Multifamily Trends Show Apartments Getting Smaller, More Expensive New Study Says

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Multifamily construction and rentals are predicted to continue strong according to a new study from Harvard University. The report shows 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, according to the annual State of the Nation's Housing 2016 from the Joint Center for Housing Studies of Harvard University.

"The report by the Harvard Joint Center for Housing Studies highlights serious affordability problems for many of America's renter households, " Rick Judson, chairman of the National Association of Home Builders (NAHB) and a home builder and developer from Charlotte, N.C said in a release. "The NAHB supports many of the policy initiatives outlined in the study to meet this ongoing challenge."
"Of primary importance, efforts to reform the housing finance system must include a federal backstop to maintain broad liquidity during all economic cycles and ensure that rental housing can continue to be built and preserved."

"The report affirms this strategy by stating that what is most important is that reform efforts do not lose sight of the critical federal role in ensuring the availability of multifamily financing to help maintain rental affordability, as well as in supporting the market more broadly during economic downturns," Judson said in the release.

Below are some excerpts focused on information about apartments and multifamily rents from the Harvard report.

Growth in multifamily starts topped 10 percent for fifth straight year

Key Housing Market Indicators Point to Strengthening in 2015

	2014	2015	Percent Change 2014–15
Residential Construction (Thousands of units)			
Total Starts	1,003	1,112	10.8
Single-Family	648	715	10.3
Multifamily	355	397	11.8
Total Completions	884	968	9.5
Single-Family	620	647	4.5
Multifamily	264	320	21.2
Home Sales			
New (Thousands)	437	501	14.6
Existing (Millions)	4.9	5.3	6.3
Median Sales Price (Thousands of dollars)			
New	283.1	296.4	4.7
Existing	208.5	222.4	6.6
Construction Spending (Billions of dollars)			
Residential Fixed Investment	550.6	600.1	9.0
Homeowner Improvements	134.8	147.8	9.6

Notes: Components may not add to total due to rounding. Dollar values are adjusted for inflation by the CPI-U for All Items.
Sources: US Census Bureau, New Residential Construction and New Residential Sales data; National Association of Realtors®, Existing Home Sales;

Highlights of the Harvard report on the multifamily side show that all key construction measures rose by double digits.

Growth in multifamily starts topped 10 percent for the fifth consecutive year in 2015, reaching a 27-year high of 397,300 units.

With single-family construction still recovering, 2015 was the fourth consecutive year that multifamily units accounted for more than 30 percent of housing starts, compared with 20 percent on average between 1990 and 2010.

Signaling further expansion, multifamily permits rose 18.2 percent last year, to 486,600 units. Overall construction activity expanded nationwide, with permitting up in 70 of the 100 largest metro areas.

Just over a third of these metros issued more permits in 2015 than their annual averages in the 1990s, and 20 issued more than their annual averages in the early 2000s. New York was the standout, with permits (primarily for multifamily units) soaring 80 percent in 2015, due in part to the impending expiration of a tax abatement program. But permitting also increased more than 25 percent last year in:

- Dallas
- Los Angeles
- Miami
- San Diego
- San Francisco

In contrast, several of the markets that had rebounded quickly after the recession saw permitting slow:

- Washington, DC (down 7 percent)
- Houston (down 11 percent)
- San Antonio (down 24 percent)

Apartments are getting smaller

While single-family homes are getting larger- almost up to 2,500 square feet,- the median size of multifamily units fell from nearly 1,200 square feet at the 2007 peak to 1,074 square feet in 2015, reflecting the shift in the focus of development from the owner to the rental market.

Half of the units completed were buildings with 50 or more apartments

Many new multifamily units are in large structures, with nearly half of the units completed in 2014 in buildings with 50 or more apartments. In addition, a majority of newly constructed units were located in dense urban areas. Indeed, about 36 percent of all new multifamily units added between 2000 and 2014 were in high-density neighborhoods, and another 30 percent each in medium- and low-density sections of metro areas. Even so, growth in the multifamily housing stock during this period was even more rapid in rural areas (up 24 percent) than in urban areas (up 19 percent).

Positive trends for multifamily

The Harvard study shows a number of positive trends—continued strong gains in multifamily construction, growing momentum in single-family construction, increases in new and existing home prices and sales, and further reductions in mortgage distress—made 2015 a year for cautious optimism.

In fact the report states, NAHB's measure of homebuilder confidence ended 2015 at its highest level since 2005. Homeowners are also feeling encouraged, with nearly half of all respondents to the latest Fannie Mae National Housing Survey believing it was a good time to sell—a sign that for-sale inventories may be set to expand. All of these indicators, along with measures of income and employment growth, will be important to watch in 2016 because of their direct implications for house

110 million people live in rental housing

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.

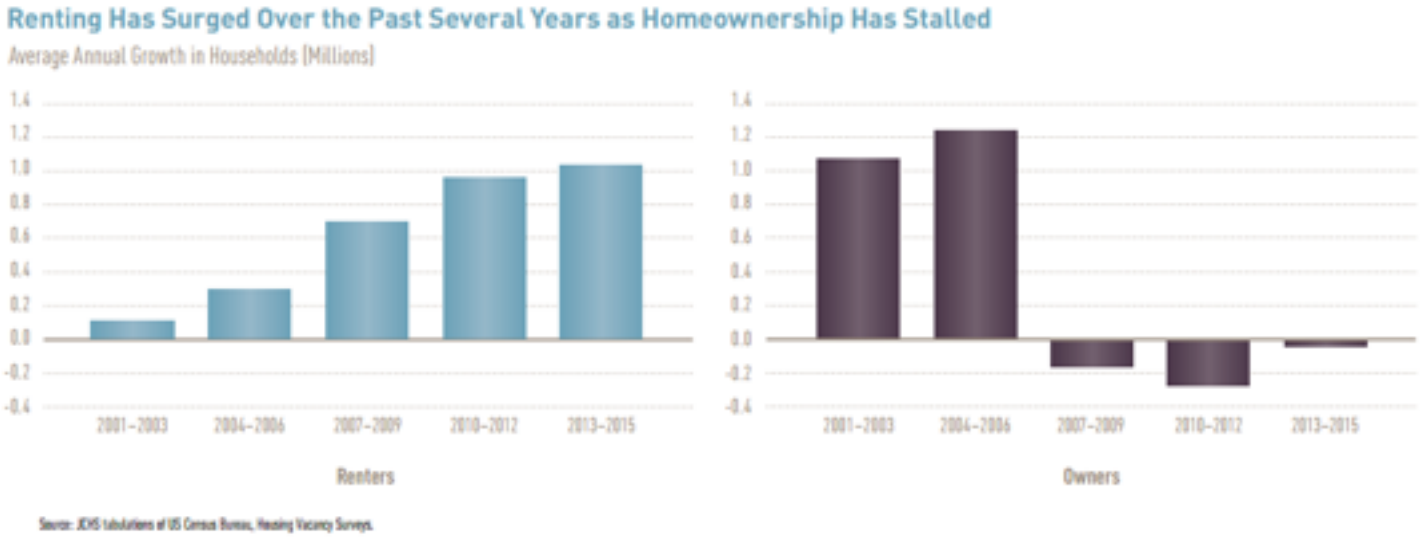
Renters are more diverse than homeowners

Renters are more diverse than homeowners in terms of age, income, and household type , according to the Harvard study. 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.

Renter households grew by 9 million in the past 10 years



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. 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 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.

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.

New construction of apartments at highest level since the 1980s

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.

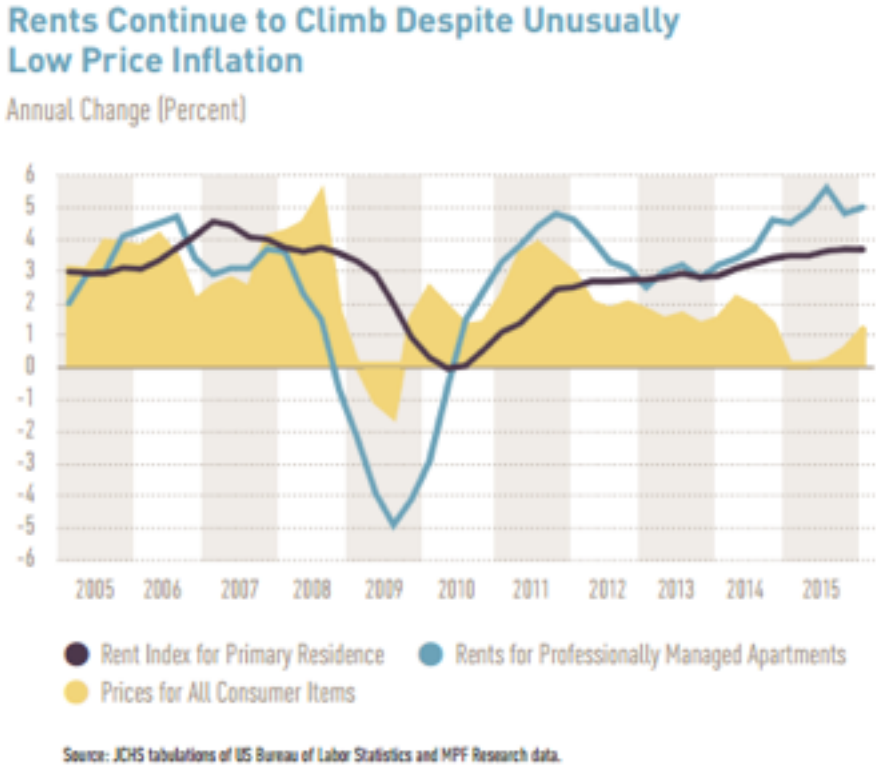
Given the relatively long multifamily development timeline, starts remain well ahead of rental completions, which increased to 304,000 units last year.

New multifamily units have fewer bedrooms

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.

Prices up sharply to $1,381 per month



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, according to the Harvard report.

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 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. 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 rental housing supply

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, according to the Harvard report.

Strong multifamily performance

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.

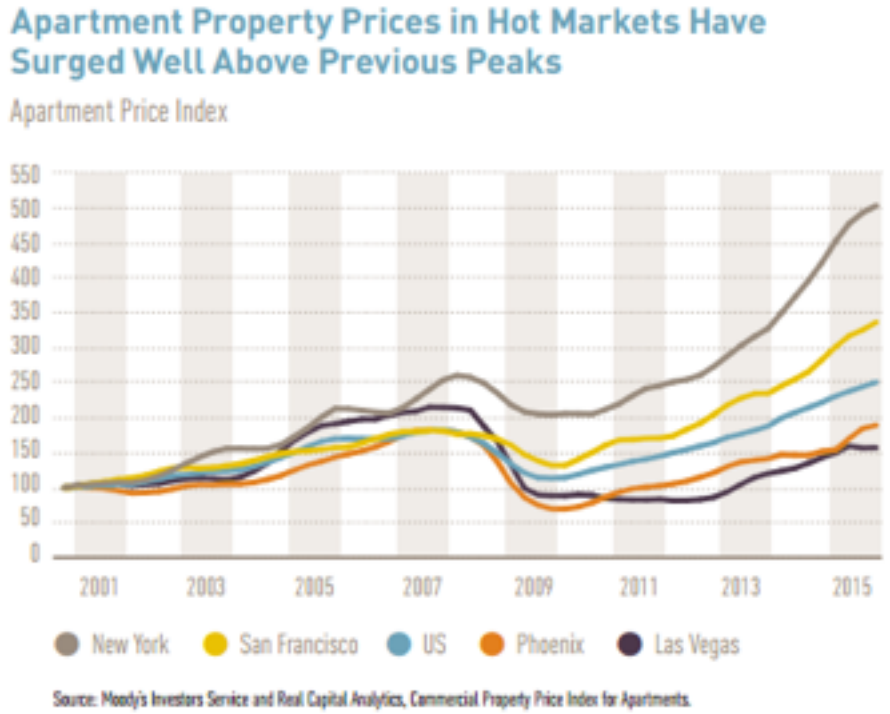
Nationwide, rents in the professionally managed apartment sector rose by a strong 5.0 percent in the first quarter of 2016, up from 4.5 percent a year earlier. Increases were widespread, with rents in nearly all 94 metro markets on the rise. At the same time, however, rent growth slowed in a few areas, 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).

Net operating income up 11 percent for commercial grade apartments

The National Council of Real Estate Investment Fiduciaries reports that net operating income for commercial-grade apartments 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.

Apartment property prices surge



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, theCoreLogic 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.

Conclusion: Overall the Harvard report says 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.

Resources:

The Harvard Study on the State of the Nation's Housing 2016
National Association of Home Builders
Census report on apartments
Realpage research
National Council of Real Estate Investment Fiduciaries