasonable cap rate after such a deduction.

2. Unfortunately, the above is not finished!

In the column of your maintenance cost, you will have to consider that now you have two kitchen's, two A/C's, two bathrooms, etc., etc. This means that you will have twice the chance that something may break and need to be repaired, and you will need to fix it.

Also, it's worth it to note that you will need more money when rehabbing the house; A/C is an essential part of the property and is usually a necessity in the summertime, especially in states like Florida, Texas, California and more...it breaks easily and always needs to be cared for. This will again increase your cost

Obviously, when it comes to a triplex or a four-plex, you need to apply the same criteria.

If you have units with a window A/C unit, you may get a lower rent, and therefore lower income tenants, but probably better in the long run, at least when it comes to any maintenance

issues.

3. The exit strategy is much more complicated than the SFH.

You see, in SFH you will most likely be able to sell the house to a first time home buyer. If you have a lovely house in a decent location with a decent school, you will always find first home buyers that are willing to buy it.

People are slowly but surely fixing their credit and/or recovering their bad credit that they incurred during the financial crisis. Obviously, if you have a good cap you bought at a good price, there is a chance that the rent will cost more than the actual 30 years mortgage, at least if the interest rate stays below 6%, which is reasonable in the next 2/3 years.

It's even happening right now...tenants are becoming the "client" by calling the landlord and asking to buy the house that they are renting. With multi-family units, it is more complicated. You can still find first time home buyers for duplexes, but I can't lie...that is rare when compared to that of an SFH.

A family usually needs a bigger house, garden, etc.

It does happen for a duplex to have a first time home buyer that can rely on the other unit to help pay the mortgage but it's more difficult, and it's usually people with lower income, which means an increase of risk.

Now if an investor is leveraging, or even if they are not, why would they buy a unit with a lower cap rate than you in an environment where the interest rates are higher?

If you need to make a profit from the unit, the cap rate will be lower for the investor than the one that you have. And if you are selling in few years, we all assume the interest rate will be higher. So, leveraging will be more expensive, and it

will make less sense investing to gain a spread.

Of course, a few things might have changed due to a rent increase and area improvement.

This can usually happen mainly IF THE INCOME OF THE PEOPLE IS INCREASING and inflation is high, the unemployment rate lowers, so basically everything that will have an impact on the shifting of the demand curve. And therefore only, in that case, you may make some money, but you will still need to consider that a buyer leveraging will be impacted but at a higher cost of borrowing.

So then why is it that multi-family and bigger units have a lower cap rate than single-family homes???

This is the catch, I think the market does not appreciate enough, and the multi-family is more attractive to investors for the following reasons:

1. Bigger size, so it's easier to place 1,2,3 million in one deal only

When realtors or asset allocation managers move money, they need to be concerned with how easy the deal can be achieved, and the need to allocate money. Usually, size is an issue. Any investor would prefer to deal with one building worth 5 million than with 40 single family homes.

2. Leveraging is easier on a building because a mortgage lender will work more on a loan of \$1/2/3 million than on a \$50,000 loan, small loans sometimes are a headache for the lenders and brokers because it is the same amount of work for a very small fee.

All of the above have a serious impact on multi-family prices. In Dade and Broward County you will see multi-family selling at a way overpriced amount.

This is a risky business because the vacancy considered is usually way underestimated, mainly in buildings that have many units and the cap rates are very low.

Multi-family prices are often times the effect of a realtor or asset manager that is desperate to allocate or find a good sized deal, but they don't represent a great investment overall, nor in income or appreciation.

Nowadays, at least in the Miami area market, it is essential to keep your bearings with you, be aware and do your numbers before entering into any deal!

Until Next Time,

Antonio Velardo