ECONOMIC AND STRATEGIC RESEARCH

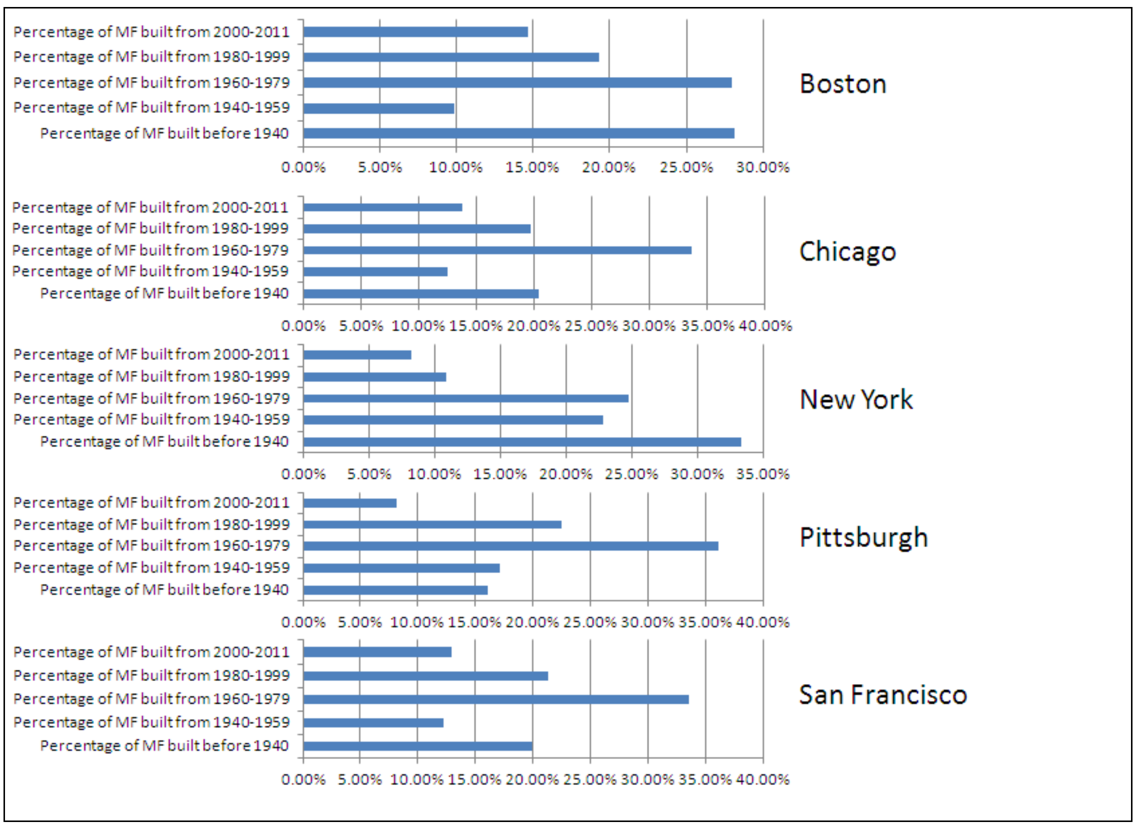
Multifamily Market Commentary – July 2014
The Nation's Aging Multifamily Housing Stock

Although America's population is rising at its slowest pace in more than 70 years, and it has taken 76 months for employment to exceed pre-recession levels, the multifamily rental sector remains healthy throughout most of the country. Multifamily development in some parts of the U.S., including Austin, Seattle, Denver, and Washington, D.C., continues to increase, thanks in large part to recent job growth and positive net migration trends. Nevertheless, in many U.S. cities the housing stock is aging, which could potentially lead to increased obsolescence and, in some cases, risks to structural safety.

Nation's Aging Housing Stock is Widespread

Not surprisingly, the New York City metro area possesses the highest concentration of older housing stock, with 56 percent of its multifamily housing having been built before 1960, and 80 percent of it built before 1980. Interestingly, while Boston is one of the nation's oldest metro areas, the age of its housing stock belies its long history. Although 66 percent of Boston's multifamily housing was built before 1980, a mere 38 percent was built before 1960, demonstrating the massive amount of growth in development of the area during the 1960s and 1970s. The nation's aging multifamily stock is not limited to the East Coast metro areas. Pittsburgh, Chicago, and San Francisco also all have concentrations of older housing stock, as shown in the charts below.

Percentage of Multifamily Stock Built by Time Period – Select Markets

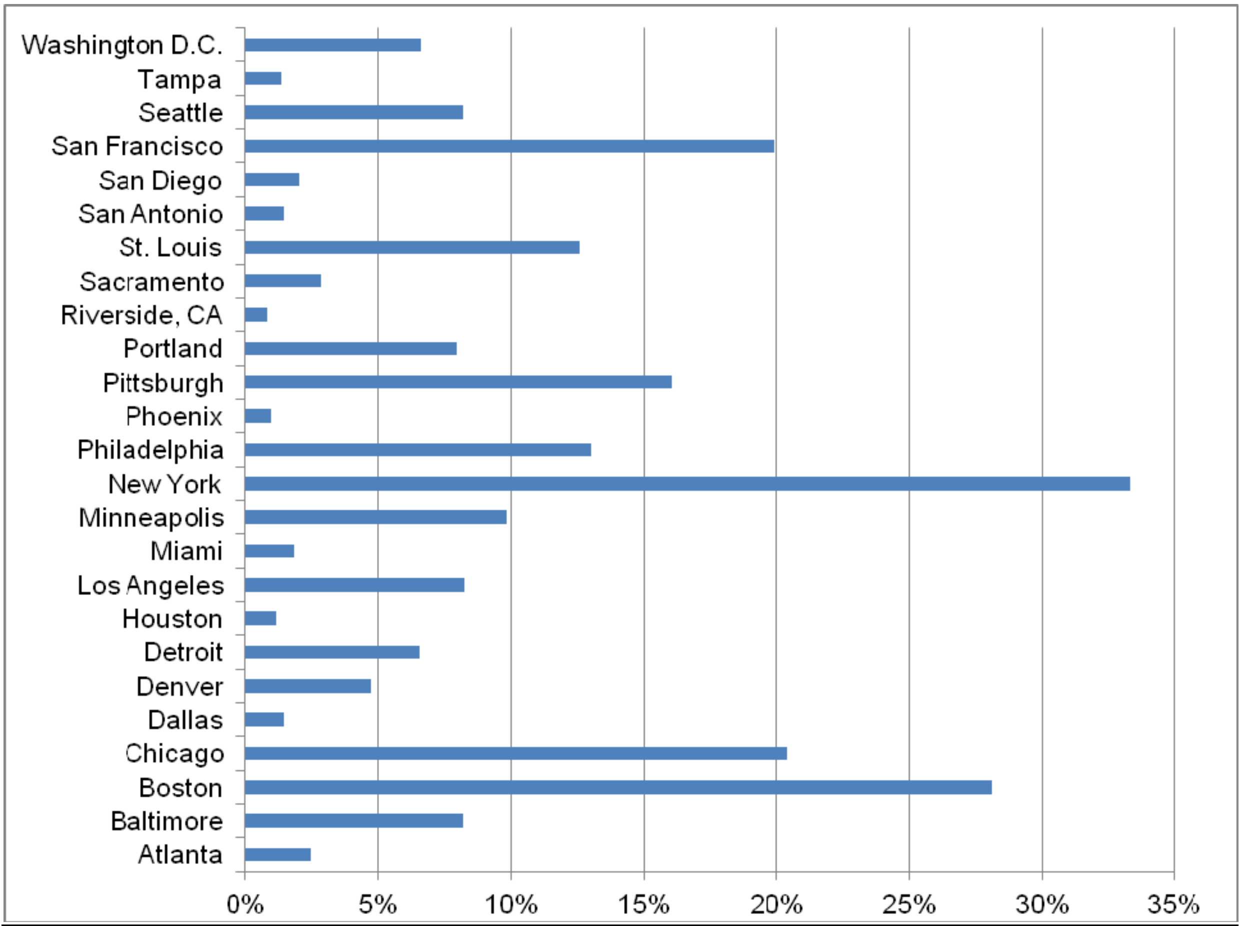


Source: 2011 American Community Survey

Historical Trends and a National Perspective

As seen in the chart below, very few metros have a significant percentage of multifamily housing more than 70 years old. Multifamily housing stock grew during the 1940s and 1950s, but it was not until the 1960s and 1970s that multifamily housing construction reached a level that continues to have a lasting effect today. Construction consistently increased across all metros during the 1960s and 1970s, and much of the development from this time still exists today.

Percentage of Multifamily Units Built Before 1940 – Select Markets



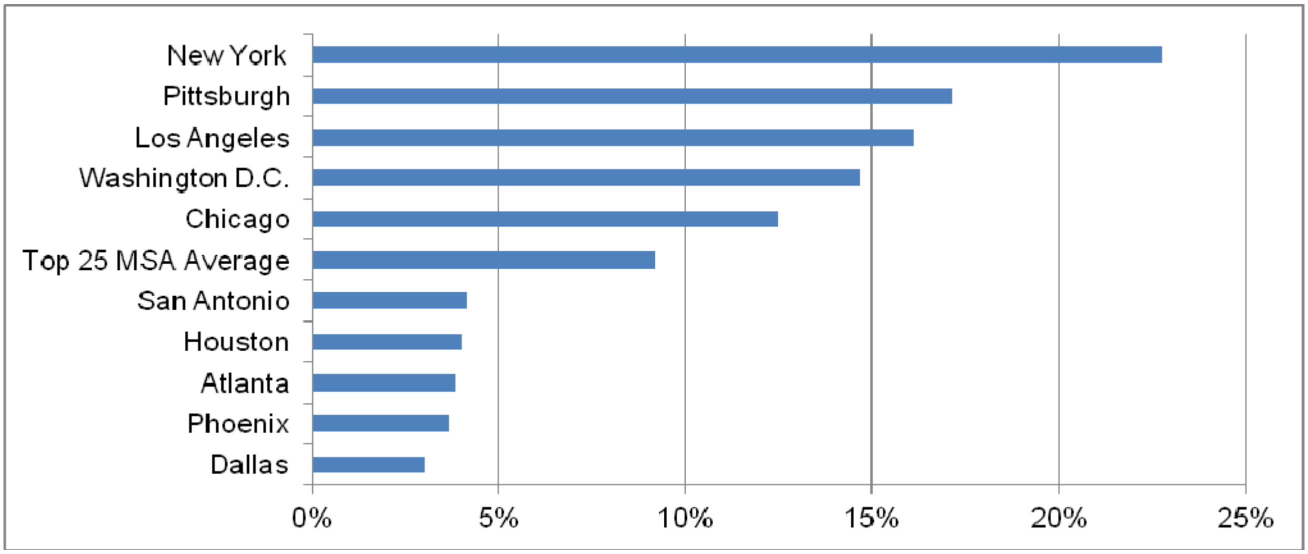
Source: 2011 American Community Survey

As shown in the chart above, only San Francisco, New York, Chicago, and Boston have 20 percent or more of apartment stock built prior to World War II. While generally older housing stock is less desirable, in these metro areas some of the much older stock may actually be considered Class A. This is due to the fact that some of this particular "Pre-War" building stock has always been in a desirable location and has been well maintained.

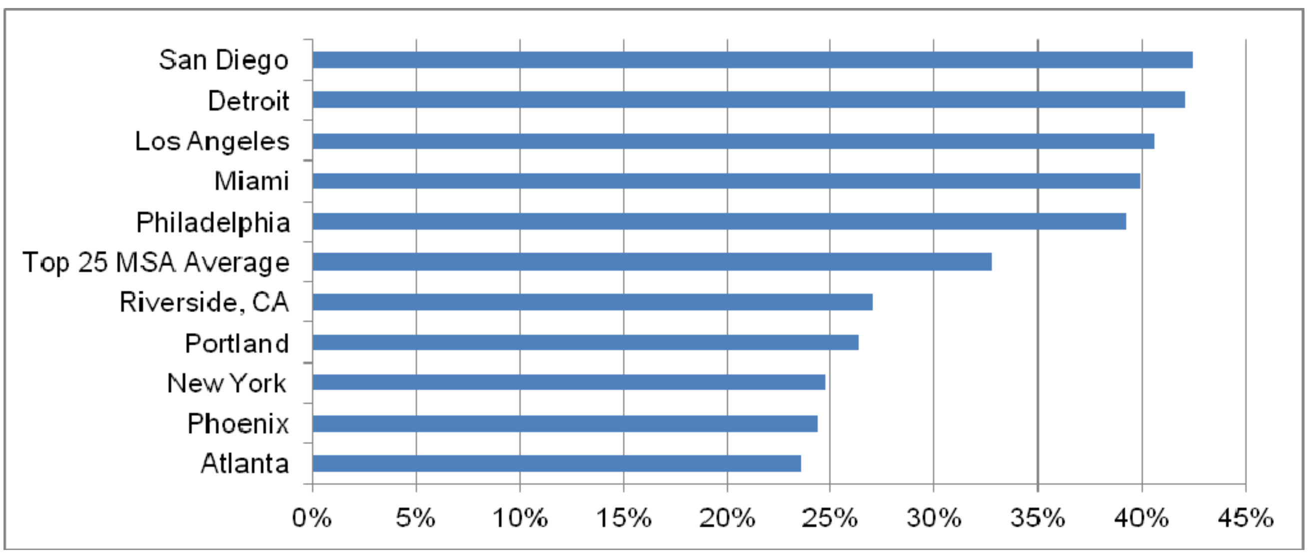
According to the National Multi-Housing Council, the "biggest wave of apartment construction occurred in the early 1970s in response to a strong economy, increased demand from the first wave of baby boomers reaching adulthood, government 'urban renewal' incentive programs, and easy credit."

Additionally, the passage of the Immigration and Naturalization Act of 1965 likely helped to increase demand for rental housing. It allowed more immigrants to enter the U.S., many of whom likely became renters first, rather than homeowners, while they worked to establish themselves in the United States. As a result of the increase in multifamily housing stock in the 1960s and 1970s, approximately 40 percent of the current apartment stock in cities such as Los Angeles, Miami, and San Diego was constructed between 1960 and 1979, as shown in the second chart below.

Percentage of Current Multifamily Stock Built From 1940-1959 – Select Metros



Percentage of Current Multifamily Stock Built From 1960-1979 – Select Metros

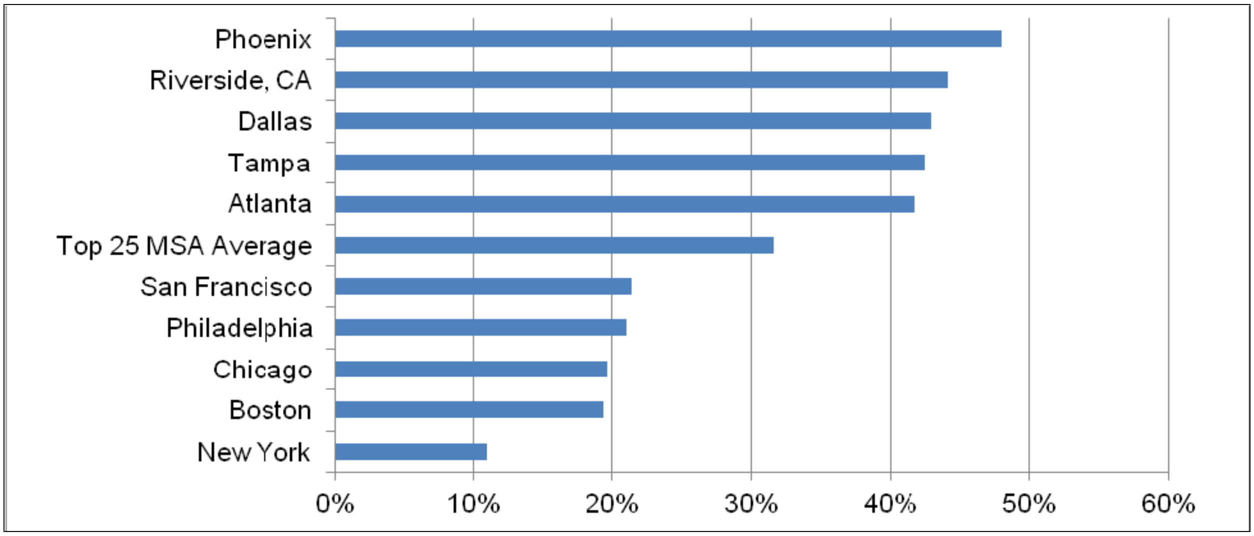


Source: 2011 American Community Survey

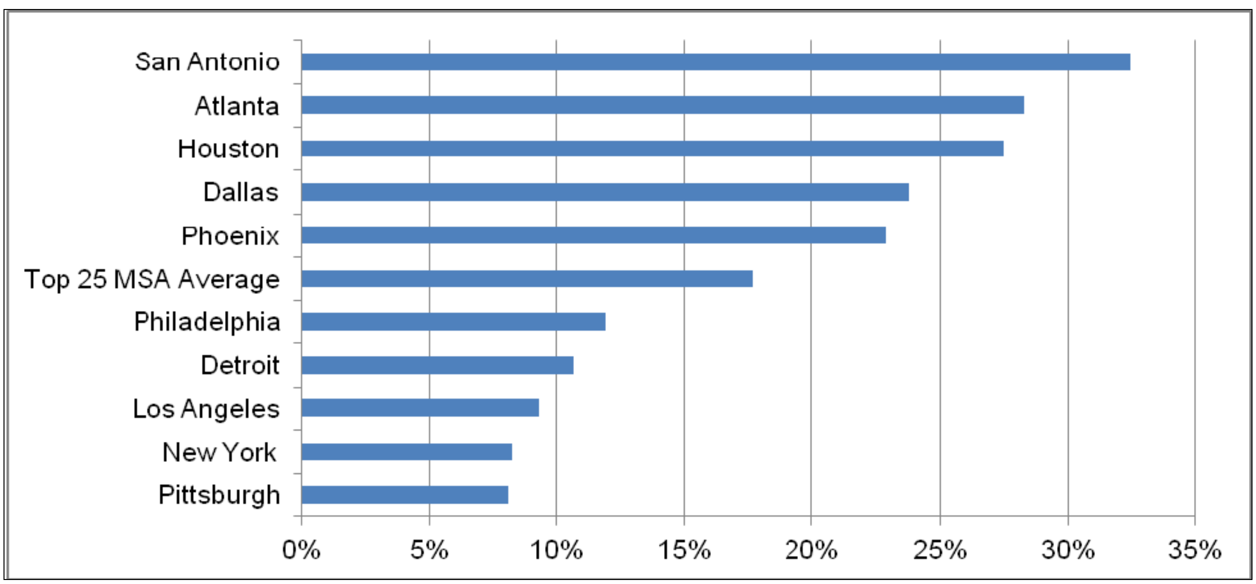
In contrast to the previous two decades, the 1980s and 1990s were stratified years for multifamily construction nationwide, as illustrated in the series of charts on the following page. The Tax Reform Act of 1986, which increased the home mortgage interest deduction, negatively impacted investment in rental housing, resulting in a big decrease in the amount of overall construction development until the mid-1990s.

As seen below, a construction slowdown in metros such as Philadelphia during the 1980-1999 timeframe resulted in multifamily housing stock from that period representing nearly 20 percent less of their multifamily housing units than multifamily housing stock from the 1960s to 1970s. Multifamily construction in New York also decreased, with less than 11 percent of its existing multifamily units constructed during the 1980s and 1990s. It is important to note that this was not the case everywhere. Phoenix, AZ and Riverside, CA each saw around 45 percent of their existing multifamily units built during this period.

Percentage of Current Multifamily Stock Built From 1980-1999 – Select Metros



Percentage of Current Multifamily Stock Built From 2000-2011 – Select Metros



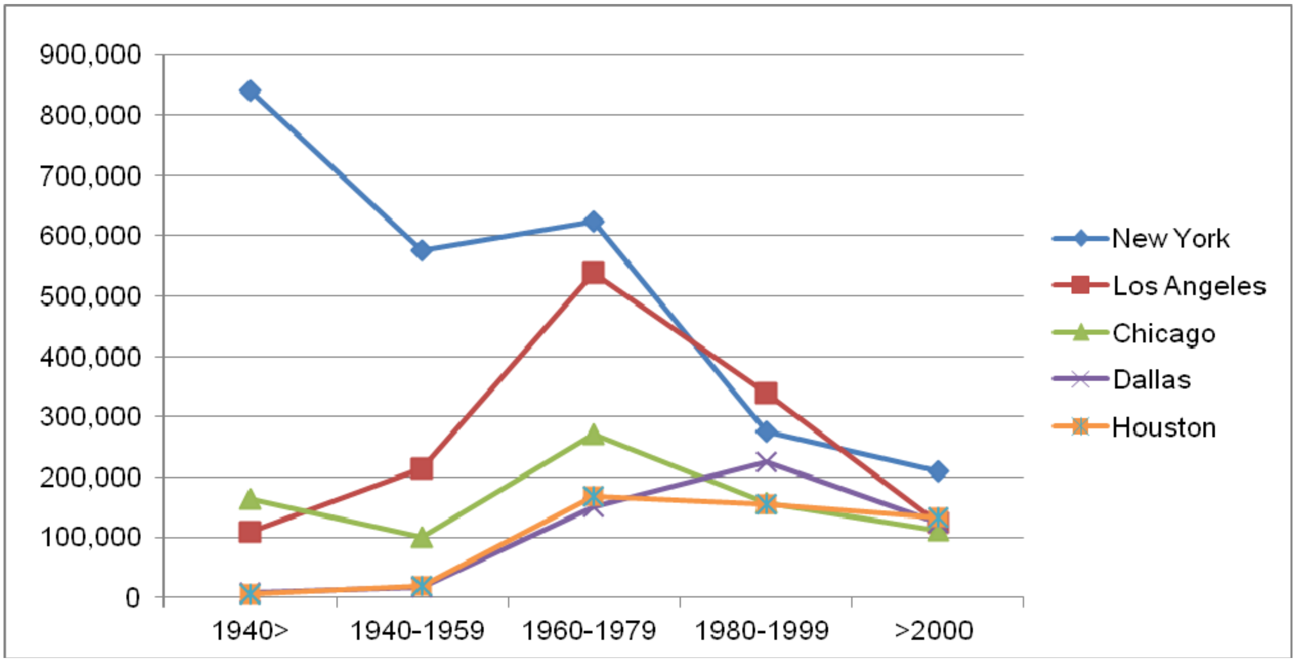
Source: 2011 American Community Survey

Top Five Metro Areas Still Utilizing 1970s Stock

As seen in the chart below, the 1960s and 1970s saw an explosion of growth within the multifamily industry that continues to impact the housing stock that still exists today. Los Angeles produced almost 150 percent more of its currently existing units in that period than it produced during the previous two decades, nearly catching up with New York.

Of the five MSAs, New York had by far the smallest increase in multifamily units percentage-wise during this time. During the 1980s and 1990s, Dallas was the lone metro with a positive gain of multifamily housing stock still in existence (50 percent more units than the period from 1960-1979), in contrast to the nationwide trend the prior two decades.

Multifamily Units Still in Existence by Time Period Built – Top Five Metros



Source: 2011 American Community Survey

Multifamily Development Came Later to Texas

Texas, a state that more than tripled in population from 1950 to 2010, was fairly nonexistent in terms of multifamily development until about 50 years ago. Since then, Dallas, Houston, and San Antonio continue to be some of the top metros in multifamily housing development growth. Indeed, San Antonio built more than 32 percent of its currently existing multifamily housing during the 2000-2011 timeframe – the same amount as the previous 20 years combined.

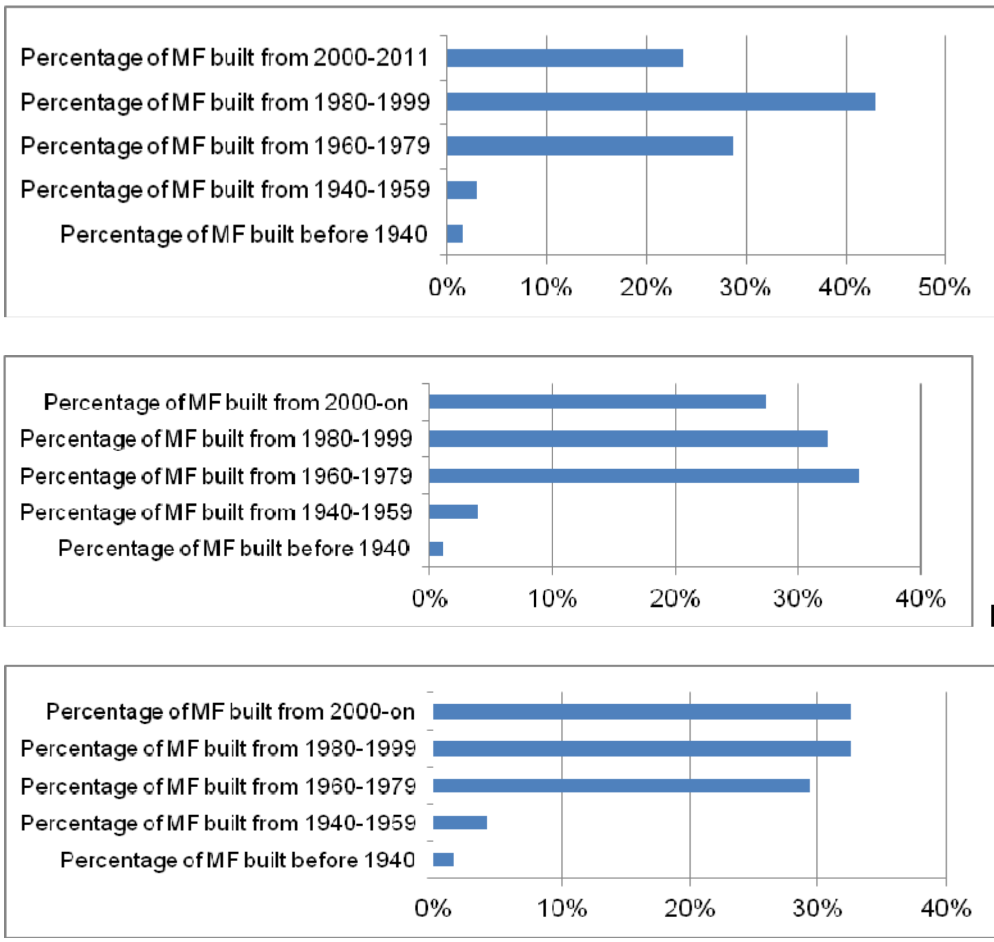
Much of this accelerated growth can be attributed to the combination of robust job growth and the low cost of living in Texas, which arises due to many factors, including a lack of state income tax and relatively affordable rent in its major metros. According to the Federal Reserve Bank of Texas, the state experienced the highest job growth rate in the nation during 2000-2013, and this held true at all levels of income.

Oil + Gas = Multifamily Growth in Texas

Much of the dramatic expansion in multifamily housing stock in Texas during the 1960s and 1970s is due to the oil boom that swept the area. While most of the nation struggled economically during the early 1970s, Texas thrived thanks to the oil and gas industry.

At its peak in 1972, Texas produced 3.4 million barrels of oil per day, compared to 1.9 million at mid-year 2012, according to the U.S. Energy Information Administration. When oil prices skyrocketed, prices for natural gas quickly rose as well. Exploration for natural gas increased, and the sector expanded to the point where one-third of all natural gas fields were located in Texas. With the boom came an influx of workers, leading the way to a big increase in multifamily construction, as illustrated in the charts below.

Percentage of Multifamily Built by Time Period – Select Texas Metros



Dallas

Houston

San Antonio

Source: 2011 American Community Survey

San Antonio and Toyota

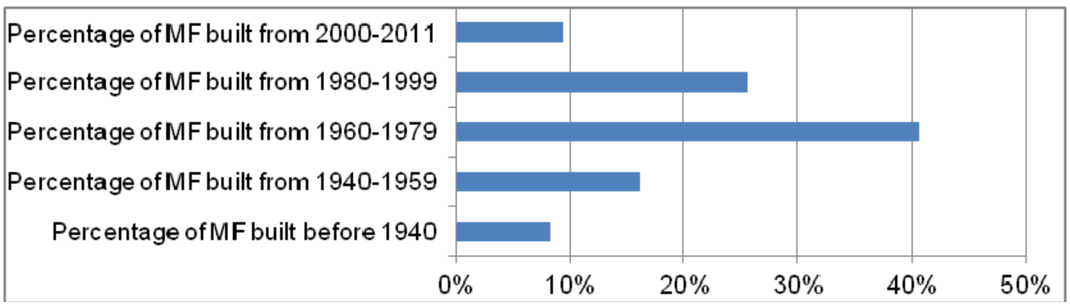
The addition of a Toyota plant just south of San Antonio in 2006 is considered a primary driver of the metro's recent economic and population growth. Though it is far from the largest employer in the area, with just under 3,000 employees, the plant brought many other companies to the region and ushered in $2.7 billion in capital investment, according to data provided by Toyota Motor Manufacturing Texas, Inc.

Most importantly, it changed the way Texas viewed job growth. Soon local and state government officials consolidated economic development plans and dedicated large amounts of capital to bringing employers to the area. As a result, strong economic growth has led to pronounced multifamily housing growth, as seen in the third chart above.

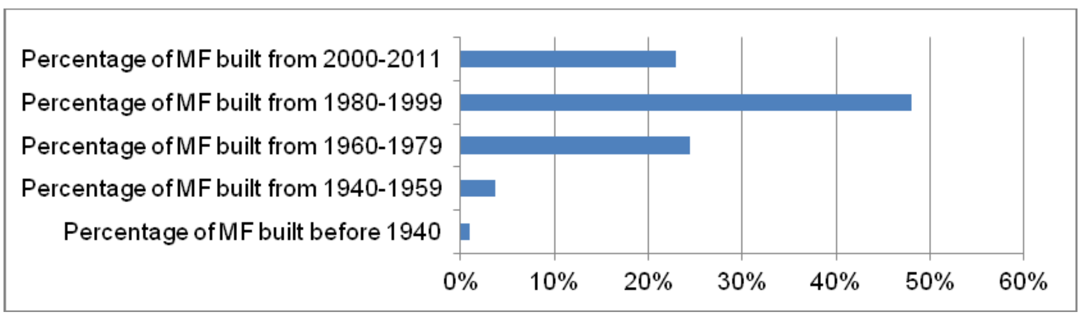
Multifamily Growth in the Sunbelt

The large-scale development in Texas, and other Sunbelt metros, can be attributed in part to something many of us take for granted today: air conditioning. In fact, the spread of widely available air conditioning units led to population and employment growth throughout the South and Sunbelt regions. Thanks in part to air conditioning technology, the South's share of the nation's population grew from 24 percent in 1950 to 30 percent in 2000, according to a May 2007 policy brief from the Taubman Center at Harvard University. This population increase created a profound need for multifamily housing, especially in Texas, where jobs were multiplying at a robust pace.

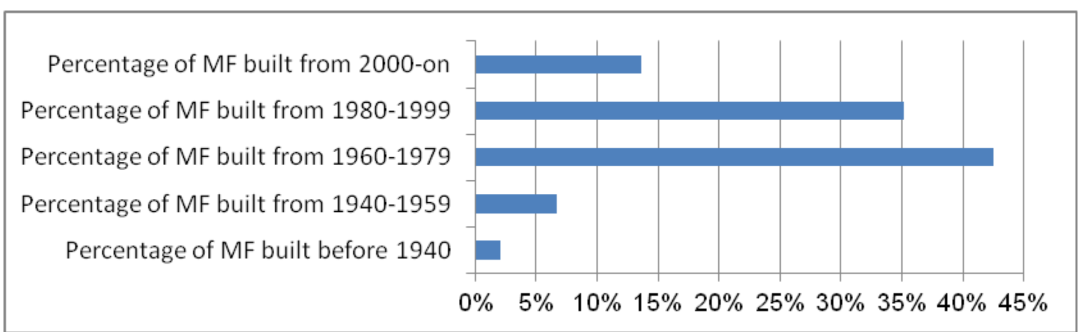
Percentage of Multifamily Built by Time Period – Select Sunbelt Metros



Los Angeles



Phoenix



San Diego

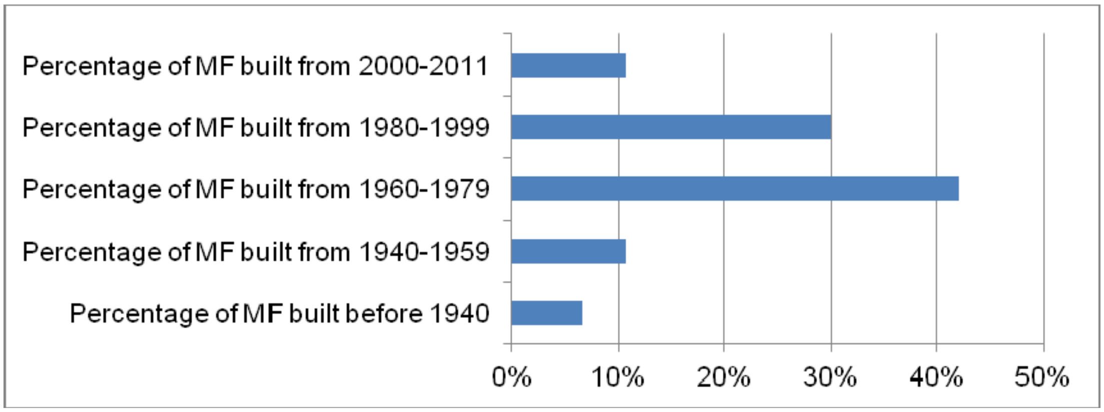
Source: 2011 American Community Survey

Phoenix, San Diego, and Los Angeles also were beneficiaries of the Sunbelt multifamily housing stock expansion at about the same time as the major Texas metros began to develop. As seen in the charts above, more than 40 percent of all current multifamily units in Los Angeles and San Diego were built between 1960 and 1979. In San Diego, the buildup of the U.S. Navy and establishment of University of California-San Diego in 1960 were primary drivers of growth, while Phoenix quickly became the hub of Southwestern tourism.

Detroit's Multifamily Stock Stuck in the Past

Large periods of economic growth were not limited to the Sunbelt. As evidenced by the graph on the following page, Detroit enjoyed a period of multifamily expansion in the 1960s and 1970s. At this time, the city was enjoying some of the highest auto sales it had ever seen – 15.49 million vehicles sold in August 1978, according to the Bureau of Economic Analysis – and, with that, Detroit enjoyed growth in jobs, people, and housing.

Since that time, the Detroit metro has seen little multifamily growth, especially during the past 10 years. In fact, the metro has suffered from negative net migration for several years. Not surprisingly, unemployment is a nagging problem. Out of a total of 372 metro areas, the Detroit metro area ranked 337th in unemployment, at 7.9 percent as of April 2014.



Detroit

Source: 2011 American Community Survey

National Multifamily Development Needed for the Long Term

While new multifamily developments are sprouting up in certain parts of the country, the bulk of the nation's multifamily housing stock is getting older. Despite the increase in new multifamily rental construction – about 386,000 units under way as of July 2014 – a good portion of these developments is concentrated in just a few submarkets within a handful of metros.

Multifamily fundamentals for most of the U.S. remain stable. There likely will be, and indeed already are, submarkets that see a slowdown in rent growth and an increase in vacancy levels, despite the fact that there are many metros with positive fundamentals suffering from a dearth of new supply.

Based on the forecasted healthy increase in the cohort of 20- to 34-year-olds cohort over the next few years, projected employment growth, demographic trends, and expected household formations, the current nationwide multifamily construction pipeline could easily be absorbed during the next three years. And, with the aging multifamily rental housing stock currently in place, we expect the demand for new development to continue to strengthen and expand over the next decade.

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