EXECUTIVE SUMMARY

U.S. APARTMENT DEMAND THROUGH 2035

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NATIONAL MULTIFAMILY HOUSING COUNCIL

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This research updates a comparable report we wrote five years ago. Some of the key assumptions from that report have come true. Slower population growth as a result of the aging population base has amplified the need for new immigrant labor to sustain economic growth. The 2020 recession was unexpectedly created by a pandemic which triggered an almost immediate stimulus effort by the Federal government in concert with a mortgage buying program that held interest rates down.

This changed the dynamics of the housing market. Southern growth markets led housing demand, and new housing formats such as Accessory Dwelling Units (ADUs) and pre-assembled housing were once again touted as tools to combat the housing affordability issue.

We did not foresee a global pandemic nor the persistent impact on the housing market. Amplified by the pandemic, population growth almost came to a halt in 2020 and 2021. As we had indicated in the last report, without immigration, the U.S. population will grow by less than 0.5% per year.

We did not anticipate a scenario in which deaths would increase by 19% in a single year, driving national population growth down to almost zero for two years in a row. The necessary rapid adaption of technology in response to the pandemic, and a cultural change that began embracing remote work at least for those service-based jobs that could function in this new environment amplified a migration pattern not only to suburban markets but to secondary cities.

High-cost urban apartment markets such as San Francisco were slow to recover. Empty urban offices and store fronts, along with cancelled entertainment venues caused a loss of urban appeal. Some recovery is underway, and we all watch anxiously to see how many of the remote work shifts become permanent.

Urban markets have indeed begun recovering, although some markets are still not back to their previous glory as data indicate that less than half of office workers are back in the office. **Economic forecasts are building in expectations that secondary cities such as Boise and Charleston will continue to grow quickly**.

POPULATION GROWTH PROJECTIONS

Nevertheless, **the aging U.S. population will continue to be a significant and primary driver of slowing demand fundamentals going forward**. Population growth slowed from around 1% per year from 1991 to 2011 to 0.6% over the past ten years and is projected to slow further to 0.4% per year through 2035. Without net in migration, population growth will slow to only 0.2% growth per year.

Immigration however is one of the great unknowns in the forecast as it is heavily influenced by public policy. In our last forecast, we projected average net in migration rates of 866,000 from 2017 to 2021, a reduction from the 994,000 average from the previous ten years as a reflection of more restrictive immigration policies at the time.

We had anticipated that immigration would increase after that to levels that were more indicative of past trends, or 1.2 million people per year on average from 2021 to 2030. The reality is that net in migration sunk to 245,000 by 2021 as already restrictive policies were amplified by the pandemic. However, even before the onset of Covid in 2020 and after a new presidential administration, immigration trends were well below our forecast numbers.

We expect immigration to average only 562,000 a year through 2035, down from our prior research forecast of 866,000 a year.

One of the most significant changes in this forecast as compared to the last is that immigration numbers are now expected to remain relatively low throughout the forecast period, averaging only 562,000 per year through 2035, reflective of uncertainties in global health trends, geopolitical uncertainties and at least in the near term more introspective global policies that have dampened the previous globalization trends. In the Scenarios section, we run a scenario in which we use the same 1.2 million average immigration number as the last forecast. In this scenario, forecast population growth increases at a similar pace as the past decade, or by 0.6% per year on average through 2035.

RENTAL DEMAND PROJECTIONS

Overall, demographic growth is expected to generate demand for another 3.7 million new rental properties with 5 or more units through 2035. In a downside scenario, we assume higher homeownership rates, lingering inflation, and low immigration rates. In this scenario, the need for 5+ rental units drops to 2.4 million. In an upside scenario characterized by lower homeownership rates and immigration rates more similar to our last forecast, another 4.8 million new units in properties with 5+ units will be needed.

Overall, demographic growth is expected to generate demand for another 3.7 million new rental properties with 5 or more units through 2035.

Leading growth will be Dallas-Ft. Worth, Houston, New York, Phoenix, Austin, and Atlanta, each of which will require more than 100,000 more rental units, or almost a million new units in total, by 2035.   However, smaller secondary markets are generally growing at a faster pace, with Boise, Austin, Las Vegas, Raleigh, and Orlando expected to grow by more than 2% per year on average through 2035, approximately twice the U.S. average of 1.1% per year. Larger markets, Phoenix and Dallas, are also expected to grow by 2% per year or more.

Impact of Homeownership

Homeownership rates are another variable that could impact the need for new apartments, i.e., if fewer households buy a home, rental demand increases. While homeownership rates are also very highly influenced by public policy, a few demographic factors are putting different long-term pressures on homeownership.

First, homeownership, across all income segments increases with age. Homeownership also increases with family formation (married or not). **All else equal, the aging population would cause the homeownership rate to increase by 3.8%** over the forecast horizon.

At the other end of the spectrum, homeownership rates remain significantly lower in minority populations, and particularly in the **Hispanic population base which outside of White Baby Boomers will be the largest growth segment of the population**. While this will create a downward drag on the homeownership rate, the Hispanic population is still a much smaller population segment with increasing educational attainment and homeownership rates.

In addition, there is **hesitancy in the younger population to embrace homeownership** as seen in the homeownership rates by age group whereas the younger population segments have not returned to pre-2008 (subprime mortgage crisis) homeownership rate levels. This trend is amplified as the age of first marriage and childbirth continue to increase.

The recent jump in interest rates seems to have dampened home buying at least in the near-term as the minimum household income to buy a median-priced house has increased by 20% just since the end of 2021. However, while sales volumes have dropped from peak 2020-21 rates, they remain above the pre-pandemic pace and home prices remain strong, particularly for homes priced over $500,000[1]. Overall, these sorts of influences begin to balance each other out.

While demographic growth will create a need for new housing, there is some evidence of a current shortage of housing as the construction market was slow to return after the 2008 financial crisis and housing costs, both for owners and renters have escalated at a double-digit pace in recent years.

We estimate another 600,000 units are needed to bring the 5+ rental back to equilibrium because of underbuilding due to the financial crisis.

Post-Financial Crisis Underproduction, Declines in Affordable Units

While the pandemic-induced slowdown in household growth over the past couple of years allowed the market to absorb much of this excess demand, we estimate **another 600,000 units are needed to bring the 5+ rental market back to an equilibrium state reflecting only moderate increases in housing costs, bringing total forecast demand to 4.3 million units**.

Housing underproduction has translated to higher housing costs—resulting in a decline of 4.7 million affordable apartments (monthly rents below $1,000) from 2015-2020

However, the above data hides a serious issue in which **the bottom of the housing market has been lost over the past five years because of escalating housing costs overall**. Specifically, 6.95 million owned housing units priced less than $200,000 were lost between 2015 to 2020 as were 4.7 million rental units with rents less than $1,000 per month. This has serious implications for underserved households as well as workforce housing. We discuss in this report the need for 'Missing Middle' housing which allows for a properly functioning housing market that enables households of all races to build household wealth through homeownership.

Going forward, a slower growth market will necessitate that housing owners and developers more closely analyze their markets as **a number of housing segments are expected to experience faster growth while other housing segments stagnate or even decline. These may include differentiation by factors such as location, housing type, tenant age or price segment**.

Aging Renters

The 55+ and 65+ renter household age segments increase through 2035 in most of the markets in our study, and their contribution to renter household growth becomes more pronounced in the middle and later years of the forecast. **These age segments are particularly important in slow-growth markets that are experiencing a decline in younger population groups**. While homeownership rates are higher in this age group, because of the size of this segment, 55+ households already account for 30% of renter households, with the 65+ segment of this group accounting for 16% of all renter households. We noticed these trends most pronounced in lower growth markets in the Midwest and Northeast. In markets such New York, Chicago and St. Louis, the 55+ age group will account for all of new apartment demand in total through 2035.

Regional Variations

Regionally, new demand through 2035 is focused in just three states, Texas, Florida and California, which will require more than 1.5 million new housing units, or 40% of net new demand. However, on a percentage growth basis, **secondary cities generally lead the way. Boise, Austin, Las Vegas, Raleigh, Orlando and Phoenix** are all expected to grow by at least double the national pace. **Dallas and Houston** are also in the top markets for percentage growth followed by **Charleston and Charlotte** to round out the top ten in our study.

Role of Single-Family Rentals

While **institutional ownership of single-family rentals (SFR) has escalated** since our last report five years ago, the market remains highly fragmented with most SFR still owned by small investors who own less than ten units. With institutional ownership at only 2% of the 12 million units in this sector, indications are that this segment is growing quickly and is likely to continue to generate merger and acquisition activity as owners scale up. The SFR market provides larger units that house a slightly older work force and are more likely to be located in good school districts. While we have limited performance data, thus far SFR seems to have provided investment returns at least equal to, if not better than, apartments over the past few years.

Worsening Affordability

Affordability continues to be a very significant housing issue, *particularly for renters*. We see a slight worsening in rental affordability since our last report despite a multitude of new housing laws as well as lower interest rates. New supply tends to focus on the upper echelon of the market which is already unaffordable to many renters. The pandemic only amplified this problem, creating double-digit price increases in many construction materials as well as increased housing prices[2].

Affordability is a complex issue that can be caused by a multitude of issues, e.g., policies that overcomplicate or restrict supply (often unintentionally), lower incomes and/or high housing costs. The meteoric rise in housing costs recently also motivated owners of small properties to just sell the properties, many of which could be converted back to owned properties, thus further reducing rental stock at the low end of the market.

Thus, addressing affordability is a complex issue. Throwing further housing laws into play does not seem to have worked over the past five years. Several markets contain a large number of older properties as well as lower quality (second tier affordable rental or STAR properties) that may provide an answer. The 1 to 4 unit segment of the housing market, also containing the Missing Middle segment, is approximately equal in size to the 5+ segment, but with significantly less institutional ownership may provide ample opportunities to provide needed housing and become more efficient through institutionalization.

Affordability is particularly a critical issue for renters in markets such as Miami, Los Angeles, New Orleans, Orlando, Riverside, and San Diego where 45% or more of renters in spend 35% or more of income on rent. High costs of housing are correlated with out migration to other areas. Southern metro areas rank highly for attracting residents from other areas. Atlanta, Austin, Dallas, Houston, Las Vegas, Miami, Orlando, Phoenix, Seattle, and Tampa have experienced strong in-migration trends.

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[1] "Summary of April 2022 Existing Home Sales Statistics," National Association of Realtors

[2] "Housing Demand and Remote Work," Mondragon, John and Johannes Wieland, Working Paper 30041, National Bureau of Economic Research, May 2022. Paper found that half of the 23.8% increase in national home prices since 2019 was caused by shift to remote working during the pandemic.