



## RENTAL HOUSING

After more than a decade of soaring demand and five years of real rent increases, rental markets across the nation remain extremely tight in 2016. Rapid growth in both renters and rents continued in most markets, although the pace moderated somewhat in certain high-cost markets. Meanwhile, multifamily construction took up the lead from single-family conversions in adding supply, but most of these new apartments are concentrated at the high end. As a result, the diminishing supply of low-cost rental housing remains in high demand, fueling ongoing concerns about the market's ability to meet the housing needs of lower-income households.

### PERSISTENT STRENGTH OF DEMAND

By the Housing Vacancy Survey's count, the number of renter households rose by 600,000 from 2015 to 2016, marking 12 consecutive years of growth and lifting net growth since 2005 to nearly 10 million (**Figure 25**). Although still solid, the level of renter growth in 2016 did represent a sharp deceleration from the previous two years.

Some 43.3 million households currently rent their housing, including more than 80 million adults and families with over 30 million children. The renter share of US households now stands at a 50-year high of 37 percent, up more than 5 percentage points from 2004, when the homeownership rate peaked.

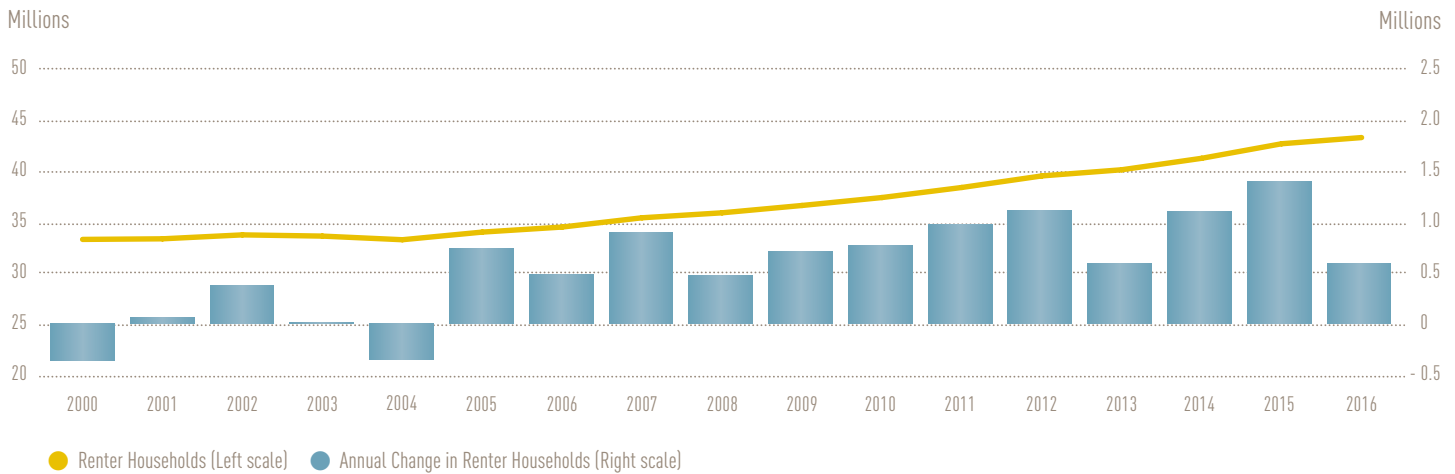
The surge in rental demand that began in 2005 is broad-based and includes several types of households that traditionally prefer homeownership—in particular, older adults, families with children, and high-income households. These changes reflect a number of factors, including the fallout from the mortgage foreclosure crisis as well as larger demographic shifts, particularly the aging of the US population.

Indeed, older households aged 55 and over accounted for fully 44 percent of renter household growth between 2005 and 2016. As a result, the share of renters in this age group increased to 27 percent last year—up from 22 percent in 2005. Renters under age 35 were responsible for the next largest share of growth (25 percent), driven primarily by their delayed entry into the homebuying market. Meanwhile, households in the 35–44 age range—the group that experienced the sharpest drop in homeownership after the housing crash—contributed 14 percent of renter household growth in 2005–2016 despite a net loss of households in this age range.

Families with children are also increasingly likely to rent rather than own their homes. The share of these households living in rental housing jumped from 32 percent in 2005 to 39 percent in 2016, accounting for 22 percent of renter household growth over this period. The large increases in renting among families with children reflect high rates of foreclosure-induced exits from

FIGURE 25

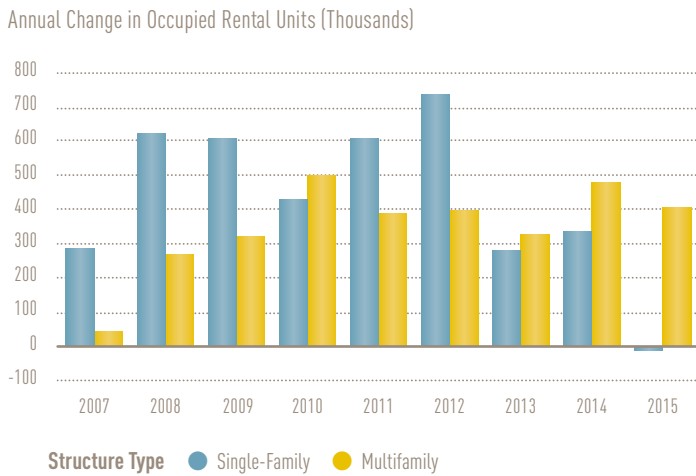
### Rental Demand Was Up for the 12th Consecutive Year in 2016



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

FIGURE 26

### Single-Family Additions to the Rental Supply Have Slowed



Note: Single-family homes include both detached and attached units as well as mobile homes and trailers. Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.

homeownership in combination with lower rates of homebuying since the Great Recession. As a result of these shifts, the share of children living in rental housing climbed from 29 percent in 2005 to 36 percent in 2016.

Meanwhile, the share of high-income households (earning at least \$100,000) that rented their homes increased from 12 percent to 18 percent from 2005 to 2016. High-income households thus drove 22 percent of the overall growth in renter households, while households earning \$50,000–99,999 accounted for an equal share. The move to renting among high-income households—most with two earners—intensified in recent years, accounting for nearly half (47 percent) of the growth in renters between 2013 and 2016.

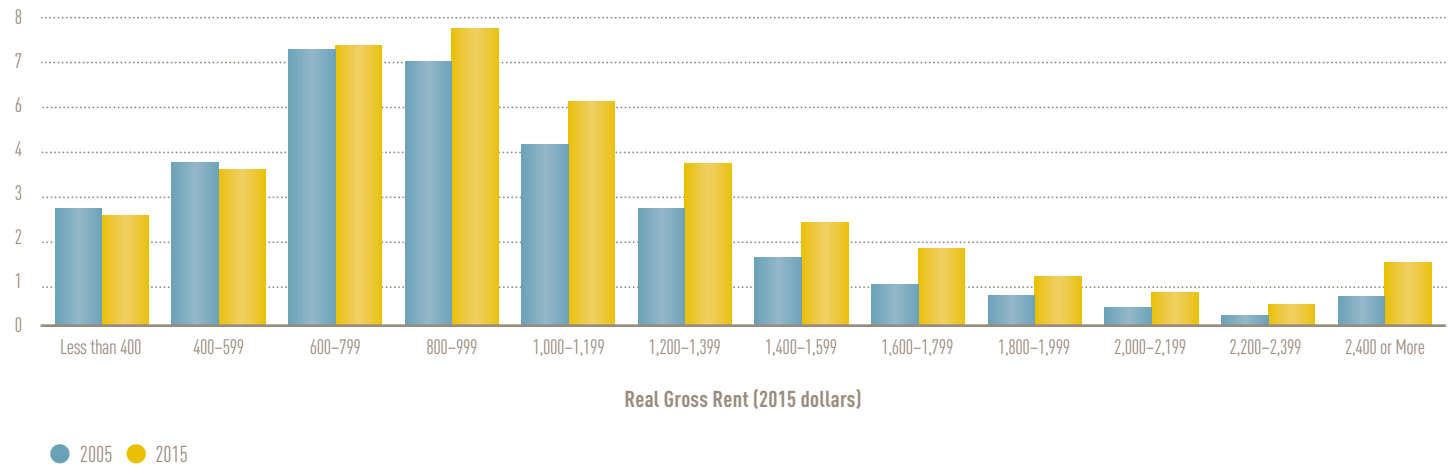
Despite the influx of higher-income households into the market, the typical renter household had an annual income of just \$37,900 in 2015—only about half the \$70,800 annual income of the typical homeowner household. In addition, 16 million renter households had annual incomes of less than \$25,000, including 11 million with incomes below the federal poverty threshold.

According to the latest American Community Survey, the share of households renting their homes continued to grow in the majority of the nation’s largest 50 metro areas between 2013 and 2015. Increases in renting even picked up pace in several markets (including Houston, Jacksonville, and Miami) relative to the previous eight years. However, the renter share of households actually fell in 11 of the 50 largest metros.

FIGURE 27

## As Losses in Low-Rent Units Continue, Growth of the Rental Housing Stock Is Shifting to the High End

Number of Rental Units (Millions)



Notes: Data exclude rental units occupied without payment of rent. Gross rents are adjusted by the CPI-U for All Items less shelter. Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.

### SHIFTS IN THE RENTAL SUPPLY

Changes in the supply of rental housing reflect a mix of new construction, conversions to and from owner occupancy and other uses, and losses of housing from the stock due to structural inadequacies and demolitions. Between 2005 and 2015, increases in single-family rental homes drove much of the growth in occupied rentals, adding nearly 4 million units on net to the national stock and lifting the single-family share from 36 percent to 39 percent. Over this period, the single-family share of occupied rental housing increased in 49 of the 50 largest metros (New Orleans being the exception), with especially strong growth in areas with high foreclosure rates and little new multifamily construction (such as Cleveland, Memphis, Phoenix, and Riverside).

But construction of multifamily housing has been increasing since 2010 and replaced single-family homes as the primary source of rental stock growth in 2013. In fact, the number of single-family homes occupied by renters fell slightly in 2015 while the number of renter-occupied multifamily units—mainly in large structures with 10 or more apartments—increased by 407,000 (Figure 26). Growth in the large multifamily share of rentals in 2013–2015 was particularly strong in metros such as Austin, Portland, and Seattle, where new construction added significantly to the stock.

Completions of new multifamily units totaled 321,000 in 2016, only slightly higher than the 2015 level but up 5 percent from annual averages in the 2000s. Over 90 percent of multifamily units started or completed last year were intended for the rental

market, and more than 80 percent were in properties with 20 or more units. In addition, nearly half of new multifamily rental units completed in 2015 were located in structures with at least four floors—more than double the share in 2005. Although typical floor area has changed little over time, newer rental units are less likely to have three or more bedrooms.

Recent additions to the rental supply remain concentrated at the upper end of the market. According to preliminary data from the Survey of Market Absorption, the typical asking rent for a new unfurnished apartment climbed by 5.6 percent annually in real terms in 2016, rising to \$1,478. Although newly constructed units have always commanded a rent premium, the asking rent for new multifamily apartments increased significantly from 61 percent above the median asking rent for all existing vacant units in the 2000s to 73 percent in 2016. The 2015 American Community Survey data for the 100 largest metros confirm this trend, indicating that nearly half (46 percent) of the rental units built in 2010 or later were in the top quartile of area rents, while more than two-thirds fell into the top half.

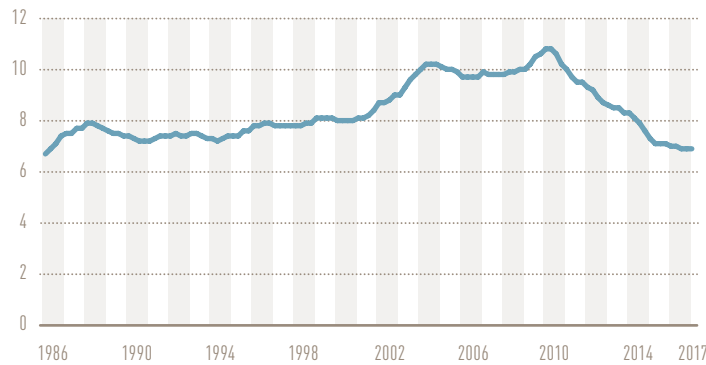
### SHORTAGES OF LOW-COST RENTALS

Although new rental construction is aimed primarily at the upper end of the market, these additions to the stock have the potential to alleviate pressure at the lower end if some units filter down to lower rent levels. But even with multifamily construction at its highest level in two decades, additions to the rental supply have not kept pace with swelling demand. As a result, rents have climbed across the board (Figure 27). Indeed,

FIGURE 28

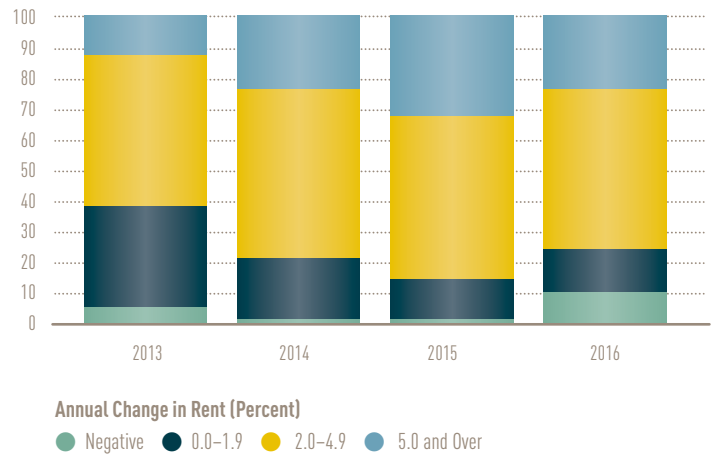
**With the US Rental Vacancy Rate at a 30-Year Low, Rents Are Still Increasing in the Majority of Apartment Markets**

US Rental Vacancy Rate (Percent)



Notes: US rental vacancy rates are four-quarter rolling averages. Metro data are for professionally managed apartment properties in the 100 market areas tracked by MPF Research.  
Sources: JCHS tabulations of US Census Bureau, Housing Vacancy Survey, and MPF Research data.

Number of Metro Markets



bolstered by new high-end construction and rising rents for existing apartments, the number of units renting for \$2,000 per month or more increased 97 percent in real terms between 2005 and 2015. At the same time, the supply of units renting for less than \$800 declined by 2 percent, with most of the loss occurring at the lowest rent levels. The total number of units renting for less than \$800 declined by over 260,000 from 2005 to 2015, a time when the overall rental stock increased by over 6.7 million units. The shift in the rental stock toward the high end is also clear from the 32 percent rise in real median asking rents since 2000.

Nearly half of the nation’s 100 largest metro areas posted absolute declines in their stocks of low-rent units (defined as having real gross rents under \$800) between 2005 and 2015. Metros with the largest losses in percentage terms included Austin, Denver, Portland, and Seattle, where supplies were down by a third or more. At the same time, 88 of the largest 100 metros reported declines in the shares of low-rent units. Among the markets with the smallest shares were San Diego, San Jose, and Washington, DC, where under 10 percent of units rented for less than \$800 in 2015.

The result is a worsening mismatch of demand and supply, with the number of low-income renters far outstripping the number of available units at the lowest end of the market. Indeed, the National Low Income Housing Coalition reports that the absolute deficit of rental units affordable and available to low-income households exceeds 500,000 in the New York and Los Angeles metro areas. In addition, the gap in units affordable and available to extremely low-income renters exceeds 50,000 in fully 31 metropolitan areas. The failure of higher-end units to

filter down to lower price points is also apparent in the deficit of units affordable and available to middle-income renters in more than 10 metro areas, including Los Angeles, New York, Miami, and San Francisco.

**VACANCY RATE AT NEW LOWS**

Despite the recent burst of multifamily construction, the national rental vacancy rate slipped to a 30-year low of 6.9 percent in 2016. Indeed, rental markets in most areas of the country remain tight. MPF Research reports that vacancy rates for professionally managed apartments in early 2017 were under 3 percent in 20 of the 100 markets it tracks, and under 5 percent in 65 of those markets.

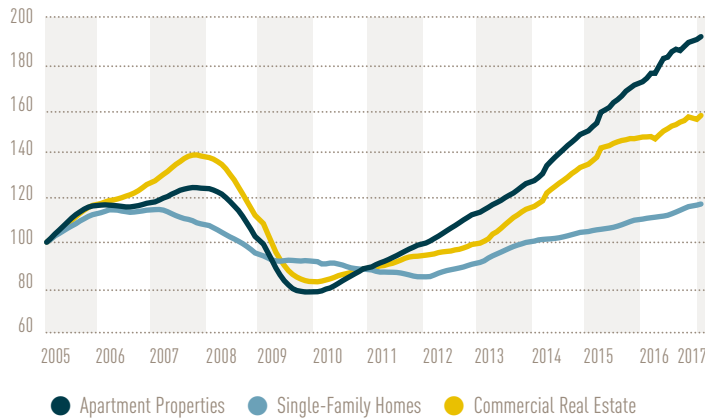
Under these historically tight conditions, rents were up both nationally and in the majority of markets in early 2017. The US Consumer Price Index for rent of primary residence rose at a 3.8 percent annual rate through April, far exceeding the 0.9 percent inflation rate for non-housing-related goods. According to MPF Research data, rents for units in professionally managed properties were up by 3.7 percent nationwide in early 2017, with increases in 91 of the 100 markets tracked.

Rental market conditions did, however, show some signs of easing last year. For one, the nominal rent increase MPF Research reported represents a slowdown from the 4.7 percent pace averaged in 2014–2015. In addition, rent gains decelerated in 2016 in more than half (58) of the 100 markets that MPF Research tracks, while the number posting actual rent declines rose to 10 (Figure 28). Among the list of metros where rents were down

FIGURE 29

## Apartment Property Prices Have Appreciated Much More Rapidly than Single-Family Home and Commercial Real Estate Prices

Index Values



Note: Data are monthly through February 2017.

Sources: JCHS tabulations of Moody's/RCA Property Price Indexes; S&P CoreLogic Case-Shiller U.S. National Home Price Index.

are several large, high-profile markets, including Houston, New York City, and San Francisco.

Within markets, signs of easing were most apparent in the high-end segment. Vacancy rates for professionally managed (Class A) rentals were up in more than two-thirds of the 100 markets in the first quarter of 2017 from a year earlier, climbing more than 2.0 percentage points in many areas to a nationwide average of 6.4 percent. At the same time, however, vacancy rates in the lowest-quality segment (Class C) fell nationwide for the seventh straight year, to just 3.8 percent.

### STRONG RENTAL PROPERTY PERFORMANCE

With ultra-low vacancy rates and widespread real rent gains, multifamily rental properties continued to perform well. According to data from the National Council of Real Estate Investment Fiduciaries (NCREIF), net operating income for investment-grade properties rose for the seventh consecutive year in 2016. While lower than the 10.7 percent gain in 2015, last year's increase was still strong at 6.9 percent.

The rise in nominal apartment property prices also slowed somewhat from a 14.8 percent increase in 2015, but remained a healthy 11.0 percent in 2016 according to Moody's/RCA Apartment Price Index. As of March 2017, apartment property prices were still rising at an 8.1 percent annual rate, and exceeded the 2007 peak by 52 percent in nominal terms and 31 percent in real terms. The impressive rebound in rental property prices far outstrips the recoveries in both the single-family housing and commercial real estate markets (Figure 29).

Meanwhile, annual investor return on investment dipped to 6.7 percent in the first quarter of 2017, following several years of double-digit gains. Still, investor demand for rental properties remains strong, with NCREIF data showing a drop in the required rate of return or capitalization rate to 4.6 percent in the first quarter of 2017—one of the lowest rates posted in records dating back to 1982. Indeed, CBRE reports even lower cap rates for Class A multifamily properties in city centers of several large markets, including Los Angeles, New York, and San Francisco.

Many property owners have taken advantage of years of strong financials to make improvements deferred during the downturn. The National Apartment Association (NAA) reports that capital spending per unit increased 13 percent annually from 2010 to 2015 in real terms. Community-wide upgrades often focus on fitness centers, business centers, clubhouses, and other common areas, while in-unit improvements typically include installation of washer/dryers and high-end kitchen appliances. According to other NAA/Axiometrics research, these upgrades and other major renovations have lifted effective rents for apartment properties 8 percent on average.

### ROBUST MULTIFAMILY LENDING

The value of multifamily debt outstanding rose by nearly \$100 billion in 2016, marking the second year of record-high increases and lifting the total to over \$1.1 trillion. More than two-thirds of the growth (\$67 billion) came from federal sources, while banks and thrifts contributed \$39 billion. In contrast, multifamily mortgage debt in commercial mortgage backed securities continued to shrink, by \$15 billion.

At the same time, however, MBA's Multifamily Originations Index indicates that growth in the dollar value of loan originations slowed from 31 percent in 2015 to just 6 percent last year. One of the reasons for this moderation may be changing multifamily lending standards. According to a Federal Reserve survey in the first quarter of 2017, one-third of domestic banks reported tightening standards for commercial real estate loans secured by multifamily residential structures, up from 22.5 percent a year earlier and no reports of tightening two years earlier.

Stricter underwriting comes partly in response to concerns over rising property prices as well as excess high-end supply in some markets. Developers also grew more cautious as evidenced by the Federal Reserve's survey of loan officers, with the share reporting stronger demand for multifamily loans falling from 20.6 percent at the end of 2015 to just 2.9 percent at the end of 2016.

Loan performance in the rental property sector continued to improve last year. Only 0.18 percent of all FDIC-insured loans secured by multifamily residential properties were in noncurrent status (90 days past due or in nonaccrual status) as of the last quarter of 2016, down from 0.28 percent a year earlier.

According to Moody's Delinquency Tracker, the noncurrent rate for commercial mortgage-backed securities (60 days past due, in foreclosure, or REO) was higher but still stood at a relatively low 2.5 percent in March 2017.

#### **THE OUTLOOK**

The last 12 years have seen unprecedented growth in rental housing demand across a broad cross-section of US households. New multifamily construction has rebounded strongly in an effort to keep up with this surge in demand, with most new supply aimed at the upper end. While there are indications that some luxury segments are becoming saturated, rental conditions in a large majority of metropolitan areas remain tight.

Growth in rental demand may, however, moderate as the share of households opting to rent appears to be stabilizing near 37 percent. But with the large millennial generation now moving into their 20s and 30s, Joint Center projections point to solid growth in renter households over the next 20 years. And even if demand were to slow, there is still broad need for additional supply—particularly of rental units at the lower end of the market where ultra-low vacancy rates are pushing up rents.

In the near term, rising vacancy rates at the upper end, record-setting apartment prices, and the specter of interest rate hikes have the potential to slow the growth in luxury units. But given how tight rental markets remain and the ongoing strength of demand, any slowdown in construction will likely be neither steep nor prolonged.