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Real Estate Investments Are Never 'Recession-Proof,' but Some Are Safer Than Others

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Factors like scarcity in the market, location and plot size insulate properties from market changes

Real estate investors and homeowners who were hard hit by the recession of the late 2000s—and those disappointed by the cooling of luxury markets around the world last year—naturally want to find that elusive investment that's guaranteed to offer returns amid economic fluctuations.

Though the U.S. housing market recovered dramatically in the years since the recession, there are concerns that stock market volatility, rising interest rates, and global trade tensions, could compound the slowdown of the real estate market, and some are bracing for another recession.

However, there's no such thing, even at the high end, as an entirely recession-proof investment, real estate analysts agree.

"No class of real estate is immune to recessions," said Richard Green, director of the USC Lusk Center for Real Estate in Los Angeles. "Recession-proof implies that if we're in a recession and someone needs to dispose of a property, they can get all their money back."

That simply does not happen, he added: "No investor should think any investment they make is recession-proof."

Fortunately, there are real estate purchases better able to weather the vicissitudes of the market than others. Multi-family homes that bring the owner rental income, properties in high-demand, low-supply locations and houses that have been designed by experts, with great attention to detail, all tend to offer greater protection from losing substantial value during economic slowdowns.

"You're never going to get something that in an economic downturn will still continue to go up," said Mark Herbert, founder of the Boulder, Colorado-based PowerPlay Destinations, a real estate sales and marketing company specializing in vacation homes. "It's a question of, what can I buy that is not going to kill me from a depreciation standpoint?"

Investors should keep in mind not only that certain types of property are more vulnerable to market fluctuations than others, but also that, with a long enough time horizon, their investments will most likely pay off.

"Because real estate has gone up so much over the years, people have looked at it as something that is an investment that will appreciate, but in the short run, things are not always that way," said Sally Forster Jones, executive director of luxury estates with Compass in Los Angeles. "With economic cycles, property values go up and down, but in the long run, real estate always goes up."

Vacation Homes

Vacation homes tend to be hit particularly hard during recessions. Following the beginning of the Great Recession, in 2008, vacation home sales fell by over 30%, compared to 2007, and prices decreased over 23% in the same time period.

Investors in vacation properties should be aware, then, that these can be risky purchases.

"Second homes connote higher risk because the owner pays the debt service on that asset after they pay for their primary residence," said Jonathan Miller, president of appraisal firm Miller Samuel. "I don't doubt that there can be opportunities in this segment for upside, but I would view it as a more vulnerable asset class in recessions."

However, with the Great Recession a decade ago came an unexpected turn for vacation properties: The rise of Airbnb has allowed vacation homeowners to earn extra income through short-term rentals. A survey of vacation homeowners from Savills and HomeAway found that in 2018, the average annual rental income on vacation homes was $21,000.

Rental income can provide some insulation from market downturns, and there are other factors, too, that help make certain types of vacation homes less risky investments.

"Saying anything is recession-proof is a tough statement to make, but any time you have scarcity in a market, whatever the market is, it sets up your investment for success," said Julie Faulpel, principal of Jackson Hole Real Estate Associates.

In Jackson Hole, Wyoming, she said, 97% of the land is protected in a conservancy or forest, dramatically limiting what can be developed. The lack of a state income tax there offers further enticement to investors.

"It's a perfect storm for high-net-worth investors looking to shelter themselves or make a long-term investment," Ms. Faulpel said.

Purchasing in a location with limited supply is key to making sure your vacation home investment doesn't depreciate dramatically in a recession, Mr. Herbert agreed.

"In 2009, when everything hit the skids, there was so much product being built in Phoenix, it was easy to get permits, and lending was easy, so everybody rushed in. In that market, when the recession hit, there was a 35% to 40% value drop," he said.

In Hawaii at the same time, though, there was a marked contrast.

"For the best locations in Hawaii, like the Maui beachfront, the dip in property values was only 10% to 12%," he said. "The reason was the barrier to entry—the ability to get anything built—was unbelievably tough. It wasn't overbuilt, and people recognized the value there."

Selecting the location of your vacation home wisely may not protect you entirely from seeing a drop in value during a recession, but it could mean that the decrease you see is much smaller than it would be elsewhere.

Also consider whether a second home will be a long-term investment, and perhaps even someday become your primary residence.

"Places like Hawaii, Cancun and Mallorca don't go through seasonal ups and downs. There are low and high seasons, but people are always going," Mr. Herbert said. "People buy a second home and eventually envision living there, so in that sense it's recession proof."

Duplexes and Triplexes

Investors in multifamily properties are lured by the prospect of rental income, which can be especially promising in central, walkable urban areas. Both Atlanta and Miami, for instance, are predicted to see increases in rental prices this year.

Again, location is key to making an investment that will have some insulation from potential market downturns.

"If you owned a duplex in Florida in 2009, you probably weren't a happy person," Mr.. Green pointed out. "That said, if you were to buy a duplex in Seattle and rent out half of it, that's a very smart thing to do. It's a low volatility investment because of the rental demand in Seattle."

In addition to rental income, investing in a multi-family property can also mean certain tax breaks and more lenient financing.

"I'm a huge fan of duplexes and triplexes. Investors get preferred interest rates, financing, and loans, and an owner can live in one unit and rent out the others and receive income from those. It helps them through good and bad times," Ms. Jones said. "There's a big audience and demand because of that."

However, in certain locations, post-recession development booms have led to a large supply of multi-family properties, which could make it more challenging to generate substantial rental income. In New York City, for instance, 20,000 new apartments, for sale and rent, will come onto an already soft luxury market this year.

"There are signs of multifamily oversupply because of easy access to capital after the financial crisis, and rent trends are showing signs of weakness," Mr. Miller said.

And according to Douglas Elliman's December 2018 rental market report for Manhattan, new leases declined by 38.5% compared to December 2017.

Again, location dictates just how safe an investment will be under shifting market conditions, but generally, duplexes and triplexes offer some insulation during hard times.

"Investing in a multifamily property is usually a very good investment," Mr. Green said. "In a bad year, you might have to cut the rent a little bit. There's a difference between saying it's an excellent investment and it's recession-proof."

Importance of Accessibility, Lot Size, and More

There are a number of other factors real estate experts point to that can help protect a property from the worst effects of a market downturn, if not insulate it entirely.

"With certain houses, we find that it does not matter the marketplace we're in," said Tami Pardee, CEO of Halton Pardee + Partners in Greater Los Angeles. "Even in a recession, there are people that still have money, and they're looking for very specific types of houses, and are very location-driven."

Homes that feel "soulful"—that is, thoughtfully designed, with close attention paid to details—will stand out even in a cooling market, she said. Furthermore, properties in specific central, walkable neighborhoods are perpetually in demand.

"If it's close to the beach and walkable, whether it's in L.A., Santa Barbara, or Santa Monica, people always buy," Ms. Pardee said. "They wait for those houses to come onto the market."

Mr. Herbert agreed that a central location, particularly in urban areas, offers some recession-proofing, particularly if that also comes with walkability and easy access to the nearest airport.

"The reality is, you want to go to the place where most people go. If you have half a million in Colorado, you can go to the suburbs and buy a great house, or go to the middle of the city and buy a small townhouse," Mr. Herbert said. "If you're looking for something more recession-proof, go downtown."

Look beyond the property itself to its lot size, as well: sometimes the land a house sits on is more valuable than the house itself, and will help to strengthen an investment.

"If you have a larger lot in an area with smaller lots, that can offer some recession proofing," Ms. Pardee said. "The more land you have, the better off you are, and you can also build on it in the future."

Of course, downturns also offer buyers with cash—and the ability to ride out tough economic times—the opportunity to make an investment that will pay off once the market picks up again.

Taking the long view is a smart approach for any type of real estate investment.

"The most important thing is to look at real estate and know that in the long run, it is cyclical," Ms. Jones said. "If you can just wait it out, it's going to turn out fine in the end."