Is the Development and Design of Multifamily Rental Housing In Line with Recent Trends?

September 16, 2013

"With the supply of multifamily apartments on the rise, developers likely will benefit from avoiding the 'cookie cutter' approach to multifamily housing."

Fannie Mae Housing Insights, Volume 3, Issue 8

Introduction

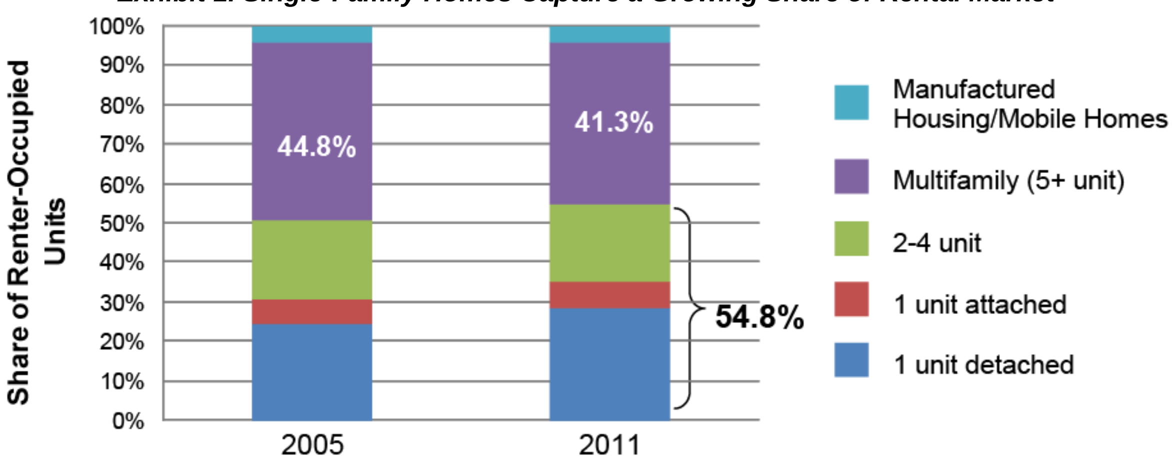
Although the U.S. homeownership rate has declined significantly to 65.1 percent as of the second quarter of 2013 from its peak of 69.4 percent in the second quarter of 2004, homeownership continues to be popular. According to data from the Fannie Mae National Housing Survey[1], which assesses consumer attitudes toward owning and renting, approximately half of the renter respondents stated that they would like to own a home someday. Even more telling, approximately 57 percent of those aged 18 to 34 years old – the cohort most likely to rent, according to the Census Bureau – also stated that they aspire to own a home. That sentiment, coming from the nation's young adults, may suggest to multifamily rental developers that perhaps this cohort is not likely to turn the U.S. into a "rentership society"[2] – at least, not by choice.

This edition of *Housing Insights* examines the demographic conditions that have contributed to an increase in multifamily supply, looks at the general characteristics of the new multifamily supply, and suggests implications for multifamily apartments given the continued stated preference to own from the primary renter cohort.

Significant Increase in Renters

Renter household formation has outpaced owner household growth during the past few years. But the majority of new renters may not be renting traditional multifamily housing – defined as units in buildings with five or more rental units. Instead, they have been renting single-family homes, as illustrated in Exhibit 1.

Exhibit 1. Single-Family Homes Capture a Growing Share of Rental Market



Source: U.S. Census Bureau, American Community Survey

[1] The Fannie Mae National Housing Survey Topic Analysis Report released on June 6, 2013 examines the results from three monthly surveys, which polled a nationally representative sample of 3,004 respondents aged 18 and older between July 5, 2012 and September 22, 2012. The three monthly samples completed during that time were combined into one dataset. All three studies were identical in wording and placement of questions. Interviews were conducted by telephone by Penn Schoen Berland, in coordination with Fannie Mae. For additional survey results: http://www.fanniemae.com/resources/file/research/housingsurvey/pdf/nhsq32012presentation.pdf

[2] Oliver Chang, Vishwanath Tirupattur, and James Egan, 2011, "Housing Market Insights: A Rentership Society?" Morgan Stanley Research, July 20, 2011

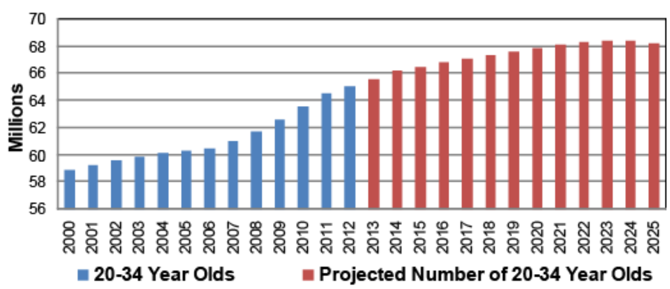
Single-family rentals (defined here as rentals in properties with one to four units) far outnumber multifamily rentals. The 2011 American Housing Survey identified 21.3 million occupied single-family rental units compared to 16.1 million occupied multifamily rental units. During the past few years, the increase in demand for rental units has tilted in favor of single-family rentals rather than multifamily units. In fact, according to the American Housing Survey, single-family rental units represented 51 percent of the occupied rental stock in 2005 compared to 44.8 percent for multifamily rental units. By 2011, single-family rental units had grown to 54.8 percent of the occupied rental stock in 2005 compared to 41.3 percent for multifamily units.

Despite these statistics, new multifamily construction has increased steadily during the past two years, according to data from the Census Bureau, leading to the question: Why is there a focus on multifamily development? The likely answer: Demographics and job growth.

Growth of Young Adult Population

Demographics are in the multifamily sector's favor over the long term. According to the U.S. Census Bureau, by 2020 the U.S. population will include 68 million people between the ages of 20 and 34, the group most likely to rent, as seen in Exhibit 2.

Exhibit 2. Young Adult Population Expected to Grow



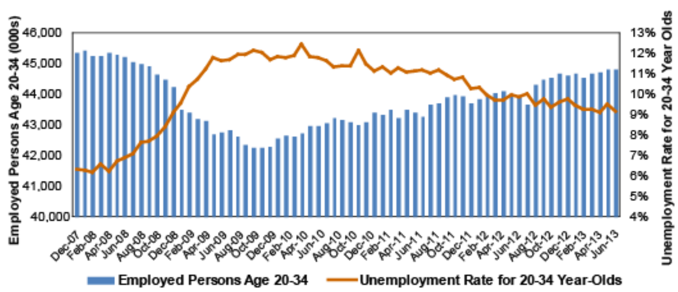
Source: U.S. Census Bureau, Population Projections and Estimates

Improving Job Growth in Prime Renter Cohort

The labor market is recovering slowly from the effects of the Great Recession, which officially lasted from December 2007 to June 2009[3].

Correspondingly, the number of employed 20- to 34-year-olds also has been growing modestly, as seen in Exhibit 3. Since January 2010, the unemployment rate among Americans aged 20 to 34 – the prime renting cohort – has declined from 11.8 percent to 9.1 percent. In addition, while approximately 2.8 million jobs were lost among this cohort during the recession, roughly 2.1 million have been regained since January 2010. The rebound in employment among young adults provides the prime renting cohort with income to rent. As developers have perceived the increase in demand, they have increased the number of multifamily units under way.

Exhibit 3. Labor Market Improves for Young Adults



Source: U.S. Bureau of Labor Statistics (BLS): Current Population Survey, per Moody's Analytics

Shared Households Decreasing Recently

According to the Census Bureau, in early 2007 there were 19.8 million shared households, or 17.6 percent of all households[4]. Shared households are characterized by the presence of an additional adult aged 18 or older who is not the head of the household, nor the spouse or cohabiting partner of the head of the household. The number of shared households increased each year from 2008 to a peak in 2010 of 22.2 million, or 19.4 percent of all households. That trend reversed with the number of shared households declining, albeit slightly, to 22 million or 19.2 percent of all households in 2011.

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[3] National Bureau of Economic Research. See http://www.nber.org/cycles/sept2010.html and http://www.nber.org/cycles.html

[4] Macartney, Suzanne and Mykyta, Laryssa "Poverty and Shared Households by State: 2011" U.S. Census Bureau American Community Survey Briefs, Issued November, 2012.

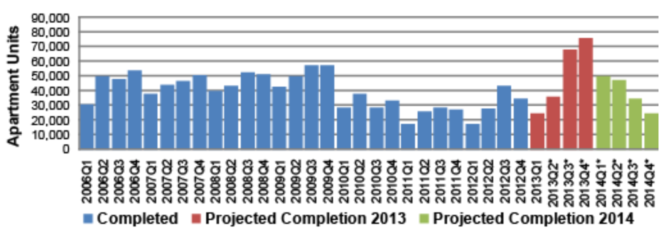
This change in households seems to coincide with the improvement in job growth, as seen in Exhibit 3.

A combination of continued job growth, smaller household sizes, and positive multifamily fundamentals (in terms of lower vacancy rates and higher rent increases) appears to have led developers to focus on building new multifamily properties, especially in larger metropolitan areas.

Multifamily Construction Rising Quickly

According to McGraw-Hill Construction's Dodge Pipeline, which monitors reported construction activity separately for the multifamily rental apartment and condo markets, apartment completions were up in 2012 after a period of below-average completions in 2010 and 2011, as seen in Exhibit 4. Excluding condos, multifamily apartment completions totaled an estimated 123,000 units in 2012, an increase of 24 percent over the estimated 99,000 units completed in 2011. As of June 2013, there were another 42,000 apartment units in the final planning/bidding stages.

Exhibit 4. A Rebound in Apartment Units Completed and Under Way



Source: CBRE-EA/Dodge Pipeline, June 2013

**Anticipated completion date*

Please note that the Dodge Pipeline data are not a forecast of construction activity; the data monitor activity reported to date. As more projects are planned and tracked, figures in future periods may increase.

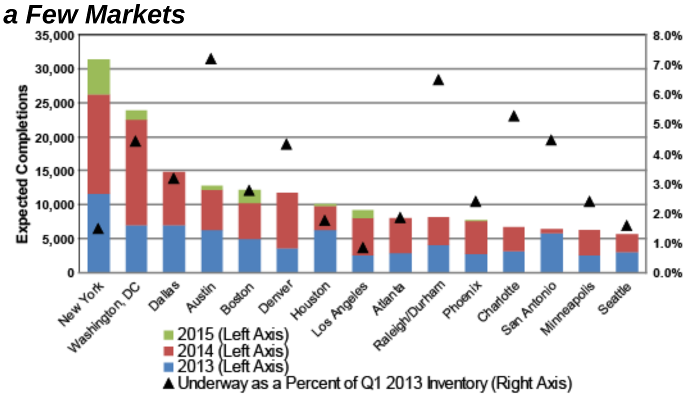
Even more dramatic is the increase in construction under way. According to McGraw-Hill Construction's Dodge Pipeline, approximately 205,000 apartment units are expected to be completed in 2013. Construction also should be healthy in 2014, when another 157,000 multifamily apartment units that are under way are expected to come online.

Construction Focused in a Few Primary[5] Metro Areas

As seen in Exhibit 5, only a handful of metro areas have more than 10,000 units under way, including New York, Washington, DC, Dallas, Austin, Boston, and Denver. In fact, the apartment market's construction activity has been uneven. For example, the Washington, DC metro, with a population of 4.6 million, has nearly as many units under way as the New York City metro, with a population of just under 12 million[6].

Many of the metro areas with the highest number of completions expected in 2013 include larger metros with a fairly significant percentage of renters, such as New York City, Washington, DC, and Boston. Other primary metros that have been able to attract development include Austin, Raleigh, Charlotte, and San Antonio. In fact, these metros have a significant amount of new inventory coming online. As seen in Exhibit 5, construction under way will increase inventory in all four metros by 5 percent or more during the next couple of years. However, these metros also are projected to have above-average job growth[7] during the next five years. In contrast, many secondary and tertiary metro areas have not attracted as much investment in developing new multifamily projects.

Exhibit 5. Apartment Construction is Concentrated in a Few Markets



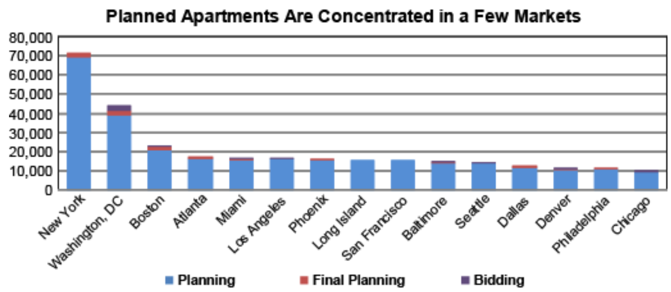
Source: CBRE-EA/Dodge Pipeline, June 2013

[5] Primary metro areas are defined here as those with a population size of greater than 1 million. Secondary metro areas have a population size of 500,000 to 1 million and Tertiary metro areas have a population size of less than 500,000.
[6] Moody's Analytics, Precis Report for Washington, DC and New York, May 2013.
[7] IHS Global Insight Metro Ranking for Total Nonfarm Employment 2013-2017 by Value

New Planned Units Also Focused in Primary Metro Areas

As seen in Exhibit 6, units in the planning, final planning, and bidding stages also are highly concentrated in a few metro areas. Many of these new projects are located in primary metros, which also are most likely to have the best job opportunities, and thereby are most likely to attract the growing population of young adults.

Exhibit 6. Planned Apartments are Concentrated in a Few Markets



Source: CBRE-EA/Dodge Pipeline, June 2013

Micro Apartments Target Solo Renters

A relatively recent phenomenon is the planning and development of "micro" units in high-cost, primary metro areas, such as New York City, Boston, and San Francisco, where rents have increased dramatically in the past few years. While size limits vary from city to city, micro apartments are generally defined as being less than 600 square feet, although some units can be even less than 300 square feet. Micro apartments shrink studio apartments down to bare essentials. Many contain such features as pull-down Murphy beds and contain hidden storage and dual-function furniture to make maximum use of the limited space.

The primary amenity of micro apartments usually is a good location – close to jobs and mass transit. In theory, these units are designed primarily to appeal to younger, price-sensitive renters who want to remain in an urban location but forgo a roommate lifestyle and live alone.

However, there have been questions about the affordability of micro apartments. According to the *Boston Globe*[8], the city of Boston has authorized the building of 190 "innovation" units (some as small as 350 square feet in the Seaport District) that will rent for as much as $1,500 a month. This would require a tenant to earn an annual salary of $60,000 based on the traditional definition of affordability where a renter pays no more than 30 percent of their income on rent and utilities combined.

Developers Focused on Younger Renters

A number of new multifamily developments under way include other features targeted to younger renters. For instance, many planned units incorporate technology-ready features, such as hidden electrical connections and places to wall-mount flat screen monitors. By incorporating green living features – like on-site recycling, energy-efficient fixtures and appliances, low-flow plumbing, and other eco-friendly options – developers are trying to capture the attention of young renters.

Renters Now, But For How Long?

While many proposed amenities target younger renters, it is unclear how long these renters will stay. The Fannie Mae National Housing Survey shows that slightly more than half of renters surveyed would still prefer to own. As shown in Exhibit 7, 51 percent of all survey renters would like to be tomorrow's owners. However, among younger renters only, 57 percent would like to own, as shown on Exhibit 8. These respondents see renting as a stepping stone to eventual homeownership and indicated that their primary reason for renting is to make themselves financially ready to own. Only 13 percent of younger respondents are likely long-term renters.

[8] Let Developers Think Small, Creating New Housing For All" The Boston Globe, June 23, 2013. See also Wong, Vanessa "Micro-Apartments in the Big City: A Trend Builds," *Bloomberg Businessweek*, March 14, 2013

Exhibit 7. Overall Renters Would Prefer Home Ownership

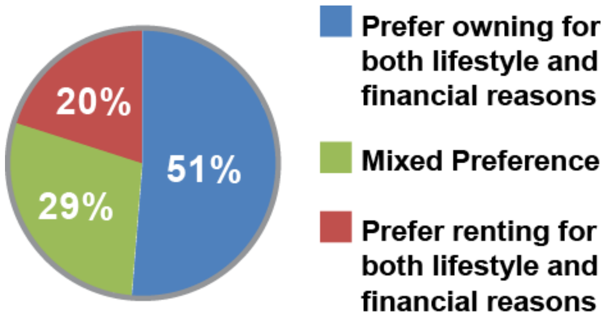
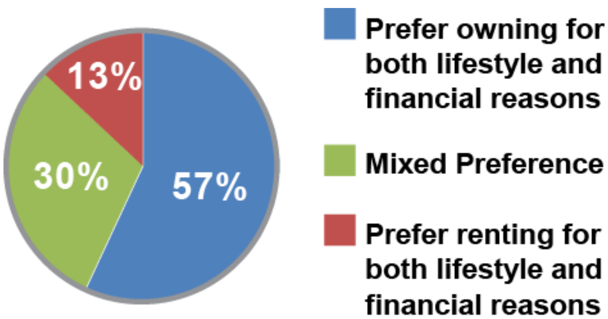


Exhibit 8. Younger Renters Have a Stronger Preference for Ownership



Source: Fannie Mae National Housing Survey Topic Analysis Report Released June 6, 2013, page 14: http://www.fanniemae.com/resources/file/research/housingsurvey/pdf/nhsq32012presentation.pdf

Avoiding the "Cookie Cutter" Approach to Multifamily Housing

The desire for homeownership among young renters has implications for multifamily development. Rather than gearing new multifamily apartments exclusively to the prime renting cohort, developers will likely benefit from offering rental units to older adults, such as "empty nesters," retirees, and seniors looking to exchange suburban, single-family homes for a more flexible lifestyle of maintenance-free renting.

There also is a need for more workforce housing, defined by the Urban Land Institute's Terwilliger Center for Workforce Housing as housing for those "earning between 60 and 120 percent of [Area Median Income], whose members often work in the country's most expensive regions."[9] These are usually major centers of employment, such as Washington, DC, Boston, and San Francisco. Many workforce households consist of families, not just single-person households, who need to rent multiple bedroom units.

Even if the current primary renting cohort does not achieve the goal of homeownership, their renting wants and needs may change as they age. Over time, today's young renters will likely demand larger apartments with more bedrooms, more on-site amenities, closer proximity to schools, and more storage space. Multifamily developers may need to react quickly and effectively over the coming years by offering the specialized kinds of rental housing that match consumers' changing needs across the stages of life.

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September 2013

The author thanks Kim Betancourt, Patrick Simmons, and Orawin Velz of Fannie Mae for valuable comments in the creation of this *Housing Insights*. Of course, all errors and omissions remain the responsibility of the author.

[9] Terwilliger, Ronald J. *America's Housing Policy—the Missing Piece: Affordable Workplace Rentals.* Washington, DC: Urban Land Institute, 2011.

