



Rental Housing

Rental housing markets experienced another strong year in 2012, with the number of renter households rising by over 1.1 million and marking a decade of unprecedented growth. New construction and conversions of formerly owner-occupied single-family units into rentals also picked up. Robust demand has reduced vacancy rates and supported higher rents in most markets—in turn, improving the balance sheets of property owners and helping to limit multifamily mortgage delinquencies.

STRENGTHENING RENTER DEMAND

The Housing Vacancy Survey reports that the number of renter households increased by more than 1.1 million in 2011–12, the eighth consecutive year of expansion and yet another year when renters accounted for all net household growth. The million-plus annual increases in the last two years put growth in the current decade on pace to easily surpass the record 5.1 million gain in the 2000s (**Figure 23**). While this rapid growth may not be sustainable, it attests to the unprecedented strength of rental demand.

As of early 2013, renters made up 35 percent of all households. Relative to owner households, renters are more likely to be young, low-income, and minority, and are also more likely to be single-person households. The median age for renters is 40, compared with 54 for owners. Their median household income was \$31,200 at last measure in 2011, almost exactly half that of owners. The minority share of renters is 47 percent, more than twice the homeowner share of 22 percent. Finally, 37 percent of renters are single-person households, a much larger share than the 23 percent of owner-occupants.

Even so, the recent surge in rental demand has not been confined to just these groups. Although renters are still younger than homeowners on average, net renter growth over the past decade has been strongest among older households. Between 2002 and 2012, the aging of the trailing edge of the baby-boom generation reduced the total number of households aged 35–44 by 12 percent, but the number of renter households in this age range increased by 8 percent. Among 45–54 year-olds, growth in the number of renters was more than three times that of total households in that age range. And among 55–64 year-olds, the number of renter households increased fully 80 percent while the total number of households rose just 50 percent.

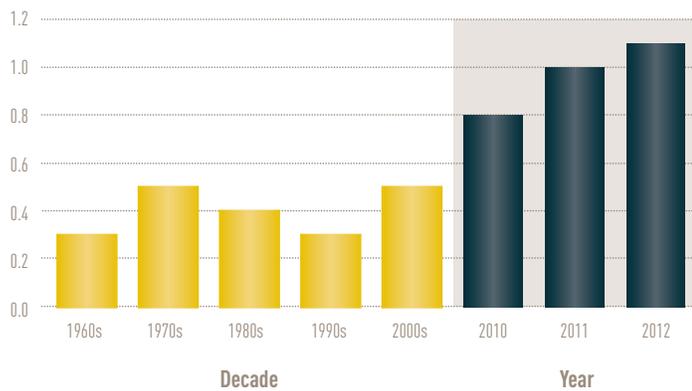
In addition, married couples with children—a family type with traditionally high homeownership rates—have contributed an increasing share of renter household growth over the last five years. Meanwhile, households in a broader range of income groups have also become renters. In fact, after having declined sharply during the boom, nearly a third of the growth in renter households in 2007–12 was among households in the top two

income quintiles. Finally, although minorities still account for a disproportionate share of renter growth, the racial/ethnic split has become more even. These trends suggest that, more than ever, the renter population mirrors the diversity of the nation's households.

FIGURE 23

Renter Household Growth in the 2010s Is Already Surpassing the Record Pace Set in the 2000s

Average Annual Growth in Renter Households (Millions)



Source: JCHS tabulations of US Census Bureau, Decennial Censuses and Housing Vacancy Surveys.

TIGHTENING RENTAL CONDITIONS

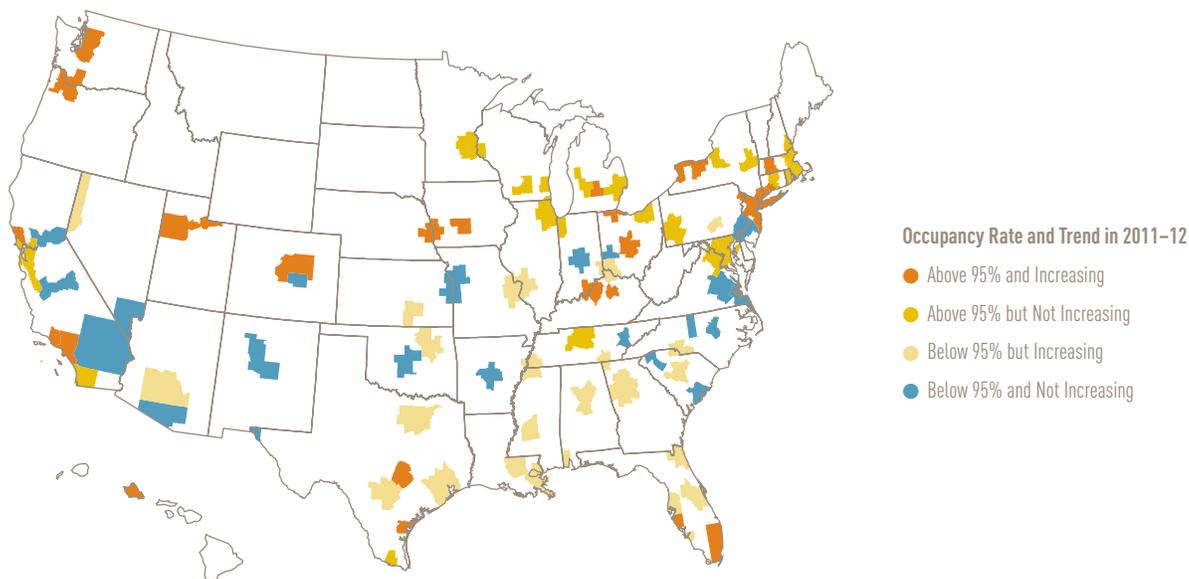
Rental markets across the country are tightening, pushing up rents at the national level and across a majority of markets. The HVS median asking rent for vacant units in 2012 stood at \$720, the highest level in US history, and the uptrend continued in early 2013. The consumer price index for rent of primary residence rose by 2.7 percent in nominal terms from April 2012 to April 2013, outpacing overall inflation of 1.1 percent. As of that month, the index had been on the rise for 34 consecutive months, with year-over-year increases at or exceeding 2.5 percent for 15. More limited data from MPF Research—covering rents for professionally managed buildings with five or more units, adjusted for concessions—indicate that nationwide rents were up 3.0 percent on average in the fourth quarter of 2012 from a year earlier.

Rents in most markets are on the rise. Fully 89 of the 93 metro areas tracked by MPF Research saw rents climb over the past year. In nine of these areas, the increases were at least 5.0 percent. Metros with the largest rent hikes include high-cost markets such as Honolulu (8.5 percent), San Francisco (8.0 percent), and San Jose (7.7 percent). Only four areas reported declines: Las Vegas (-1.7 percent), Greensboro (-0.9 percent), Tucson (-0.3 percent), and Albuquerque (-0.2 percent).

Alongside rising rents, rental vacancy rates continued to drop over the past year both nationwide and in most metros (Figure 24). The US rental vacancy rate stood at 8.7 percent in 2012, down

FIGURE 24

Rental Markets in Most Large Metro Areas Are Tight or Tightening



Notes: Estimates are based on a sample of investment-grade properties for 93 metropolitan areas. Changes are measured fourth-quarter to fourth-quarter. Tightening is defined as an increase in the rental occupancy rate in 2011-12.
Source: JCHS tabulations of MPF Research data.

from 9.5 percent in 2011 and 10.6 percent in 2009. While at its lowest level since 2001, the national rate was still elevated compared with the 7.6 percent averaged in the 1990s.

Across structure types, the steepest declines were among larger multifamily buildings, which had also posted the highest vacancy rates during the worst years of the housing bust. According to MPF Research, vacancies in professionally managed buildings with five or more apartments fell from a high of 7.9 percent in 2009 to just 4.9 percent in 2012—the lowest annual vacancy rate since 2007.

MULTIFAMILY PROPERTY AND LOAN PERFORMANCE

With vacancy rates falling and rents rising, rental property owners had another good year. The National Council of Real Estate Investment Fiduciaries estimates that net operating income (NOI) for institutionally owned apartments rose 6.1 percent over the course of 2012. While a slowdown from the 10.4 percent increase in 2011, NOI growth was still above the historical average and marked a significant improvement from the losses in 2009–10. Factoring in changes in property values, the annual return on investment for apartment owners averaged a solid 11.2 percent in 2012, within a percentage point of pre-downturn levels in the 2000s (Figure 25).

Improving cash flow and rising property values have also benefited multifamily loan performance. Among FDIC-insured banks and thrifts, the share of multifamily loans at least 90 days delinquent shrank from more than 4.0 percent in late 2009 to less than 2.0 percent by mid-2012. While

multifamily mortgages owned or guaranteed by the GSEs held up well throughout the downturn, their performance also improved last year. Serious delinquency rates among Fannie Mae-backed loans dropped by more than half in 2012 alone, declining by 0.35 percentage point to 0.24 percent. Delinquency rates for Freddie Mac multifamily mortgages also declined, ending the year at a modest 0.19 percent.

The delinquency rate for apartment loans held in CMBS improved as well, edging down from 14.4 percent at the end of 2011 to 13.1 percent at the end of 2012 but still well above the historical average. The relatively high rate of delinquencies and slow recovery of multifamily CMBS loans reflect the fact that the CMBS delinquency rate includes loans on properties that are in foreclosure or are real estate owned, but other delinquency rates generally do not.

EXPANDED MULTIFAMILY LENDING ACTIVITY

With production and sales activity ramping up, multifamily loan originations rose sharply in 2011–12 even as overall multifamily mortgage debt outstanding increased only modestly. According to the Mortgage Bankers Association, the annual dollar volume of multifamily loans originated was up 36 percent in 2012, with fourth-quarter originations fully 49 percent above the year-earlier volume. Meanwhile, total net amount of multifamily mortgage debt outstanding grew by just 2.0 percent in real terms, from \$826.8 billion in 2011 to \$845.7 billion in 2012. After adjusting for inflation, total debt outstanding in 2012 was only 0.2 percent below the 2009 peak of \$847 billion and more than \$265 billion (46 percent) above the 2002 level.

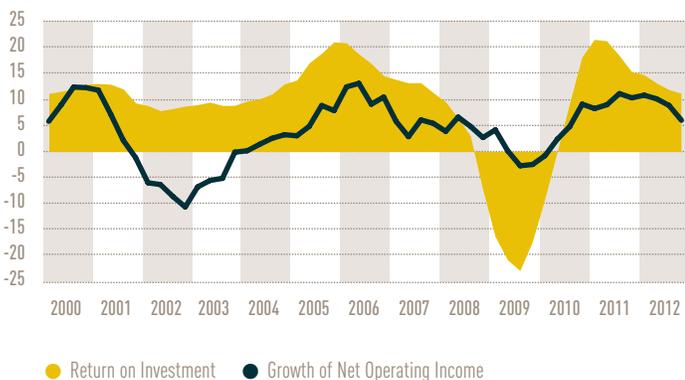
When other sources of capital exited in the wake of the financial crisis, Fannie Mae, Freddie Mac, and FHA/Ginnie Mae dramatically expanded their presence in the multifamily finance market, and they remain the primary players in that market today (Figure 26). Together these government agencies held or guaranteed 44.5 percent of all outstanding multifamily mortgage debt in 2012, with their debt outstanding up by \$24 billion in real terms from 2011 to \$376 billion. Still, other institutional sources of financing began to step up, with banks and thrifts increasing their multifamily loans by \$11 billion in 2011–12. Life insurance companies and pension funds also raised their participation to \$1.0 billion and \$0.8 billion, respectively. Meanwhile, the real amount of outstanding loans held in CMBS dropped by \$11.4 billion.

Although Fannie Mae and Freddie Mac both reported strong multifamily lending growth in 2012, with a combined \$62.6 billion in new purchases and guarantees, the continued ramp-up in FHA-insured loans reduced Fannie and Freddie's share of the overall multifamily business from previous years. FHA moved from an annual level of new commitments of just over \$2 billion in fiscal 2008 to \$14.6 billion in fiscal 2012. In terms of the number of rental units financed, this jump translates into an increase from 48,000 in 2008 to more than 200,000 in 2012.

FIGURE 25

Rental Property Investments Continued to Generate Solid Returns in 2012

Annual Rate (Percent)



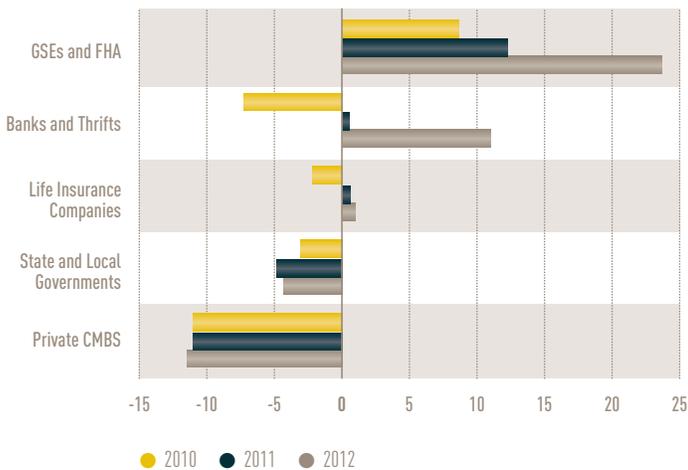
Notes: Data are for apartments. Net operating income is defined as gross rental income plus any other income less operating expenses. Annual rates are calculated across four quarters.

Source: JCHS tabulations of National Council of Real Estate Investment Fiduciaries (NCREIF) data.

FIGURE 26

Federal Sources Continue to Dominate the Multifamily Market, Although Lending by Banks and Thrifts Has Picked Up

Change in Multifamily Loans Outstanding (Billions of 2012 dollars)



Note: Dollars are adjusted for inflation using the CPI-U for All Items.
Sources: JCHS tabulations of Mortgage Bankers Association, Quarterly Reports; US Federal Reserve Board, Flow of Funds Accounts of the United States; US Federal Deposit Insurance Corporation, Quarterly Banking Profile.

Consistent with efforts to reduce its footprint in the owner-occupied market, the federal government has announced plans to pull back from multifamily lending as well. The Federal Housing Finance Agency’s stated goal is to reduce new multifamily lending by 10 percent in 2013 through a combination of higher prices, tighter underwriting, and more limited product offerings. FHA’s fiscal 2013 budget also projects a decrease in new multifamily commitments in the coming year.

Scaling back the lending capacity of the GSEs and FHA raises concerns about future financing for affordable multifamily housing. Government-backed loans are an important source of long-term, fixed-rate financing that is particularly suited to assisted housing developments that need to lock in financing costs to match the term of affordability. As policymakers take steps to reduce the role of the GSEs and FHA in multifamily lending, it is important to bear in mind the key role these institutions play in the affordable segment of the market, as well as in underserved and weaker markets where capital outside of government channels is scarce. But with government resources also constrained, there is a need to look for innovative ways to fill these gaps. One such example is a risk-sharing effort between FHA and state and local housing finance agencies that has been used to finance more than 100,000 affordable rental units at a lower cost to the federal government.

ADDITIONS TO THE RENTAL STOCK

Construction of approximately 186,000 new rental units (including both multifamily and single-family) was completed in 2012, still well below annual averages in the 1990s and 2000s. But with starts of new rentals rising over the course of the year to about 258,000 units, completions should return to more normal levels (Figure 27). Most of these units will be in multifamily buildings. In fact, more than 90 percent of multifamily units started in 2012 were intended for rent. By comparison, up to 45 percent of new multifamily units started at the height of the housing boom were intended for sale.

Given the high cost of new construction, most of these units are well out of reach for the growing ranks of low-income renters. The typical new unsubsidized apartment completed in the third quarter of 2012 had an asking rent of \$1,185. To afford such a unit at the 30-percent-of-income standard, a potential renter would need an annual income of more than \$47,000.

Since 2007, however, conversions of single-family homes from the owner to the rental market have contributed significantly more than new construction to the expansion of the rental inventory. Indeed, tenure switching has not only provided much needed housing for the growing number of renters, but it has also helped to stabilize communities hard-hit by rising vacancies during the housing crash.

The American Housing Survey shows that conversions of single-family units alone added 1.4 million units on net to the rental stock between 2009 and 2011, on top of the 1.0 million net increase that occurred between 2007 and 2009. While single-family homes have always made up a significant share of the rental inventory, the shares of renters living in these units rose substantially from 30.8 percent in 2005 to 34.1 percent in 2011. As a result, renters now occupy nearly one out of every six single-family homes.

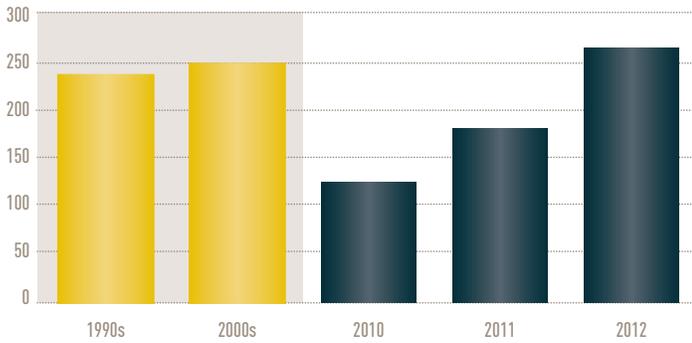
Small investors and local property owners continue to own the vast majority of the nearly 14 million single-family rentals nationwide. But since 2011, large investment pools have acquired single-family homes on an unprecedented scale with the intention of managing the properties as rentals. According to CoreLogic, institutional investors accounted for fully 30 percent of 2012 home sales in Miami and 23 percent in Phoenix. The largest of these investor groups have amassed portfolios of 10,000–20,000 single-family homes, many of them distressed properties concentrated in a few select markets.

A key issue for markets where investors have been most active relates to the longer-run impact on housing prices. For now, investors are earning returns from rents, but eventually they are likely to liquidate their real estate holdings when prices have recovered sufficiently. Over the past 12 months, prices of bottom-tier homes have already climbed sharply in several key metros including Atlanta (up 37 percent), Las Vegas (up 34

FIGURE 27

While Rental Housing Construction Has Rebounded to More Normal Levels ...

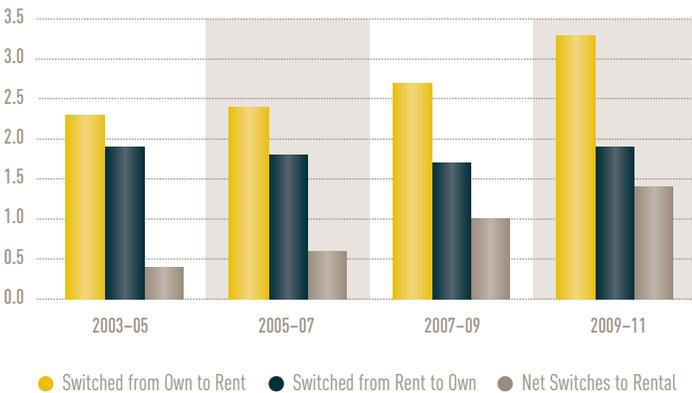
Average Annual Rental Starts (Thousands)



Source: JCHS tabulations of US Census Bureau, New Residential Construction.

... Conversions of Single-Family Homes from Owner-Occupied to Rental Account for Much of the Recent Increase in the Stock

Single-Family Units Switching Tenure (Millions)



Source: JCHS tabulations of HUD, American Housing Surveys.

percent), and Phoenix (up 39 percent). If many investors were to decide to lock in their gains by selling, house prices in these areas could again weaken.

THE OUTLOOK

Rental markets have rebounded so sharply that some observers have expressed concern about overheating. But so far, the indicators point to a healthy recovery. Construction activity has revived from its low during the recession but is still in line with the moderate levels of the 1990s. Meanwhile, vacancy rates continue to edge down and rental rates are moving up, providing no suggestion that supply has begun to outstrip demand.

But with long lags in bringing new multifamily units to market, it is certainly possible that demand could soften even as supply continues to ramp up. At its current pace, renter household growth remains roughly double the pace during the previous record-setting decade. As the homeownership market recovers, renter household growth will very likely slow and rental markets will have to adjust accordingly. Since much of the increased demand for rental housing has been satisfied by the expanded supply of single-family rentals, future market adjustments may come from a return of these units to owner-occupancy. In addition, the echo-boom generation should provide important ballast for rental demand in the coming years, helping to absorb the supply of new apartments coming on the market.

As with owner-occupied housing, a critical issue for the rental market going forward is whether other sources of multifamily financing will step up as the GSEs and FHA curtail lending. While the participation of private capital has increased in recent years, it is unclear how well these sources will meet the growing demand for multifamily financing, particularly for the affordable and underserved market segments.