



RENTAL HOUSING

Rental housing markets across the country tightened again in 2015. While multifamily construction ramped up for the fifth consecutive year, demand continued to outstrip supply, pushing down vacancy rates and pushing up rents. Although renter household growth is likely to slow from its current pace, rental demand should remain strong over the coming decade, keeping markets under pressure—particularly at the low end.

A VITAL RESOURCE FOR A DIVERSE NATION

Rental housing serves all types of households in a broad range of communities. In total, about 36 percent of US households—representing nearly 110 million people, including 30 million children—lived in rentals last year. While more than half of central city households rented their housing, the renter shares in suburban communities (28 percent) and in non-metro areas (27 percent) are also large.

Renters are more diverse than homeowners in terms of age, income, and household type (**Figure 26**). Although young adults are the age group most likely to rent, 34 percent of renter households are headed by an individual age 50 and over and 40 percent by an individual aged 30–49. While more than a third of renter households earn less than \$25,000, a sizable and growing number of high-income households also choose to rent for the flexibility and convenience it provides. Families with children, one of the household types most likely to own homes, are increasingly likely to rent. Indeed, families with children make up 31 percent of renters, but only 27 percent of homeowners.

Renters are also more racially and ethnically diverse than homeowners. Minorities and foreign-born households account for half of renter households, compared with just one in four homeowners. The differences are particularly striking among black and Hispanic households, with each group making up 20 percent of renters but less than 10 percent of owners.

A DECADE OF BROAD-BASED DEMAND

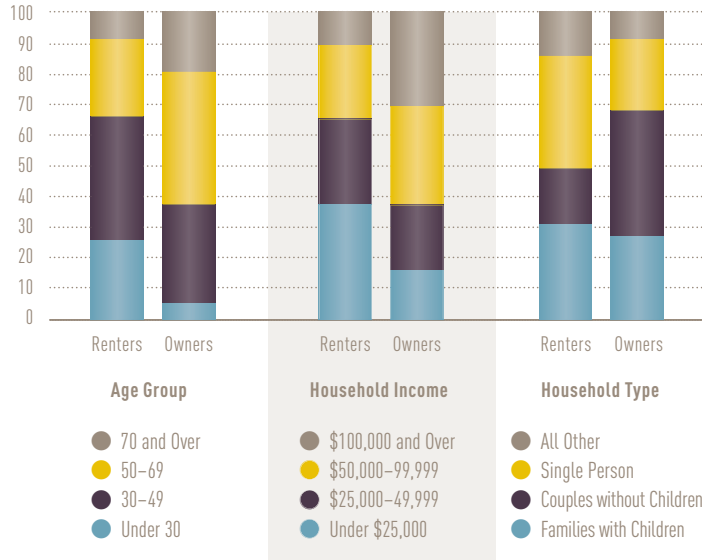
As measured by the Housing Vacancy Survey, the number of renter households soared by nearly 9 million from 2005 to 2015—the largest increase over any 10-year period on record. Moreover, 2015 marked the largest single-year jump in net new renter households, up 1.4 million, with most of the gains posted in the first half of the year. Renters have thus accounted for all of the net growth in households since 2005 (**Figure 27**).

Much of the jump in rental demand has come from middle-aged households. Current Population Survey data indicate that the number of renter households in their 50s and 60s rose by 4.3

FIGURE 26

Renter Households Reflect the Full Diversity of US Households

Share of Households (Percent)



Notes: Couples include both married and unmarried partners. Families with children include single parents and couples with children under age 18. Data are three-year rolling averages.
Source: JCHS tabulations of US Census Bureau, 2013-2015 Current Population Surveys.

million in 2005-2015, driven by both the aging of baby-boomer renters and declines in homeownership rates among this age group. Renter households age 70 and over also increased by more than 600,000 over the decade. Meanwhile, households in their 30s and 40s accounted for 3 million net new renters despite the dip in population in this age group. Households under age 30, however, made up only 1 million net new renters, reflecting the steep falloff in headship rates among the millennial generation following the Great Recession.

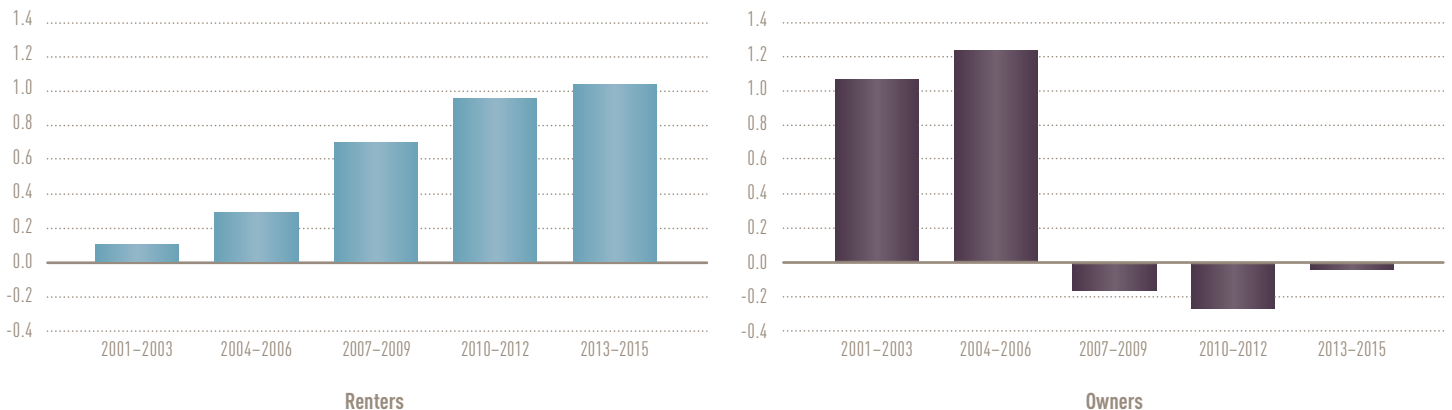
With the overall aging of the US population and the growth in the number of baby-boomer renters, single persons living alone (up 2.9 million) and married couples without dependent children (up 1.6 million) propelled much of the growth in renter households over the past decade. At the same time, though, the number of renters with children—including both couples and single-parent families—rose by 2.2 million.

While demand picked up across households of all incomes, nearly half of the net growth in renters (4.0 million) was among households earning less than \$25,000. Even so, the number of new renters earning \$50,000 or more increased nearly as much (3.3 million), including 1.6 million households earning \$100,000 or more. Top-income households have been the fastest growing segment over the past three years, but still make up only an 11 percent share of all renters.

FIGURE 27

Renting Has Surged Over the Past Several Years as Homeownership Has Stalled

Average Annual Growth in Households (Millions)



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

Minority and foreign-born households contributed two-thirds of the increase in renters in 2005–2015. Native-born minorities led growth, with 3.9 million households in this group joining the ranks of renters. Foreign-born minorities added another 1.9 million renter households. While minorities and immigrants traditionally drive growth in renter households, the number of native-born white renters also increased by 3.0 million over the past decade.

EVOLUTION OF THE SUPPLY

The single-family housing stock absorbed nearly two-thirds of the decade-long growth in renter households, lifting the single-family share of occupied rentals (including mobile homes) from 34 percent in 2005 to 40 percent in 2015. The sharp increase in single-family rentals resulted from conversions of millions of owner-occupied homes following the housing crash, stemming largely from the wave of foreclosures but also from owners' reluctance to sell in a depressed market.

In contrast, new construction was responsible for much of the growth in the multifamily stock. Indeed, the number of multifamily starts intended for rent climbed from a low of about 92,000 units in 2009 to 370,000 units in 2015, the highest level since the 1980s. Given the relatively long multifamily development timeline, starts remain well ahead of rental completions, which increased to 304,000 units last year.

According to the Survey of Market Absorption, new multifamily units have fewer bedrooms on average than those built over the past two decades. More than half of the unfurnished, market-rate rentals in structures with five or more units that were completed in 2014 were either studios or one-bedroom apartments—the largest share in history, and well above the 36 percent average share in the 1990s and early 2000s. Only 7 percent of apartments added in 2014 had three or more bedrooms, down from about 13 percent in earlier periods. Construction was also more concentrated in urban areas, with 57 percent of completions in the past two years located in principal cities compared with an annual average of 45 percent dating back to 1970.

While newer rentals have always commanded higher prices than older units, the premium for new apartments has risen sharply even as their size has decreased. The median asking rent for a new market-rate multifamily unit built in 2015 was \$1,381 per month, more than 70 percent higher than the overall median contract rent for multifamily apartments. The rent premiums for new studio and one-bedroom apartments were at highs of 90 percent and 78 percent, respectively. The steep rents for new units reflect rising land and development costs, which push multifamily construction to the high end of the market. They are also a measure of the growing demand from high-income renters for luxury apartments.

At the other end of the market, growth in the low-rent supply is largely driven by downward filtering of older units. For example, fully 15 percent of units renting for less than \$800 per month in 2013 had rents above this cutoff in 2003 (in inflation-adjusted terms). At the same time, however, many low-rent units were upgraded to higher rents. On balance, filtering increased the supply of units renting for under \$800 by just 4.6 percent between 2003 and 2013, a gain that was more than offset by the permanent loss of 7.5 percent of similarly priced units (Figure 28). Factoring in other changes to the stock, the number of low-cost units rose only 11.2 percent over the decade—less than half the increase in higher-rent units and far below the growing number of low-income renters for which these low-cost units would be affordable.

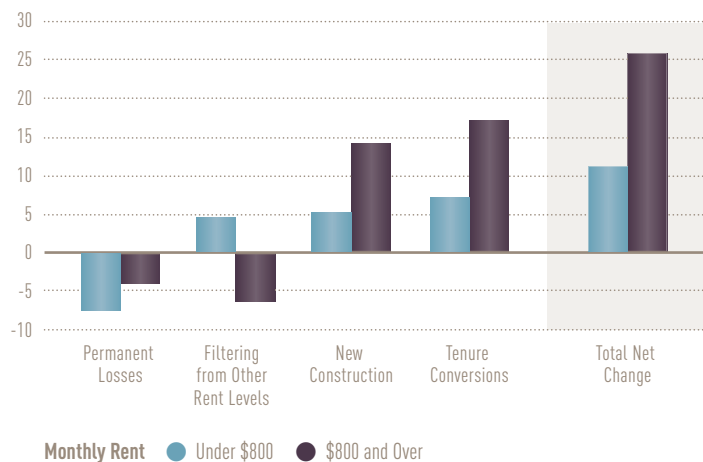
SEVERE GAPS IN SUPPLY

With the private market failing to provide housing affordable to many of the nation's lower-income households, the demand for low-cost rentals far outstrips supply. The shortfall is particularly acute for extremely low-income renters (earning up to 30 percent of the area median), but also extends to very low-income renters (earning up to 50 percent of the area median). A National Low Income Housing Coalition study found that, in 2014, there were only 31 rental units affordable and available for every 100 extremely low-income renters, and 57 rental units affordable and available for every 100 very low-income renters (Figure 29).

FIGURE 28

Permanent Losses and the Slow Pace of Filtering Continue to Limit the Supply of Low-Rent Units

Components of Change in the Rental Stock, 2003–2013 (Percent)

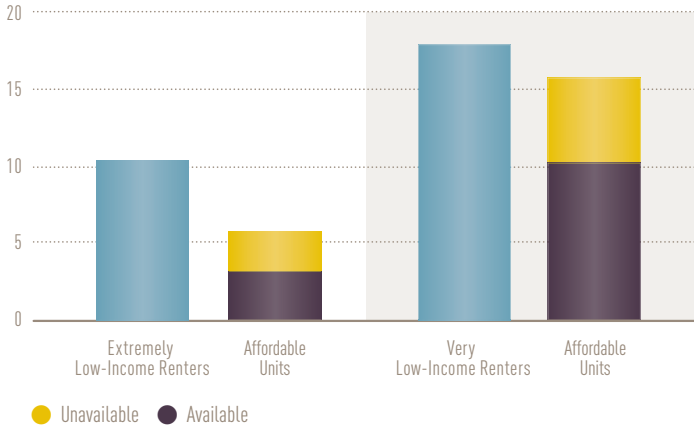


Notes: Estimates include only units with cash rent reported. Total net change includes conversions to and from other uses, such as seasonal and non-residential.
Source: JCHS tabulations of HUD, American Housing Surveys.

FIGURE 29

Low-Income Renters Far Outnumber the Supply of Available Units They Can Afford

Households and Units in 2014 (Millions)

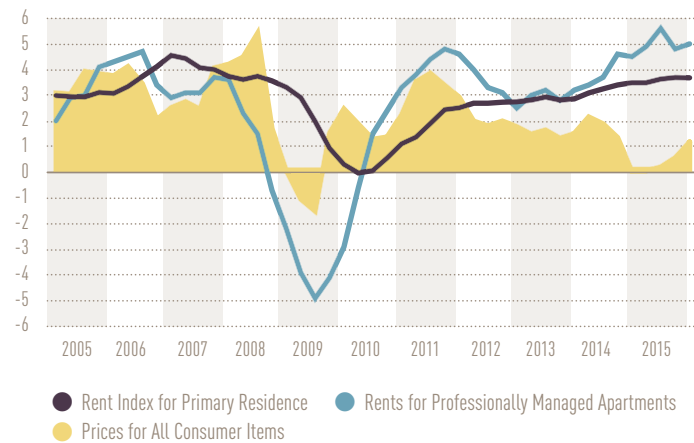


Notes: Extremely/very low-income households earn no more than 30%/50% of area medians. Affordable units have rents up to 30% of household income after adjusting for household and unit sizes.
Source: JCHS tabulations of National Low Income Housing Coalition, *The Gap: The Affordable Housing Gap Analysis 2016*.

FIGURE 30

Rents Continue to Climb Despite Unusually Low Price Inflation

Annual Change (Percent)



Source: JCHS tabulations of US Bureau of Labor Statistics and MPF Research data.

While large everywhere, the gap is especially wide in many faster-growing metros of the South and West. For example, Austin, Dallas, Las Vegas, Los Angeles, Orlando, Phoenix, Portland, Riverside, Sacramento, and San Diego all had no more than one affordable and available unit for every five extremely low-income renter households living in the area. The housing shortage for extremely low-income renters is most acute in the New York (610,000 units) and Los Angeles (382,000 units) metro areas.

Affordable rentals that can accommodate larger families are particularly difficult to find. As a result, the share of four-or-more-person renter families with children that were living in crowded conditions (more than two persons per bedroom) was nearly 19 percent in 2013, compared with an overall share of renter households of 5.5 percent. The incidence of overcrowding among large families classified as very low income is even higher at 25 percent.

One obvious reason for overcrowding is that larger rental units are generally more expensive than smaller units. Even more important, though, many of the larger units affordable to extremely low-income households are occupied by higher-income households. This includes 52 percent of three-bedroom units affordable to four-or-more-person households with extremely low incomes, 23 percent of two-bedroom units affordable to three-person households, and 28 percent of studios or one-bedroom units affordable to two-person households.

Accessible rentals are also in short supply. As of 2011, less than 40 percent of the rental stock had no-step entries, and only 7 percent had extra-wide halls and doors allowing wheelchair access. In total, just 1 percent of rental units offered these features as well as single-floor living, lever-style door handles, and accessible electrical controls. And although newer rentals in larger multifamily buildings are somewhat more likely to include these five basic accessibility features, their pricing is often out of reach for low-income elderly and disabled households.

PERSISTENT MARKET TIGHTENING

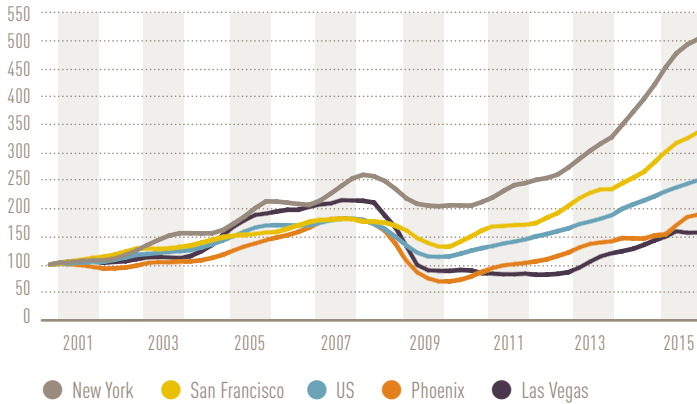
The inability of supply to keep up with the rapid rise in demand has led to the longest period of rental market tightening since the late 1960s. Starting in late 2010, the national rental vacancy rate fell for five consecutive years, hitting just 7.1 percent in 2015—its lowest point since 1985. In 2014–2015 alone, the vacancy rate for multifamily buildings with five or more units edged down another 0.9 percentage point while that for single-family rentals slipped 0.2 percentage point.

Growth in the Consumer Price Index for rent of primary residence continued through 2015, far outstripping overall inflation (Figure 30). This is a marked departure from the long-run trend, with rent increases averaging slightly below general inflation since the 1960s. Nominal rents continued their climb through March 2016, with annual rates of increase pushing 3.7 percent.

FIGURE 31

Apartment Property Prices in Hot Markets Have Surged Well Above Previous Peaks

Apartment Price Index



Source: Moody's Investors Service and Real Capital Analytics, Commercial Property Price Index for Apartments.

At the metro level, rent inflation ranged from under 2.0 percent in Cleveland, Philadelphia, and Washington, DC, to 6.0 percent or more in Houston, San Francisco, and Seattle.

The professionally managed apartment sector remains tight in most major markets, with MPF Research reporting a vacancy rate of just 4.2 percent in the first quarter of 2016—a 30 basis-point decline from a year earlier. Much of the recent tightening occurred within the two lower tiers (Class B and C) of the market. Overall vacancy rates varied widely from 3.0 percent or less in Los Angeles, Miami, Minneapolis, New York, Portland, and Sacramento, to more than 6.0 percent in Houston, Indianapolis, and Memphis. While more than two-thirds of the 94 metro areas that MPF Research tracks reported lower vacancies in the first quarter of 2016, a few major markets—such as Denver, Houston, and Pittsburgh—saw an uptick in rates from a year earlier.

Nationwide, rents in the professionally managed apartment sector rose by a strong 5.0 percent in the first quarter of 2016, up from 4.5 percent a year earlier. Increases were widespread, with rents in nearly all 94 metro markets on the rise. At the same time, however, rent growth slowed in a few areas, including Denver and Houston. In 18 of the nation's 25 largest markets, rent increases in the middle tier (Class B) outstripped those in the upper tier (Class A).

STRONG MULTIFAMILY PERFORMANCE

Investor returns on rental properties continued to climb last year. The National Council of Real Estate Investment Fiduciaries reports that net operating income for commercial-grade apart-

ments increased for the fifth consecutive year in 2015, up nearly 11 percent from 2014. The annual rate of return on rental property investments rose to 12 percent, driven in large part by price appreciation. This strong performance has attracted investor demand, pushing capitalization rates for apartment properties down to 4.8 percent by year-end—the lowest level since the third quarter of 2008.

According to Moody's/RCA Commercial Property Price Index, prices for apartment properties rose 13 percent in 2015, marking the sixth consecutive year of double-digit growth. As of March 2016, apartment property prices stood 39 percent above their previous peak in late 2007. By comparison, the CoreLogic index indicated that single-family prices remained 5 percent below their pre-recession high. Prices for apartment properties in highly walkable central business districts increased the most last year (19 percent), while those in car-dependent suburbs rose somewhat more slowly (13 percent).

While strong nearly everywhere, apartment property prices in certain markets have skyrocketed. As of the fourth quarter of 2015, prices in the New York metro area stood 93 percent above their previous peak, while those in San Francisco were up 85 percent (**Figure 31**). Apartment prices in Boston, Denver, and Washington, DC, also topped previous peaks by more than 50 percent. In contrast, property prices in Las Vegas and Phoenix were up more modestly, likely because of the large oversupply of single-family homes available to meet rental demand.

With rental property prices on the rise, delinquency rates for most types of multifamily loans fell in 2015. The share of multifamily loans held by FDIC-insured institutions that were at least 90 days past due or in non-accrual status dipped to just 0.28 percent in the fourth quarter, down from 0.44 percent a year earlier. In addition, the Mortgage Bankers Association indicates that 60-day delinquency rates for commercial/multifamily loans held by life insurance companies were at 0.04 percent, comparable to rates for loans held by Fannie Mae (0.07 percent) and Freddie Mac (0.02 percent).

Multifamily loans held in commercial mortgage-backed securities (CMBS) posted a sharp drop in what had previously been relatively high delinquency rates. According to Moody's Delinquency Tracker, the share of CMBS loans that were 60 or more days past due, in foreclosure, or in the lender's possession peaked at nearly 16 percent in early 2011 before steadily retreating to about half that share at the end of 2015. The share then fell to 2.1 percent in early 2016, but still more than double the 0.9 percent average in 2001–2007.

Unusually strong market conditions and historically low interest rates helped to propel a sharp rise in multifamily loan originations last year. The MBA Originations Index indicates that the dollar volume of multifamily loans originated increased 31 percent in 2015. Meanwhile, total loans outstanding (including

both originations and repayments/write-offs) shot up by nearly \$100 billion, to more than \$1 trillion.

Bank and thrift balances rose by \$47 billion (16 percent) in nominal terms over the past year, while debt backed by federal sources increased by \$48 billion (11 percent). The federal government held or guaranteed 45 percent of all outstanding multifamily mortgage debt in 2015, a large share by historical standards. With Fannie Mae and Freddie Mac still in conservatorship after nearly eight years, the government's future footprint in the multifamily lending market remains an open question.

THE OUTLOOK

Rental demand is expected to remain robust over the next decade as the youngest members of the millennial generation reach their 20s and begin to form their own households. Moreover, if homeownership rates for households in their 30s and 40s continue to slide, rental demand will be stronger still. For their part, the aging baby-boom generation will boost the

number of older renters, ultimately pushing up demand for accessible units.

It is unknown whether high-income households will continue to fill the growing inventory of higher-end rentals or make the transition to homeownership. Regardless, expanding the rental supply through new market-rate construction should provide some slack to tight markets as older units slowly filter down from higher to lower rents. Once high-end demand is sated, developers in some areas may turn their attention to middle-market rentals, although high development costs mean that building new units affordable to even moderate-income households is difficult without government subsidies.

And without public subsidies, the cost of a typical market-rate rental unit will remain out of reach for the nation's lowest-income households. Indeed, with housing assistance insufficient to help most of those in need, the limited supply of low-cost units promises to keep the pressure on all renters at the lower end of the income scale.