5 / RENTAL HOUSING

Rental markets are basically stable despite the upturn in homeownership. Demand from higher-income households is still on the rise, and construction of rental housing picked up again last year after a slight dip. Low vacancy rates across the board are pushing up the prices of multifamily properties, while also keeping the pressure on rents. Conditions at the lower end of the market are especially tight, with high demand for a shrinking supply of low-cost units adding to affordability concerns.

MODEST DECREASE IN RENTER HOUSEHOLDS

All three major annual household surveys show a decline in renter households, although the size of the decrease varies. According to the Housing Vacancy Survey, the share of renter households dropped a full percentage point from 2016 to 2018, to 35.6 percent **(Figure 25).** By the Current Population Survey's measure, the number of renter households fell by 460,000 in 2017–2018, while the Housing Vacancy Survey puts the decline at 110,000, with a slight rebound in the first quarter of 2019. Although a year behind, the latest American Community Survey also shows a drop of about 473,000 renter households in 2016–2017.

The modest downturn occurred across the country, with the number of renter households declining by an average of 2 percent in 32 states between 2016 and 2017. Similarly, just over half of all metros with populations above 50,000 and micropolitan areas with populations between 10,000 and 50,000 lost renters over this period. In general, the largest and most expensive metros posted the biggest decreases in renter households while smaller areas posted gains.

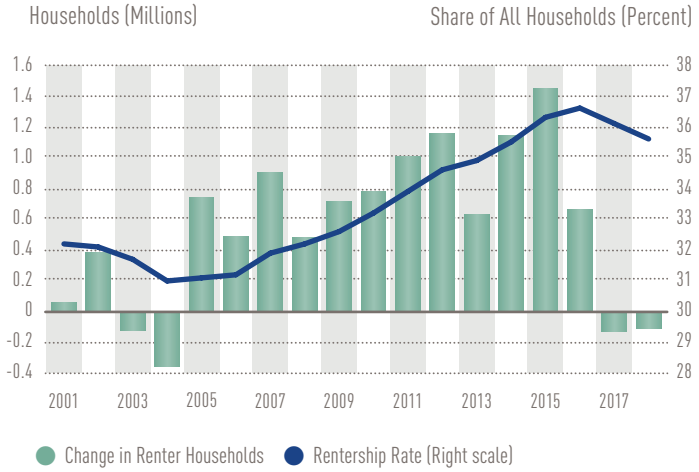
Despite the overall decline in renter households, there was strong growth in the numbers of older and higher-income households that now rent their housing. According to the Current Population Survey, the number of renter households headed by a person age 55 and over rose by about 189,000 in 2018, following gains of 343,000 on average in the prior two years. With these increases, older households now make up more than a quarter of renters. Households under age 35, however, still account for the largest share of renters at 38 percent.

Meanwhile, a growing number of higher-income households rent their homes. Consistent with nationwide growth in households with incomes of at least $75,000 in constant 2017 dollars, the number of renters in this income group rose by 311,000 from 2017 to 2018. This was the eighth consecutive annual increase in higher-income renters, lifting their numbers by 4.6 million, or 66 percent, since 2010 **(Figure 26).** The share of renter households earning at least $75,000 now exceeds 25 percent, up from 19 percent in 2008.

The uptick in higher-income renter households reflects a broader shift in renter incomes as the economy continues to improve.

FIGURE 25

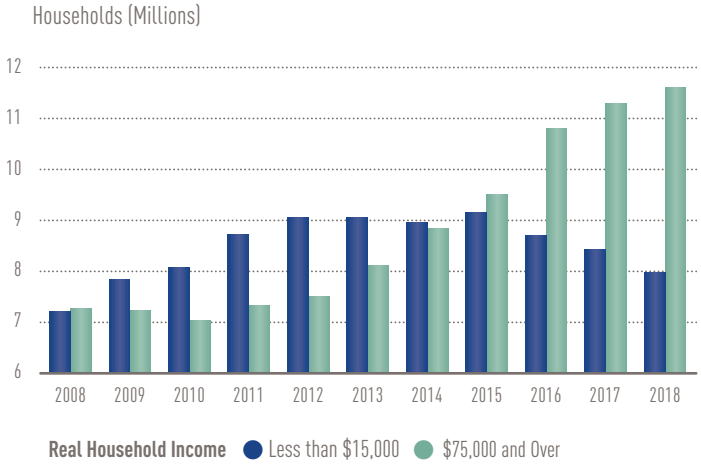
The Number and Share of Renter Households Declined Again in 2018



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

FIGURE 26

Growth in Higher-Income Renters Has Helped to Sustain Rental Demand



Note: Income categories are adjusted to 2017 dollars using the CPI-U for All items.
Source: JCHS tabulations of US Census Bureau, Current Population Surveys via IPUMS CPS.

Indeed, the number of renter households making less than $15,000 declined by 451,000 in 2017–2018. Despite these positive trends, though, more than half of all renter households still make less than $45,000. In fact, the real annual median renter income fell slightly from $40,850 in 2017 to $40,530 in 2018.

CONSTRUCTION STILL GOING STRONG

Whether measured by completions, starts, or permits, rental housing construction remained strong in 2018. Even after a 5 percent dip last year, the number of completed rentals was close to a 30-year high at 360,000 units, including 316,000 in multifamily buildings with at least two units. Rental starts were up 5 percent from 2017, to 392,000 units, with nearly 90 percent in multifamily buildings. Permits for new units in multifamily structures with at least five apartments totaled 427,400 units in 2018, a slight increase from the 424,800 permitted in 2017.

According to the Survey of Construction, 53 percent of new multifamily rentals completed in 2017 were in properties with at least 50 units, while only 6 percent were in buildings with less than 10 units. Many newly completed apartments offer added amenities. For example, 71 percent of the units that came on the market in 2017 had access to an on-site swimming pool and almost 90 percent had in-unit laundry.

While no doubt desirable, these amenities have helped to lift asking rents. The Survey of Market Absorption shows a median asking rent of $1,670 for new apartments in unsubsidized multifamily buildings completed in the first quarter of 2018. By comparison, the American Community Survey reported a median asking rent in 2017 of just $1,010 for apartments in buildings with at least five units. Nationwide, 29 percent of newly completed apartments in early 2018 had asking rents at or above $2,050 while another 35 percent had rents between $1,450 and $2,049. Median asking rents for new units were highest in the Northeast at $2,260—a full $1,000 above the median in the Midwest. Nearly three-quarters of multifamily rental units completed in 2018 were in the South (43 percent) and West (29 percent), where median asking rents topped $1,500.

In addition, American Community Survey 5-year estimates indicate that 92 percent of occupied rental units built between 2014 and 2017 were located in metropolitan areas with populations of 50,000 and above. Of these units, 56 percent were in suburban neighborhoods and the remainder in core cities. Meanwhile, only 6 percent of occupied rental units added in 2014–2017 were in smaller micropolitan areas and 2 percent in rural areas. Compared with the locations of existing rentals, the shares of new units built in urban, micropolitan, and rural areas are slightly lower while the share built in suburban areas is slightly higher.

Although the number of renter households declined in 2018, demand for newly constructed units remained steady with the growth in higher-income households. According to the Survey of Market Absorption, 79 percent of apartments completed in 2017 were rented before the second half of 2018—on par with absorption rates in the early 2000s before the housing market downturn. RealPage data for the first quarter of 2019 confirm that demand for professionally managed apartments is closely tracking new rentals **(Figure 27).** At the regional level, demand early this year modestly exceeded new supply in the Northeast and Midwest, while supply essentially matched demand in the South and West.

SHIFTS IN THE EXISTING RENTAL STOCK

The nationwide supply of occupied or vacant housing units for rent fell by 338,000 between 2016 and 2017—the first net reduction in the number of rental units since 2006 and the largest annual decline in the last 15 years. The decrease in rental housing was widespread, occurring in more than half (53 percent) of all 383 metro areas.

Single-family rentals accounted for the largest losses, falling by more than 250,000 units in 2017. Even with this sizable decline, though, single-family homes still make up about a third of the national rental stock, or about 15.8 million units. Moreover, since most of these lost single-family rentals were built between 2000 and 2009, it is likely that they were converted to owner occupancy rather than permanently removed from the housing stock. Just under half of the lost single-family rental units were in the South, where single-family homes make up 38 percent of the rental stock. Although the number of single-family rentals increased in the Northeast in 2017, single-family homes still represent only a fifth of the region's rental supply.

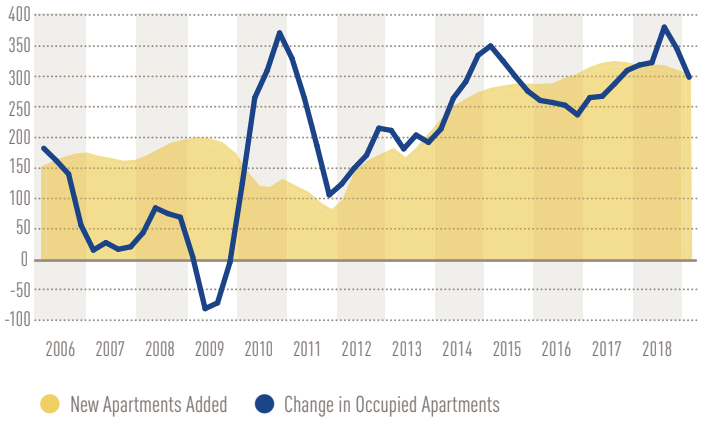
Some 142,000 rentals lost in 2017 were in multifamily buildings with two to four units. Like the drop in single-family rentals, conversions to owner occupancy likely explain some of the decline in rental units in smaller buildings. Indeed, the share of households living in these buildings that rented their apartments dropped slightly from 83.4 percent to 82.7 percent in 2017.

While rental losses have been concentrated in smaller structures, new construction has continued to add units in larger buildings. The number of rentals in buildings with 20 or more apartments rose by 201,000 from 2016 to 2017, with just over half of these additions in buildings with at least 50 apartments. While somewhat smaller than in previous years, the increase in rental units in buildings with 20 or more units in 2016–2017 was the fourth annual net gain in a row, bringing total additions from 2013 to 2017 in larger buildings to more than 1 million apartments.

FIGURE 27

Apartment Demand Continues to Grow in Line with Additions to Supply

Rental Units (Thousands)



Note: Change in occupied apartments, or net unit absorptions, is the change in physically occupied units from one period to the next.
Source: RealPage data.

CONTINUING TIGHTNESS OF RENTAL MARKETS

Rents nationwide continued to climb in 2018, up 3.6 percent for the year according to the Consumer Price Index. While this was a slight deceleration from 3.8 percent in 2017, rent growth picked up pace again in the first months of 2019. Year-over-year rent growth hit 3.8 percent in April, more than double the rate of inflation for other items. RealPage data for multifamily apartments in 150 metros also show an acceleration, with nominal rent growth increasing from 2.6 percent in the first quarter of 2018 to 3.3 percent in the first quarter of 2019. Meanwhile, CoreLogic data indicate that rent growth for single-family units increased from 2.7 percent in January 2018 to 3.2 percent in January 2019.

RealPage data also show that rents for multifamily units are rising fastest in the West, where year-over-year growth climbed from 3.5 percent at the beginning of 2018 to 3.7 percent in the first quarter of 2019. Rents were also up 3.2 percent in the South in early 2019, but less than 3.0 percent in the Midwest and Northeast.

Of the 150 metros tracked by RealPage, 87 posted nominal increases in rents for multifamily units above 3.0 percent from the first quarter of 2018 to the first quarter of 2019. In 25 of those metros (including Eugene, Gainesville, and Phoenix), rents rose by more than 5.0 percent. Nominal rents declined in only three metros (College Station, Fargo, and Santa Rosa) over this period.

Rent growth in all segments of the market continued in early 2019. With demand from higher-income households increasing, rent growth for higher-quality properties (with a CoStar rating of four or five stars) rose from 2.1 percent at the beginning of 2018 to 2.9 percent at the beginning of this year. At the same time, rent increases for lower-quality properties (with a CoStar rating of one or two stars) slowed slightly from 3.2 percent to 3.0 percent over this period. This is the weakest growth in that segment in the last four years, coinciding with the drop in the number of lowest-income renter households. Nevertheless, the persistent rise in rents for lower-quality units remains a cause for concern.

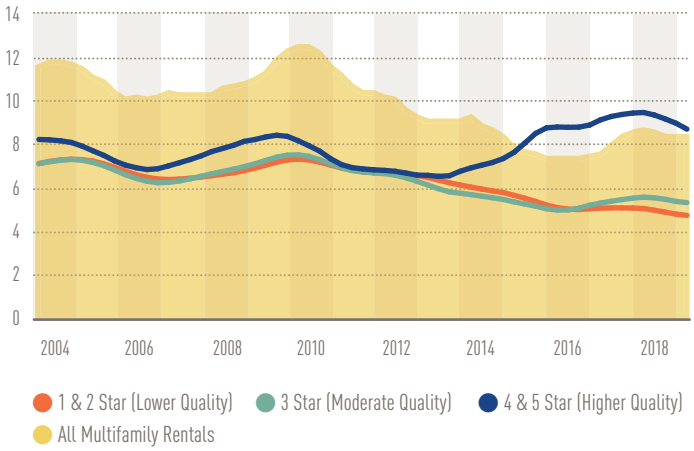
Low vacancy rates have kept the pressure on rents. The Housing Vacancy Survey reports a further decline in the annualized rental vacancy rate from 7.2 percent in the first quarter of 2018 to 6.9 percent in 2019. Annualized vacancy rates are lowest in the West (4.8 percent) and the Northeast (5.3 percent), although tightening is evident across all regions. In addition, rental vacancies in 94 of the 150 metros tracked by RealPage fell from the beginning of 2018 to the beginning of 2019.

Vacancy rates also dipped across property classes **(Figure 28).** Rates for CoStar's top-ranked properties declined through 2018 to 8.6 percent at the beginning of 2019 after several years of softening. At the same time, the rate for lower-quality properties fell from 5.0 percent in the first quarter of 2018 to just 4.8 percent in the first quarter of 2019, while that for moderate-quality properties edged down from 5.6 percent to 5.4 percent. The Housing Vacancy Survey also shows a year-over-year decline in single-family rental vacancies from 6.2 percent to 5.8 percent in the first quarter of 2019.

FIGURE 28

Rental Vacancy Rates Fell Across the Board in 2018

Share of Units Vacant (Percent)



Notes: Apartment quality is based on the CoStar Building Rating System. CoStar data include market-rate apartments in buildings with five or more units. Housing Vacancy Survey data include all apartments in buildings with five or more units. Vacancy rates are smoothed four-quarter trailing averages.
Source: JCHS tabulations of US Census Bureau, Housing Vacancy Surveys, and CoStar data.

HEALTHY RENTAL PROPERTY PERFORMANCE

With steady rent gains and low vacancy rates, net operating incomes for multifamily properties remained strong in 2018. The National Council of Real Estate Investment Fiduciaries reports that annualized growth of net operating income jumped from 3.4 percent in the first quarter of 2018 to 7.5 percent in the first quarter of 2019. At the same time, National Apartment Association data show a 2.1 percent nominal rise in operating expenses and an 11.3 percent increase in capital expenditures. As a result, annualized returns on investment held steady at 5.9 percent in early 2019—well below the 10.4 percent average in 2013–2016 but still far outstripping overall inflation.

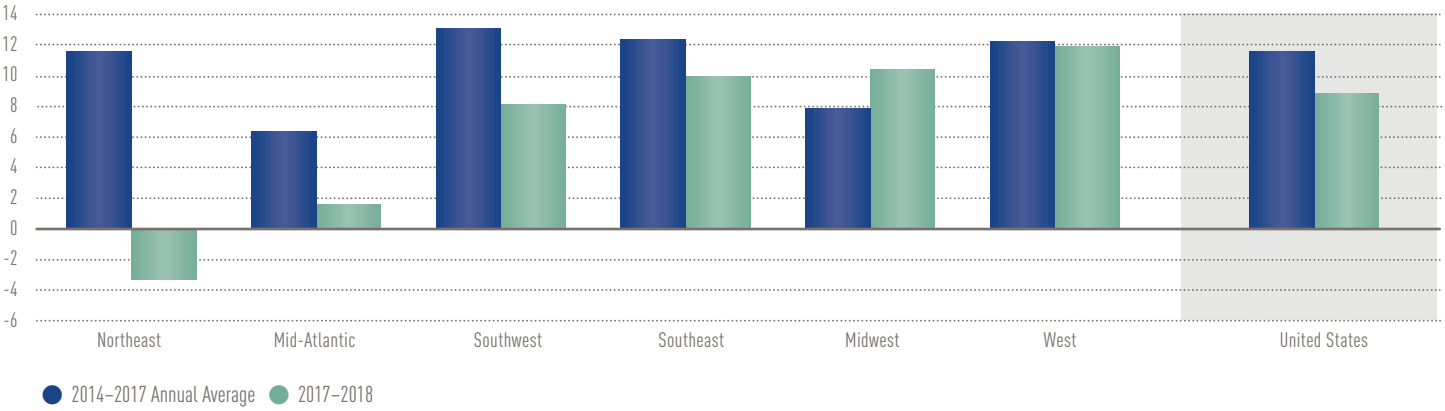
According to the Real Capital Analytics Commercial Property Price Index, apartment prices cooled at the end of 2018 but still posted year-over-year growth of 9.0 percent. Growth in rental property prices continued to slow through the beginning of 2019, but prices were still up 7.1 percent year-over-year in April. The largest price increases in 2018 were in the West at 11.9 percent **(Figure 29).** The Northeast was the only region where nominal property prices lost ground last year, declining 3.3 percent after averaging 11.6 percent fourth-quarter to fourth-quarter growth for the previous three years. Nationally, prices rose the most for properties in car-dependent suburbs and for garden-style apartment buildings.

The ongoing rise in property prices has increased the cost of investing. The Freddie Mac Apartment Investment Market Index, measuring the relative value of multifamily investments, dropped 7.5 per-

FIGURE 29

Despite Some Slowdown Last Year, Apartment Property Prices Continue to Climb in Most Regions

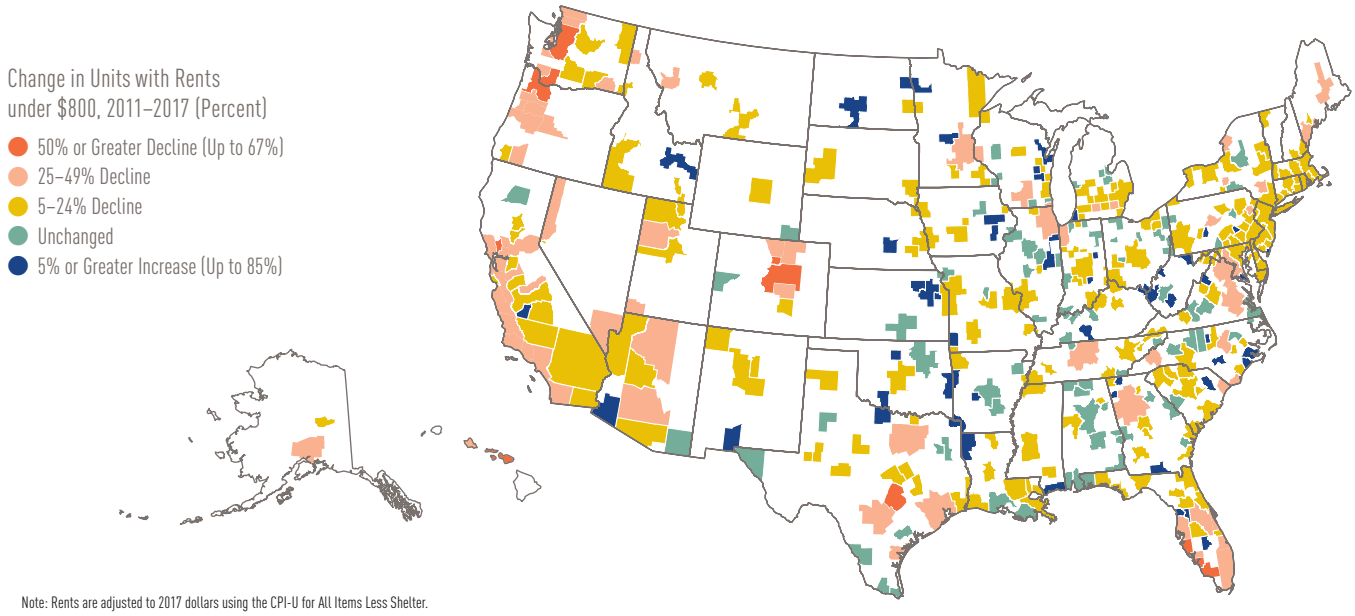
Year-over-Year Change in Prices (Percent)



Note: Price growth is calculated from fourth quarter to fourth quarter.
Source: JCHS tabulations of Real Capital Analytics data.

FIGURE 30

The Low-Rent Stock in Most Metros Has Declined Substantially Since 2011



Note: Rents are adjusted to 2017 dollars using the CPI-U for All Items Less Shelter.
Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates and Missouri Census Data Center data.

cent year-over-year at the end of 2018, indicating that growth in net operating incomes did not offset the rise in prices. Declines in all 13 metros covered by the index suggest that conditions are becoming less favorable for new multifamily investors.

The capitalization rate, or annual net operating income divided by property price or value, is an indicator of the rate of return investors can expect over one year. According to Real Capital Analytics, cap rates were largely unchanged from 2017, but stood at just 5.4 percent in the last quarter of 2018—their lowest point in a decade. Meanwhile, CoStar data indicate that cap rates averaged 5.0 percent for their highest-rated multifamily units in the first quarter of 2019 and 5.4 percent for mid- and lower-quality units. Across all property classes, cap rates are lowest in top-tier markets such as Boston, Los Angeles, and New York, and highest in bottom-tier markets such as Cleveland, Memphis, and Oklahoma City.

Rising property prices have not slowed transactions, however. Real Capital Analytics reports 9 percent year-over-year growth in apartment transaction volumes in the fourth quarter of 2018, following a slight dip in 2017. The mid- and high-rise segment led in deal volume with a 34 percent annual increase, while the garden apartment segment posted a relatively weak 2 percent uptick. Dallas and Los Angeles had the highest sales volumes in 2018, with transactions totaling more than $9.2 billion each.

Access to financing has been critical to these property purchases. The Mortgage Bankers Association Originations Index, which tracks origination volumes for multifamily properties, increased 32 percent year-over-year at the end of 2018—double the pace at the end of 2017. Multifamily mortgage debt outstanding was at a decade-long high of $1.4 trillion. With returns holding steady, delinquencies for multifamily debt last year were at their lowest level since the Federal Deposit Insurance Corporation began reporting these data in 1991. The noncurrent rate was just 0.14 percent in 2018, almost a full percentage point lower than in 2013.

Multifamily financing activity will likely remain stable this year, although credit conditions may tighten. A moderate net share of banks responding to the Federal Reserve's Senior Loan Officer Opinion Survey reported tightening lending standards. At the same time, a small net share of respondents also noted weakening demand for multifamily lending.

SHRINKING SUPPLY OF LOW-COST RENTALS

The supply of low-rent housing continues to decline in metro markets across the country **(Figure 30).** In 2016–2017 alone, the stock of units renting for less than $800 fell by 1 million or 4.9 percent. Moreover, the number of units in this rent range decreased every year since 2011, bringing the total net decline to four million (17 percent). Just over three-quarters of all 383 metros with populations of at least 50,000 lost nearly 20 percent of their low-cost stocks on average in 2011–2017.

New construction has not made up for these declines. According to the Survey of Market Absorption, only 9 percent of apartments in

unsubsidized multifamily buildings completed in the first quarter of 2018 had asking rents below $1,050, and only 4 percent rented for less than $850. The National Multifamily Housing Council also notes that new construction has not even served the middle of the market, with the share of new apartments affordable to median-income renter households dropping to less than 3 percent annually over the last decade. The focus of new construction on higher-cost units has thus shifted the overall distribution of rents upward.

Meanwhile, low-rent units are increasingly concentrated in older buildings, which puts them at a greater risk of loss from the stock and their residents at greater risk of displacement. Indeed, the share of units renting for under $800 that are at least 50 years old increased from 35 percent in 2007 to 43 percent in 2017. About half of the households living in low-rent units built before 1970 are single persons, while another 26 percent are families with children. About a fifth are headed by an adult age 65 and over. Moreover, nearly half of these tenants spend more than 30 percent of their incomes on rent and utilities, despite living in the lowest-cost housing that the market has to offer.

THE OUTLOOK

The modest decline in the number of renter households over the last two years may deliver some short-term relief from rising rents. Thus far, however, any positive impact of the decline has been offset by the ongoing increase in higher-income renters, who drive a growing share of market activity, and by low vacancy rates, which are keeping overall conditions tight.

Going forward, demographic trends should support strong rental demand. The Joint Center estimates that renter household growth will total 4.2 million by 2028 if homeownership rates remain near their current levels. And even if the homeownership rate rises by 1.6 percentage points over the decade, the high-end projection indicates that renter household growth will still total at least 2.1 million given expected increases in the adult population. On the supply side, however, conditions at the lower end of the market will remain challenging as millions of low-income households compete for an already insufficient number of affordable rental units.