Rental Housing: Compelling Fundamentals for the Foreseeable Future

Homeownership is often viewed as a symbol of the American dream, but for many that aspiration is increasingly difficult to attain. Housing supply is tight, down payments are progressively more difficult to save enough for, and mortgage rates have shifted dramatically higher over the past two years.

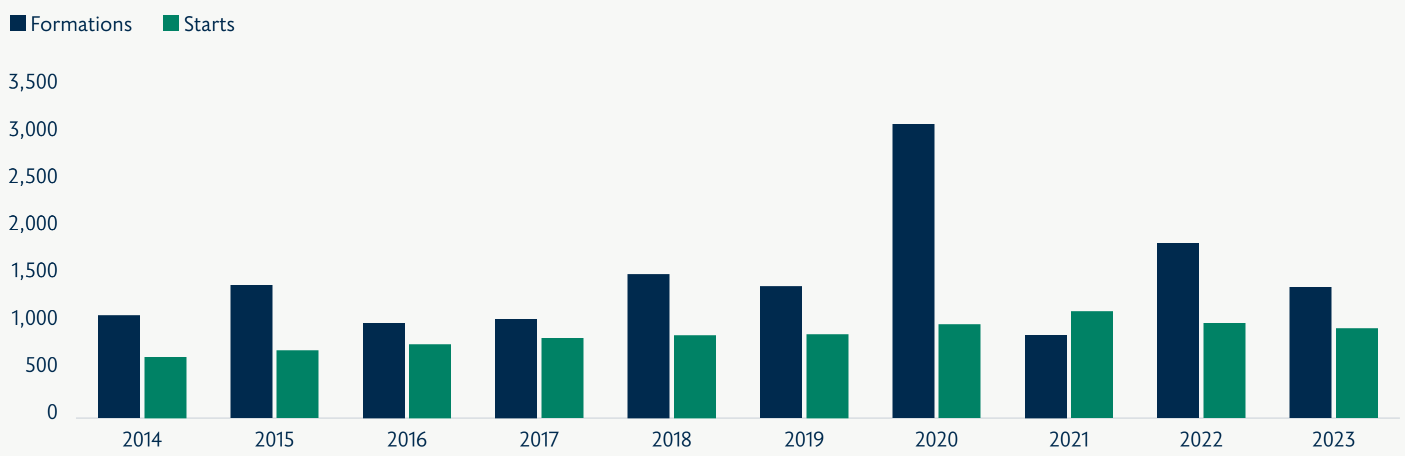
Instead, more and more people are continuing to remain in rental housing. The result is the rental market for housing is extremely robust and supported by strong fundamentals that suggest an attractive long-term outlook for the sector. We believe these factors have created a compelling opportunity for real estate investors.

In our view, there are two main factors underscoring why the demand for rentals is strong and not expected to slow.

I. A shortage of new homes for potential buyers. The United States is simply not building enough homes to account for the number of people setting up their own households. As a result, there is a sizable shortage of new homes after more than a decade of under-building relative to population growth (**Figure 1**).

Indeed, as shown in the chart below, the gap between single family home constructions and household formations grew to 5.8 million homes over the 10-year period between 2014 and 2023. It is important to note that this figure overstates the housing shortage since new multifamily homes offer options both to buyers and renters. According to U.S. Census data, if multifamily construction starts are included—which is predominantly rental units—this gap is cut to 1.7 million homes. Nonetheless, this still translates into a significant housing shortage. The pace of household formations well exceeds the available housing supply and new home construction.

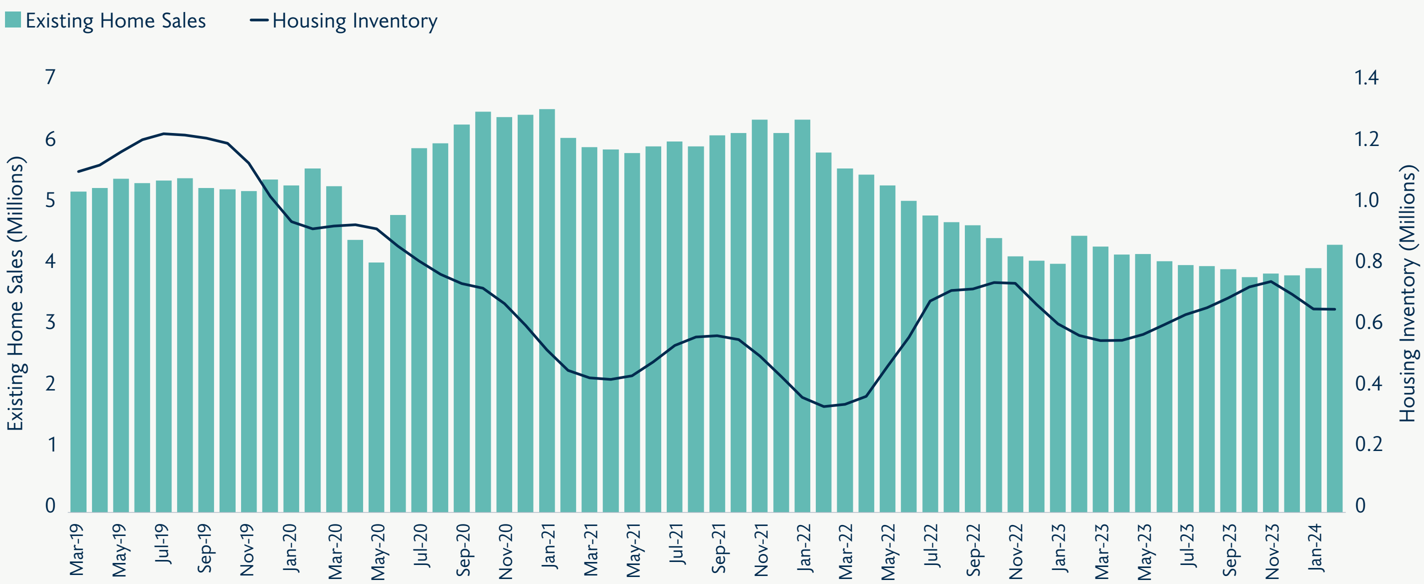
Figure 1: U.S. Household Formations and Single Family Home Starts (Thousands)



Source: Green Street and U.S. Census Data, as of March 2024.

In addition, the housing shortage worsened during the COVID-19 pandemic. According to the National Association of Realtors, the housing inventory has declined 45% in just five years (**Figure 2**).

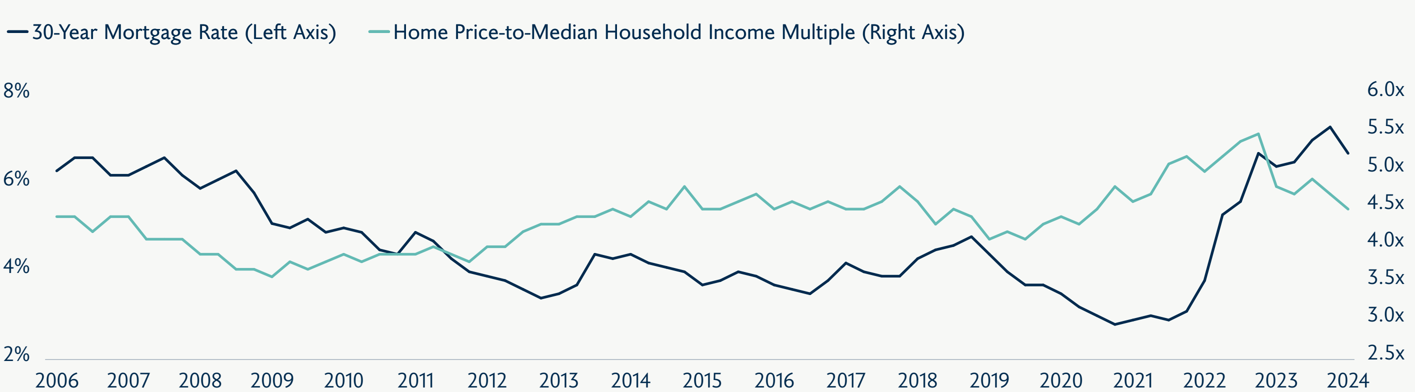
Figure 2: U.S. Existing Home Sales and Housing Inventory (Not Seasonally Adjusted, Millions)



Source: National Association of Realtors, as of February 2024.

II. Homeownership is more unaffordable. For many would-be homeowners, buying a house has become significantly more difficult. While mortgage rates have climbed upward, higher interest rates have not led to a significant decline in housing prices. The bottom line is that a lending environment with higher mortgage rates, combined with home price appreciation, is resulting in a significantly wide gap between monthly costs to rent versus own (**Figure 3**).

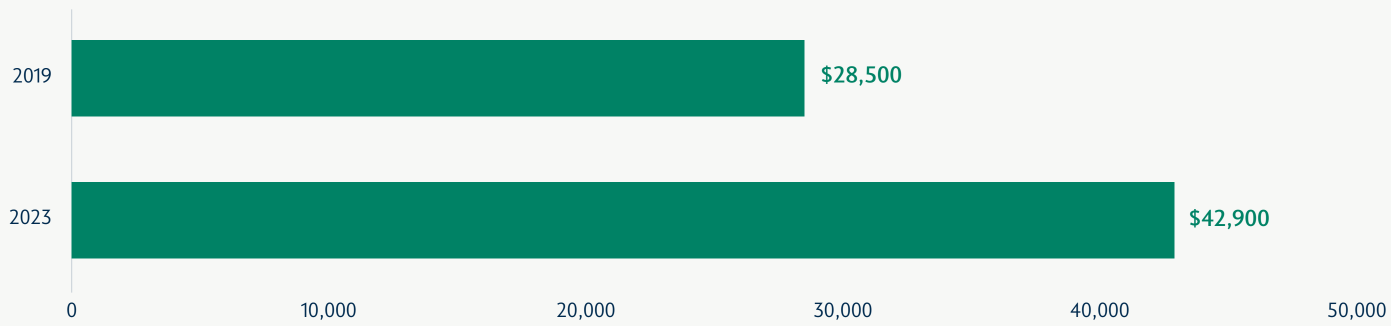
Figure 3: Housing Affordability



Source: Green Street, as of March 2024.

Meanwhile, saving for a down payment, which has always been a challenge for would-be homeowners, is now even more of a struggle. Because home prices appreciated rapidly over the past four years, the average down payment is now 50% higher (**Figure 4**). Not surprisingly, the required savings for a down payment is often just as much of a barrier to ownership, if not more so, than mortgage rates. Adding to the challenge, many younger would-be homeowners hold outsized debt balances from student, auto and credit card debt, a further obstacle to being able to buy a house.

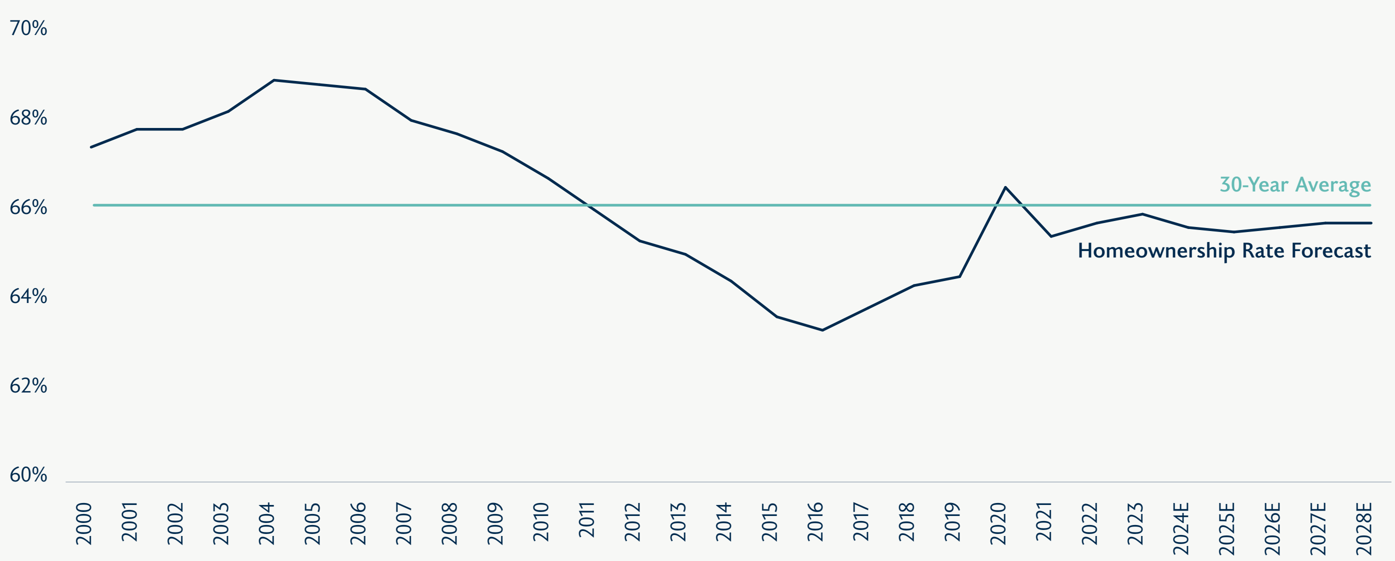
Figure 4: Average 10% Down Payment in Top Single Family Rental Markets



Source: Green Street, as of April 2024.

It should come as no surprise, then, that many renters are unable to make the transition to homeownership. Sure enough, the homeownership rate has fallen to below the 30-year average (**Figure 5**) and is expected to remain lower for years to come.

Figure 5: U.S. Homeownership Rate



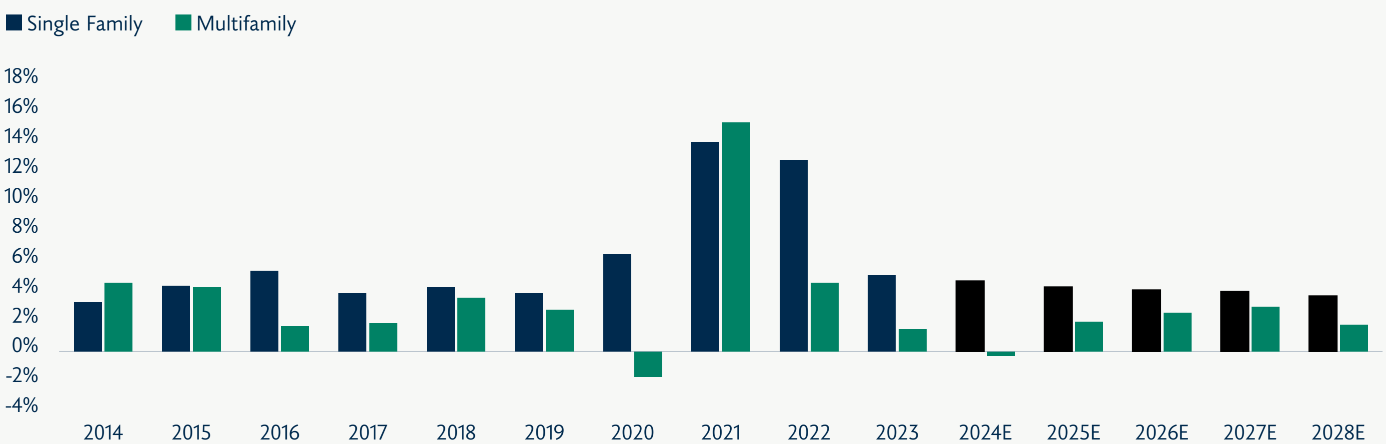
Source: Green Street, as of April 2024. There is no assurance that such events or projections will occur, and actual outcomes may be significantly different than those shown here.

Given this environment, we can expect more households continuing to rent for extended periods. That, in turn, should translate to steady rental growth. Moreover, the labor market remains strong enough to drive positive household formations and growth in rental demand. The U.S. economy has continued to post positive gains in jobs, while unemployment has remained at moderately low levels and wage growth has steadily increased.

However, according to data from the National Association of Realtors, the national median home price as of the end of 2023 was $391,700, requiring an annual salary of more than $109,000 to make the mortgage payment on a traditional 30-year fixed-rate mortgage. According to the U.S. Bureau of Labor, the average U.S. annual salary in Q4 of 2023 was just $59,384.

The current buying environment poses a hefty challenge for would-be homeowners, but overall healthy economic fundamentals should continue to support the rental market. Rental housing, for both single family and multifamily, is one of the few real estate sectors that could see strong rental growth over the next few years **(Figure 6**).

Figure 6: Estimated Revenue Growth for Rental Housing



Source: Green Street; revenue is represented by revenue per available foot growth, as of April 2024.

In summary, the fundamentals for rental housing are strong and support a long runway for growth in the sector. The high cost of homeownership, rooted in higher mortgages and inadequate savings for a down payment, is resulting in a widening affordability gap between the monthly cost of owning versus renting. In addition, the dearth of housing supply could take years to resolve, while increased demand from outsized population growth in the prime age group for homeownership continues to stress the market. All these elements combined suggest that the rental home market for real estate investors should remain very attractive for not just the short or medium terms but the longer term as well.

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