SPECIAL REPORT

Marcus & Millichap

HOUSING AFFORDABILITY

AUGUST 2022

Mortgage Rate Surge Thwarts Affordability; Apartments Offer Relief from Housing Shortage

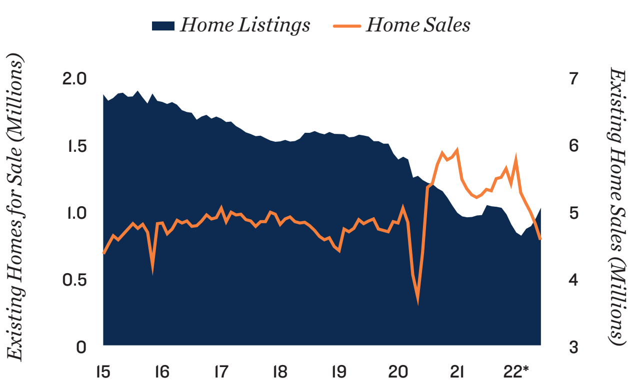
Fight against inflation derails single-family housing. The pandemic and ensuing lifestyle changes dramatically impacted the single-family market. A rush of people sought larger living options to accommodate at-home work and education. Exceptionally favorable financing fueled the market, resulting in a massive squeeze of listing inventories. With more people seeking homes than the market could service, prices rose at a staggering pace. When the Federal Reserve stepped up its fight against inflation by aggressively raising the overnight rate by 225 basis points through July, however, it triggered a mortgage rate surge and the housing market took a hit. The average rate for a 30-year fixed-rate mortgage surpassed 5 percent in the second quarter, the highest mark since the Global Financial Crisis. Additional Fed rate hikes may put even more pressure on the cost and criteria to obtain a home mortgage, condensing the buyer pool and cooling the hot sector.

Slowdown in home purchasing does not signal a bursting bubble. Potential buyers of single-family homes are facing lofty prices, simultaneous with decade-high mortgage rates, making entry challenging for first-time buyers. At the same time, many existing owners are locked into more favorable mortgages established when rates were very low in 2020-2021, reducing their incentive to move up the quality stack. As purchase activity wanes, some markets may endure a near-term price softening. However, in most metros the number of homes available for purchase remains well below historic norms, serving as a buttress for values. These dynamics and a healthy labor market imply that recent trends are not indicative of a bubble ready to burst.

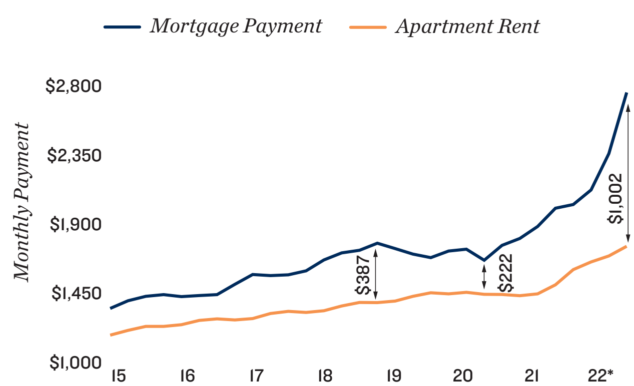
Extreme affordability gap emphasizes multifamily appeal. Prior to the mortgage rate jump, homebuying was mostly constrained by the limited for-sale inventory. Now, more homes are being listed, but fewer are selling. Much of the housing demand is funneling to the rental market, resulting in very tight vacancy and historic rent growth. The average effective rental rate in the U.S. grew almost 17 percent year-over-year in the second quarter of 2022. Despite this leap, apartments remain a markedly less-costly option than home ownership. The affordability gap in the U.S., or the difference between an average monthly mortgage payment on a median priced home compared to an average rent obligation, was about $280 before the pandemic. At the end of 2020, it was roughly $375. Halfway through 2022, the gap is a striking $1,000. As a result of this elevation, the estimated minimum annual income to afford a house in the U.S. eclipsed $120,000 in June, a threshold that 73-plus percent of households cannot afford. By comparison, that average was close to 50 percent between 2010 and 2019.

Relational value of apartments is a major consideration. Renting an apartment is especially attractive for the cost-saving benefits they provide, and for a variety of lifestyle elements. In most cases, apartment complexes are in better locations than the type of entry-level homes that align with the financial capabilities of a first-time buyer. Additionally, some apartments offer amenities, such as pools and workout facilities, services and community-based activities. Furthermore, rentals offer greater flexibility in the form of short-term leases and require little maintenance or upkeep by the tenants themselves.

Listings Slowly Tick up as Purchasing Slows



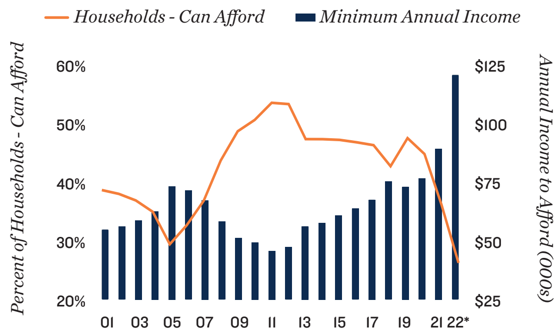
Mortgages Substantially Outpacing Rents



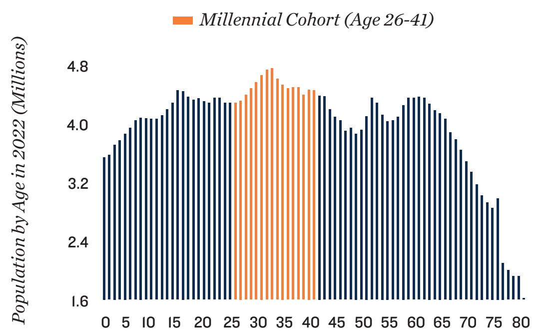
* Through June

Sources: Marcus & Millichap Research Services; Capital Economics; Federal Reserve; Freddie Mac; Moody's Analytics; Mortgage Bankers Association; National Association of Home Builders; National Association of Realtors; Pew Research Center; RealPage; U.S. Bureau of Labor Statistics; U.S. Census Bureau; Wells Fargo

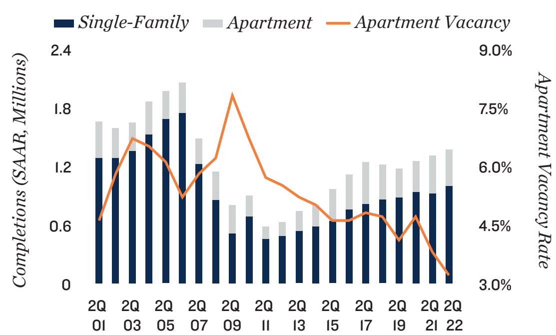
Fewer Households Can Afford to Own Homes



Millennial Cohort Plays Key Role in Shortage



Builders Trying to Catch up With Demand



** Minimum Income Through June 16, Households Through April*

Sources: CoStar Group, Inc; Capital Economics; Federal Reserve; Freddie Mac; Moody's Analytics; Mortgage Bankers Association; National Association of Home Builders; National Association of Realtors; Pew Research Center; RealPage; U.S. Bureau of Labor Statistics; U.S. Census Bureau; Wells Fargo

Affordability Limitations Will Extend the Renter Lifecycle

Population dynamics suggest longer-term rental tailwinds. The millennial cohort is the largest generation in the U.S., with an estimated 72.2 million Americans spanning the ages of 26 to 41 as of 2022. This demographic is important to the housing market, as the age range correlates with a period when people typically begin to grow their households and seek out larger living spaces. Historically, single-family homes have been a practical and affordable vehicle to achieve this, but the landscape has changed dramatically. Given that the minimum annual income needed to buy a home is now well above $100,000, doubling in a span of just six years, a sizable portion of millennials will rent longer than past generations. It is increasingly likely that Gen Z will follow suit. These circumstances reinforce the imperative need for historic levels of multifamily development to help relieve excess demand.

Record apartment construction only puts a dent in the shortage. Builders have been unable to keep pace with demand during the pandemic, due to various factors. On the materials side, key products — including concrete, lumber, gypsum, copper and steel — all became significantly more expensive amid supply chain headwinds. The pace of growth retreated recently, however, each of these products were 20 to 120 percent more expensive in June 2022 than at the end of 2019. Labor constraints have also stunted development, with the industry boosting wages to attract workers in a competitive market. This headwind appears to be easing as well, with the U.S. construction sector job count surpassing the pre-pandemic peak in March 2022. Nonetheless, many developers are hesitant to step on the gas, with lingering fears of the impact that overbuilding prior to the Global Financial Crisis had on the industry. Multifamily builders are helping to fill the gap, with project starts hitting a four-decade high earlier this year. Despite this, population dynamics show that developers need to take it up another gear if there is any hope of meeting demand.

Housing conditions garner attention from the White House. The Biden administration announced the Housing Supply Action Plan this May, responding to intense home price run-ups during the past two years, which has added to inflation. The plan primarily focuses on building affordable dwellings, including manufactured housing, and re-evaluating zoning to permit greater density. Increased development should help alleviate the demand backlog in select segments servicing lower-income residents, a step in the right direction, but the housing shortage will persist. Meanwhile, a spillover from the single-family market to upper-tier apartments is driving up rent costs in this segment, pushing demand down to mid- and lower-tier rentals.

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Sources: Marcus & Millichap Research Services; Capital Economics; CoStar Group, Inc; Federal Reserve; Freddie Mac; Moody's Analytics; Mortgage Bankers Association; National Association of Home Builders; National Association of Realtors; Pew Research Center; RealPage; Real Capital Analytics; U.S. Bureau of Labor Statistics; U.S. Census Bureau; Wells Fargo

Price: $1,500