



Rental Housing

Rental housing is reasserting its importance in US housing markets. With so much turmoil on the for-sale side, many households have reconsidered their financial choices and opted to rent rather than buy. Despite three years of increasing demand, however, apartment builders have trimmed multifamily rental construction in the face of stubbornly high vacancy rates. Whether the deepening homeownership downturn will result in tighter rental markets depends on how much of the excess supply of for-sale housing is converted to rentals and how quickly homebuying conditions improve.

Demand Comeback

Even at the peak of the homeownership boom, about a third of American households rented their housing. Many renters prefer the convenience and relative ease of moving that renting provides, or view renting as a safer financial choice. Others rent because they cannot qualify for a mortgage or afford homeownership. Not surprisingly, the majority of renter households are likely to have lower incomes and wealth or to be in life transitions—including the young, the foreign born, and divorced or separated individuals.

Over the long run, the share of households that rent is shaped by changes in the age distribution of adults, household composition, and racial/ethnic mix. In the short term, however, economic conditions and mortgage lending standards can be even more important drivers of tenure choice. From 1995 to 2005, long-term demographic trends slightly favored the rental market but price appreciation and low interest rates fueled a homebuying boom. Indeed, if the 1995 homeownership rates by age and race/ethnicity had held, the overall rate would have declined by 0.3 percentage point rather than surged by 4.2 percentage points.

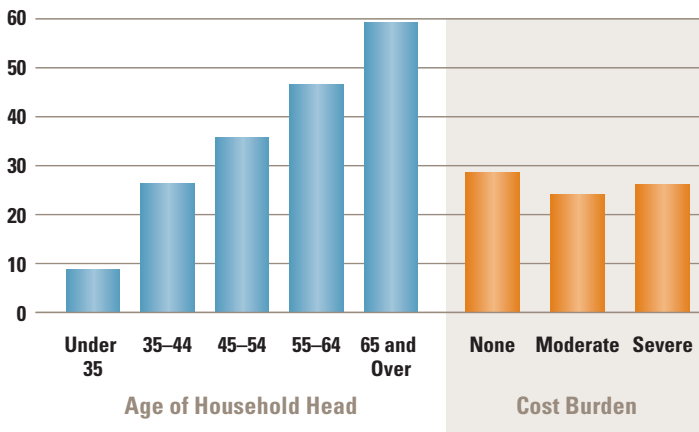
In late 2004, however, economic conditions started to tip back in favor of renting. As a result, the reported increase in the number of renter households was more than 2 million from 2004 to 2007. At first, the uptick was driven by how unaffordable homeownership had become, as well as by the release of pent-up rental demand in some regions where job and income growth had slowed after the 2001 recession. Black households led the revival of demand, followed later by gains among white and Hispanic renters. For reasons that are still unclear, growth in the number of Hispanic homeowners continued to outpace that of Hispanic renters.

More recently, the upheaval in housing and credit markets has made renting more attractive for a growing number and share of households. Although a rising tide of former owners who have lost their homes to foreclosure are now turning to rentals, it is primarily the impact of tighter credit standards and the uncertainty generated by falling home prices that is driving growth in demand. Over the longer term, though, homeowners who defaulted on their loans will provide an enduring lift to the number of renter households because they will likely need years to undo the damage to their credit scores.

Figure 23

Age, Not Affordability, Drives How Long Renters Stay in Their Homes

Share of Renters Living in the Same Units for Five Years or More (Percent)



Notes: Long-term renters lived in their units from 2000 to 2005. Moderate (severe) burdens are housing costs of 30–50% (over 50%) of household income.

Source: JCHS tabulations of the 2005 American Housing Survey, using JCHS-adjusted weights.

In addition, some former homeowners may even have problems qualifying for rentals. First Advantage SafeRent reports that the credit scores of applicants to large rental properties across the country—including public and subsidized housing—who had been delinquent on subprime loan payments were about 24 percent lower than those of typical applicants. Currently, about one-third of applicants with mortgage delinquencies are rejected at large rental properties. Unless managers of these large properties ease credit standards for new tenants, a considerable share of applicants that recently defaulted on mortgage loans will find their housing choices confined to mostly smaller rental properties.

Renter Mobility

With so much focus on failed owners who must now rent, it is easy to lose sight of the fact that many households rent by choice. Moreover, a sizable share stay in the same units for a considerable length of time. More than a quarter of renter households surveyed in 2005 reported they had lived in their units for five or more years.

Like owners who remain in the same homes for several years, longer-term tenants are apt to be older. In 2005, nearly 60 percent of senior renters and 46 percent of renters age 55 to 64 had lived in the same units for at least five years (Figure 23). Still, 26 percent of 35 to 44 year-old and 36 percent of 45 to 54 year-old renter households also reported long-term residency. Given the large share of long-term tenants that are at least 55 years old, these renters are

likely to be either married couples without children or singles. In fact, more than 45 percent of long-term renters live alone.

After accounting for age, however, long-term renters are no different from short-term renters in terms of housing cost burdens, income, and race/ethnicity. In fact, the likelihood that non-elderly households will remain in the same rental units for at least five years is nearly equal across these characteristics. One group of renters that does tend to move frequently, however, is single-parent households—an unfortunate pattern that is proven to disrupt children’s educational progress and undermine their general well-being.

Moving from one rental to another is far less costly than buying and selling a home. Households usually rent if they expect to relocate within a short time. Not surprisingly, then, nearly half of renter households in 2005 reported moving into their units within the prior two years, compared with about 14 percent of owner households. Among renters who recently moved into their units, about one in five were starting out as new households, two-thirds had come from other rentals, and one in seven had moved from units they had owned.

Switching to renting is in fact quite common among owners who move. Just under a quarter of owners who relocated in 2003–2005 rented their next homes. Of these, 24 percent had moved for job-related reasons and 34 percent because of a change in marital status or family situation. But even if the number of owners that shift back to renting were to double because of the mortgage mess, they would still make up little more than one-quarter of households that move into rentals in a typical year.

Mixed Metro Performance

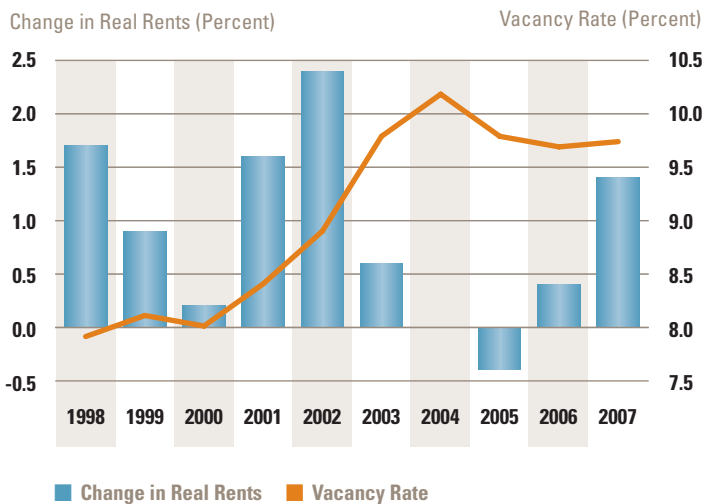
Despite firming demand, the national rental vacancy rate held at near-record levels in 2007. This indicates that additions to the stock from new construction and conversion of for-sale units to rentals matched growth in the number of renter households plus losses from the inventory. Nevertheless, the leveling off of vacancy rates after a period of increase was enough to lift nationally weighted real rents for the second year in a row (Figure 24).

At the metropolitan level, however, rental market conditions varied considerably. Changes in vacancy rates in the 75 metros covered by the Census Bureau ranged from a 4.5 percentage-point decline to a 5.0 percentage-point increase, with more metros reporting higher vacancies relative to 2006. Meanwhile, inflation-adjusted rents rose by as much as 5.3 percent in 9 of the 14 metros covered by the Consumer Price Index (CPI), and fell by less than 1.0 percentage point in the other 5. By this measure, the largest rent increases were in Miami, Seattle, and Los Angeles, while the modest declines were primarily in distressed metros such as Detroit and Cleveland (Table W-10).

The national median rent rose just 0.6 percent in real terms last year according to M|PF Yieldstar (which covers rental properties preferred by institutional investors), but by 1.4 percent as measured by

Figure 24

With Rental Vacancy Rates Leveling Off, National Average Rents Increased for the Second Year



Sources: US Census Bureau, Housing Vacancy Survey; Bureau of Labor Statistics, Rent of Primary Residence, adjusted for inflation by the CPI-U for All Items.

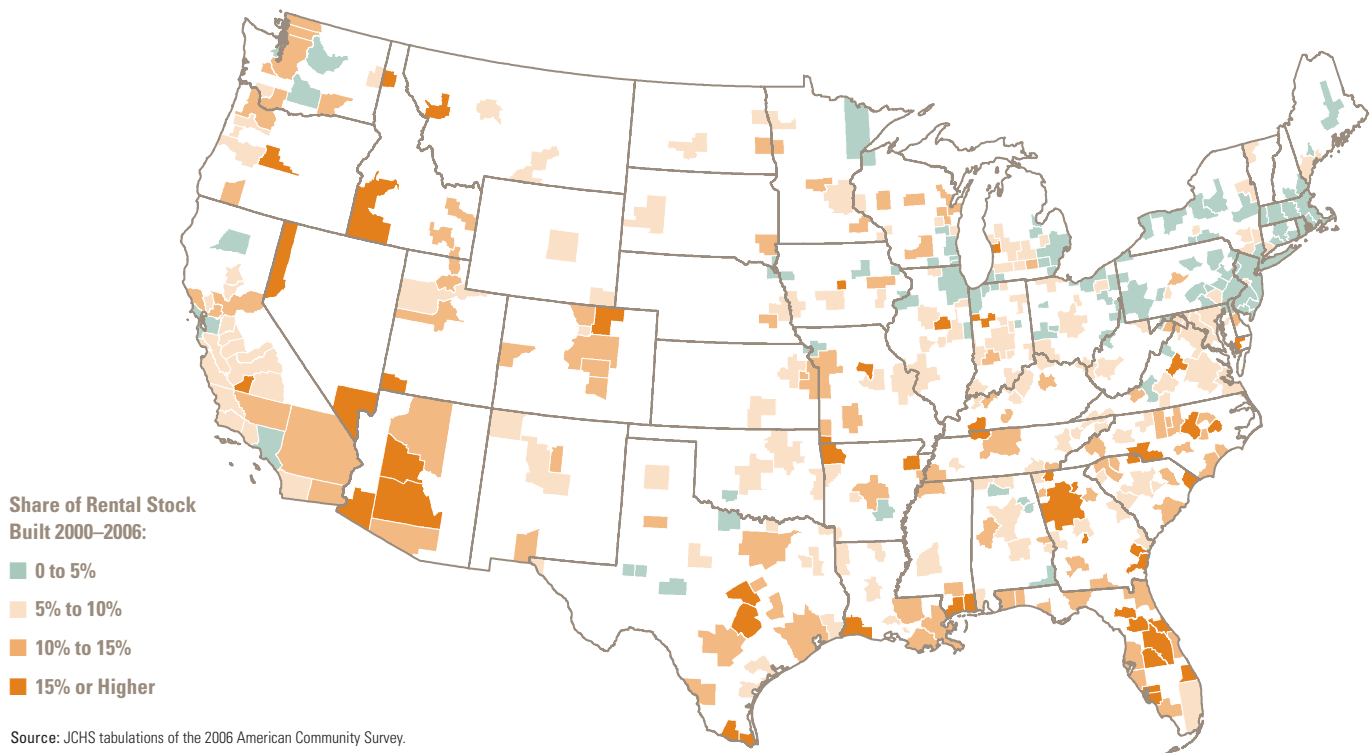
the broader CPI estimate. But like the CPI, MJPYieldstar reported a wide variation in real rent changes across the country, with 27 out of 57 metros posting a decline between the fourth quarters of 2006 and 2007. According to this measure, some of the largest declines were in Florida (excluding Miami), where conversions of excess multifamily for-sale housing to rentals have glutted the market. In contrast, real rents in the West, and especially in a handful of coastal California metros, were up by as much as 9 percent. With housing markets in California under increasing pressure, however, these rent increases could soon end.

The Rental Supply

With the national vacancy rate climbing from 2000 to 2004, falling back slightly in 2005, and then flattening over the last two years, construction of new rental units declined for the seventh consecutive year in 2007. Completions of for-rent units in multifamily structures fell to just 169,000, down 15 percent from 2006 and 38 percent from 2000. Even though completions of for-sale units also dropped, the rental share of all multifamily completions dipped below 60 percent for the first time in the 43-year history of recordkeeping.

Figure 25

Many Fast-Growing Metro Areas Have Added Substantially to Their Rental Stocks



On a national level, just nine percent of the rental housing stock was built between 2000 and 2006. In many fast-growing locations, however, newly constructed rentals represent a large share of the inventory (Figure 25). For example, more than 20 percent of renter-occupied units in Las Vegas, Austin, and Fort Myers were added during this period. In some smaller metropolitan areas, new construction accounted for an even greater share of the rental stock than of the owner stock.

While prompted by stronger rental demand in some areas, new construction in many others has replaced units permanently lost to abandonment, demolition, and disasters. This is especially true in slow-growing regions of the country where the housing stock is older. According to a Joint Center analysis of the 1995 and 2005 American Housing Surveys, center cities in the Northeast saw one rental unit permanently removed for every three built. In Midwestern center cities, the ratio was one unit lost for every two built. Even in a healthy construction market like the suburban West, where almost a half-million new rentals were built, two units were lost for every three added.

Some other net removals were due to the conversion of rental properties into condos by owners seeking to cash in on the home-buying frenzy. Real Capital Analytics reports that acquisitions of large multifamily rental properties (valued at \$5 million or more) intended for condo conversion removed more than 300,000 rental units in 2005 and 2006. These removals offset almost two-thirds of the multifamily rental units completed over this period. But when the pool of investors demanding these condos dried up, the bottom

dropped out of the for-sale market in 2007 and condo conversions plummeted. Meanwhile, some for-sale units reverted to rentals. As a result, existing units are now flowing on net into the rental market and will likely add to the stock in the near term.

The Aging Rental Stock

The nation faces the steady attrition of its oldest rental units. With one-fifth of the rental inventory built before 1940, older units outnumber those constructed since 2000 by about four to one. Unfortunately, losses of older rentals remain high, with 9 percent of pre-1940 units that existed in 1995 permanently removed from the stock by 2005—more than four times the rate of removals of units built in the 1980s.

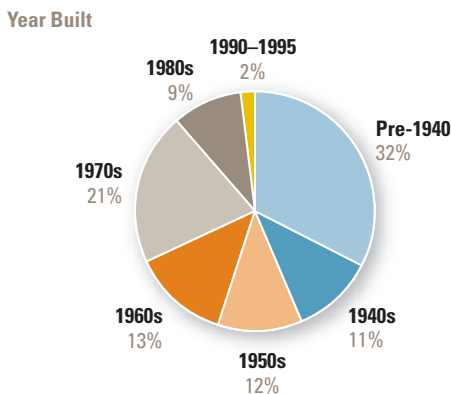
Because older units are generally smaller, have lower rents, and are located in center-city neighborhoods that are home to many low-income households, they play an important role in the affordable housing stock. In fact, a third of units renting for less than \$400 in 2005 were built before 1940, and another third were built between 1940 and 1970.

Loss rates of older affordable units are even higher than on just older units. About 14 percent of the low-cost rental stock built before 1940 and 10 percent of the low-cost stock built between 1940 and 1970 was permanently removed between 1995 and 2005 (Figure 26). The ongoing loss of these units is a significant public policy concern. Once removed, these modest rentals are difficult to replace with new units of similar size and cost. In particular, the

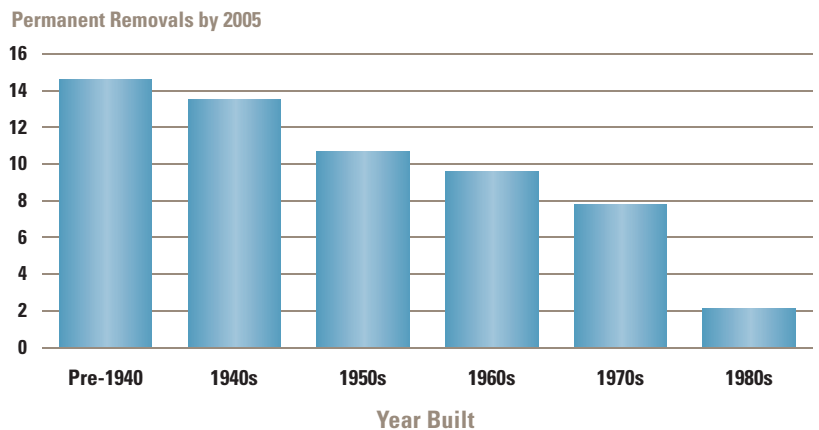
Figure 26

Older Units Make Up Much of the Affordable Rental Stock ...

Share of Units in 1995 with Rents Under \$400 (Percent)



... and Have Especially High Loss Rates



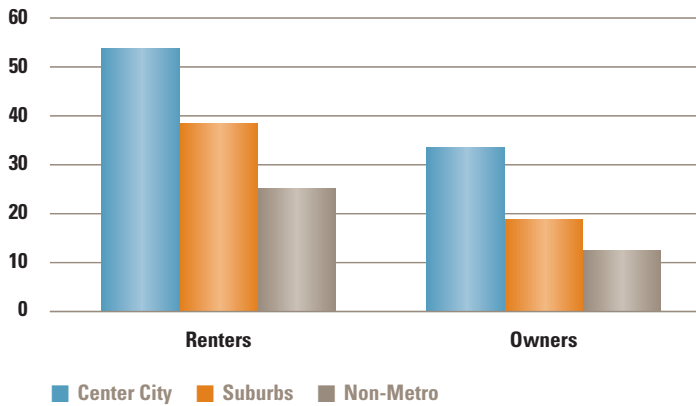
Notes: Permanent removals are defined as rental units in 1995 that were either destroyed or demolished by 2005. Rents are adjusted to 2005 dollars by the CPI-U for All Items.

Source: JCHS tabulations of the 1995 and 2005 American Housing Surveys, using JCHS-adjusted weights for 2005.

Figure 27

Minority Households Are More Likely to Live in Center Cities than in Non-Metro Areas

Minority Share of Households (Percent)



Notes: Minorities are householders other than non-Hispanic whites. Metro definitions are based on 1990 Office of Management and Budget boundaries.

Sources: JCHS tabulations of the 2005 American Housing Survey, using JCHS-adjusted weights.

median rent for units built before 1940 is only \$650—much lower than the \$825 for newly built units.

With one-quarter of unassisted low-income renters living in pre-1940 housing, further losses of older units will erode the already limited affordable supply. Although rehabilitating modest, older rental units is less expensive than replacing them, federal and state preservation programs often take a back seat to new construction and tenant-based support. At the same time, local land use regulations and building codes in many areas make it difficult or impossible to construct comparably modest housing in the places where it is being lost.

Older, lower-cost rentals are also being lost to rent inflation. The low-cost units that do remain in the stock are often in gentrifying areas. In fact, according to the US Department of Housing and Urban Development, 18 percent of all rentals that existed in 2003—but 22 percent of rentals built before 1940—had moved up to a higher rent range by 2005. Among remaining older, lowest-cost units—the only ones affordable to households with incomes below 30 percent of area medians—the rents in more than half shifted up to a higher range between 2003 and 2005. To keep these units in the affordable stock, government would have to ask owners to restrict rent increases and to compensate them for the loss of income they incur from holding rents to below-market levels.

Non-Metropolitan Trends

According to American Community Survey (ACS) estimates, 5 million renter households—or one out of every seven—lived

in non-metropolitan areas in 2006. Based on this source, only 14 percent of new rental construction since 2000 occurred in these areas. But when compared with the 1990 definitions of metropolitan boundaries from the American Housing Survey, it is clear that many were only recently reclassified from non-metro to metro. As a result, rental construction is much more highly concentrated in these outlying counties than the ACS would suggest. Indeed, using the 1990 metro definitions, the share of rentals built in non-metro areas in 2000–2005 was a much larger 33 percent.

Metro and non-metro rental properties differ in character. Some 38 percent of rentals in non-metropolitan areas are detached single-family homes, compared with just 17 percent in center cities. Even more striking, manufactured housing makes up 16 percent of non-metro rentals but just 1 percent of center-city rentals. Non-metropolitan areas also have higher shares of larger and less expensive rental properties.

The types of renters living in non-metro areas also differ from their urban counterparts. For example, minorities make up only a quarter of non-metropolitan renters but more than half of center-city renters (**Figure 27**). In part, this disparity reflects the smaller minority population in non-metro areas overall.

In addition, non-metro renters generally have less education, with 87 percent lacking college degrees compared with 77 percent of metro renters. While non-metro renters also tend to have lower incomes, the lower rents they pay mean that a smaller share of non-metro than metro renters are severely cost burdened. Non-metro renters—and especially low-income and minority renters—do, however, have a higher incidence of housing quality problems.

The Outlook

In the short run, rental markets will play a central role in the broader housing market adjustment to excess supplies and mounting foreclosures. Failed homeowners will come into the rental market with badly damaged credit records that may limit their options. For their part, discouraged home sellers may choose to rent out their vacant properties. The balance between the flow of for-sale units into the rental stock and the increase in rental demand from former homeowners will determine the course of rents in specific markets.

In the longer run, demand for rental housing will depend on both demographic trends and financial market conditions, including the cost and availability of mortgage credit. The growing share of minority households and the strong pace of immigration will support solid growth in renter households. While overall demographics slightly favor homeownership, homeowner demand will remain suppressed until credit standards are relaxed, mortgage interest rates fall further, and home price appreciation returns.