EconoPlay®
Reality-based economic forecasting
Delivering economic intelligence from Main Street to Wall Street

Inflation/Housing

Apartment Brokers: Rent Trajectory Still Rising In Hot Markets, Slowing in Outer Rings

- *New Rental Space Being Readily Absorbed, Mitigating Downward Price Pressures*
- *Still an Owner's Market, But Landlords Being More Careful Not to Overreach*
- *Rising Rents Engender a (Non-Threatening) Shift Back to Home Ownership*

By Gary Rosenberger

NEW YORK (EconoPlay) Oct. 10 – Rents in cool downtown markets show no sign of slowing despite a trove of new supply, but the trajectory is slowing in outlying markets as landlords take care not to overreach, industry officials say.

New multifamily construction is being absorbed as quickly as it's being built – and if there's no downward price pressure from the added inventory, it's because they're packed with enough amenities to make anyone think twice about owning.

Job growth is lifting all boats, and relocations have been especially robust this year – working magic for all segments of real estate. Indeed, a shift to ownership appears to be no threat to the rental market, where occupancy is now at a seven-year high.

Rents should stay buoyant because today's job market requires mobility. Who knows how long the consultancy gig will last or even if the next job will be in the same city?

The flip side is that rents are high and it's easy to resell a home, so the ownership option is more viable than ever for those who are up to the task of owning and can snag a mortgage and down payment.

"It was a good year. Rents went up and demand went up, especially during the summer months," said Debbie Done, president of Apartment Search, a locator service in St. Louis. "Demand was high and availability was tight, so everyone was able to increase their rental rates and get them back up again, I'd say up 5 percent over the year prior."

The biggest rent increases happened in neighborhoods that fell the hardest to "accommodate the sluggish market." And much of the demand is coming from young couples "still scared off by the whole home purchase deal," she said.

"People this day have no comfort level that 'I'm here to stay and this is what I will do for the rest of my life'," she said. "They have to be mobile. They have a job, but they don't know whether down the road they'll transfer with the company or go with a new company that might not be in the same town."

Not all of St. Louis is in demand. “I do hear about people saying they’re not interested in the Ferguson area,” she lamented, referring to where a policeman shot and killed an unarmed teen, igniting two months of protests. “All I can say is that it’s so nice to see the Cardinals in the playoffs to offset the bad news of Ferguson.”

Two Trajectories

Joy Anzalone, chief operating officer at Burton Carol Management in Cleveland with properties in Ohio, Michigan, and Florida, sees her markets moving in two distinct directions. “The urban downtown properties are exploding and rents continue to climb, just as they have over the past two years,” she said.

Developers are bringing a lot of new product into those downtown neighborhoods, and they are chock full of amenities and upscale finishes that allow them to charge higher rents and entice young urban dwellers, she added.

In outlying areas, the rent increases are slowing. “The ring around [those hot areas] are still good – and definitely better than they were post-2001 and after 2008,” she said.

But landlords in those outlying markets are shifting their focus from rent increases to tenant retention, or as Anzalone puts it, “from trying to catch up from so many bad years to stabilizing their buildings and not creating turnover while still getting fair increases.”

She has noticed “some shift” to ownership from people who “wanted to buy all along and were just waiting for the right time, or to feel secure in their employment.”

“Now there are so many wonderful apartment buildings that people are choosing apartment living more than ever. I used to sell that point of view hoping to convince people. But it’s reality now,” she said.

But the allure fades if rents go too high. “We do lose some people in the $900 range that are buying their first home,” she said. The flipside are homeowners opting for the more carefree lifestyle of apartment living. So, “it's all cyclical.”

One driver of apartment (and housing) demand is relocations – and that business is through the roof – benefiting both rentals and home resales, said Jeff Rowe, vice president at CORT Destination Services in Cincinnati, a national relocation service provider.

“The employee relocation industry is really strong. We’re having the best year we ever had. It’s a scenario where all boats are rising. There’s just a lot of relocation activity whether it’s permanent moves or temporary assignments,” he said.

As he budgets for 2015, the year “looks every bit as strong as 2014 was, if not stronger, and 2014 was a record year, so we’re bullish,” Rowe said.

“Everybody seems to be doing well, competitors and clients. There hasn’t been one client that I’ve talked to that isn’t excited about their business,” he said.

A Shift to Ownership

All of the above is contrary to expectations. His clients projected a flat 2014. Instead, his relocation business is up almost 40% over 2013, he said.

What’s more, transferees are opting for equal parts ownership and renting. “People are selling their homes quicker, which also enables them to buy quicker,” Rowe said.

“Over the prior four years people weren’t able to easily sell their existing homes, which forced them into a rental situation,” he said. Now both options (renting and buying) are equally viable. “This year is the first time in a long time that rentals and sales are about equal where, before, the rental industry easily outpaced sales.”

Yet despite the shift back to ownership, and the deluge of multifamily construction, rents continue to rise. “Occupancy at these properties is extremely high, and owners are in a position where they can consistently raise rents,” Rowe explained.

Nor does he think that the shift to ownership is detrimental to the rental side. “It’s strong on both fronts,” he said. “It’s been a while since I’ve seen both industries feel this good about themselves.”

There is a general consensus in the apartment industry that the market changed in their favor around four years ago, when it captured the youth market. “This younger generation of workers will be a generation of renters, and properties being built today have the quality and amenities geared to their lifestyle,” Rowe said.

Yet even that is running into market forces. “People are thinking I can buy a house for roughly what I pay for rent. This is especially true in markets that were hit hard, where prices dropped to where it makes sense to buy,” he said.

Thus the rough parity: “Neither rentals nor home sales are dominating the marketplace,” Rowe said. “I think ownership is going to dominate again over time. It’s moving in that direction. For that reason, the apartment industry is not expecting to get the same rent increase next year that they got this year.”

Except for maybe the San Francisco Bay area, which “is on fire,” Rowe said. “There we advise our clients that if they find something they like, put in the application immediately because it will be gone by the end of the day.”

Houston is also “getting tight” because of the burgeoning energy sector. “We’re doing far more relocation activity into Houston than to any other market in the United States. So that’s another market where it’s getting tough to find rentals,” he said.

In Houston as rentals get scarce, and rents move into monthly mortgage territory, the shift to ownership becomes more pronounced, Rowe said.

But in coastal California, houses are so expensive that ownership may be out of reach no matter how high the rents go. “The tornado has not stopped. Demand is still strong. It continued to climb the last four years, and I don’t see it coming down in the near future at all,” said Kevin Miller, president of Westside Rentals with seven offices covering Santa Barbara to San Diego.

Rent increases in the hotter beach communities of LA are up around 15% from just six months ago. “There are lots of reasons why. The first reason is jobs. The beach cities are where tech starts ups and companies decided to plant their feet,” he said.

Downtown LA is also in the sights of tech startups lured to an exquisite combination of inexpensive space, architecture (high ceilings, exposed beams), and young talent funneling into cool downtown neighborhoods. “Young people don’t want to live in a tract home 25 miles from the city. They want to live where there’s bars and restaurants and, by the way, work three blocks away so they don’t even need a car,” he said.

Miller sees “very little movement” back to home ownership. “It’s still difficult to get a loan, down payments are through the roof, and employment can be shaky in the venture capital world. When the money runs out, you have to be mobile,” he said.

Besides, home prices are prohibitive. “After you spend every dime you have for a $300,000 down payment, you then have the privilege of a $1.2 million mortgage, plus property taxes and association fees,” he added. “But you can still afford to live in that area if you rent, and you can move wherever the job market takes you.”

A Record Jump

Tamela Coval, an executive strategist for CORT, says her best “down and dirty” estimate of apartment occupancy nationally is 95.6% in the third quarter, which is a seven-year high.

Rent growth in that same quarter soared by 3.5% – “the best three-month jump in history,” she added.

A number of factors played into that but topping the list is job growth (and high-paying jobs at that). “One byproduct of an improving job market was that young people moved out of mom and dad’s basement,” she quipped.

There is also plenty of amenity-filled new construction (always more expensive than old construction) to satisfy the demand.

And pent-up demand was further unleashed “when the weather improved from a horrific first quarter,” Coval said.

“Landlords continue to extract whatever rent increases they can out of their residents, causing rents to inch higher,” she noted. They are further empowered by revenue enhancement software that monitors supply and demand and resets asking rents daily, much like selling a seat on an airplane.

Markets that lagged the recovery are now gaining lost ground. Las Vegas, in the top tier of hot rental markets, “is showing 4.6 percent rent growth, but their rents are still well under pre-recession rates,” Coval said.

New York remains the nation’s most expensive market with average rents 47% higher than San Francisco, the second most expensive market, she said.

So how is the most expensive rental market in the U.S. faring?

“My gut take on the matter is that demand has plateaued. But then again, it always softens after the summer season,” said Larry Rosenberg, president of RDNY (Rent Direct New York), a web-based rental locator covering New York’s five boroughs and beyond.

New York is a seasonal market and demand will decrease through winter – after all, who wants to move in the middle of a blizzard? What then follows is the inevitable spring bounce, when rent increases start anew and rise through to the end of summer.

“Rents have plateaued at a high level,” Rosenberg added. “Increases are no longer happening and, heading into winter, we see luxury buildings beginning to offer rental incentives to renters, rental agents, or both.”

In the city’s middle market, he has already noticed a slight decrease of about 3% to 5% in asking rents.

Yet all the new construction is exerting just the mildest downward pressure on rents. “In part, I believe this is because a lot of the new construction in prime locations is condos,” he said. “New rental buildings are more often in secondary locations, much of it in Brooklyn. As such, some of that new construction is bringing in near-Manhattan prices to neighborhoods that have never seen such high rents before.”

Demand was also crazy for vacation home rentals in Martha's Vineyard this past summer, and early indications suggest more of the same next year, said Meghan Kill, owner of Sandcastle Realty, specializing in vacation rentals on the island.

She has already written more leases in August and September for next summer than she did last year, yet despite intense demand, owners are now reluctant to raise rents.

Largely, that's because prices are high already (median rents vary from $3,000 to $10,000 a week or more). Besides, owners got their increases in 2013 and 2014. "Now they want to book their homes and not chase anybody away," Kill said.

The biggest change she sees is that people are booking longer – three weeks instead of the one week that typified bookings during the recession, which she takes as a vote of confidence in the economy and in people's personal financial security.

A second big change is a longer booking window. Now is the tail end of the booking season for next summer. "It used to be in January and February. But if you wait until then there's not so much available," Kill said.

The U.S. Labor Department releases September PPI on Wednesday, Oct. 15 and September CPI on Wednesday, Oct. 22, both at 8:30 a.m. ET.

For real-time subscription information or newsroom, please contact: info@econoplay.com, 212-780-0532 or go to www.econoplay.com and click the free-trial icon.