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Part II: The Economic Dimension

An Analysis of the Omaha Apartment Market

By Donald A. Nielsen and John P. Zipay

Dr. Nielsen is professor of real estate and land use economics at the University of Nebraska at Omaha. Mr. Zipay is regional services coordinator with the Omaha-Council Bluffs Metropolitan Area Planning Agency. Acknowledgment is extended to the R. J. Wilson Company, Real Estate Appraisers, for technical assistance and office facilities provided during the course of this study. As customary, the authors assume full responsibility for the contents of this article.

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, which had been headed for a 1981 total that falls far below the levels of only a few years ago, 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

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.

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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.
New Residential Units Authorized for Construction
Omaha SMSA: 1960-1981

FIGURE NO. 1

Multi-Family


Single-Family and Duplex


New Residential Units Authorized for Construction
Omaha SMSA: 1960-1981

FIGURE NO. 1

Multi-Family


Single-Family and Duplex


source: U.S. Bureau of the Census, C-40 Construction Reports

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.

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, 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 near 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 establishing high interest rates. The result was the 1974-1975 recession, the worst since the 1930's. The impact of this plan of monetary restraint on real estate development was disastrous.

During the 1974-1975 recession period, inflation abated somewhat by falling briefly below a 6 percent annual rate. In the ensuing economic recovery period of 1976 to 1979, the rate climbed above the double-digit mark once again. Near the end of 1979, the Federal Reserve Board again implemented a policy of restraint which later became known as the "October Massacre." The Federal Reserve Board then changed the thrust of its policy from focusing on monitoring interest rates to concentrating on the volume of money supply reserves, referenced as monetary aggregates M-1A, M-1B, M-2, etc. The result was to set off a roller-coaster pattern for interest rates as shown in Figure 2.

The tight monetary policy of the Federal Reserve, which increased the prime rate ultimately to 21.5 percent, helped cause the recession of 1980. This recession was referred to by economists as "stagflation," a condition where the inflation rate remained well above the double-digit level and unemployment rose almost to the double-digit rate.

Economic Conditions

As the nation moved into 1981, the economy was experiencing an inflation rate of 9.6 percent. This slowed to a 7.4 percent compounded annual rate in the second quarter as measured by the Consumer Price Index. In contrast to the Consumer Price Index, the Bureau of Labor Statistics' measure of wholesale prices, the Producer Price Index for finished goods, rose just above 4 percent for the first four months of 1981, or at an annual rate of almost 13 percent. In August, 1981 this index rose only a seasonally-adjusted 0.3 percent, bringing the annual rate of increase over the second four months of 1981 sharply downward. These rate reductions in the Producer Price Index should become visible within a few months in the Consumer Price Index.

Despite this improved performance of prices which reflects a winding down of inflationary pressures in the economy, the Federal Reserve Board has remained committed to a monetary policy which results in high interest rates. Current expectations are that the Federal Reserve

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.
supply after the dramatic tightening that substantial portion of their loan sectors of the economy. The reasons behind the financial market, many business executives and financial analysts believe that if the Federal Reserve Board does supply money to a rate consistent with the Federal Open Market Committee of the Federal Reserve Board, in the August, 1981 Federal Reserve Bulletin, reaffirmed its commitment to reducing the growth of money to a rate consistent with non-inflationary growth. The Reagan Administration tax cuts starting in October, 1981 and the increased expenditures for national defense are expected to provide a substantial expansionary impulse to the economy, failing which the increased demand for credit from both the private business and government sectors. Unless substantial increased year-to-year commitments of the Reagan Administration’s budget, the budget for this year is expected to provide a “baseline” to the liquidity problems of depository institutions, it is not expected to provide a large influx of new money for the construction loans or home mortgages. One reason might be that the Federal National Mortgage Association, known as Fannie Mae, will issue special one-year securities which banks and thrift institutions could purchase with the All Certificates. From the liquidity problems of depository institutions, it is not expected to provide a large influx of new money for the construction loans or home mortgages. One reason might be that the Federal National Mortgage Association, known as Fannie Mae, will issue special one-year securities which banks and thrift institutions could purchase with the All Certificates. From the liquidity problems of depository institutions, it is not expected to provide a large influx of new money for the construction loans or home mortgages. Another factor not to be overlooked is that more and more potential renters are opting for the purchase of homes and condominiums. Many feel that the best type of investment is the purchase of a home and paying high interest rates is offset by tax deductions and anticipated appreciation in value. The demographic demand of new households created by the “baby boomers” could bring about 25 percent personal income tax cut over 33 months. These measures should further reduce the construction industry is significantly affected decisions regarding new construction projects having a central location or close to employment 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 or homes.

In recent months the national economy has been giving conflicting signals regarding future economic conditions. 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 or homes.

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