
MULTIFAMILY
HOUSING
THE NEW AMERICAN DREAM ?
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SUSTAINABILITY

After nearly four consecutive years of growth in multifamily housing starts, many industry players and analysts are beginning to wonder if this property sector is becoming a bit overheated and overbuilt. How much apartment construction is under way, and is it sustainable?

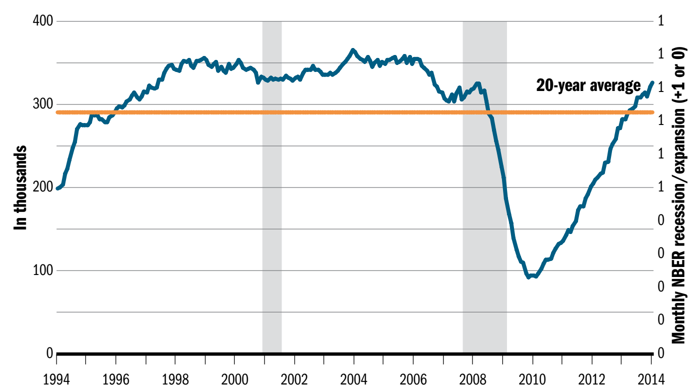
Trends in apartment construction

"If we build it, they will come." This misquote was often thrown around during the housing bubble years in discussions that aimed to justify new construction. In this case, the "it" could have been just about anything in real estate—homes, retail spaces like outlet malls and restaurants, office buildings, or even stadiums. It's unlikely that this phrase gets much play today. Construction activity across many fronts has been fairly anemic—except for multifamily construction.

According to May 2014 data from the U.S. Census Bureau, the 12-month moving average of multifamily starts has rebounded from the 2008–10 downturn. In fact, these starts have been on a strong upward trajectory for the past four years that has shown little, if any, sign of slowing. In 2013, starts even climbed past the 20-year average (see the chart).

June 2014 data from Axiometrics reveal that more than 225,000 apartment units across the nation are in lease-up—a number just shy of 295,000 apartment units under construction and more than 878,000 apartment units in some phase of planning. (Units in lease-up are in the process of acquiring tenants.) Not all of the planned units are guaranteed to break ground, of course, but the number of units on the drawing board is roughly three times as large as the number of units under way, suggesting that apartment activity may continue to be quite healthy for years to come (see table 1 on page 26).

Multifamily Housing Starts
(seasonally adjusted, 12-month average)



Source: U.S. Census Bureau through May 2014

Between 13 and 14 percent of these apartment units, depending on the phase, are located in the Southeast, according to Axiometrics. Perhaps not surprisingly, most of the Southeast

Table 1
Multifamily Housing in the Southeast

	Lease-up	Under construction	Planned
Alabama	2,762	1,268	6,337
Florida	19,171	21,113	73,877
Georgia	4,832	8,887	29,529
Louisiana	725	822	3,191
Mississippi	80	50	816
Tennessee	4,988	8,272	17,216
Southeast	32,558	40,412	130,966
U.S.	225,090	294,718	878,516

Source: Axiometrics

Table 2
Owning a Home versus Renting

	Cost of owning a single-family home ($/month)*	Apartment rent ($/month)	Own premium or discount**
Miami	1,112.00	1,213.00	–8.3%
Jacksonville	709.00	809.00	–12.4%
Orlando	764.00	927.00	–17.5%
Birmingham	657.00	803.00	–18.2%
Nashville	721.00	902.00	–20.0%
Atlanta	609.00	869.00	–29.9%
Tampa	623.00	897.00	–30.5%
Average of 52 markets	978.00	1,052.00	–7.0%

*Assumes a 5 percent 30-year fixed rate mortgage and 20 percent down payment
**A positive value indicates it is more expensive to own than rent; a negative value indicates it is less expensive to own than rent.
Source: CBRE-EA

activity is concentrated in and around urban areas, mostly in Florida, Georgia, and Tennessee.

Can this level of activity and growth be sustained?

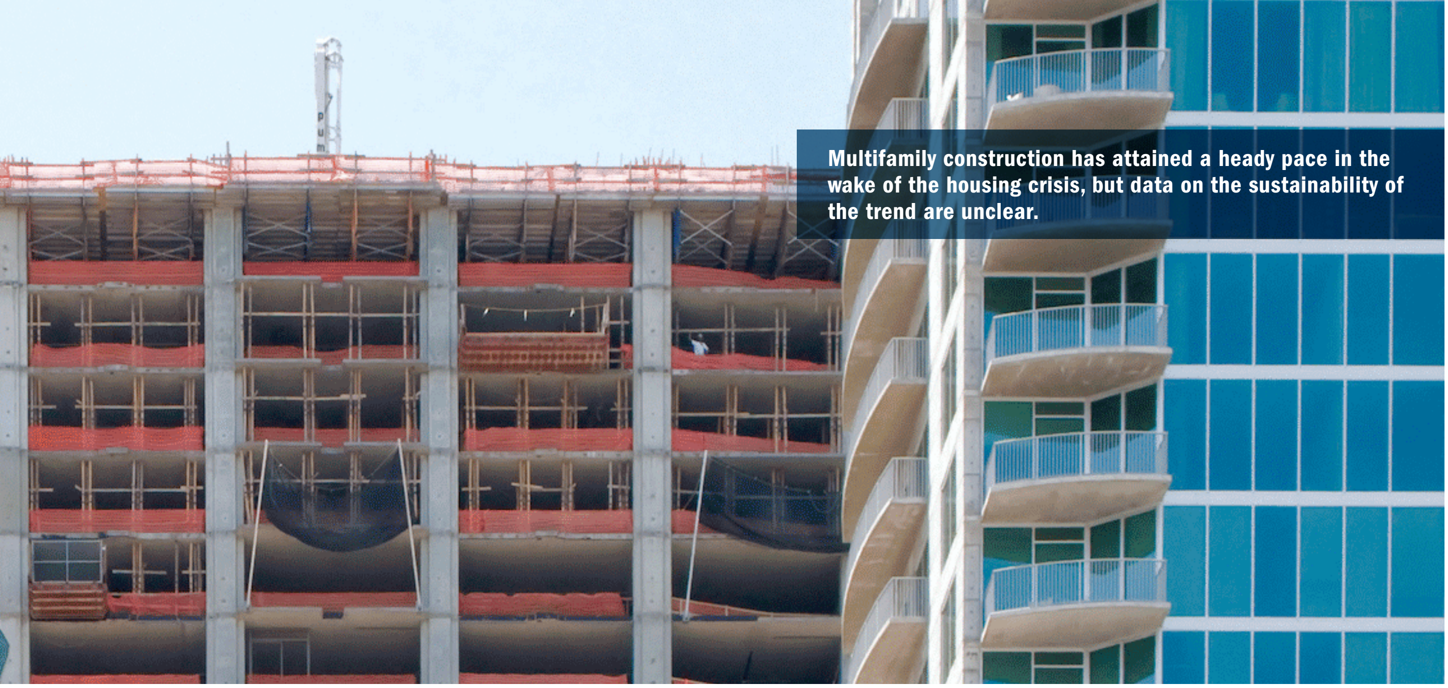
The million-dollar question really seems to be whether all this construction is sustainable. Those who say that multifamily construction is getting a bit overheated may have a point. Recent analysis from CBRE–Economic Associates (CBRE-EA) indicates that, across many major Southeast markets and in most markets across the nation, it is cheaper to buy a home than it is to rent an apartment (see table 2).

A May 2014 blog post by K.C. Sanjay on the Axiometrics website provides some insight into current market fundamentals. Sanjay, a senior real estate economist, wrote, "The fact that annualized national effective rent growth rose to 3.4% and occupancy increased to 94.8% in April was a surprise…because it exceeded the expectations that rent growth and occupancy would begin tailing off about now." His post featured a scatter plot of occupancy levels and rent growth that revealed that a handful of metro areas in the Southeast—including Miami, Nashville, Orlando, and Tampa—have stronger occupancy levels than the United States. Some of these same metro areas have also seen higher effective rent growth than the United States. Despite the strong performance so far, as more supply comes online, some of the Atlanta Fed's business contacts and Axiometrics analysts have said they expect fundamentals to begin to weaken.

Strong rent growth and occupancy levels may make it cheaper to buy a home than rent an apartment, but mortgage credit availability and accessibility may serve as a major barrier to potential homebuyers. One challenge that many buyers have to overcome is the down payment. Interestingly, Freddie Mac posted an *Executive Perspectives* piece in June 2014 highlighting misconceptions about down payments. Christina Boyle, vice president and head of single-family sales, wrote, "Today's consumers persistently overestimate the size of a down payment they need to finance a home." She cites a finding from Zelman & Associates: nearly two of every five people surveyed estimated they would need a down payment of at least 15 percent of the purchase price. Further, only one in four people felt they could qualify for a mortgage. But Boyle also pointed out that more than one in five borrowers who took out a conventional, conforming mortgage put down 10 percent of the purchase price or less. The upshot is that if the cost of buying is less than renting, and if homeownership may be more within potential buyers' reach than many of them believe, then the strength in multifamily housing could get sapped as households move toward owning.

Timing is the key

If there is a cost advantage to homeownership, and mortgage availability is better than many people think, then why aren't we



Multifamily construction has attained a heady pace in the wake of the housing crisis, but data on the sustainability of the trend are unclear.

seeing a movement back to homeownership? In trying to answer this question, we have to consider the preferences of the two demographic groups likely to have the most influence: the millennials, born roughly between 1980 and 1995, and the baby boomers, born between 1946 and 1964.

Carl Hudson, director of the Atlanta Fed's Center for Real Estate Analytics, points out in this issue's "Fed @ Issue" that the road back to homeownership might be a long one if, with the millennials, preferences have shifted more toward mobility. So even if mortgages were available and attainable, the appeal of renting may just be greater than the desire to own a home.

A quick look at Fannie Mae's May 2014 National Housing Survey results can shed some light on preferences. Current renters and respondents who indicated that they are millennials noted that their biggest obstacles to getting a mortgage were affording the down payment and closing costs and overcoming an insufficient credit score or history, factors that are consistent with the high levels of student loans this generation carries. More to the point about preferences, the survey revealed that the majority of young renters as well as young owners believe that owning a home makes more sense than renting. Thus, rather than shunning homeownership, it appears likely that the millennials are simply delaying their move to homeownership, which bodes well for multifamily housing in the intermediate term.

But in the longer term, considering both the attitudes toward owning and the reality that owning is cheaper, many of today's renters will likely eventually make the transition to homeownership, which would reduce the demand for apartments. Moreover, the apartment market fundamentals may be strong now, but many analysts expect to see deceleration and deterioration of these fundamentals as more supply comes online. Taken together, these factors suggest that the current level of multifamily construction may not be sustainable into the future.

Baby boomers, on the other hand, may have an opposing influence. Jordan Rappaport, a senior economist at the Kansas City Fed, published an article in the fourth quarter of 2013 that posits that the "longer term outlook is especially positive for multifamily construction, reflecting the aging of the baby boomers and an associated shift in demand from single-family to multifamily housing." Rappaport looked at the main short-run and long-run determinants of housing supply and demand in an effort to understand the booms and busts and to forecast the trend in housing construction. He projected that multifamily construction will peak by the end of the decade at a level that is two-thirds higher than its highest annual level during the 1990s and 2000s and then plateau at a level that is 15 percent above annual average starts during the 1990s and 2000s.

It is too soon to tell whether the strength in multifamily construction will continue or how supportable it really is. Much of the evidence suggesting it is not sustainable for the long term rests on the shoulders of the millennials. Millennials are coming of age in an environment of wage-growth stagnation. (See "The Economic Plight of Millennials" in the January–April 2014 issue of *EconSouth*.) Many young people are laden with student loan debt and financially unable even to form new households, let alone face the decision of whether to rent or buy. At the same time, the evidence suggesting the upward trend in multifamily construction is sustainable rests on the shoulders of baby boomers. Could it be that both sides of the argument have it right? ∎

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