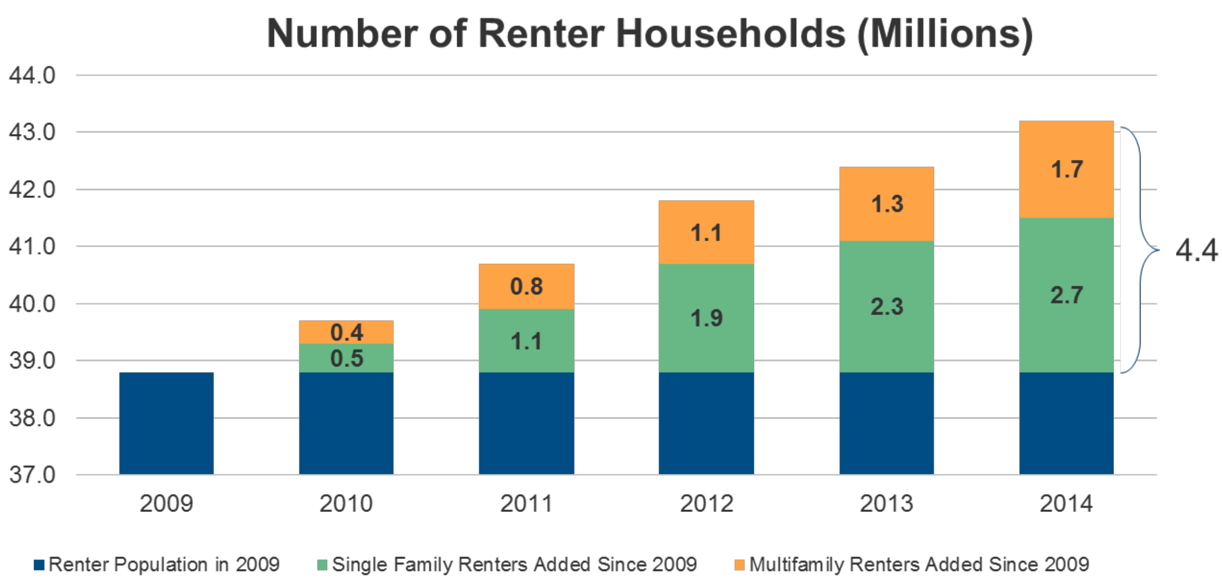
Multifamily Market Commentary – November 2015
The Supply Gap is Substantial for Lower Income Households

The demand for affordable rental housing continues to increase each year, yet the amount of new supply – especially in terms of multifamily units – remains out of balance. Affordable rental housing is not just a multifamily issue: It also encompasses single-family homes, two-to-four family homes, even seniors housing. In all of these cases, the gap in supply and demand continues to widen, due to a "perfect storm" of strong demographic trends, high construction costs, and an increase in renter household formations.

Rental Demand is on the Rise

Although there are an estimated 43 million renters in the U.S. as of 2014, the majority – about 53 percent – rent one-to-four-unit family homes. This segment of renters has been increasing steadily since 2009, as seen in the chart below. Approximately 4.4 million single-family and multifamily renter households were created between 2009 and 2014, representing just over an 11 percent increase in the overall number of renter households in just five years. Yet, the majority of these renter household formations – 2.7 million – occurred in one-to-four-unit family housing, roughly double the amount of demand for multifamily housing. The substantial increase in rental demand for one-to-four-unit family rentals, most especially in single-family detached units, corresponds to the decrease in the homeownership rate, which continued at to a 48-year low of 63.7 percent on a seasonally adjusted basis as of the end of the third quarter 2015 – approximately 5.5 percent lower than the rate at the beginning of 2004.



Source: American Community Survey, Fannie Mae

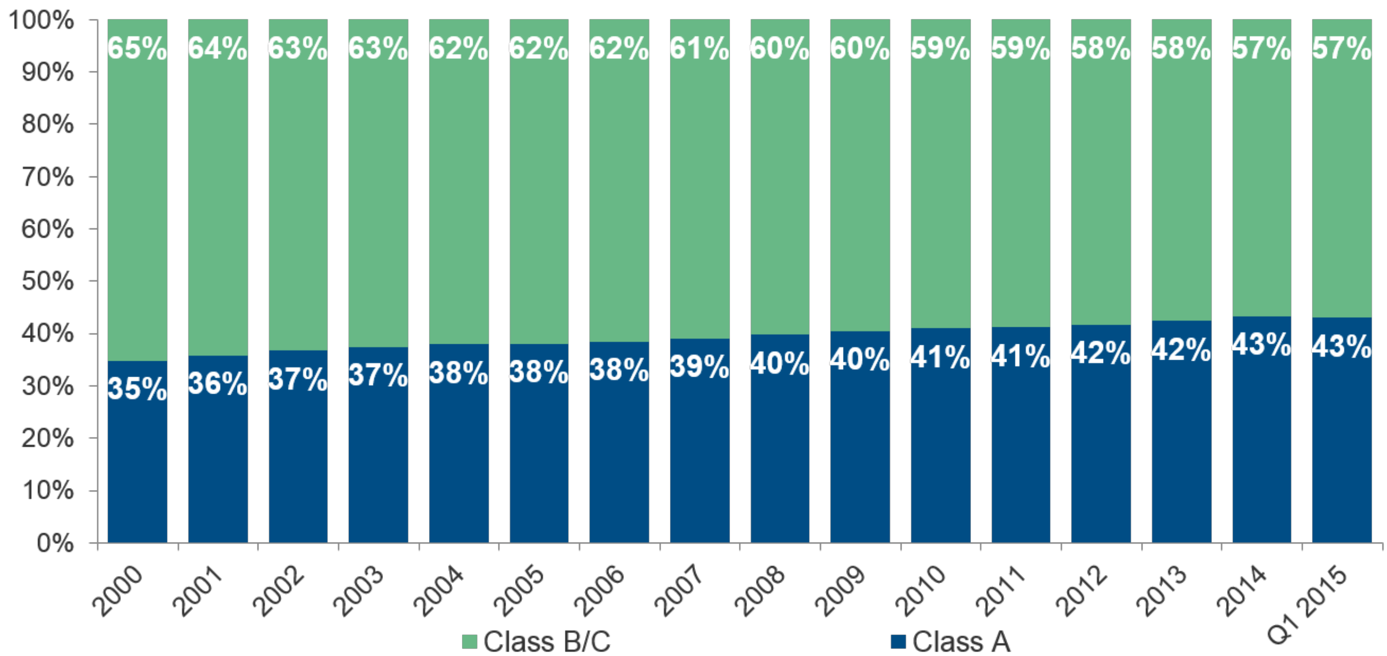
Note: Excludes "other" renter category that may include recreational vehicles, rv's, manufactured housing.

Demand for multifamily rental housing has also been robust, growing by an estimated 1.7 million households, which is approximately 10 percent higher since 2009. Reasons for this surge include continued job growth, positive demographic trends with both younger and older aged cohorts moving into multifamily rental units, and the movement away from homeownership. As a result, demand has also been on the rise for unsubsidized affordable multifamily rental housing. Also known as conventional affordable multifamily, it is usually identified as consisting of class B- and class C-type units.

Diminishing Affordable Multifamily Supply

A complex set of factors has limited the supply of affordable housing over the last decade. During the 2004 to 2007 housing boom, a significant number of multifamily units were removed from rental stock and converted to condominiums. During the Great Recession, financing for construction and rehabilitation of older apartment stock became severely limited. As a result, both the amount of new multifamily rental supply and the rehabilitation of older existing stock was well below the historic average. Concurrently, as many as 120,000 units are estimated to be lost from the nation's multifamily inventory annually, and these units tend to be of an older stock and are considered to consist of more affordable units.

Multifamily Inventory Share by Class Type



Source: Reis, based on multifamily sample tracked

Data from REIS, a third-party data vendor that surveys the multifamily market, provides indications to trends in stock for the more affordable multifamily segment of the market, identified as Class B/C. Since 2007, the number of Class B/C units has remained virtually unchanged at about 5.7 million units, even as the number of renter households has grown. Even more notable, as shown in the chart above, the end result is that the share of these more affordable Class B/C units has recently declined to 57 percent of an estimated 10.1 million units of professionally managed multifamily rental stock – down from 65 percent at the end of 2000 – since most of the new supply coming online over the past few years is in the luxury class A segment.

Diminishing Affordable Share of Supply + Strong Demand = High Rents

As shown in the chart above right, national estimated rent growth for class B and C multifamily rental units has been above 3.0 percent for nearly two years. Indeed, it has been at more than 4.0 percent for over a year now, far outpacing the rent growth for higher-end class A multifamily rental units.

As shown in the middle chart, vacancies in the conventional affordable multifamily rental segment have remained below 5.0 percent since June 2012 and are now approaching vacancy rate levels generally seen at subsidized multifamily properties.

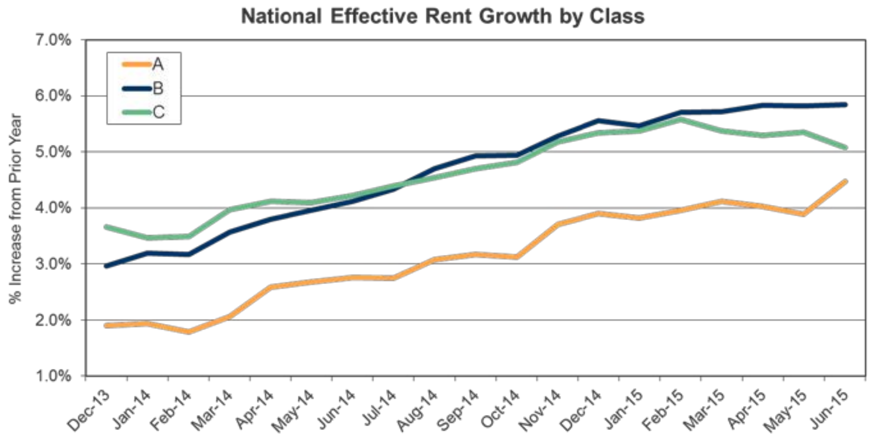
As of December 2014, vacancies of class B and C properties were estimated at 3.4 percent, which was just 1.1 percent higher than those recorded at subsidized Low Income Housing Tax Credit (LIHTC) properties. Demand is strong, helping drive the steep increase in rents for class B and C units.

Rental Housing Cost Burden Worsening

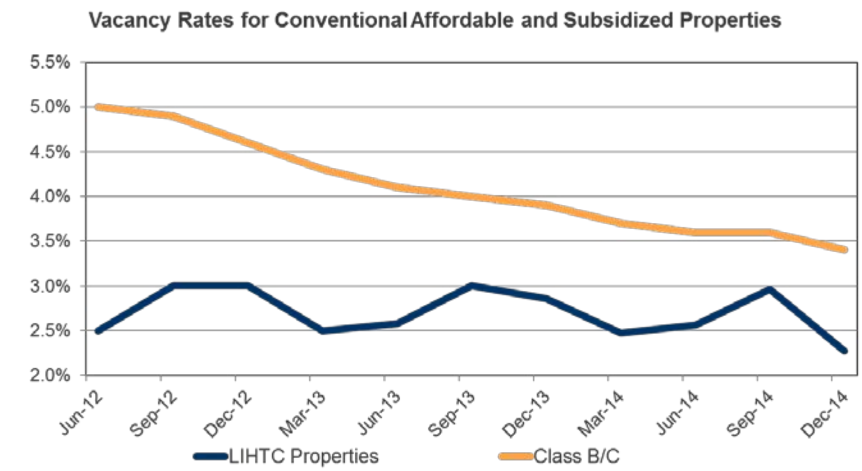
The combination of lack of supply and increasing demand suggests a direct link in the widening disparity in severe housing cost burdens between owners and renters. A household with a severe housing cost burden is defined as one that pays more than 50 percent of its gross income for rent and utilities.

As shown in the chart lower right, as recently as in 2013, 25.0 percent of working renter households were severely cost-burdened compared to just 17.1 percent of working owner households. Further, the percentage of renters that are severely cost-burdened has remained fairly constant since 2009, while the percentage of working owners with severe housing cost burdens has declined by an estimated 4.1 percent.

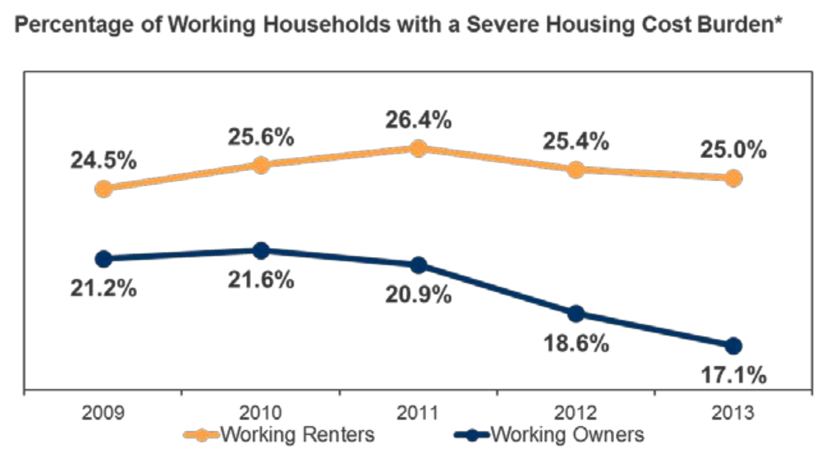
One of the after-effects of the Great Recession was slow job and wage growth. As a result, rent growth has outpaced growth in household income on an annual basis since the end of 2009, thereby contributing to the plunge in housing affordability and the worsening of the housing cost burden for many renters.



Source: Axiometrics



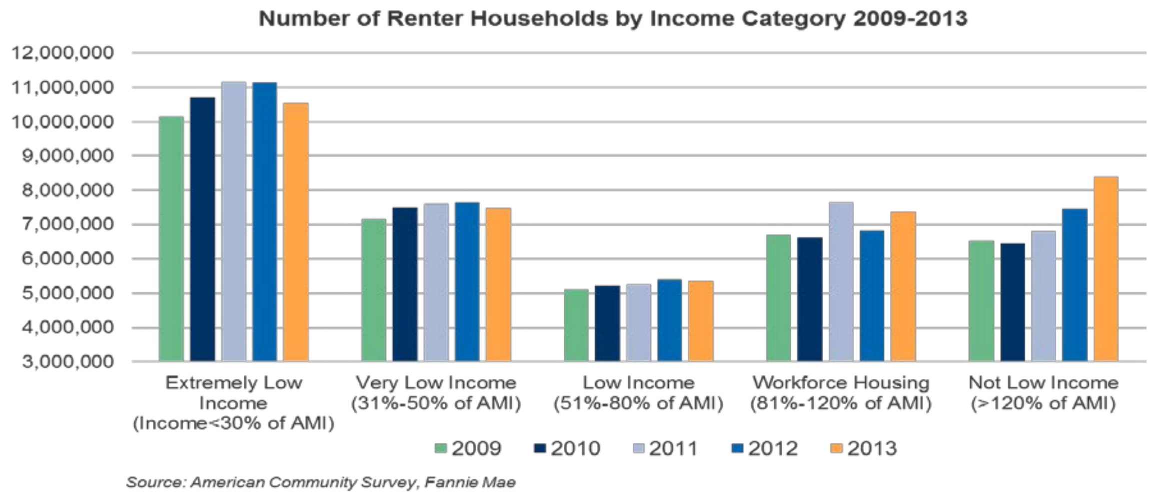
Source: Integratec Tax Credit Central, REIS



Source: Housing Landscape 2014 and 2015, Center for Housing Policy
** A Household With a Severe Housing Cost Burden is one which pays more that 50% of income for rent and utilities.*

Significant Supply Gap

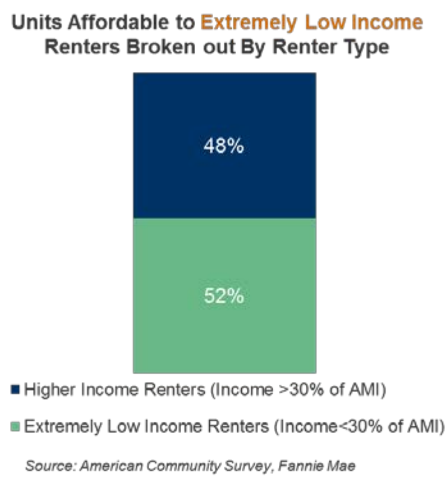
There is a significant supply gap in affordable rental housing resulting from demand far outstripping supply. The amount of the gap varies depending on a household's relation to its Area Median Income (AMI). As shown in the chart below, nearly one out of every four renter households – an estimated 10.6 million – were considered to be *extremely low income* in 2013, earning less than 30 percent of AMI for their locality. There were just 6 million rental units affordable to these households, resulting in an absolute shortage of 4.6 million units. For *very low income* households, classified as those earning between 31 percent and 50 percent of AMI, the situation is somewhat better. Despite these households earning more income, there is still a significant gap of 2.2 million rental units affordable to this AMI category of renter.

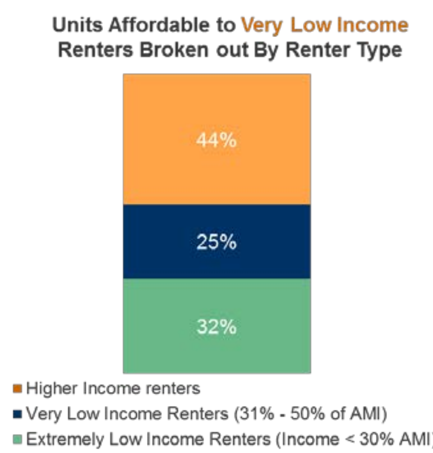


As shown in the chart above, the number of high income renters – classified as those earning 120 percent or more of the AMI for their locality – has grown steadily since 2009. These households could afford to be homeowners but are choosing to rent. It is important to remember that these higher income renters – and indeed renters of any income category – are able to occupy housing stock affordable at lower AMI categories, rather than rent more expensive housing units. This mismatch worsens the supply gap for affordable rentals.

As seen in the adjacent chart, a sizable percentage of rental units affordable to extremely low income and very low income households are actually occupied by renter households earning more than the maximum income for each category. At 52 percent, only a slim majority of units affordable to extremely low income renters are actually occupied by extremely low income renter households. The remainder are occupied by households earning more than 30 percent of AMI.

This mismatch is even more striking in very low income households. Approximately 44 percent of households occupying this rental housing category earn more than 50 percent of the local AMI.





Only 25 percent of the occupants are actually in the very low income category of 31 to 50 percent AMI. The remaining 32 percent of households occupying this stock are actually in the extremely low income category of 30 percent AMI or less. That means that these extremely low income households are paying more in rent than they should be, resulting in a housing cost burden for those renters who can least afford it.

Subsidized Multifamily Properties Remain an Important Source of Affordable Housing

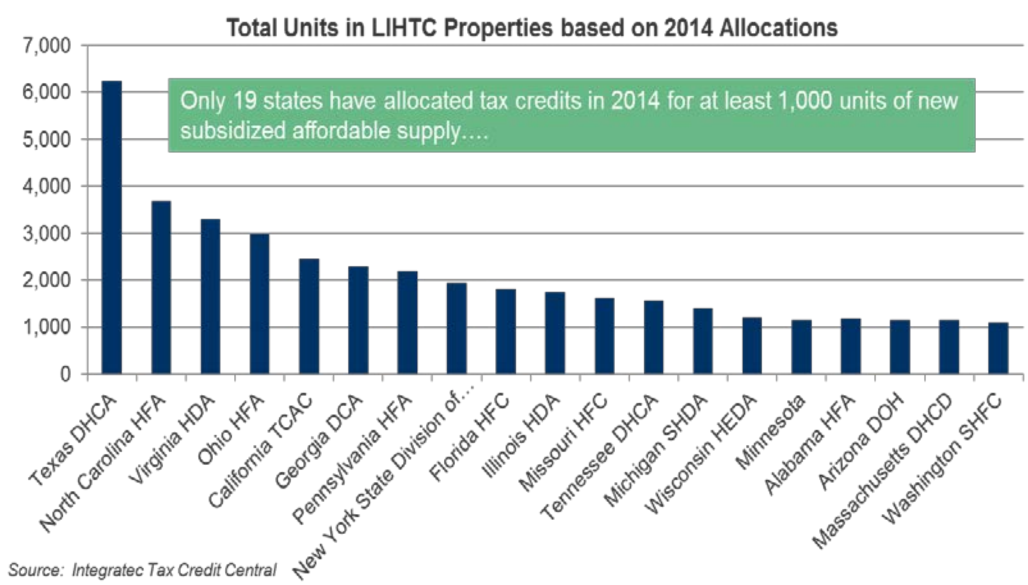
With a total of 5.1 million units, subsidized affordable multifamily remains an important source of affordable housing, representing about a quarter of all multifamily rental housing. About 2.2 million units are subsidized with Low Income Housing Tax Credits (LIHTC) and 1.5 million are subsidized with Project Based Section 8. As shown in the table to the right, this represents the substantial majority of units with active subsidies.

However, it appears that there has been a decline in LIHTC units placed in service over the past few years. Prior to 2008, approximately 120,000 units were placed in service each year. Since then, only about 80,000 units have been placed in service annually, a small number relative to the 2.2 million unit supply gap for very low income renters.

Subsidy Program Name	Number of Projects	Number of Units
LIHTC	32,000	2.2 Million
Project Based Section 8	21,000	1.5 Million
Rural Housing - 515	8,000	395,000
Public Housing	7,000	1.2 Million
HOME	6,000	250,000
FHA Insured (subject to affordability restriction)	5,200	563,000
Section 236	200	42,000
Section 202	2,200	113,000
Rural Housing Service 538	400	23,000

Public and Affordable Housing Research Corporation and the National Low Income Housing Coalition (2015). National Housing Preservation Database. Retrieved from http://www.preservationdatabase.org

Properties most likely have multiple subsidies.



Source: Integratec Tax Credit Central

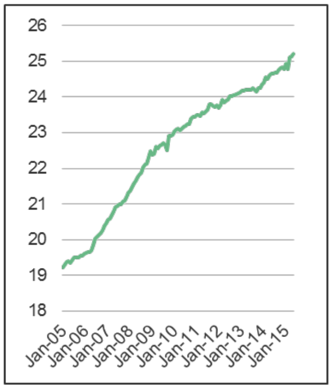
The amount of LIHTC awarded annually is fixed and based on population size of each state. In addition, not all tax credits support affordable rentals for families with children: About 30 percent are allocated for low income seniors. The most populous states receive the most tax credits allowing these states to have the highest production of new and rehabbed units, as shown in the adjacent chart.

In addition, given that the LIHTC program is now 25 years old, many subsidized properties need renovation to avoid becoming obsolete. At a minimum, financing the preservation of this existing stock is an important component of maintaining current housing levels.

Cannot Just Build Our Way Out

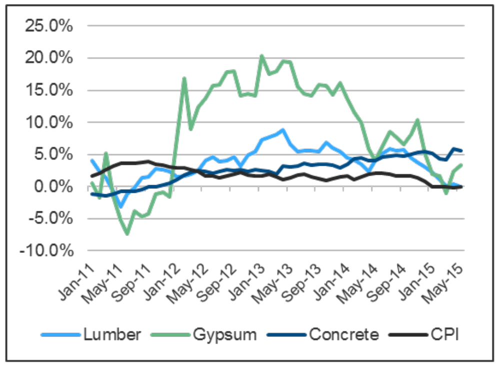
Despite the rise in new multifamily construction starts – as high as 475,000 units currently underway as of August 2015 – the multifamily market cannot build its way out of the current affordable rental housing shortage. In many places, new multifamily supply is inhibited by the rising prices of developable land and building materials along with fewer construction workers, as seen in the charts on the following page.

Average Hourly Earnings of Non-Supervisory Construction Workers



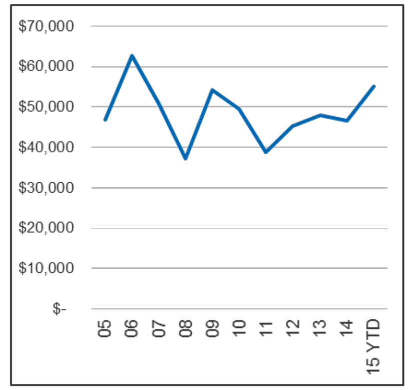
Source: Bureau of Labor Statistics

Materials Year over Year Percent Change



Source: BLS Producer Price Index

Multifamily Development Site Land Prices



Note: Prices are per buildable unit.
Source: Real Capital Analytics

While it would seem that construction costs would be manageable in less expensive metro areas, it is not always the case. Indeed, construction costs can vary widely, depending on the location. According to 2013 data from RS MEANS, which collects data on construction costs for commercial buildings, the average construction cost for a four-to-seven-story apartment building in the U.S. is about $168 per square foot (excluding land costs, soft costs, and financing costs). While that is close to the average for a few metros such as Baltimore ($167), Denver ($168), and even Miami ($160), it was far below the averages for not only such usual suspects as New York City ($237) and San Francisco ($220), but also for less likely places, including Pittsburgh ($184), Portland ($180), Detroit ($185), and Kansas City ($187).

As a result, developers appear more willing to take risks in those metros that have a large number of multifamily renters and that can command higher asking rents. Most new multifamily construction underway is primarily Class A properties located in about 12 of the nation’s largest metropolitan areas. For example, the metros with almost 20,000 units underway include New York, Washington, DC, Houston, Seattle, Denver, Boston, Austin, Atlanta, Los Angeles, and Dallas. There is far less construction underway in secondary markets.

As an added challenge, even though many of these properties can have up to 30 percent of units earmarked for lower income renters due to local and municipal inclusionary housing requirements, it is unlikely that these requirements will produce enough supply to meet the ever-increasing demand for affordable rental units.

Eliminating the Supply Gap Needs a Holistic Solution

With 23.0 million one-to-four-family rental units and 18.3 million multifamily rental units, eliminating the supply gap is more than a multifamily issue. The supply gap needs a holistic housing solution and, therefore, any comprehensive effort to eliminate the gap must also include one-to-four-family rental housing.

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