Wealth Management™ 2020
Market Outlook

Workforce Housing Investment a Safe Harbor as Recession Clouds Gather

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Recession warning signs are flashing: the expansion has passed the 10-year mark and officially became the longest in U.S. history; the yield curve, a strong predictor of previous recessions, inverted earlier this year; the trade wars with China are stressing multiple sectors of the U.S. economy including agriculture, automotive and consumer technology, and now the wealthy are starting to curb discretionary spending.

The probability of a 2020 recession has been hovering around 25 to 30% according to some economic models, and the prevailing sentiment among investors is one of caution. As a result, many investors are looking for alternative investment opportunities that will sustain value and cash flow through a downturn and be well-positioned when the recovery returns.

Market conditions, including the lingering effects of the last recession making it more difficult to obtain or afford a mortgage, rising personal debt levels, and stagnant wages particularly for the working class, have converged to create a housing crunch. Another recession is likely to push even more people into the rental market, as millennials choose to further delay home ownership at the same time as baby boomers look to downsize.

This "rentership society" is expected to grow by more than 7 million through 2025, and 80 percent of the renter demand, representing 4 million units, is from renters with incomes less than $75,000. These individuals are "renters by necessity." They make up the lesser known, but increasingly important and lucrative workforce housing segment. They are individuals and families who don't qualify for federally subsidized housings, but who are being met with a dearth of supply of safe, well-maintained, and non-luxury rental housing. They are also college grads with student debt. Demand for workforce housing will only increase when the next economic downturn arrives, and consumers look to decrease costs of living to accommodate employment instability.

This opens the door for savvy investors, including family office portfolios, who are seeking alternative investments to place their capital in workforce housing development. Workforce housing in class B and C multifamily buildings offers a lesser-tapped mar-

ket with good fundamentals for investors—steady demand, low vacancy rates, and the ability to incrementally raise rents with low capital expenditure on improvement. Value-added real estate combines bond-like attributes of 4-8% current income, with the potential for capital appreciation, much like dividend-paying stocks and ETFs, but often with less volatility. In addition, real estate provides inflation-protected returns.

A particularly strong case presents for investors to consider direct investments in the workforce housing apartment sector. Both the consumer need for lower to mid-market rate housing and the investor opportunity will be further enhanced in an economic decline. To best seize the opportunity, private investors should look to partner with a real estate investment management firm that understands the local market trends, has strong operator relationships, employs institutional best practices and is a proven steward of capital.

Now is the time for investment advisors to prepare and diversify their clients' portfolios for the next economic downturn. Multifamily investments, and workforce housing in particular, are especially defensive and worthy of consideration to not only current cash flow distributions, but to further insulate portfolios against a broader market decline and inflation. An added bonus: these investments also fulfill a desperately underserved need—affordable housing—that will only be enhanced by an economic downturn. ■

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