Workforce Versus Luxury: How Much Risk Exposure Does Multifamily Have to the Local Jobs Market?

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It is well known that jobs are a key variable for the multifamily sector. A robust jobs market means people have the money to move into accommodations and to pay rent. A decline in the number of jobs means fewer people are able to lease units at existing rent levels. So jobs are a source of both risk and opportunity for multifamily investors. But what type of multifamily is most exposed to risk from the jobs market? In this article, I compare multifamily properties based on their affordability, i.e., based on the average level of rent per unit.

Intuitively, there are reasons to believe that more affordable (e.g., workforce) housing would be more exposed to changes in the jobs market than less affordable (e.g., luxury) multifamily would be, but there are also reasons to believe it may be less exposed. On the one hand, tenants in luxury apartments typically have greater financial resources and flexibility than do those who rent by necessity in more affordable properties. A (temporary) job loss might have less impact on the housing decisions of someone in a luxury property than the potentially disastrous effect such a loss could have on someone who can afford to rent in only a less expensive property. The implication is that more affordable properties may have higher risk exposure to the jobs market than do less affordable ones.

Conversely, housing is a necessity and is one of the last things to be given up when faced with a financial crisis such as a job loss. Further, a poor economy may mean that people start to "trade down" in terms of housing and are forced to look for more affordable options than they would rent in a better jobs environment, creating more demand for less expensive rental options. The implication of this is that more affordable housing may be less sensitive to the jobs market than more expensive properties would be.

In terms of which type of multifamily property will typically have the greatest sensitivity to the jobs market, reasonable arguments can be made on both sides. Therefore, this is really an empirical question, What do the data say? In this article, I look at whether and how exposure to the jobs market differs depending on the affordability of a multifamily property.

Local Jobs and Local Affordability

Although national numbers on jobs created or lost typically generate the most headlines and hit the nightly news, real estate is a business based on specific locations, and jobs in the local market are most important. I use data on the number of (nonfarm) jobs in specific metro areas from the Bureau of Labor Statistics, where each metro is defined by its core-based statistical area (CBSA).[1] For each quarter from 1Q2008 to 3Q2024, I calculate the percentage change from four quarters ago (i.e., the annual percentage change calculated on a rolling basis each quarter) in the number of jobs in each CBSA as a measure of the strength of the local jobs market. Using local jobs numbers ensures the analysis accounts for the fact that some metro areas may have stronger or weaker jobs markets than others, which will affect the performance of multifamily properties in that metro.

Likewise, classifying properties by their affordability depends on local conditions. To implement this, I use data on all apartment properties in the NCREIF database and, for each, compare its average rent (calculated as the rental income for the property per occupied unit) to the area median income (AMI) for the CBSA in which the property is located. There are many ways to define what level of rent makes a property more or less affordable, and I use the following simple definitions:

1. Most Affordable: Average rent per occupied unit is less than 30% of income for someone making 80% of AMI in the CBSA in which the property is located.
2. Mid-Market: Average rent per occupied unit is less than 30% of income for those making 120% or less of AMI in the CBSA in which the property is located but more than 30% of income for those making 80% or less of AMI.

1. The Bureau of Labor Statistics (BLS) employment numbers for metros in New England are not based on CBSA but rather on New England City and Town Area (NECTA). Hence, a few metro areas might have a slight geographic mismatch between the BLS jobs numbers and the real estate data from NCREIF (which is based on CBSA in all cases). This applies only to Boston; Worcester, MA; New Haven, CT; Bridgeport, CT; and Providence, RI.

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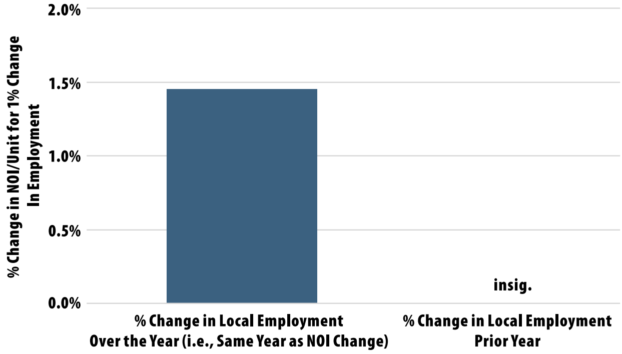
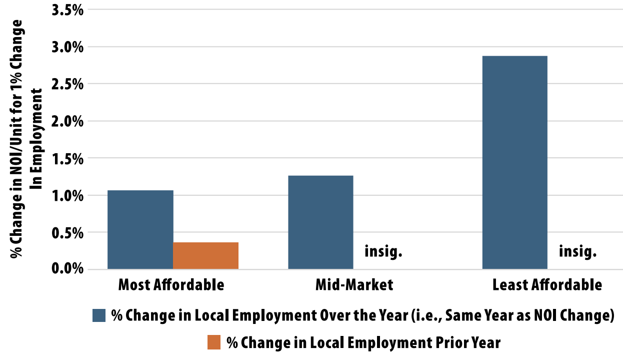
Exhibit 1: Relationship Between NOI per Unit and Local Employment: All Multifamily



Source: PREA Research based on data from NCREIF and Bureau of Labor Statistics
Note: "insig." means that a statistical test indicates that the relationship is not strong enough to reliably be judged different from no relationship at all.

Exhibit 2: Relationship Between NOI per Unit and Local Employment: By Affordability



Source: PREA Research based on data from NCREIF and Bureau of Labor Statistics
Note: "insig." means that a statistical test indicates that the relationship is not strong enough to reliably be judged different from no relationship at all.

3. Least Affordable: Average rent per occupied unit is less than 30% of income for only those making more than 120% of AMI in the CBSA in which the property is located.

Note that the use of the term *affordable* here is not related to any regulatory definitions; the properties classified as most affordable are not necessarily "capital A" Affordable. Rather, I use most affordable in a more intuitive form to refer to properties with rents that are more likely to be attainable by people at lower levels of income compared with others in the metro area. The most affordable properties, and mid-market, would thus correspond to many market participants' definition of "workforce housing."[2]

How Is Multifamily Profitability Affected by Jobs?

To see how different categories of affordability in multifamily are affected by changes in the local jobs market, for every quarter between 1Q2008 and 3Q2024 (the start date being determined by the availability of the AMI data in the NCREIF database) and for each CBSA, I calculate the annual percentage change in net operating income (NOI) per unit on a rolling quarterly basis on average across properties in each affordability class. NOI per unit is based on total units in each property, not just occupied, because the jobs market can affect both rents and occupancy. I then look at the relationship between changes in NOI per unit and percentage changes in employment in the CBSA over the year. Because changes in the labor market may take time to affect the apartment market, I also look at how growth in NOI per unit is affected by the prior year's change in local employment.

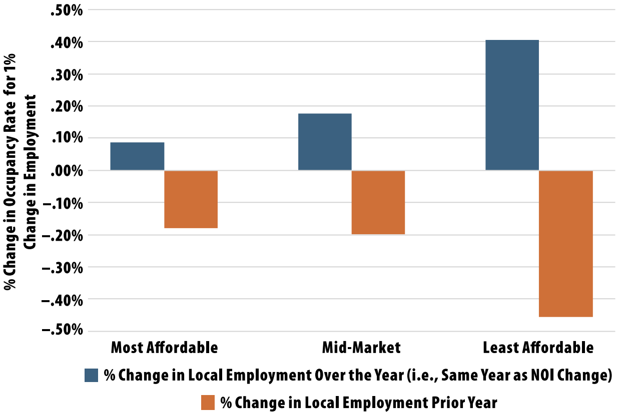
Those of you who remember your economics classes will recall that comparing percentage changes in two variables can be interpreted as an elasticity. The estimates in the exhibits provide an estimate of the elasticity of NOI per unit with respect to local employment—i.e., if the number of jobs in a metro area increases (or decreases) by 1%, by what percentage is NOI per unit expected to change?

To analyze the relationship between NOI per unit and local employment, I employ a statistical methodology that uses data from all metros, accounts for differences across those metros, but gives a single, national estimate of the relationship between NOI per unit and local employment.[3] This approach therefore allows the individual differences across metros to be included in the analysis but gives a single estimate of the elasticity.

2. Some properties may have low rents but be value-added investment plays in which rent will be driven up over time. To control for this, I also compare rents two years ago with AMI. To be in the final sample, a multifamily property must have been purchased at least two years ago and the average rent two years in the past would put it in the same category as this quarter's average rent. I also exclude properties in which expenditures on building improvements in the quarter are more than 10% of current property value to avoid including value-added in the sample.

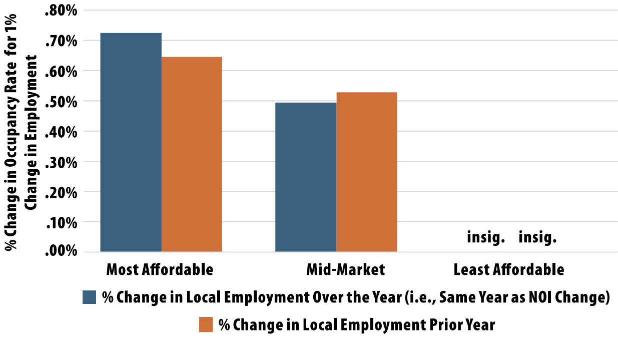
3. For the technically inclined reader, I use a panel regression with random effects across CBSAs. Note that using fixed effects across metros yields very similar results. Technically, random effects are preferred here because of the overlapping nature of the data over time, which will create autocorrelation in the regression residuals. Because the random effects model is estimated using generalized least squares, it can incorporate this dependency in the residuals.

Exhibit 3: Relationship Between Occupancy and Local Employment: By Affordability



Source: PREA Research based on data from NCREIF and Bureau of Labor Statistics

Exhibit 4: Relationship Between Rent and Local Employment: By Affordability



Source: PREA Research based on data from NCREIF and Bureau of Labor Statistics

Note: "insig." means that a statistical test indicates that the relationship is not strong enough to reliably be judged different from no relationship at all.

As a baseline, Exhibit 1 shows the relationship between NOI per unit and local jobs markets calculated across all multifamily properties. The results show that a 1% increase in local employment is associated with a 1.45% increase in NOI per unit for multifamily properties that year. There does not seem to be any identifiable lagged effect; there is no relationship between NOI per unit and the percentage change in employment the previous year.

With that as a baseline, let's now look at whether this elasticity is different depending on the affordability of the properties. Exhibit 2 shows the results broken down by affordability category. The main conclusion is obvious from the exhibit—the least affordable properties have a higher sensitivity to changes in local employment than do more affordable properties. For the least affordable properties, a 1% increase in the number of jobs in the CBSA is associated with a 2.87% increase in NOI per unit. For the most affordable properties, the impact on NOI per unit is only 1.06%. So all types of multifamily gain when jobs numbers increase and lose when jobs disappear, but the effect is more than twice as large for the luxury end of the market.

More affordable properties also show a small lagged effect, with changes in employment the prior year related to changes in NOI this year, that is not seen in other affordability categories. But even with that extra lagged effect, these properties are still far less sensitive to employment than are the least affordable multifamily properties.

The (admittedly somewhat esoteric) statistic R-squared (not shown in the exhibits) taken from the estimated model shows how the importance of the local labor market varies across affordability categories. The R-squared measures how much of the variation in NOI per unit, across CBSAs and over time, is related to variation in the employment numbers. For the most affordable category, the R-squared is 3%, indicating that only a very small amount of variation in NOI per unit can be linked to employment. For mid-market properties, the number is 10%, and for the least affordable properties, it is 21%. So while only a tiny amount of the variation in NOI per unit is linked to labor markets for the most affordable housing, more than a fifth of the variation across cities and over time is linked to employment for luxury multifamily. This reinforces the idea that changes in employment are a key variable for luxury properties but a much smaller consideration for workforce housing.

Note that higher (or lower) exposure to labor markets is not necessarily a good or bad thing for investors—it depends on the specific strategy, outlook, and risk tolerance. In markets experiencing high employment growth, luxury multifamily will gain more from that growth and reward investors targeting growth and higher returns. On the other hand, if employment falls, luxury properties will suffer the greatest losses in NOI. Essentially, higher-priced apartment properties are more exposed to the macroeconomic cycle (in the form of jobs). With lower sensitivity to local jobs numbers, workforce

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housing is more insulated from the economic cycle—it will tend to show lower gains during good times but also be less exposed during periods of job losses.

What Drives the Differences in NOI Exposure to Jobs?

NOI at a property depends on a number of things, including expenses. But on the revenue side, the two main variables driving NOI are occupancy and rent. To get a better idea of what is driving the results on NOI per unit, I repeat the analysis but look at the relationship between employment and average occupancy and rent per occupied unit across the affordability categories. Exhibit 3 shows the results for occupancy and Exhibit 4 for average rent.[4]

Occupancy in luxury multifamily is far more sensitive to jobs than is occupancy in more affordable multifamily properties. This explains the greater sensitivity of NOI per unit in the luxury segment—an increase in jobs in the area provides the financial resources for tenants to move into higher-priced properties. More affordable multifamily occupancy does not get the same level of boost from an increase in jobs. On the other hand, this also means that workforce housing is better able to maintain occupancy after a drop in the local labor market and hence has a lower risk exposure to local employment.

It is interesting that for all types of multifamily there is a delayed and negative reaction in occupancy to an increase in jobs one year in the past. This seems counterintuitive because it implies an increase in jobs leads to a decrease in occupancy one year later. While interesting and slightly perplexing, I do not explore this any further in this article. Perhaps, and this is purely speculation, an increase in jobs leads individuals to move up the housing ladder given some time—affordable renters move to mid-market, mid-market to luxury, and luxury into owner-occupied single-family homes, resulting in a decrease in occupancy in all three categories. While that is a potential explanation, I leave a fuller look at this phenomenon to future researchers.

On the rent side of the equation, the opposite results are seen from occupancy. Rent in the most affordable segment is actually more sensitive to jobs than in the least affordable segment. This makes sense given that the definition of affordability is linked to local incomes—as jobs increase, presumably AMI increases in the area as well, meaning that rent at a higher level can still be considered affordable. Hence, more affordable properties are able to increase rents and still preserve occupancy when there is a booming local jobs market. Rent in more expensive properties, however, is not as sensitive to jobs—an increase in jobs does not tend to drive rent higher for luxury multifamily, and it therefore gains from an increase in occupancy as more people are able to afford rents in higher-amenity properties.

Upsides and Downsides

As already noted, it is neither good nor bad that NOI in workforce housing is less sensitive to jobs market conditions than luxury multifamily—whether this is a feature or a drawback depends on what investors want from their multifamily investments. Because of its ability to retain occupancy even when jobs are disappearing, workforce housing NOI is less exposed to macro-level risk throughout the cycle. On the other hand, that also means that workforce housing has limited ability to drive NOI higher during economic good times, something luxury multifamily seems much more able to do. Investors interested in timing entry into growth markets to generate excess returns will likely find luxury a more appealing segment (although they should know that they are exposed to more risk if their growth forecasts prove incorrect). Investors that are more interested in a slow-and-steady approach with less exposure to risk from labor market fluctuations may find the characteristics of workforce housing more appealing (although that gives them limited ability to benefit from increased growth in jobs).

There is no right answer here, as each segment has upsides and downsides for investors. The important thing is for investors to understand the dynamics in different segments of the multifamily market so that they can make informed decisions and target the types of properties that make the most sense for their particular needs. ■

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4. Note that results on occupancy are based on percentage change in occupancy rate, not occupancy level. For example, going from 80% occupancy to 85% occupancy is a 5%/80% = 6.25% change in occupancy rate, and that is the variable used in the analysis.