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Are Higher Rents Overburdening Households?

By Victor Calanog and Barbara Byrne Denham

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Rent growth in the apartment market has slowed in 2017 as heavy construction has exceeded demand in a number of markets raising vacancy rates in 50 of 82 metros tracked by Reis in the third quarter. The heavy construction still underway has been a concern in the apartment market that has and will continue to keep a lid on rent growth. After growing 6.1% in 2015, rent growth was 3.6% in 2016 and should fall short of that this year. While this is not good news for landlords, lower rent growth helps ease housing costs for the 44 million U.S. households living in renter-occupied housing.

While we have been reporting construction, occupancy and rent trends in the apartment market periodically, it is important to take a step back and look at some broader demographic and income trends to see if these trends are in balance. First, the major demographic trend in this expansion is the growth in renter-occupied households. Since 2010, this segment has grown by 10% or 4.1 million households, dwarfing the growth in owner-occupied households which was 149,000 or 0.2% growth. In fact, the number of owner-occupied households as of 2016 finally exceeded the peak of 2010 after falling in 2011 to 2013.

The other trend that has surprised analysts throughout this expansion is the slow wage growth. Overall, average salaries and wages have grown 2.5% per year from 2009 through 2016. This is down from an average wage growth of 4.2% from 2003 to 2008 according to data from the BLS and Bureau of Economic Analysis. This lower earnings growth contrasts rent growth from 2009 to 2016 which averaged 4.3% per year.

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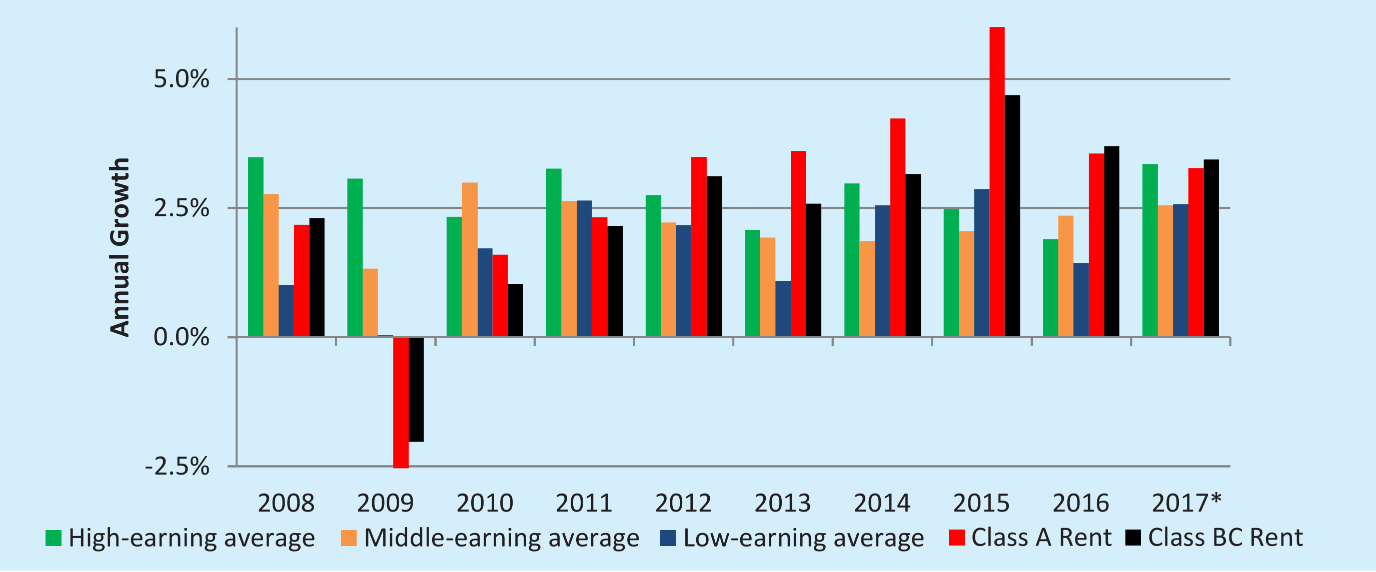
However, wage growth has differed somewhat by industry. Those in high-paying industries have seen wages grow at a stronger pace than those in mid-level paying industries and low-paying industries. The chart below looking at wage growth by segment over time with rent growth by Class A vs Class BC rents shows that Class A rents grew faster than high-earning industry wage growth most years from 2012 through 2016 but have since decelerated growing in line with high-earning wages. Class BC rents, on the other hand, grew slightly faster than both low and middle-earning wages from 2012 through and including 2017. So should this be cause for alarm?

For the record, the Census data shows that the number of "rent burdened households" or those spending more than 30% of household income on rent and utilities climbed from 45.7% of households in 2005 to 48.9% in 2010 but has since fallen back to 46.1% in 2016. In other words, while "asking rents" have increased more than wages, the rents that tenants are paying have not increased at such a rate as to overburden more households than it did a decade ago.

Moreover, rent growth should decelerate further in 2018 as inventory levels increase faster than demand growth. This should slow both Class A and BC rent growth at the same time that wages should increase as the economy approaches full employment. Thus, we may hit a true equilibrium where wages and rents grow at the same pace. We hope to revisit this analysis in a year to see if in fact this equilibrium is reached.

Average Wage Growth vs. Apartment Rent



*Year over year as of the second quarter

Source: Reis and U.S. Bureau of Labor Statistics

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