YARDI® Matrix

RESEARCH

Multifamily's Robust Demand

Paul Fiorilla
Associate Director of Research

Boomers to Lead Robust Multifamily Demand

The apartment sector has flourished in recent years as the U.S. economy has rebounded from the global financial crisis, leading occupancies, rents and property values to soar. New supply, which bottomed during the credit crisis, has bounced back to historical averages, prompting concerns that oversupply is rearing its ugly head. However, based on an analysis of economic, demographic and social trends, we believe that those fears are unjustified. By and large, the results of the analysis point to outsize growth in renter demand over the next decade and possibly beyond.

Much of the increased demand has been attributed to the now-familiar story of the Millennials, the 80-plus million-strong cohort that is growing into prime renter age and increasingly moving into urban apartments. Millennials will continue to be a key component of multifamily demand in coming years, even as they start to age out of the 20- to 34-year-old prime renter cohort. Less noticed, however, is the increase in demand coming from the other end of the age spectrum, the Baby Boomers, who are now in their 50s and 60s. Based on demographic and social trends that are likely to continue, today's Boomers will be a key driver of demand for apartments—whether traditional multifamily, single-family rentals or age-specific senior housing—going forward.

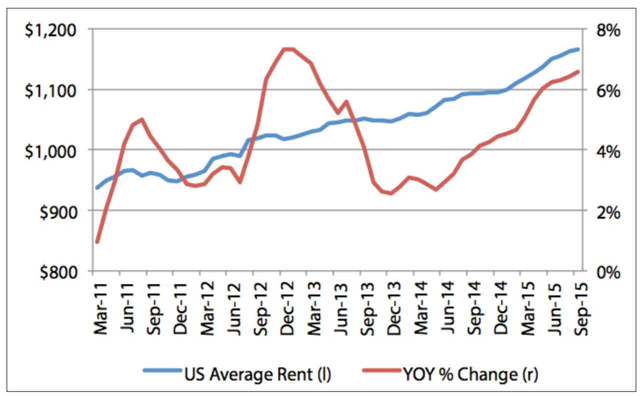
Current Cycle

The U.S. multifamily market is in a sweet spot. Occupancies are at or near all-time highs in most markets. Rents are rising at almost unprecedented levels. According to Yardi Matrix, rents in the U.S. rose a cumulative 20.2% between January 2011 and September 2015 and are not showing signs of slowing down. In fact, rents climbed 6.8% year-over-year as of September 2015, the fastest rate on record during the current market cycle. Elevated renter-household formation on the heels of several years of weak supply has been the primary force behind rent growth. Vacancy rates are at or near all-time lows in most markets, and it will take more than a year or two of heavy supply to change the supply-demand dynamic.

Property values are also soaring, as apartments have outperformed all other commercial real estate segments. As of August 2015, U.S. multifamily property values were up 114% from the January 2010 trough and had eclipsed the last peak in December 2007 by 33%, according to the Moody's/RCA Commercial Property Price Index (CPPI). For perspective, prices in other core commercial property sectors increased 84% since the trough and are only 8% above the most recent peak.

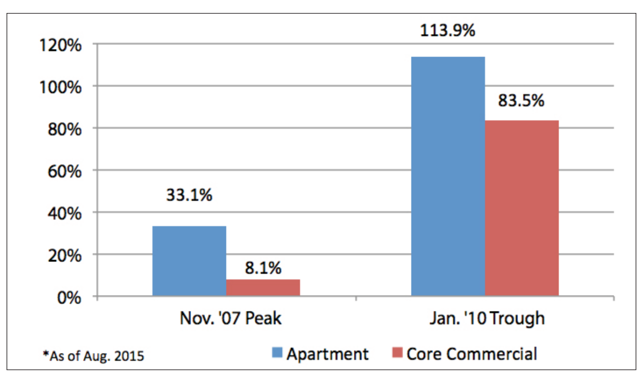
The apartment sector's strong performance reflects a variety of trends, including the desire of global

Average U.S. Multifamily Rent



Source: YardiMatrix

Change in Value: Apartment vs. Core Commercial*



Source: Moody's/RCA CPPI

investors to increase allocations to U.S. real estate in general and multifamily in particular. It also reflects investors' confidence that multifamily property fundamentals will continue to improve as a result of the continuation of demographic and social trends, including:

- The growing number of Millennials entering the 20-to-34-year-old prime renter cohort.
- Job growth that is enabling Millennials to move out of their parents' homes.
- The general population shift to urban areas with concentrations of rental housing.
- The declining homeownership rate: Americans of all ages lack the financial wherewithal or ability to meet banks' stringent credit requirements of banks. Furthermore, young adults face crushing student debt and are also putting off buying homes for lifestyle reasons such as waiting longer to get married and have children. Older Americans are giving up large suburban homes for both financial and lifestyle reasons.

By now, these trends are familiar—whether and for how long they continue are key factors in gauging future multifamily demand.

Rental Demand to Grow

Multifamily absorption has been strong for years, but has the wave passed? Demand for multifamily is based on a number of factors, including population changes, household formation and the proportion of renters versus those who own a home. To calculate future rental demand, we used U.S. Census Bureau forecasts of population growth and household formation by age cohort and factored in projected homeownership rates by age cohort.

Our study contains three scenarios, depending on potential trends in homeownership. Our baseline scenario assumes that homeownership rates will remain at current levels. While it isn't likely that homeownership rates will not change, we believe that the rate is nearing a bottom. If homeownership rates continue to fall, we would expect it to stimulate a policy response, as the housing market's contribution to the broader U.S. economy already is falling short of its historic watermark.

An optimistic scenario for rental demand assumes that homeownership rates will continue to decline slightly, which means more households will rent. The most pessimistic scenario assumes that homeownership rates will rise to the midpoint between where they are today and the 10-year average. We believe that this pessimistic scenario is unlikely because it would hinge upon a quick reversal of social and economic trends that have been building. Lower homeownership rates are associated with marrying and having children at later ages and preferences for living in urban neighborhoods, where a greater percentage of housing stock is for-rent compared to the suburbs.

Preferences and trends are fluid, which makes them hard to predict. Millennials' preference to live in urban cores has had a profound impact on commercial real estate, not only multifamily but all property types. A holistic live-work-

Total U.S. Renter Households, Current and Forecast

Total	Dec-15	Dec-20	Dec-25	Dec-30	Dec-35
High	42,118,578	45,359,466	48,287,593	51,277,271	54,071,825
Middle	42,118,578	44,315,429	46,116,991	47,887,644	49,394,244
Low	42,118,578	42,380,216	44,114,610	45,798,038	47,226,349

Sources: Census Bureau, Yardi Matrix

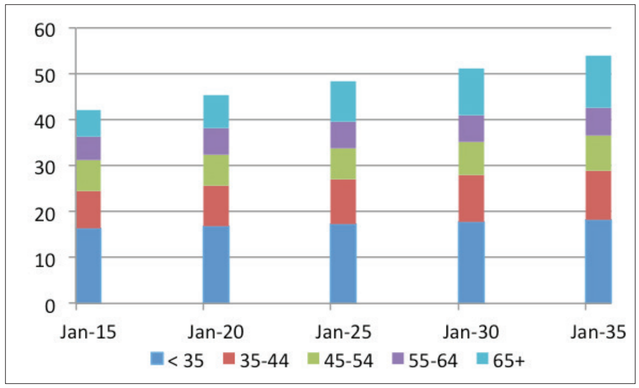
play lifestyle has given rise to "24-hour" core markets and "18-hour" secondary markets that combine housing, offices, shopping and entertainment. It is possible that as Millennials age into child-rearing years, this trend will reverse and many will seek out suburbs for better schools and quieter streets. Banks might loosen credit as the financial crisis moves further into the rear view mirror, which could help push homeownership rates back up. Even if trends that favor renting start to reverse at some point, the shift will be slow and gradual, so it will take years for the homeownership rate to rise significantly.

With that caveat, even under the most pessimistic scenario, in which homeownership makes a comeback, demand for multifamily units will rise by 2.3 million over the next decade and 4.6 million over the next 15 years. The demand growth comes mainly from the increase in population and households.

Under our baseline scenario, in which homeownership remains at current levels for each of the individual age cohorts, rental demand will rise steeply. In this case, demand for multifamily units will total 2.2 million over the next five years, 4 million over 10 years and 5.8 million over 15 years. That works out to somewhere between 350,000 and 400,000 units per year, roughly in line with the long-term average annual construction of apartments in the U.S.

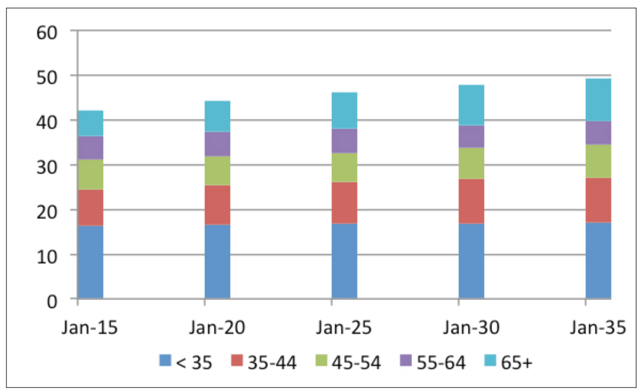
Under our most optimistic scenario, we project that current homeownership trends will continue modestly and the homeownership rate will decline by 50 to 100 basis points in each age cohort. This might be the most likely scenario, given that the homeownership rate shows little sign of stopping its decline. Under this optimistic scenario, some 2.9 million renter households will be created over the next five years, 6 million over the next decade and 9 million over the next 15 years. The result would be roughly 600,000 new renter household units per year, which is well above the 350,000-unit long-term annual average for U.S. multifamily supply. If this scenario comes to pass, then not only is the current level of development not going to create oversupply but unless new construction increases, there will be a chronic undersupply. That could produce continued outsize rent growth and exacerbate the problem of affordability that is reaching crisis proportions in some markets.

Renter Demand: High Projection (Mil)



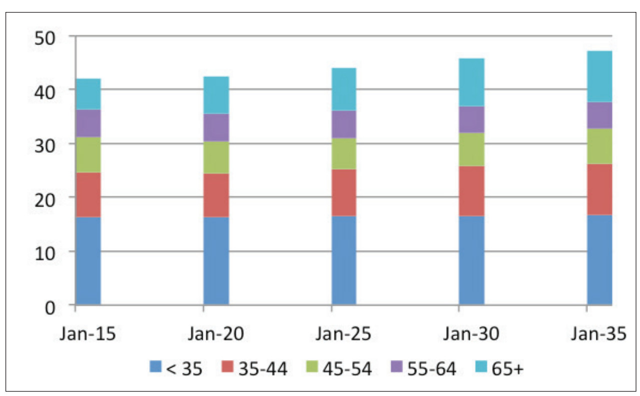
Sources: Census Bureau, Yardi Systems

Renter Demand: Baseline Projection (Mil)



Sources: Census Bureau, Yardi Systems

Renter Demand: Low Projection (Mil)



Sources: Census Bureau, Yardi Systems

It should be noted that not all renters wind up in traditional multifamily units. In fact, the fastest-growing share of the U.S. housing market in each age cohort is single-family rentals (SFR). SFRs have always comprised a much smaller portion of the rental market than multifamily, but the share of SFRs has grown from about 5% of the total housing stock in 1994 to about 7% in 2014, according to the Mortgage Bankers Association. SFRs have grown steadily since the credit crisis. One reason is that there are a number of former homeowners who lack the credit scores needed to buy a house but still prefer the amenities and location of a single-family home. Also, the segment is growing due to the entrance of institutional investors that have created a new business model in which they buy and/or finance large numbers of single-family homes. Traditionally, SFRs have been owned and operated by small investors.

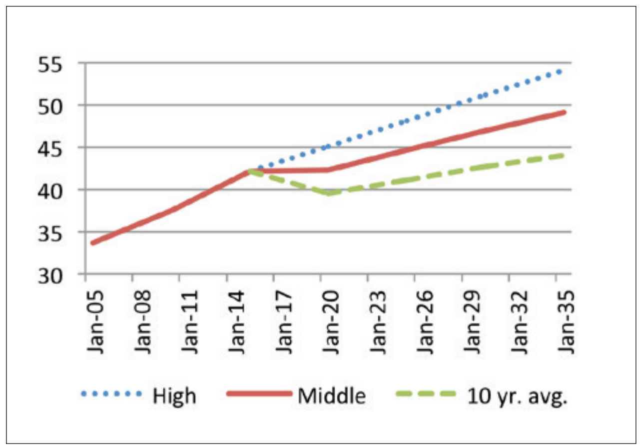
Demand by Age Cohort

Based on our calculations, demand for rental housing seems likely to increase strongly for another decade or more. In order to assess demand more specifically, however, it helps to understand the demand by age cohort because people want and need different types of housing at different points in their lives.

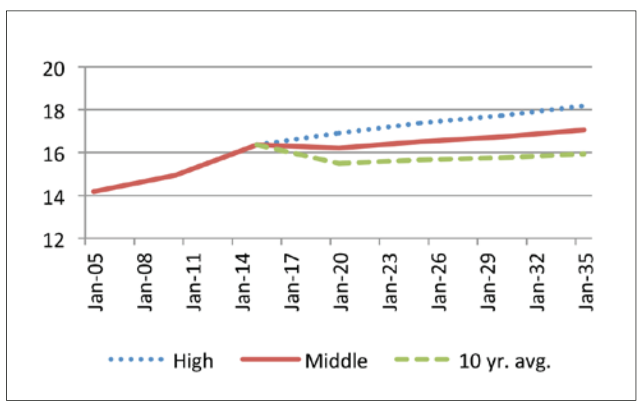
By age cohort, by far the largest increase in multifamily demand over the next decade will come from the 65+ group, the Boomers. For example, if we use our baseline scenario, the 65+ group will account for more than half of new demand: 1.2 million of the additional 2.2 million rental units to be created over the next five years and 2.3 million of the 4 million units to be generated over the next 10 years. If we use our more optimistic scenario, the 65+ cohort will comprise 1.5 million of the 3.2 rental units to be generated over five years and 3.1 million of the 6.2 million units to be generated over 10 years.

The 65+ cohort's domination of the increase in multifamily demand largely stems from its size. Baby Boomers are not only aging into retirement, they are living longer (hence, they need places to live) and a growing number are renting rather than owning. The big question related to demand for living space for the aging Baby Boomer generation is their choice of housing. Will they congregate in senior housing complexes, move to urban apartments with desired amenities or stay in their own homes? Will they flock to traditional retirement climates such as Florida and Arizona or will they opt to remain near families closer to where they spent the bulk of their lives? The answers to those questions will determine the long-term demand for residential construction.

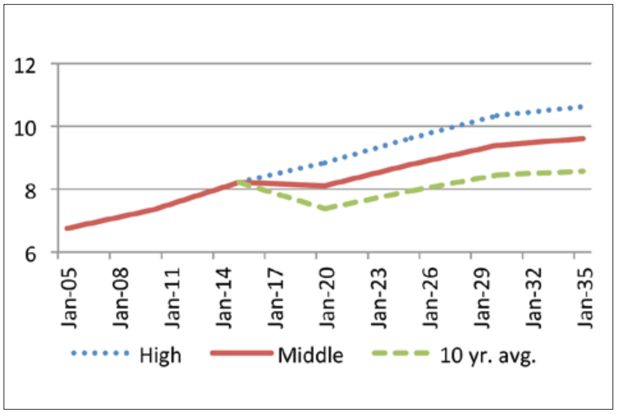
Total U.S. Rental Households (Mil)



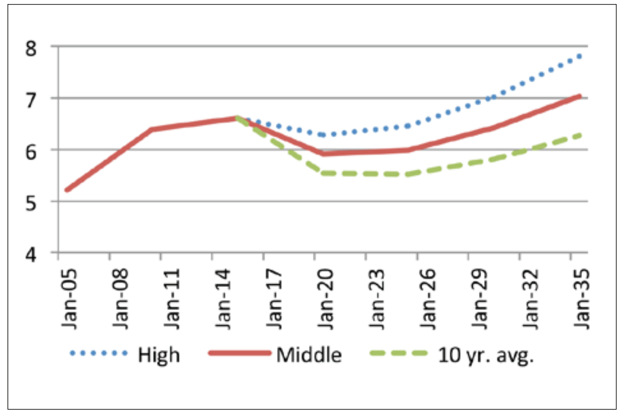
U.S. Rental Households <35 (Mil)



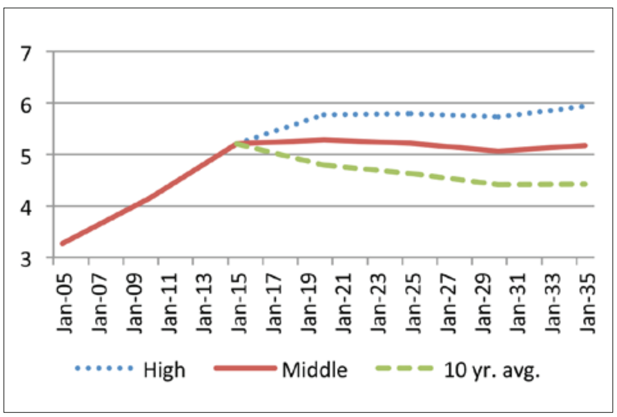
U.S. Rental Households 35-44 (Mil)



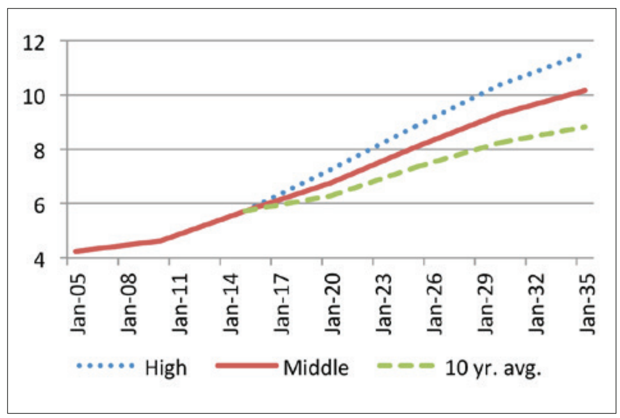
U.S. Rental Households 45-54 (Mil)



U.S. Rental Households 55-64 (Mil)



U.S. Rental Households 65+ (Mil)

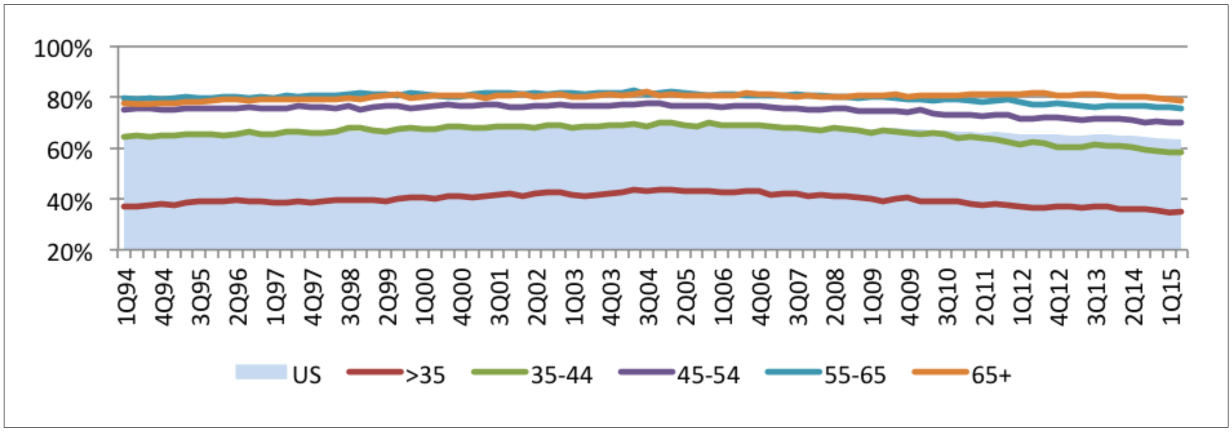


Sources: Census Bureau, Yardi Systems

After the 65+ cohort, the group with the most demand will be the 35-44 group. Our baseline scenario projects demand for an additional 500,000 apartment units over five years and 1.2 million units over 10 years. Our optimistic scenario projects demand for an additional 600,000 units over five years and 1.4 million over 10 years. Again, this is based on demographics as the Millennials age from the under 35 category to the 35-44 group. A big question in projecting demand is whether today's Millennials act more like their parents and buy homes as they enter child-rearing years or if they will continue to gravitate to cities, whether they are parents or not.

Demand for apartments from the Millennial generation will be more muted. Under our more optimistic scenario, there will be demand for an additional 1 million units over the next decade from those 35-and-under. Our baseline scenario produces just over 400,000 units of demand over the next decade. Why the cooling of Millennial demand? In large part, it is the result of the older Millennials aging into the 35-44 age cohort, which historically has a higher level of homeownership. Gen X, the cohort that follows the Millennials, is simply not as large.

U.S. Homeownership Rate by Age Cohort, 1994-2015



Sources: Census Bureau, Yardi Systems

Impact of Social Trends, Demographics

The Baby Boomer generation doesn't generate as much discussion as Millennials when it comes to multifamily demand. But the data indicates that not only will they be a significant generator of demand going forward, they have been an underrated part of the rising demand in the current cycle. According to an analysis by the Federal Reserve Bank of Kansas City, between 2007 and 2013, Boomers (individuals between ages 50 and 69) increased occupancy in multifamily units by 1.3 million, compared to a 459,000-unit increase in multifamily occupancy among 20-to-34 year olds (Millennials). Put another way, 70% of the increase in multifamily occupancy in the current cycle came from Boomers, compared to 24% from Millennials. Another 14% increase in multifamily occupancy came from individuals ages 70 and up, while there was an 8% decrease in occupancy among individuals ages 35 to 49, which is an age when many move out of apartments into single-family homes.

What prompted the increase in rentals among Boomers? The biggest factor is the size of the age cohort. At 78 million, the Boomer generation is just behind Millennials as the largest generation in the history of the U.S. Improvements in medical technology mean that individuals over age 50 are living longer than previous generations. The youngest Boomers are in their early 50s, so by virtue of sheer numbers, there will be rapid growth in age groups of 50+ in coming decades. Over the next 15 years, the 50-and-older population is projected by the Census Bureau to grow by 20%, to 134 million in 2030 from 112 million today. Meanwhile, the 20-to-50-year-old cohort is projected to grow by only 9%, to 140 million in 2030 from 128 million today. In other words, the 50+ population will grow by 22 million, almost double the 12 million increase in the 24-to-49-year-old population.

Another factor is the decline in the homeownership rate. While discussion around this topic has largely focused on Millennials, every age category has seen a decline in homeownership. Although the rate among households headed by individuals ages 55 and up has not declined as rapidly as with the younger age groups, there has been a steady decline in recent years. The homeownership rate of the 55-to-64 age group fell to 75.4% in 2Q15 after peaking at 82% in 2Q04. For the 65-and-up cohort, homeownership stands at 78.5% after peaking at 81.8% in 3Q04. It's not clear whether the homeownership rate has bottomed or will keep declining, but it is unlikely to trend upwards. Boomers face the same financial pressures as younger generations—many are underemployed and/or have had homes foreclosed upon—and bank credit remains tight since the credit crisis.

While homeownership will remain the dominant form of housing for senior citizens, some Boomers will no doubt become less interested in maintaining large suburban houses with high property taxes, expensive maintenance costs and the burden of physical tasks such as lawn care and snow removal. Boomers also may have different goals for retirement than preceding generations. Today's 50+ cohort—especially those that are well-off—are staying active longer than those of the same age in past generations. Rather than retiring to quiet rural locations, a growing number of empty nesters are seeking urban locations where they can enjoy theater, restaurants, sporting events and more.

Location is another aspect. Some Boomers are maintaining primary or secondary apartments within proximity to their families instead of permanently moving to locales such as Florida and Arizona. That would help explain some of the demand for high-priced urban luxury apartments that seem to be priced out of reach of the Millennial generation.

Conclusion

Forecasting demand for commercial properties is an inexact science, and is subject to broad shifts in the economy and social trends that are notoriously difficult to predict. That said, except in dire economic circumstances, demand for rental properties will almost certainly continue to be robust in the next decade and beyond. The growing population and evolving social and demographic trends will produce a steady increase in demand for multifamily units. In particular, the size of the Boomer generation, combined with economic and social forces, is likely to produce growing interest in rental properties among households headed by individuals age 55 and up in coming years.

While we believe that increased development will be needed to meet the demand for units, construction should be targeted, since it will be increasingly important for housing to cater to the needs and aspirations of specific consumer groups. Developers must be careful to build the type of product with amenities that will attract tenants. What's more, demand won't be consistent across the country but will be concentrated in pockets where job growth is strongest and Millennial and senior households want to live.

Contacts

- **Jeff Adler**, Vice President & General Manager of Yardi Matrix: Jeff.Adler@Yardi.com, 1-800-866-1124 x2403
- **Jack Kern**, Director of Research and Publications: Jack.Kern@Yardi.com, 1-800-866-1124 x2444
- **Paul Fiorilla**, Associate Director of Research: Paul.Fiorilla@Yardi.com, 1-800-866-1124 x5764
- **Dana Seeley**, Senior Research Analyst: Dana.Seeley@Yardi.com, 1-800-866-1124 x2035