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Multifamily Executive

Rising Operating Expenses Slam Multifamily Industry

Learn how multifamily owners and operators are taking on these higher costs.

By **Christine Serlin**

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A. David Lynd, president and CEO of Lynd Living, started his career in the multifamily industry in 1997 and has been involved in over 180,000 apartments. Over the past 25-plus years, he has experienced every major correction—the dot-com bust, natural disasters like Hurricane Katrina, the Great Financial Crisis, and the pandemic.

But the high levels of inflation the nation has seen recently is taking a bigger toll on multifamily stakeholders.

“This is the hardest operating environment I have ever seen,” says Lynd.

He says in past events, the nuts and bolts of the economy still were functioning, people had jobs, and the person renting an apartment was fine for the most part.

“This go-around, the average guy is getting ripped to shreds by insurance costs, groceries, rent, tuition. That is the reason why this environment is so challenging, no one is exempt from this one. Everybody is getting hit,” he says. “Underlying fundamentals are strong, but what people can pay and how much they can pay because wallets are getting tight is making it a real challenge.”

Multifamily property owners across the country are feeling many of the same pressures.

According to Yardi Matrix data, national total operating expenses for multifamily properties increased 13% from 2020 to 2022. Only two markets saw a slight decrease in operating expenses from 2021 to 2022, while the majority saw increases over 5%.

“Operating expenses are up across the board. In a year where many owners are impacted by massive increases in insurance, taxes, and rising interest rates, the pressure to operate on less is very real,” says Elizabeth Meyers, director of operations, Denver, for Kairoi Residential. “Different communities are impacted in different ways depending on the market and the way they are financed.”

Jeff Adler, vice president at Yardi Matrix, says just as rents increased in a lot of Sun Belt markets, expenses also went up. However, because of operating leveraging, net operating incomes (NOIs) went up more.

What it does say, according to Adler, is that in markets that became stressed with a big influx of people moving in, the labor and materials markets also became stressed.

"It came in both the form of rent increases the industry received, but also maintenance costs and material costs went up. That's the 2022 roundup," he says. "When you look at the places with the lowest increases in expenses, they are the ones with the lowest levels of in-migration. It was the mirror image of the rent story. It was interesting, to me, to see that revenue and expenses did move in the same general direction."

However, Adler warns that issues are only getting more dicey for multifamily owners and operators in 2023.

"[Property] taxes are actually a lagging indicator. They go up slowly as reassessments occur. Taxes are going to be going up this year and next year even as values are coming off their peak. Then there will be a large amount of appeals that will go on," he says. "Insurance costs, both property insurance and casualty insurance, are absolutely going up and in a meaningful way—more so in markets affected by storms, but even in places in the interior U.S."

In addition to property taxes and insurance, Adler says stakeholders can easily expect to see an additional 5% to 6% in labor costs, particularly for the labor that is deployed to property management, such as maintenance and leasing employees.

He adds that some relief should be seen in terms of material costs; however, while costs might not be at the high levels seen last year, they will still be "uncomfortably high."

"When you combine all that with decelerating rent growth, increasing pressure will lead to pressure on NOIs," Adler says. "The industry is under revenue pressure and under expense pressure. While most folks didn't pay too much attention in 2021 and 2022, it's definitely a focus this year."

Navigating the Challenges

Lynd cites the availability of materials as well as the cost of real estate taxes, insurance, utilities, and labor as the biggest expenses.

"Labor was the first shoe to drop—we increased everyone up to over $15 an hour during the pandemic so that our people could maintain a quality of life without inflation eating their lunch," he says. "It's harder to attract people than it was before. Our wages are up at least 10%."

Lynd is utilizing a few solutions to control costs. For example, it's important to have deals signed up with suppliers in advance for forward-looking inventories as well as second and third options. "For every major category—like carpet and appliances—have accounts established so you can pivot and not hurt move-ins," he says.

On the insurance front, Lynd has a program in place where renters have to carry a first-loss insurance policy, which gets the company a higher deductible and lowers insurance costs. And it has focused on checking for water leaks and monitoring water flow and electric usage to cut down on its utility costs.

"We also are spending a whole lot of time retaining good-paying renters," he says. "You don't want to trade out a renter who has demonstrated they can pay for a new renter with an unknown payment history."

Calynne Oyolokor, senior vice president of FirstService Residential's Multifamily Rental Division, says its clients across New York City also are seeing a steady rise in annual operating costs, particularly for insurance premiums, natural gas, and electricity.

"The most drastic increases are most often related to insurance, where providers are almost unilaterally raising premiums, reducing coverage, and introducing exclusionary clauses that can expose our clients to increased risk. Excess liability coverage, commonly referred to as umbrella policies, are increasingly limited for multifamily owners, which is also a cause for concern—especially considering the history of extraordinary judgments levied against building owners for slip-and-fall cases, construction accidents, and contractor lawsuits."

She says FirstService-managed properties benefit from its in-house insurance brokerage and energy advisory teams whose core focus is to identify products and solutions that reduce its clients' annual operating costs.

"Most recently, our energy advisers brokered a deal with a local community distributed energy developer, where properties that subscribed to their clean energy program receive Con Edison credits that offset monthly delivery charges. Buildings that subscribed to the program, which has zero sign-up fees, will save up to $10,000 each month. That's obviously a huge win for our clients," she says.

Meyers says Kairoi has refocused its attention on the details to ensure no stone is unturned.

"We are rebidding contracts and trying to find savings in bulk," she says. "We are also focusing on business partnerships to help make our resident events budgets go further. We do find though, that when the communities are running at the highest level possible, income can help offset a lot of the expense pressure. Residents though are feeling the same increases in costs in their daily lives so the level of expectation on operators seems to be the highest we've ever experienced."

Finding the Silver Lining

If there's a bright spot to the challenging environment, says Meyers, it is the opportunity to go back to the basics.

"After years of unprecedented market rent growth across most of the country, it is more important than ever to check in. It is easy to say you're performing at the highest level when rent is organically growing by 10% or more on its own. Not many are running a tight ship when the 'getting is good.' When rent growth halts or, in some instances, is negative, now all of a sudden owners and operators are looking at their expenses with a fine-tooth comb," says Meyers. "This is something you'd hope was being done the entire time, but a questionable market makes it a necessity."

She adds that many employees have come into the industry during the good times so this is the first they are being trained to manage through uncertainty.

"Learning resilience is an important lesson that cannot be falsely created," Meyers says. "Now is the time when solid operators are going to shine, and we are happy about that."

Bob Pinnegar, president and CEO of the National Apartment Association, agrees.

"We're shifting back into where management really makes a difference," he says. "This is very much a year of back to the basics. Keeping track of your revenues and expenses will be a priority as will be working with your residents—as we all know, the resident you retain is far more cost effective than going out to market a unit and turn it. That's why you're now seeing the industry manage to occupancy rather than manage to rent."

ABOUT THE AUTHOR

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