



Rental Housing

Renter household growth surged in 2011, spurred by the decline in homeownership rates across most age groups. With vacancy rates falling and rents on the rise, returns on rental property investments are improving and multifamily construction is making a comeback in many markets. The aging of the echo-boom generation into young adulthood favors strong rental demand for years to come.

CONTINUED GROWTH IN RENTER HOUSEHOLDS

Extending the sharp turnaround in rental demand, the number of renter households climbed by 1.0 million in 2011, the largest annual increase since the early 1980s. The 2000s as a whole already marked the highest decade-long growth in renter households in the last 60 years (**Figure 25**). After a small net loss in 2000–4, renter household growth averaged 730,000 each year through 2011, nearly three times the 270,000 average in the 1990s.

Young adults under age 25 generally drive the growth in new renter households. Although down from 5.0 million in 2001–6, the number of net new renters in this age group was still a substantial 4.7 million in 2006–11. The recent turnaround in renter household growth was fueled to an even greater extent by 25–34 year-olds, who accounted for fully 645,000 net new renter households over this period. In contrast, the previous cohort of 25–34 year-olds was responsible for a net loss of 328,000 renter households in 2001–6. More households aged 35–44 are also renting, reducing the net outflow in their age group from 1.5 million in 2001–6 to just 400,000 in 2006–11.

GROWING DIVERSITY OF RENTER HOUSEHOLDS

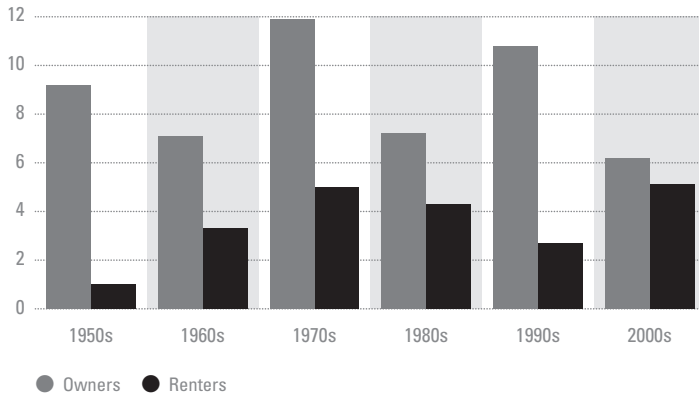
Because they are younger on average than whites and less likely to own homes, minority households make up a large and growing share of renters. In 2011, minorities accounted for only 30 percent of all households but 46 percent of renters. They also contributed 59 percent of the increase in the number of renter households between the homeownership peak in 2004 and 2011. Blacks accounted for 24 percent, Hispanics 17 percent, and Asians and other groups 18 percent of this recent growth. Although whites were responsible for less than half of renter household growth, their numbers still increased by 2.1 million over this period—a sharp departure from the large declines in the 1990s and early 2000s.

An especially noteworthy shift is the rising number and share of married couples that now rent rather than own homes. While still only 36 percent of all renters in 2011, married couples accounted for 50 percent of the growth in renter households over the previous five years. More middle- and upper-income households are also renting. During the first half of the 2000s,

FIGURE 25

Renter Household Growth Set a New Record in the 2000s

Net Change in Households (Millions)



Note: Census data do not include post-enumeration adjustments.
Source: JCHS tabulations of US Census Bureau, Decennial Censuses.

most of the increase in renters occurred among households earning less than \$30,000 while the number of higher earners fell significantly. After 2006, though, households earning more than \$30,000 accounted for just under half of renter growth. In fact, after dragging down renter household growth during the homebuying boom, households earning more than \$75,000 contributed nearly a fifth of the increase in 2006–11.

Some of the unusual features of recent renter household growth—particularly the sharp increases in older and married-couple renters—may persist as long as foreclosure rates remain elevated. But as household formations among the echo boomers rise and homeownership rates among middle-aged households stabilize, the shares of new renter households that are younger and minority should continue to increase.

REBOUND IN MULTIFAMILY STARTS

Until recently, rising demand has been met through absorption of excess vacant units and conversion of single-family homes to rentals. Completions of multifamily rental units totaled just 123,000 in 2011, the lowest annual level since 1993 and bringing the drop since 2009 to 40.9 percent.

While single-family homes have always been popular rentals, the share of renter households living in single-family units increased from 31.0 percent in 2006 to 33.5 percent in 2010. In turn, the share of the single-family stock for rent or being rented expanded from 14.4 percent to 16.1 percent, adding 2.0 million units to the inventory. Increases in the share of single-

family homes for rent or rented are particularly large in states with high foreclosure rates, indicating a shift of many distressed properties from the owner to rental market (Figure 26).

Even so, the overall rental vacancy rate fell from 10.6 percent in 2009 to 9.5 percent in 2011, the lowest annual posting since 2002. With vacancy rates shrinking and renter household growth strengthening, multifamily development has staged a recovery. In 2011, construction began on 178,000 units in buildings with two or more units, up from 109,000 two years earlier. In early 2012, multifamily starts increased to 225,000 units on a seasonally adjusted annual basis (Figure 27). While still well below the roughly 340,000 starts averaged each year in the decade prior to the downturn, a continuation of current trends would give multifamily construction a substantial lift this year.

The rebound is fairly widespread, with permits up in all but three of the 25 markets that had the most multifamily construction in the decade preceding the bust. The largest gains were in Dallas and Washington, DC, where permits jumped by more than 5,000 units last year. Houston, Los Angeles, and New York also posted increases of more than 3,200 units. Even in these areas, though, permit volumes remained at half or less of recent peaks. The principal exception is Washington, DC, where multifamily permits in 2011 were only 10 percent below the 2005 peak. Not surprisingly, multifamily permitting is weakest (less than one-fifth of previous peaks) in areas such as Atlanta, Las Vegas, Miami, Orlando, and Phoenix, where the housing bust was especially severe.

RENTAL MARKET TIGHTENING

According to the Housing Vacancy Survey, rental vacancy rates in more than two-thirds of the nation's largest 75 metros fell in 2011. In more than a third of these areas, the decline from the national peak in 2009 exceeded two percentage points. The absorption of excess units in Austin, Dayton, and Phoenix was particularly rapid, pushing vacancy rates down by more than 5.0 percentage points over the past year. At the other extreme, vacancy rates in a few metro areas, such as Orlando and Tucson, remained above pre-bust levels.

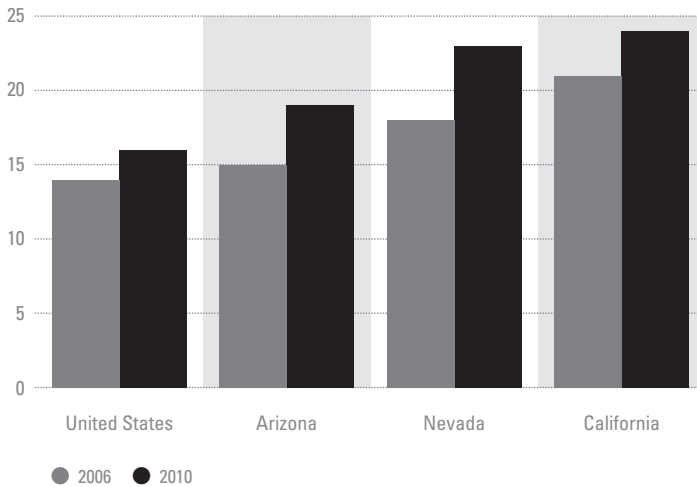
This tightening has lifted rents, at least at the upper end of the market. The broad Rent of Primary Residence measure from the Consumer Price Index indicates that nominal rents edged up just 1.7 percent in 2011—less than the 3.2 percent rise in overall prices but still more than the increase reported in 2010. But the narrower measure based on MPF Research data shows that nominal rents for professionally managed properties with five or more units, adjusted for concessions, rose 4.7 percent from the fourth quarter of 2010 to the fourth quarter of 2011—double the 2.3 percent increase a year earlier. While evident in all regions, rent increases were largest in the Northeast (6.5 percent) and the West (5.2 percent).

Real rents climbed in 38 of the 64 metro areas tracked by MPF Research (Figure 28). Rents in West Coast markets such as San

FIGURE 26

Growing Shares of Single-Family Homes Have Shifted to Rentals, Especially Where Foreclosure Rates Are High

Share of Single-Family Units for Rent or Rented (Percent)

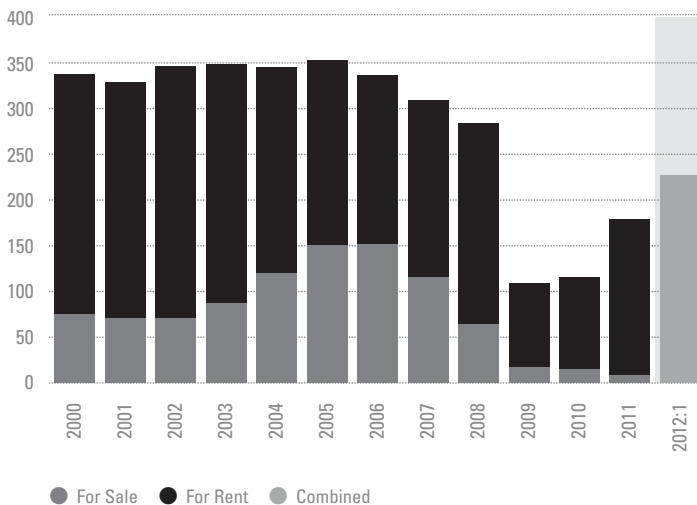


Source: JCHS tabulations of US Census Bureau, American Community Surveys.

FIGURE 27

With Demand Surging, Multifamily Rental Construction Has Revived

Multifamily Starts (Thousands)



Note: Starts in 2012:1 are at a seasonally adjusted annual rate.
Source: JCHS tabulations of US Census Bureau, New Residential Construction.

Francisco (up 11.0 percent) and San Jose (up 8.8 percent) posted the largest increases. In other high-occupancy metros such as Austin, Boston, New York, and Oakland, real increases averaged 3.7 percent or more. In contrast, rents in fully two-fifths of the markets tracked did not keep up with inflation, although the declines were generally modest. Only five markets saw real rents fall more than 1.0 percent in 2011, with Las Vegas reporting by far the largest decline (3.6 percent).

IMPROVING RENTAL PROPERTY PERFORMANCE

Tighter rental markets have bolstered cash flow and returns on multifamily properties. As measured by the National Council of Real Estate Investment Fiduciaries, commercial apartment prices climbed 10.0 percent in the fourth quarter of 2011 from a year earlier, marking a 34.4 percent increase from their fourth-quarter 2009 low. NCREIF also reports that the quarterly returns on investment in these properties averaged 3.7 percent in 2011, yielding an overall return of 15.5 percent last year (Figure 29). While below the outsized earnings posted in the second half of 2010, these returns exceed the average performance in the first half of the 2000s—not to mention the substantial losses in 2009.

Despite these signs of strength, not all segments of the multifamily market are out of the woods. Of particular concern are properties with loans held in commercial mortgage backed securities (CMBS). According to Moody's Delinquency Tracker, 14.1 percent of such loans were at least 60 days past due in the first quarter of 2012, down just slightly from the 15.7 percent peak at the start of 2011. These poorly performing loans were generally issued during the boom years when lending standards were much more relaxed.

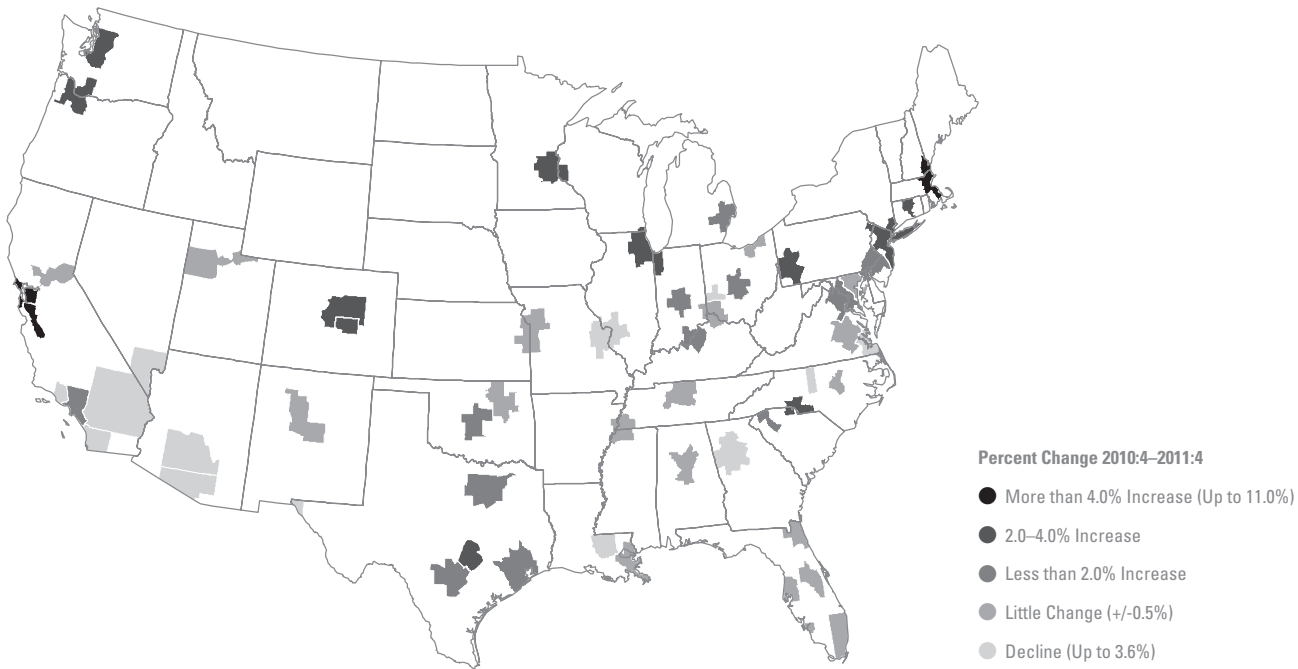
By comparison, delinquency rates for other types of apartment loans have been lower and quicker to recede. For example, the share of noncurrent multifamily loans held in bank portfolios fell by nearly half from the mid-2010 peak, down to 2.5 percent at the end of 2011. Multifamily loans backed by Fannie Mae and Freddie Mac have performed even better, with delinquency rates well below 1.0 percent.

EMERGING RECOVERY IN MULTIFAMILY LENDING

Once the recession hit, government lending was responsible for virtually all of the net growth in multifamily loans outstanding. In 2010, agency and GSE portfolios as well as MBS accounted for a \$14.8 billion net increase in outstanding multifamily loans, while banks and thrifts contributed a modest \$2.0 billion. In 2011, however, the strength of the multifamily recovery bolstered investment interest, and banks grew their portfolios by \$5.8 billion and life insurance companies by \$2.3 billion.

Nevertheless, Fannie Mae, Freddie Mac, and FHA still contributed the lion's share of new lending last year, increasing their backing of multifamily loans by \$18.4 billion. An

Real Rents Are Rising in Many Locations Across the Country



Notes: Rents are adjusted for inflation by the CPI-U for All Items. Estimates are based on a sample of investment-grade properties. Source: JCHS tabulations of MPF Research data.

important but often overlooked aspect of the debate over the government's future role in the mortgage market is whether these guarantees, if continued, should apply to multifamily lending. The government backstop in this market segment was clearly critical during the downturn. With rental demand surging and adding strength to the recovery, policy makers will need to ensure that a restructured mortgage market can provide an adequate supply of capital to fuel expansion of the multifamily stock.

SHRINKING SUPPLY OF LOW-COST RENTALS

The housing bust and Great Recession helped to swell the ranks of low-income renters in the 2000s, increasing the already intense competition for a diminishing supply of low-cost units. According to the American Community Survey, the number of renters earning \$15,000 or less (in real terms) grew by 2.2 million between 2001 and 2010. The number of rental units that were both adequate and affordable to these households, however, declined by 470,000 over this period. As a result, the gap between the supply of and demand for these units widened (**Figure 30**). In 2001, 8.1 million low-income renters competed for 5.7 million affordable units, leaving a gap of 2.4 million units. By 2010, the shortfall had more than doubled to 5.1 million units. Moreover,

of these affordable units, more than 40 percent were occupied by higher-income renters.

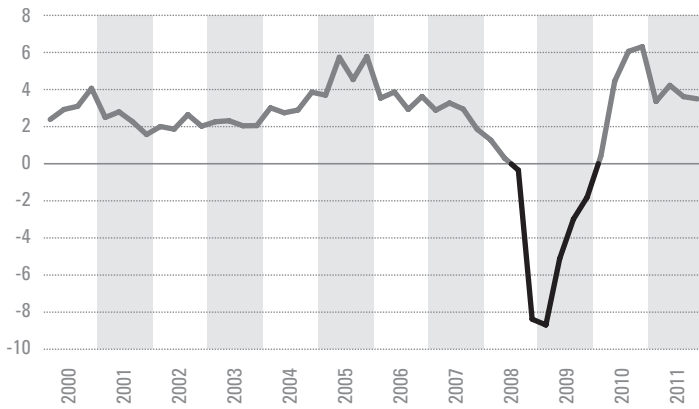
Data from the American Housing Survey reveal the range of forces that work to deplete the affordable rental inventory. Nearly three of ten units renting for less than \$400 in 1999 were lost from the stock a decade later. Demolitions and other permanent removals claimed nearly 12 percent of the stock, but conversions to seasonal use and temporary removals also contributed to the decline. And contrary to popular wisdom, the filtering of properties from higher to lower rents over time has not replenished the supply. In fact, losses due to rising rents are a major drain on the low-cost inventory: for every two units that moved down to the low-cost category between 1999 and 2009, three moved up to higher rent levels. As a result, 8.7 percent of the low-cost rental stock was upgraded to higher rents on net over the decade.

Meanwhile, most new construction adds units at the upper end of the market, with the median monthly asking rent for newly completed apartments exceeding \$1,000 each year in 2006–11. The median would be even higher if not for the substantial share of multifamily construction assisted by the federal Low Income Housing Tax Credit program in recent years. By comparison,

FIGURE 29

Rental Market Tightening Has Restored Returns on Multifamily Properties to Pre-Recession Levels

Quarterly Return on Investment (Percent)



Note: Return on investment incorporates net operating income and changes in the market value of the property.
Source: National Council of Real Estate Investment Fiduciaries, Apartment Property Index.

the rent affordable (at 30 percent of income) to a renter household with the median income of \$30,700 in 2010 is just \$770 per month. To someone earning \$15,000 a year (the full-time equivalent of the federal minimum wage), an affordable rent would be \$375 per month. Stepped-up efforts to preserve the existing low-cost rental stock will therefore be necessary to help meet rapidly growing demand among low-income households.

THE OUTLOOK

Barring a dramatic bounceback in homeownership, renter household growth should remain strong for some time. In the near term, larger shares of younger households are opting to rent while foreclosures are forcing many older households out of homeownership and into the rental market. But even as the economic recovery gains traction and homeownership rates level off, rental demand should get a boost from higher household formations among the echo boomers.

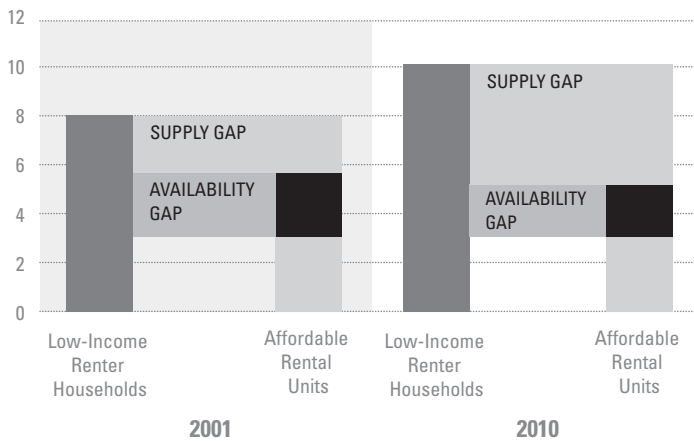
With demand growing strongly, multifamily construction should increase in many metropolitan markets. The exceptions may be metros with stubbornly high vacancy rates, many of which are located in states hit hard by the foreclosure crisis. But capital must be available to support this new construction. Lending by banks and life insurance companies has begun to pick up, but federal sources still guarantee a large majority of new loans. If the federal government pulls back from the multifamily market, private lending will have to increase substantially to support this important segment of the housing market.

Tighter rental markets make it increasingly difficult for lower-income households to find affordable housing. With rents on most newly constructed units well out of reach, the recent jump in multifamily production will do little to alleviate the shortage. Instead, public subsidies are needed to close the gap between what low-income households can afford to pay for rent and what it costs to develop decent housing. At present, the Low Income Housing Tax Credit program is the primary means of adding to the affordable housing stock, but reaching lowest-income renters will take deeper subsidies than this program currently provides.

FIGURE 30

The Gap Between the Number of Low-Income Renters and the Supply of Affordable, Available, and Adequate Units Continues to Widen

Millions



● Vacant or Occupied by Low-Income Renters ● Occupied by Higher-Income Renters

Notes: Low-income renters have annual incomes of \$15,000 or less. Affordable units have rents under \$377 per month (30 percent of monthly household income). Adequate units have complete kitchen and plumbing facilities. Household income and rent are in constant 2010 dollars, adjusted for inflation by the CPI-U for All Items.
Source: JCHS tabulations of US Census Bureau, American Community Surveys.