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An Analysis of the Omaha Apartment Market

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Introduction

The housing construction industry has always been looked on as one of the key indicators of the American economy. When the economy was soaring, the housing industry often saw favorable conditions. In the past several years, however, it has not seen the best of times. New residential starts, both locally and nationally, appear to be headed for a 1981 total that falls far below the levels of only a few years ago.

Multi-family housing has led the downturn. While the single-family market has at least retained some degree of responsibility in numbers of units until this year, new multi-family construction has virtually bottomed out. As shown in Figure 1, the Omaha area has also seen relatively few multi-family units built in the past few years. Multi-family construction in the three-county Omaha SMSA since 1974, a period spanning almost seven years, is less than half of a single year's effort only a decade ago.

Without the federal government offering financial advantages for construction and rent subsidy payments to enhance occupancy and stimulate private sector response, the total would be even lower. While new construction has been limited, the local apartment market has not been inactive. Many complexes have changed hands in recent years, large out-of-state corporations have assumed management functions, and a number of developments have shed old names for new marketing images.

The construction industry's performance in recent years—lackluster at best—has been hampered by rising raw material and energy costs, wildly escalating interest rates, and the effects of inflation. Yet in many respects the residential construction industry should be bolstered by a favorable set of demographic circumstances in the 1980's resulting from a far greater supply of new households ready to assume occupancy than in any decade this century.

The purpose of this article is to examine the Omaha apartment market within this construction drought, identify the market conditions operating in today's economy that have hampered expansion, and to examine the short- and long-run outlook for the apartment market.

Apartments in the '70's

With the annual production of new multi-family units in the late 1960's and early 1970's at a level far surpassing areawide household growth, major problems began to be associated with market absorption. By 1973, the market was clearly overbuilt. Newspaper accounts of that period describe a surplus of at least several years' worth of units with an average vacancy rate commonly quoted at 8 percent. In an attempt to gain a market foothold, some apartment managers offered inducements ranging from free moving and a waiving of the first month's rent to "mini-vacations" and Las Vegas trips. As the national and local economy began to flounder with the approach of mid-decade, foreclosures became commonplace, and construction, which had been planned even through the building permit stage, was terminated.

As the decade continued, the supply of units that had not been absorbed began to shrink. While consistent data sources identifying the rate at which this occurred are not available, some insights can be gained from a variety of private market studies prepared for investors testing the market. Usually prepared under contract, these reports gradually spread throughout the real estate community in a variety of copied forms.

Editor's Note: This is the second of a two-part series on apartments in the Omaha area. The first, a geographic look at construction patterns, appeared in Volume VIII, Number 4 of the Review. A major focus was the evolution of apartment construction from the pre-1950's downtown base, infusion through the central Omaha core, and then expansion into large suburban developments. A series of proportional circle maps identified all new multi-family units in Douglas County in five-year increments during the past 30 years. Copies of this article are available from CAUR upon request.
From these sources a gradually lowering vacancy rate can be tracked through the decade.

8.1 Occupancy Patterns

Most of these private reports have concentrated on examining the suburban apartment market. For the purpose of measuring the economic dimensions of the total Omaha apartment market, a telephone survey was instituted. This survey was conducted January 19 through February 17, 1981. The apartment complexes selected were those actively seeking residents through advertisements in the telephone directory, newspapers, and the "Greater Omaha Apartment Guide." As such, they represented the so-called "active" market. The 19,000-plus units sampled comprised an estimated one-half of the area's apartment stock.1

Answers were sought and cross-classified by number of bedrooms for the following categories: number of units, square footage, monthly contract rent, and number of units not currently occupied or committed for rent. Each contact person was assured that information provided would remain confidential and would be presented as summary data by geographic areas of sufficient size to prevent disclosure. Table 1 presents the results of this survey. The nine geographic zones used represent various submarkets within the community and match, to a large degree, the suburban area delineations identified in the private contract research discussed earlier. Of the 19,059 units surveyed, a total of 723 or 3.8 percent were found to be vacant. That percentage was, with some obvious exceptions, relatively consistent by geographic zone and type of unit. Those exceptions, however, marked the situation where a few apartment complexes within the sample had vacancies far above average. If these were somehow excused from consideration, the vacancy rate would drop to nearer 3 percent.
percent. Although the results presented in Table 1 might appear to be somewhat dated, spot-checks of the units sampled at the time of this writing showed a market as tight or perhaps even tighter than these rates indicated.

Residential Construction

The declining number of permits issued in the Omaha metropolitan area, as shown in Figure 1, dramatically depicts the status of the residential construction industry as of the summer months of 1981. Although the current calendar year has not ended, Figure 1 shows a total based on performance during the first eight months of this year compared with the same period in 1980. If this pattern continues, then the annual total will be lower than at any time in the past two decades.

In the past decade, inflation has been a persistent problem. In the early 1970's, inflation jumped into the double-digit percentage range in contrast to the relatively stable prices of the 1960's. This alarmed bankers, financiers, economists, and particularly the Federal Reserve Board, which set about implementing a policy of monetary restraint by establish-

Figure 2

YIELDS ON SELECTED SECURITIES
June 1979 - August 1981

source: Federal Reserve Bank of St. Louis

data plotted are averages of daily rates for weeks ending on Friday
Board will continue to reaffirm its commitment to a tight monetary policy at least through the remainder of 1981 and beyond. The Federal Reserve's decision in September of 1982, even though evidence is beginning to mount that the problems of the auto, housing, and real estate industries are starting to spread into other sectors of the economy. The reasons behind the financial market's belief that many business executives and financial analysts believe that if the Federal Reserve Board does not immediately begin to loosen monetary policy, supply after the dramatic tightening that Federal Reserve Bulletin,folios consist of long-term mortgages at least through the remainder of 1981 increased expenditures for national defense. In the last quarter, the growth in short-term money supply after the dramatic tightening that has occurred, its credibility will be diminished. As a result, many of these factors have had a detrimental effect on savings have continued to hamper the construction of the new certificates will have an effective rate of 12.61 percent. Fannie Mae could issue the one-year certificates at 15 percent, lower its borrowing costs, and make substantial refinancing to a 3.39 percent spread. The apartment building picture in this context is that the building of new rental housing do not bode well for the Omaha apartment market and could impose another stagnating block to new multi-family construction within the short-run. Added to the new construction woes are modifications in the rates for calculating property value and depreciation which tend to favor renovation of older buildings.

Conclusion
In recent months the national economy has been giving conflicting signals regarding the future of the rental market. While vacancy rates for apartments fell to an average rate of 3.8 percent in early 1984 for the Omaha area, and rental rates have been increasing indicating a demand for units, renter have not been increasing fast enough to provide sufficient return on investment to justify new construction. The rental market has been shifted to favor owners over renters. Thus, the rate for new construction has been elevated, the inflation in operating expenses relative to the revenues generated from rental rates indicates that new apartment construction will not be feasible in the Omaha area for some time.

Possibly some areas of the city could increase rental rates without losing occupancy due to tenant demands for these locations. This may be true for apartment projects having a central location and close to employments centers or transit routes. With the increased cost of energy and gasoline prices, apartment dwellers are willing to pay higher rents for prime locations. These factors also affect decisions regarding new construction. To the investor armed with sound market research and a well-designed plan, a venture may prove profitable. Other persons, however, may be better off investing in non-residential pursuits which promise a higher and, oftentimes, more predictable return than apartments. In the long run a number of events are operating on the construction industry. The administration's tax cut proposals are ready to be implemented. The provisions call for lower capital gains taxes, faster depreciation write-offs, tax rate indexing to avoid bracket creep, and a 25 percent personal income tax cut over 33 months. These measures should improve the economic picture on earning spreads for apartment investors.

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The term “apartment” fits a number of definitions. In its most elemental form, it is a room or set of rooms with housing facilities and a ventilation system. It may apply to a flat above a commercial building as well as to a house. As used in this article, however, apartments are units within a residential structure built to contain one or more dwellings. They are synonymous with “multi-family” dwellings or multi-dwelling buildings. To the investor armed with sound market research and a well-designed plan, a venture may prove profitable. Other persons, however, may be better off investing in non-residential pursuits which promise a higher and, oftentimes, more predictable return than apartments. In the long run a number of events are operating on the construction industry. The administration's tax cut proposals are ready to be implemented. The provisions call for lower capital gains taxes, faster depreciation write-offs, tax rate indexing to avoid bracket creep, and a 25 percent personal income tax cut over 33 months. These measures should improve the economic picture on earning spreads for apartment investors.

This will then reduce the rate of growth of the construction in the Omaha area appear rosier. Optimistically, the policies of the administration will result in a reduction in the inflation rate which will then lead to a reduction in the high interest rates. This will then reduce the rate of growth in construction costs and allow revenues to catch up. If these policies are put into effect, the longer-term implications for the construction industry are significantly positive.