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Rental Housing

With the economy generating jobs and homeownership faltering, rental markets continued their gradual recovery last year. In fact, the 1.2 million growth in renter households in 2004–2006 more than made up for losses in 2002–2004. This renewed demand helped to reduce vacancy rates and firm up rents across much of the country.

RENTAL MARKET TRENDS

With the national rental market slowly picking up, multifamily vacancy rates retreated slightly and the single-family rate finally leveled off (**Figure 23**). Demand strengthened in every region but the Northeast in both 2005 and 2006. The South showed the largest absolute increase in renters last year, accounting for three out of five net renter households added nationally. Even with a faltering economy and stagnant job growth, the Midwest posted the second-largest increase in renters and the biggest percentage gain.

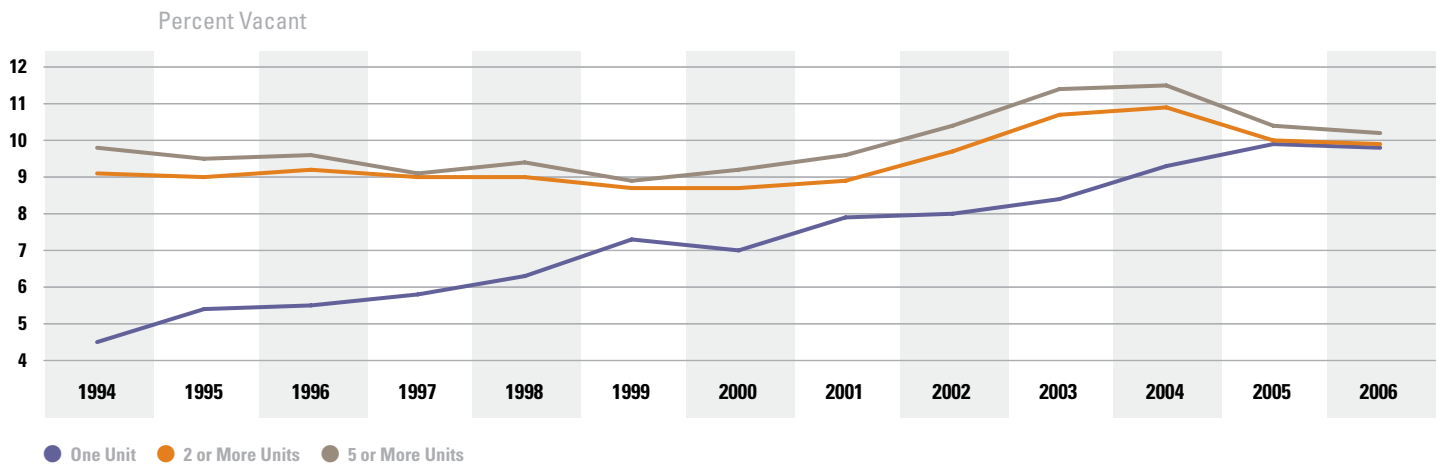
Despite anemic demand, rents in the West rose more than twice as fast as in any other region, with eight metros registering increases of at least five percent (**Table W-5**). These gains reflect the third straight year of vacancy rate reductions, driven by the declining supply of rental units in the West. In contrast, strong demand helped to reduce vacancy rates in the South and the Midwest, but left them still well above the national average. Meanwhile in the Northeast, the short-lived rental recovery ended in 2006 with slackening demand and rising vacancy rates.

With rents back on the rise in most areas, the net operating incomes of apartment properties finally rebounded. After an unusual period when property values were climbing even as operating incomes were falling, growth in value and income once again aligned in 2006. Now that the yields available from other investments have improved, investors are less likely to drive up the prices of rental properties much ahead of operating incomes.

RENTAL SUPPLY CHANGES

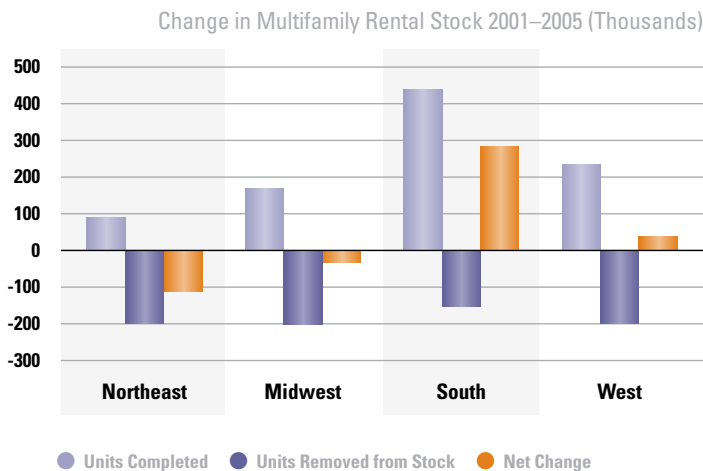
Despite the completion of nearly one million units, American Community Survey estimates indicate that the multifamily rental supply increased by less than 200,000 units between 2002 and 2005. Many of the new units thus replaced apartments converted to condos

FIGURE 23 After Years of Increase, the Single-Family Vacancy Rate Has Levelled Off and Multifamily Markets Have Tightened



Source: US Census Bureau, Housing Vacancy Survey.

FIGURE 24 Most of the Recent Multifamily Rental Construction Has Merely Offset Losses



Notes: Multifamily rental units are renter-occupied and vacant for-rent apartments in structures with at least two units. Units removed from stock represent the difference between units completed in 2002–2005 and the net change in units 2001–2005 and include conversions as well as losses to abandonment, demolition, and disasters.

Sources: JCHS tabulations of the 2001 Census Supplemental Survey and the 2005 American Community Survey; US Census Bureau, New Residential Construction.

or removed through abandonment, disasters, and demolitions. In the Northeast and Midwest, the new multifamily rentals primarily met replacement demand (Figure 24). In the South, the additional supply went largely to house a growing number of renter households.

The rush of condo conversions driven by the home-selling boom persisted into 2006, helping to reduce rental vacancies. According to Real Capital Analytics, the number of rentals in larger multifamily properties converted to for-sale units jumped from just a few thou-

sand in 2003 to 235,000 in 2005, before dropping to about 60,000 in 2006. At the same time, new construction of multifamily buildings intended for rental use dipped from 262,000 units in 2003 to 184,000 in 2006. But now that condo sales are softening in some locations, sellers unable to get their prices may return their units to the rental market, while some newly built multifamily properties intended for sale may also be converted to rentals.

On the single-family side, the rental market has absorbed some of the net increase resulting from the heavy production of recent years. As a result, the single-family share of vacant for-rent units rose from 26 percent in 2003 to 31 percent in 2006, lifting the single-family rental vacancy rate by 1.4 percentage points over this period. Despite easing in 2006, the single-family rental vacancy rate may resume its climb if owners of for-sale homes decide to wait for the inventory correction to play out, and rent their units rather than drop their prices.

RENTAL PROPERTY OWNERSHIP

In 2001, individuals and married couples owned 19.3 million of the nation’s rental units, while partnerships, corporations, and other institutions owned another 15.6 million. With more than half of the stock in their hands, smaller owners thus have a significant impact on the direction of the market as a whole.

Individuals and couples are more likely to own smaller properties, holding 84 percent of the rental properties with 1–4 units and 65 percent of those with 5–19 units. After controlling for property size, though, individual and institutional owners are surprisingly similar. For example, while owners of smaller properties are less likely to have mortgages than owners of large properties, nearly equal shares of institutional and individual owners in each property-size category carry mortgages and have similar loan-to-value ratios (Figure 25).

Structure type rather than ownership therefore appears to govern financing decisions, with smaller properties less leveraged relative to larger properties.

Individuals and couples do, however, tend to own older properties and charge lower rents. As a result, they hold much of the affordable rental stock and may face low or negative net operating incomes. The fate of the affordable housing supply therefore relies critically on finding ways to assist these small property owners in preserving their rental buildings.

RENTAL DEMAND CHANGES

While rental demand has barely increased in the past decade, the composition of demand has changed markedly. In particular, the minority share of renter households climbed from 37 percent in 1995 to 43 percent in 2005, and is expected to exceed 50 percent by 2015.

In 10 states plus the District of Columbia, minorities already constitute more than half of all renter households. Eight of these states are located in the South and West, joined by New York and New Jersey in the Northeast. Minorities also make up the majority of renters in 9 of the nation's 10 largest metropolitan areas. Indeed, they account for two out of every three renters in Los Angeles and Miami, and even larger percentages in some smaller Texas metros.

Much of the increase in the minority renter population reflects the dramatic growth in Hispanic households. From just 5 percent in 1995, Hispanics represented 16 percent of all renters in 2005. With families accounting for 72 percent of Hispanic renter households, the minority share of family households rose to more than 50 percent (Figure 26). Given that their presence is greatest where immigration is highest, Hispanics make up more than 40 percent of

renter households in traditional gateway metropolitan areas such as Los Angeles and Miami.

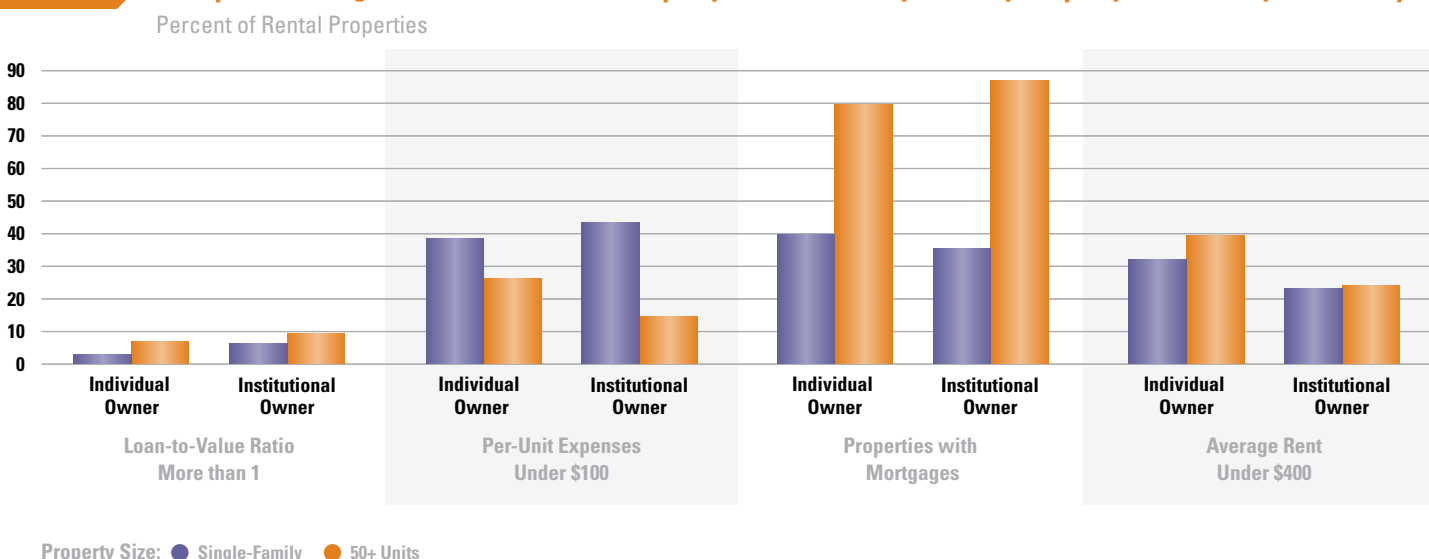
The age distribution of renter households has also changed over the past decade. As the baby boomers moved into their 40s and 50s, the share of renters in this age range grew from 27 percent to 32 percent (Table A-9). With the aging of the baby-bust generation, the share of renters in their 30s dropped from 28 percent to 23 percent over this same period. Shares of renters in their 20s and 60s held steady. As a result, the marginal growth in rental demand has come primarily from middle-aged households.

Meanwhile, the share of renters living in family households declined from 54 percent in 1995 to 51 percent in 2005. This decrease reflects lower rates of remarriage as well as the longer lifespans of the widowed. Despite the sharp increase in Hispanic households with their much higher propensity to live in families, the family share of minority renter households also fell, from 66 percent to 62 percent.

The extended homeownership boom siphoned many moderate- and higher-income households from the rental market, raising the share of renters in the bottom income quartile from 38 percent in 1995 to 41 percent in 2005. While still overrepresented in this group, the share of minority renters in the bottom quartile actually shrank from 47 percent to 44 percent thanks to strong minority income gains in the latter half of the 1990s.

Rental markets have thus become more racially and ethnically diverse, as well as more skewed toward middle-aged and lower-income households. To meet this new mix of demand, housing suppliers need to pay greater attention to affordability issues, provide more amenities for middle-aged and senior citizens, and address the cultural differences of people born outside the United States.

FIGURE 25 Except for Average Rent Levels, Rental Property Financials Vary More by Property Size than by Ownership



Note: Institutional owners are primarily partnerships and corporations.
Source: JCHS tabulations of the 2001 Residential Finance Survey.

DECENTRALIZATION OF RENTER HOUSEHOLDS

While many have joined in the migration to the suburbs, renters are still much more likely than homeowners to live near the urban core. In 2000, the median distance from the central business districts (CBDs) of the nation's 91 largest metropolitan regions for renters was 9.4 miles, while the median distance for homeowners was 13.8 miles.

Minority renters, in particular, remain highly concentrated in center cities. For black renters, the median distance from the CBD increased from 4.3 miles in 1970 to 7.4 miles in 2000. But for white renters, the median distance started at 7.7 miles and then increased to 10.6 miles over the same three decades.

With minorities expected to account for all of the net growth in renter households but with most new rental opportunities located in the suburbs, the decentralization of minority renters should continue and may even accelerate. But for many low-income center-city renters, moving to the suburbs poses an economic hardship because they have to rely on public transportation to get to work.

Indeed, members of renter households made up less than 30 percent of all commuters in 2005 but 60 percent of those commuting by public transit (Figure 27). The fact that 38 percent of center-city renters and 52 percent of low-income center-city renters do not own cars underscores the importance of access to public transit—a resource that most suburban communities lack.

THE RENT VS. OWN CHOICE

Over a million households joined the ranks of renters in the last two years. While part of this increase undoubtedly reflects the large number of newly formed households that made the choice to rent, some share is likely due to an increase in households making the move

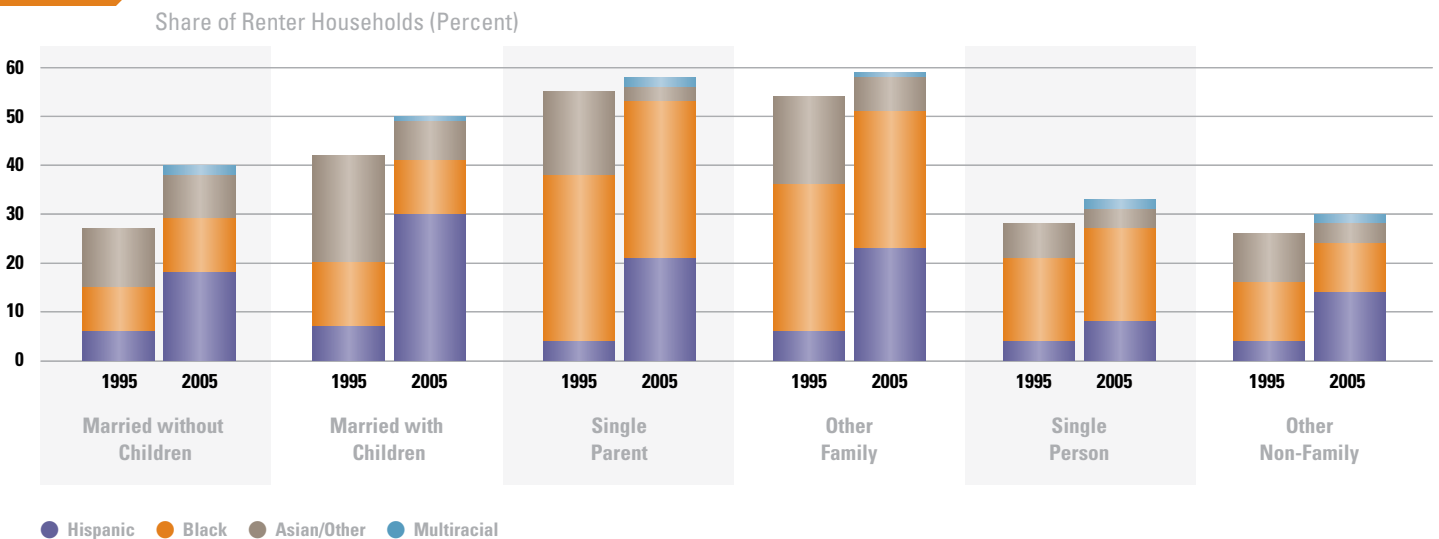
from owning to renting. Normally, millions of owner households revert to renting every year. When last measured in 2005, fully 2.7 million former owners reported moving to rental units in the prior 12 months. Half of these owners became renters because of a change in their family or employment situation, but only a handful switched to reduce their housing costs.

In 2004, the difference between the median monthly living expenses for owners and renters was just \$200. Since most owners were still benefiting from double-digit price appreciation, few saw renting as more financially attractive. As interest rates and house prices rose and rents remained stable, however, the difference between the median costs of buying a home and renting jumped to more than \$400 per month in 2006 (Table A-2). This suddenly made renting both a bargain and a safer bet. With house price appreciation less assured in the coming year or two, more newly formed households and existing owners may choose to rent, at least for a time.

The rising number of foreclosures has also increased the demand for rental housing. Even though loan problems had just started to surface in 2006, the number of homes entering foreclosure at the end of the year was up by more than 75,000 from the end of 2005 on a non-seasonally adjusted basis—equivalent to 14 percent of the net growth in renters last year. While some households that lost their homes may have dissolved, most are likely to have moved into rental housing.

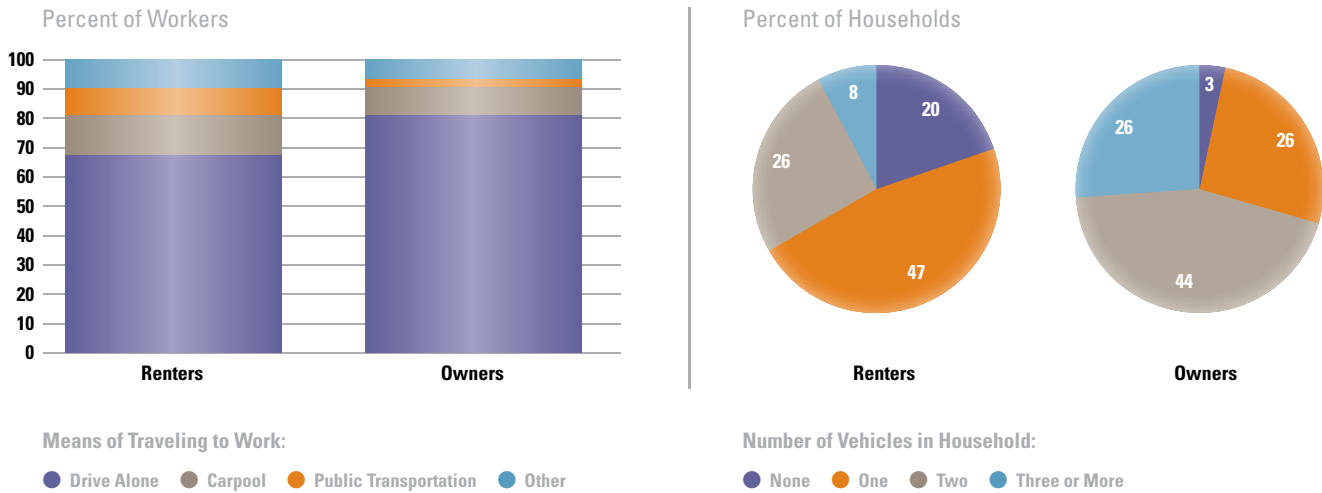
Indeed, the number of households that rent out of necessity may well grow. The combination of higher ownership costs, tighter underwriting standards, and the erosion in credit quality among the current pool of renters will prevent many from buying homes. Even improved market conditions are unlikely to help, given that both house prices and interest rates would have to fall dramatically to make ownership as affordable as it was in 2000–2003.

FIGURE 26 Hispanics Are Driving Growth in the Minority Share of Renters Across All Household Types



Notes: Black, Asian/other and multiracial are non-Hispanic. Hispanics may be of any race. Asian/other includes Aleuts, Native Americans and Pacific Islanders. The American Housing Survey added the multiracial category in 2003. Respondents choosing this category are assumed to have selected one of the other minority racial/ethnic categories in prior years. JCHS-adjusted weights used in 2005 data. Source: JCHS tabulations of the 1995 and 2005 American Housing Surveys.

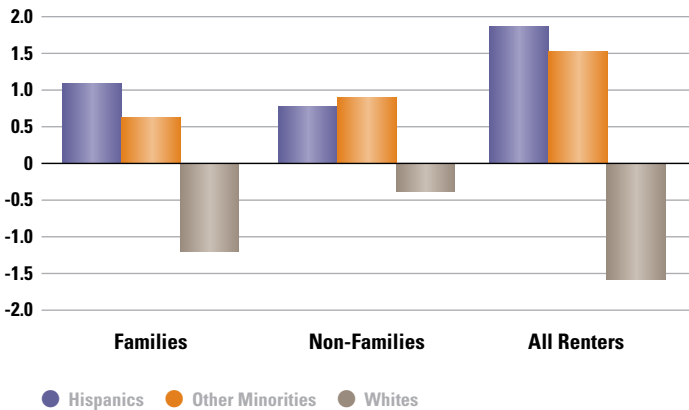
FIGURE 27 Renters Are More Reliant on Public Transportation and Less Likely to Have Cars than Homeowners



Notes: Transportation data is for all workers over age 16 living in households. Public transportation excludes taxicabs.
 Source: US Census Bureau, 2005 American Community Survey.

FIGURE 28 Hispanics and Other Minorities Will Fuel Renter Household Growth Over the Next Decade

Projected Change in Renter Households
 2005–2015 (Millions)



Notes: Other minorities and whites are non-Hispanic. Hispanics can be of any race. Non-family households include single persons and non-relatives living together.
 Source: George S. Masnick and Eric S. Belsky, "Addendum to Research Note N06-1: Hispanic Household Projections Including Additional Tenure Projection Detail by Age and Broad Family Type for Non-Hispanic White and Total Minority Households," JCHS Research Note N06-4, 2006.

homebuying conditions, it should be temporary. Indeed, a quicker-than-expected rebound in home sales could prevent discouraged sellers from renting out their homes, thereby keeping rental markets tight. Even if home prices continue to drop, the correction is unlikely to close the growing gap between the costs of homeownership and what many renters can afford.

And even if today's high homeownership rates persist, the rapid growth in minority and immigrant households should still boost the number of renter households by about 1.8 million over the next decade (Figure 28). Hispanics will account for 55 percent of the growth in minority renter households between 2005 and 2015, increasing by 1.9 million and more than offsetting the 1.6 million drop in white renters. By 2015, Hispanics should thus make up 22 percent of all renter households and 29 percent of all family renter households.

At the same time, the share of renters in their 20s will increase as the older members of the echo-boom generation and young immigrants form new households. The share of renters in their 30s and 40s, in contrast, will shrink significantly as the baby-bust generation moves through these age ranges. The share of renters in their 60s and 70s will increase only slightly, given that many seniors prefer to remain in their own homes or to move to supportive housing rather than to rental units.

All of these shifts in demand will keep the need for decent, affordable rental housing strong. Rental production will likely continue to be concentrated in the suburbs, providing units for primarily higher-income renters who can afford to live some distance from public transportation and other services. Meanwhile, cities will have to find new ways to stimulate in-fill production and preserve existing units to meet the housing needs of the growing low-income renter population.

THE OUTLOOK

Just how the recent run-up in condo construction and conversions, as well as the oversupply of single-family homes, will affect the rental market is hard to guess. It is possible that strengthening rental demand will stimulate more production and/or that weakening homeownership demand will encourage owners to rent their unsold properties. But whatever lift rental demand gets from today's weaker