

# Housing is BACK

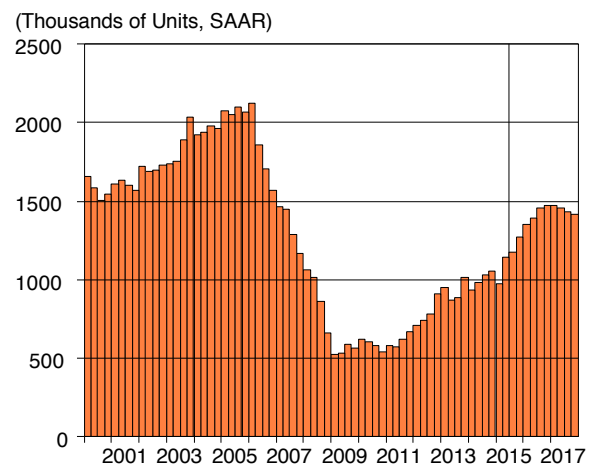
David Shulman  
Senior Economist, UCLA Anderson Forecast  
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**After a long, hard slog, housing starts (both single- and multi-family) are poised to approach the long-term average (1959-2014) of just under 1.5 million units in 2016.** (See Figure 1) Specifically we are forecasting housing starts of 1.14 million units this year and 1.42 million units and 1.44 million units in 2016 and 2017, respectively. This level of activity is well above 1.00 million units recorded in 2014 and the 2009 low of 0.55 million units. Remember that the level of activity we forecast is far from the mid-2000s boom level of above two million units a year. We would also note that with the shift to multi-family starts, the per-unit GDP “bang for the buck” has declined, but that factor has been partially offset by increased emphasis on higher-end housing in the new construction market.

Our forecast is underpinned by continued growth in real GDP that will likely run at a 3% rate in 2016, continued jobs gains in excess of 200,000 a month for most of the forecast period, relatively low mortgage rates—at least through 2016 and household formations in excess of one million a year in 2016 and 2017. (See Figures 2, 3, 4 and 5) To dig into the weeds, our estimates for household formation is derived from the Current Population Survey which when compared to the Housing Vacancy Survey seem conservative. Further, the improving labor market will act as an ongoing stimulus to household formations.

Although low mortgage rates have been with us for years, what is important is that credit standards have eased

Figure 1 Housing Starts, 2000Q1 -2017Q4F

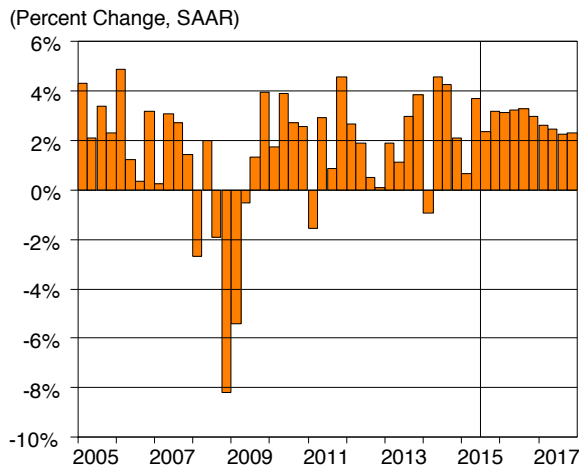


Sources: U.S. Department of Commerce and UCLA Anderson Forecast

with respect to FICO scores and down payment requirements have been reduced. To be sure we are not going back to the “wild west” lending standards of 2005, but compared to 2010, and yes early 2014, mortgage credit conditions have decidedly eased. Moreover, we do not believe that higher mortgage rates will meaningfully cut into housing activity until 2017 as a rise in rates will initially hasten buyers into the market out of fear that rates will go much higher. Time will tell whether or not this assumption is too heroic.

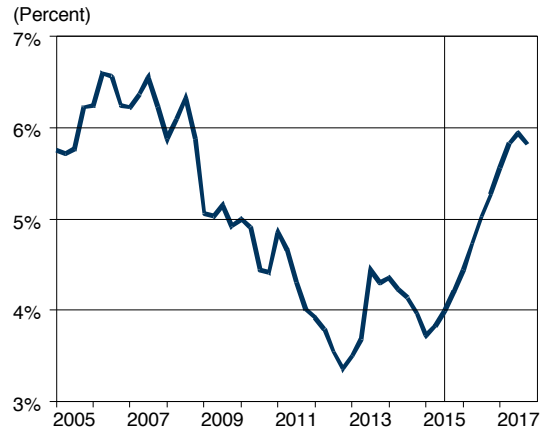
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Figure 2 Real GDP Growth, 2005Q1 - 2017Q4F



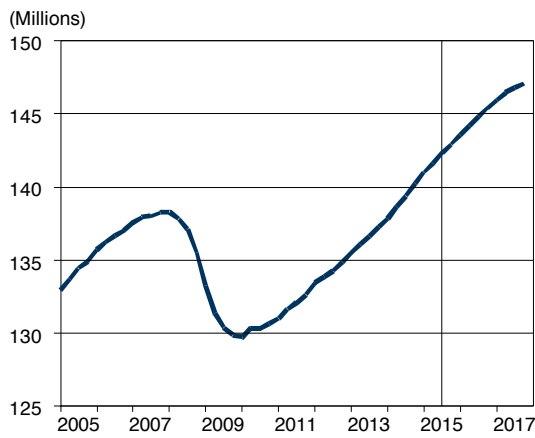
Sources: U.S. Department of Commerce and UCLA Anderson Forecast

Figure 4 30-Year Conventional Mortgage Rate, 2005Q1 - 2017Q4



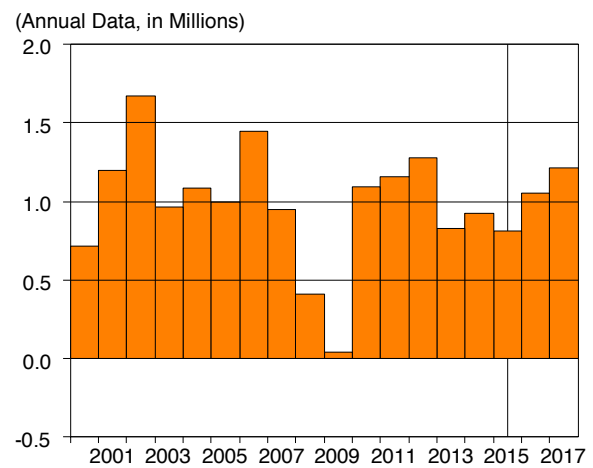
Source: Freddie Mac and UCLA Anderson Forecast

Figure 3 Nonfarm Employment, 2005Q1 - 2017Q4F, SAAR



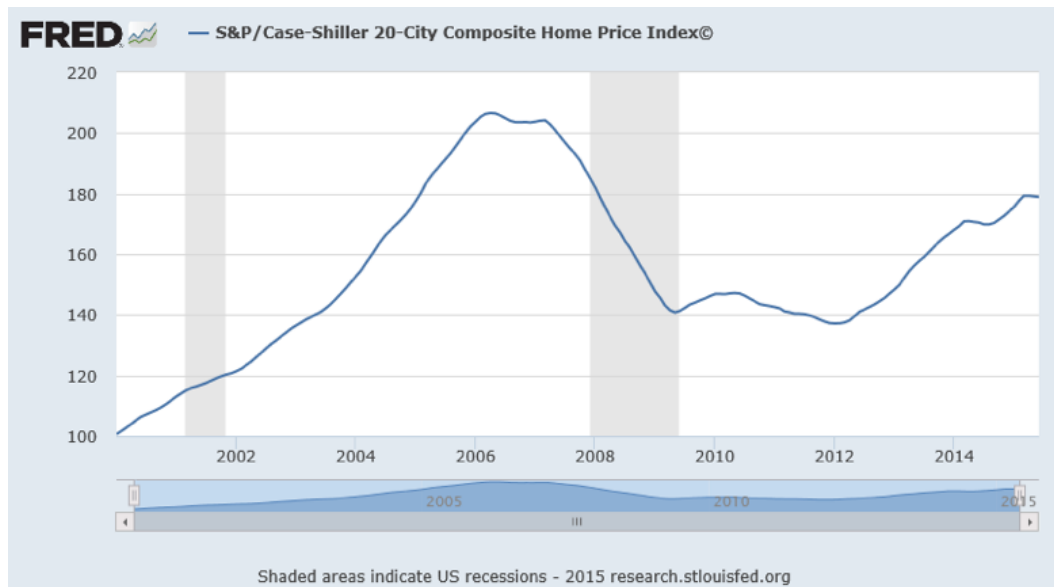
Sources: U.S. Department of Labor and UCLA Anderson Forecast

Figure 5 Household Formations, 2010-2017F



Sources: U.S. Bureau of the Census and UCLA Anderson Forecast

Figure 6 S&P/Case-Shiller Home Price Index, 20 City Composite, 2000 - June 2015, 2000=100

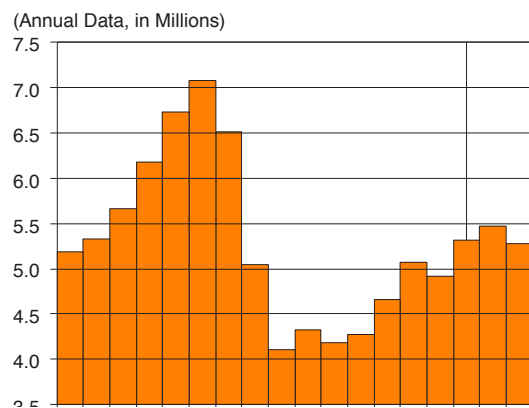


Sources: Standard and Poor's via FRED

The rebound in housing construction is being confirmed by rising home prices with the widely reported Case-Shiller Index up 5% year-over-year and up 30% since the low in 2012. (See Figure 6) Similarly, existing home sales are forecast to be 5.3 million units this year up from the 4.1 million unit low in 2008. (See Figure 7) We forecast that existing home sales will reach 5.5 million units in 2016 and modestly decline to 5.3 million units in 2017.

**Interestingly, the housing recovery is occurring under the backdrop of an unprecedented decline in home ownership. Specifically, the home ownership rate has declined from 69% in 2005 to the current 63.5%, which is roughly where it was in 1989. (See Figure 8) The decline in the home ownership rate is attributable to the after effects of the housing crash of 2006-2010 which scared off would be homeowners, tighter mortgage requirements,**

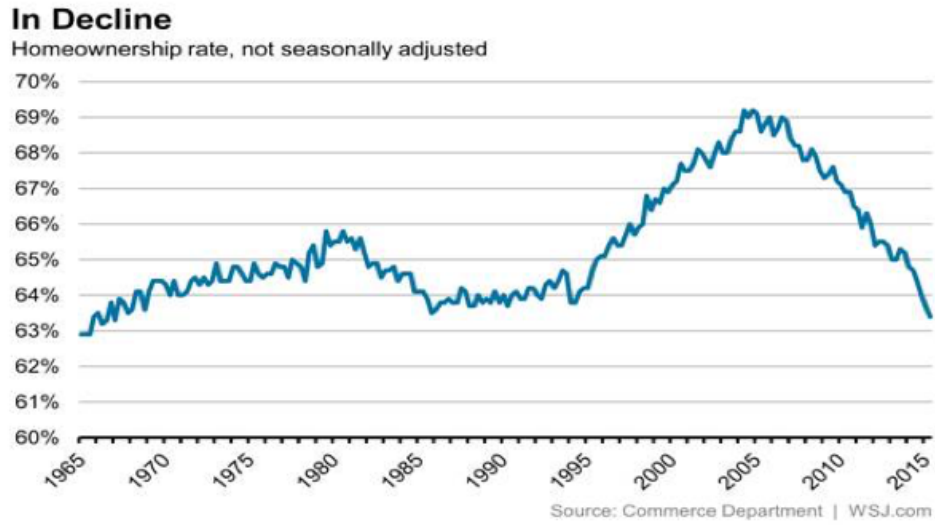
Figure 7 Existing Home Sales, 2000 - 2017F



Sources: National Association of Realtors and UCLA Anderson Forecast

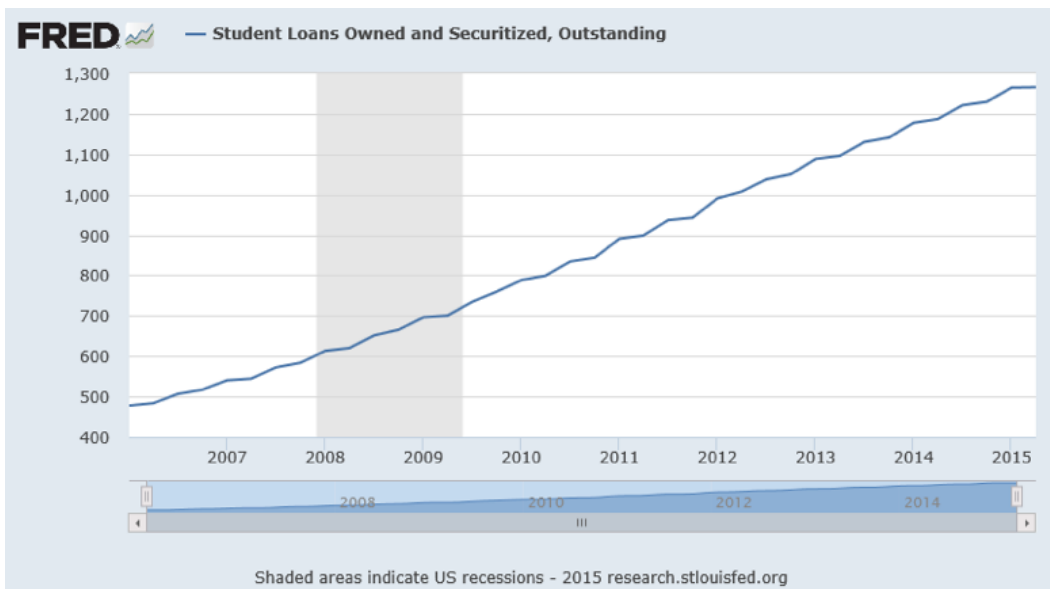
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figure 8 Homeownership Rate, 1965 - 2015Q2, NSA



Sources: U.S. Department of Commerce and WSJ.com

Figure 9 Student Loan Debt, 2006Q1-2015Q2F, \$Billions



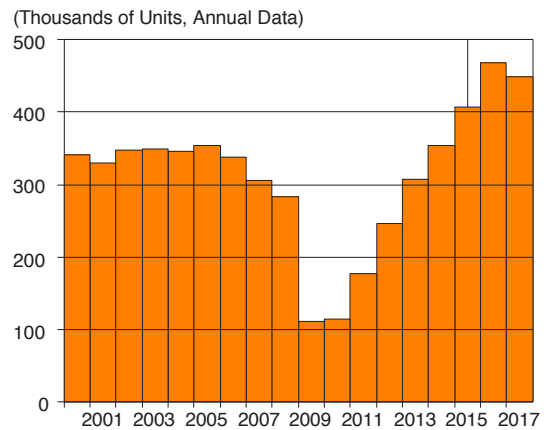
Sources: FRED

sluggish income growth, a shift in consumer preferences to urban versus suburban lifestyles, and the rapid growth in student loans which now exceed \$1.2 trillion (See Figure 9) In fact, the biggest drop in homeownership has taken place in 25-34 year old cohort where the rate dropped 5 full percentage points from 1993 -2014.<sup>1</sup> We believe that this declining trend has about run its course and will soon begin reversing. In support of this notion we note that the recent decline in life events associated with home ownership such as marriage and childbirth have ebbed and are now in the process of reversal.

### The Boom in Multi-Family and Rentals

The flip-side of the decline in the homeownership rate is a rise in renting which has triggered a boom in multi-family housing starts (See Figure 10). Multi-family housing starts which bottomed in 2009 at 112,000 units will exceed 400,000 units this year and average 460,000 units over the next two years. The boom is underpinned by rents increasing at a 3.5% a year rate in the official data, but according to the publicly traded apartment real estate investment trusts, rents are increasing on the order of 4.5-5.0%. (See Figure 11) As we have noted before, the official data tends to lag the actual market place because of the prevalence of rent controlled jurisdictions in the official sample. Simply put, rents in con-

Figure 10 Multi-Family Housing Starts, 2000Q1 - 2017Q4F

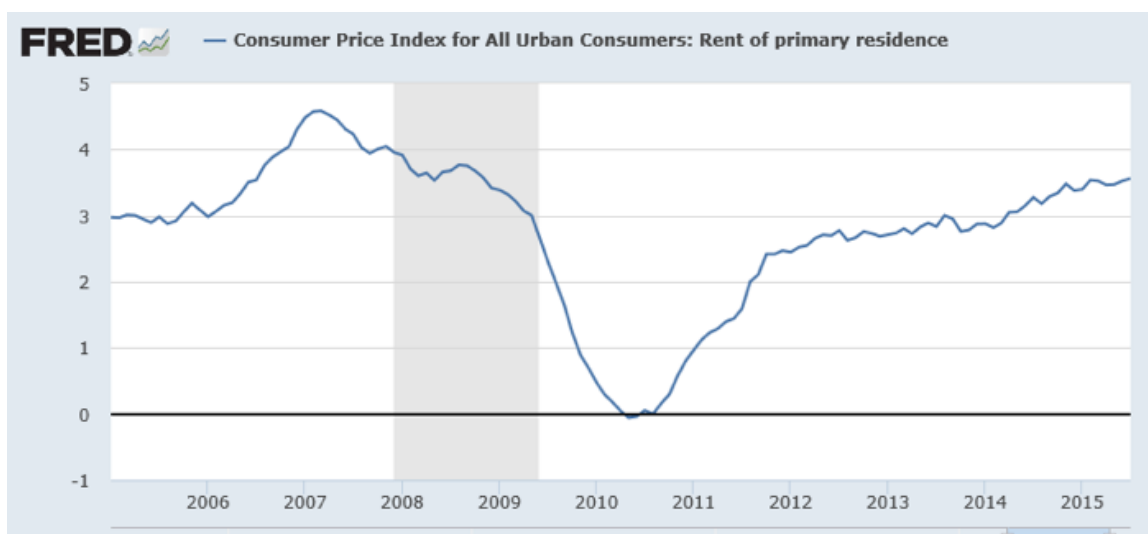


Sources: U.S. Department of Commerce and UCLA Anderson Forecast

trolled jurisdictions aren't typically marked to market until a vacancy occurs. The primary reason that rental increases have been sustainable is a very low 4% national (based on 79 cities) apartment vacancy rate, roughly half of what it was a few years ago. (See Figure 12)

Moreover, this cycle has given rise to nationally oriented single-family rental businesses funded by institutional

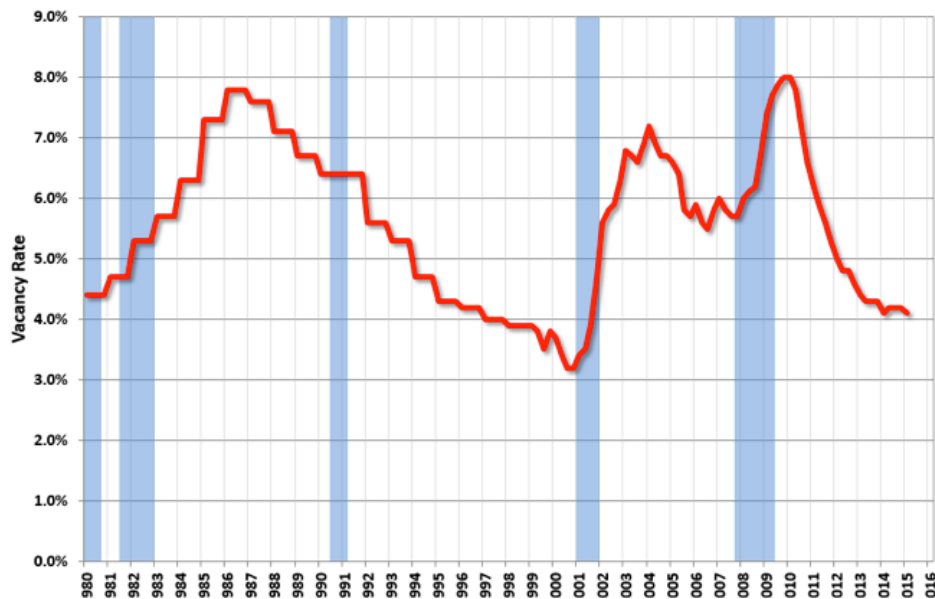
Figure 11 Consumer Price Index, Rent of Primary Residence, January 2000 - July 2015, Percent Change Year-Over-Year



Source: U.S Bureau of Labor Statistics via FRED

1. "The State of the Nation's Housing 2015," Joint Center on Housing Studies, Harvard University.

Figure 12 Apartment Vacancy Rate, 1980 - March 2015



Source: REIS and [calculatedriskblog.com](http://calculatedriskblog.com)

investors and public offerings of shares. This business is the creature of the huge amount of bank foreclosed property that came on the market in the aftermath of the financial crisis enabling the bulk buying of single-family homes. Thus far, single-family rentals have captured an unprecedented half of the total rental market over the past few years and the public companies have been reporting rental growth on the order of 4% a year. In fact we are now witnessing the purchase of new single-family homes for the rental market by investment institutions and the development of homes for rent by traditional home-builders. This consumer preference for single-family rentals is one of the reasons we believe that the American dream of at least living in a single-family home is far from dead and ultimately many of those rental units will turn into owner occupied housing.

The trends outlined above have not gone unnoticed by the investment community as torrents of cash has flowed into the sector driving up apartment values and spurring new construction. In a yield constrained world, the cash flows associated with apartment ownership have looked increasingly attractive to institutional and retail investors alike and that has driven initial yields down to below 5% and to below 4% in the more favored markets. Just to note, initial yields on apartment projects were close to 8% at the height of the financial crisis.

However, because we expect interest rates to rise over the next few years, the decline in homeownership rate to level off and high new construction levels to negatively impact vacancy rates, the apartment boom is likely to show real signs of strain by late next year.

More importantly, with rents rising faster than incomes, affordability will soon become a binding constraint on rents. For example, from 2004-2014, the percentage of households paying more than 30% of their income rent increased from 40% to 46%.<sup>2</sup> With developers building for the top of the market, meaning high income renters, they may not yet to be cognizant of this trend, but they will soon find out that the high-end apartment market might not be as deep as they think.

### Conclusion

Yes, housing is back. It will not be a rerun of the 2005 boom, but starts will soon approach 1.5 million units a year. The multi-family apartment boom will continue throughout 2016 as developers race to keep up with demand for urban infill housing. Nevertheless, housing activity will begin to gradually fade in 2017 as mortgage rates rise and apartment vacancies increase.

2. Ibid.