CAPITAL SQUARE

THE DECISION TO RENT OR BUY FAVORS THE RENTAL MARKET

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THE DECISION TO RENT OR BUY IS SLANTED MORE IN FAVOR OF THE RENTAL MARKET THAN EVER BEFORE

TAKEAWAYS

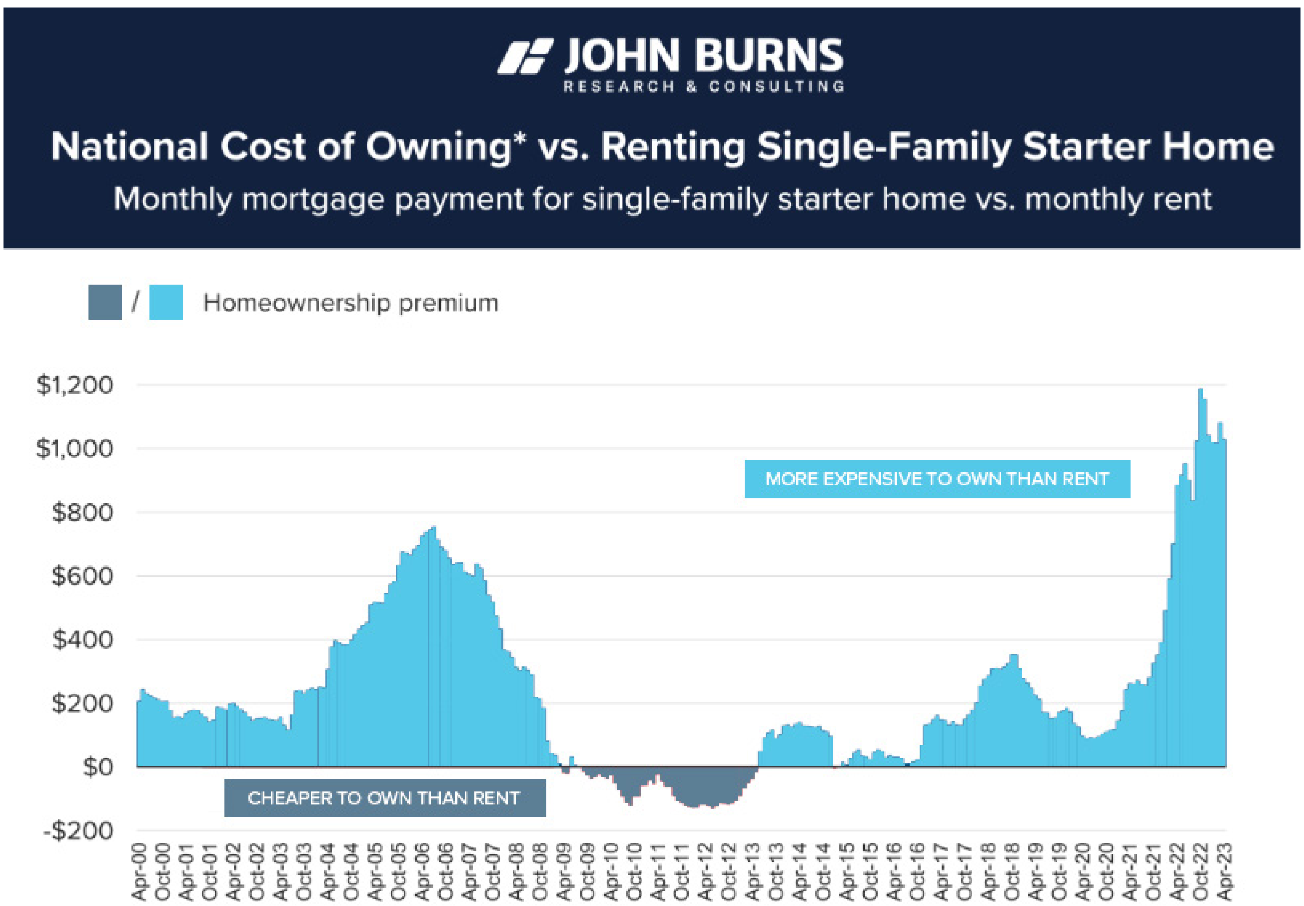
- Rising mortgage rates have made this the worst time to buy, rather than rent, in a generation. John Burns Research and Consulting estimates that it is 52% more expensive on average to own versus rent.[1]
- Several factors unique to the current market, including a limited housing supply propping up home prices and new multifamily deliveries limiting rental increases, means that the mismatch of owning versus renting appears unlikely to self-correct any time soon.
- The headlines have all focused on the pain of rising mortgage rates; however, the flipside of the discussion is that the relative attractiveness of the rental market bodes extremely well for multifamily and build-for-rent (BFR) communities.

> Despite the self-correcting nature of families' decisions to buy or rent based on relative value, many factors support the current imbalance and point to renting looking like the more attractive alternative for a prolonged period.

THE FIRST MAJOR RATE INCREASES IN A GENERATION HAVE MADE HOME OWNERSHIP FAR LESS APPEALING

Home ownership in the United States has not been this expensive relative to renting since at least 1996.[2] Why is that the case? It makes sense that the decision of renting versus owning would generally stay in balance based on tradeoffs that families make when deciding on a living arrangement. Homeowners benefit from increases in net worth through home price appreciation, as well as the pride of ownership, but must deal with repair and maintenance costs. Renters need not worry about repair costs and have additional flexibility in being bound by only a lease contract, but they cannot participate in the upside of a rising housing market. Overall, we would expect that the opportunity costs from one decision becoming relatively more attractive would push families in that direction and rebalance the rent-versus-buy equation.

Nevertheless, we are experiencing a housing market where it looks more expensive to buy relative to renting than has been seen for 25+ years. According to John Burns Research and Consulting, the latest readings show that it is a staggering 52% more expensive on average to own versus rent a single-family home.[3] This equates to an average $1,030 per month premium for mortgage and maintenance costs of ownership relative to rents for a similarly priced home:



*Cost of owning (including payment + maintenance): We assume the purchase of a home at 80% of the current median-priced existing home with a 5% down payment and a 30-year, fixed-rate mortgage. We include PITI plus mortgage insurance and maintenance costs. We assume the purchase price to be for a rent-ready home and do not include renovation or acquisition costs in our calculation. Annual maintenance costs range from 0.85% to 125% of the home's value and vary by market. Maintenance costs cover small repairs as well as large capital expenditures, like replacing a roof.

Single-family rent: we assume a home valued at 80% of the current median-priced existing home. We look for homes at this valuation in current single-family for-rent listings and then collect the asking rents. We also add renter's insurance to the cost of renting, which is based on state level data. Note: historical values do not exactly match last year's article as we added a new data source that provides more real-time responsiveness to this metric.

Source: John Burns Research and Consulting, LLC (Data: Apr-23, Pub: Jun-23)

Rapidly rising interest rates, a condition that has not been experienced in a generation, have been the primary driver of this extreme mismatch in the housing market. Following Covid-era lockdowns, the past three years have seen both rents and home prices increase materially, with growth estimated at 22% and 28% respectively. These factors alone have done little to upset the balance of renting versus owning. However, surging interest rates mean that mortgage payments have increased 89% from their 2020 lows.[4] This increase in rates, coming at a point when the economy has otherwise supported both home prices and rents, has meant that nothing offsets or balances the added pain to ownership as rates run higher.

THE FACTORS SUPPORTING THE MISMATCH IN OWNERSHIP VERSUS RENTING APPEAR PRIMED TO CONTINUE

Despite the self-correcting nature of families' decisions to buy or rent based on relative value, many factors support the current imbalance and point to renting looking like the more attractive alternative for a prolonged period. To begin with, a substantial correction in home prices or a massive interest rate cut necessitated by a deep recession would be required for mortgage payments to come back into balance with rents. This seems less and less likely, as inflation readings continued to cool in October 2023, furthering the idea of a "soft landing," which would generally support stable housing prices and interest rates.[5]

In addition to the relative stability that has been experienced in home prices and interest rates, several factors unique to the current economic situation are likely to support a continued imbalance of renting versus owning. On the home ownership side, there is the much-reported phenomenon that homeowners locked into mortgages at extremely low rates feel forced to remain in their current house to maintain a highly favorable monthly payment. These homeowners are going to great lengths to stay in their home and are likely to do so moving forward, creating limited supply in the housing market for the foreseeable future. This limited supply should continue to prop up housing values despite the negative effects of rate increases.

We would expect limited housing supply to translate to steady rental rate increases on the multifamily side due to increased demand from families priced out of the home ownership market. However, another factor unique to the current market is hindering this rebalancing effect. A glut of new supply of multifamily properties is limiting the ability of rental landlords to take advantage of the unaffordability of home ownership.[6] So, while landlords may otherwise rebalance the rent-versus-own equation with significant rent increases, the unique factors of the current market actually appear likely to keep the balance strongly in favor of renters for a prolonged period of time.

RENTING LOOKS EVEN BETTER FOR POTENTIAL FIRST-TIME BUYERS, WITH BUILD FOR RENT AS A GREAT OPTION

The pain of rising mortgage payments can be felt across the board but is even more acute for first-time homebuyers. The data suggests that first-time homebuyers make smaller down payments, meaning the sting of rising rates affects them to a greater extent.[7] Repeat buyers on average put down 17%, while first-time buyers averaged a down payment of 6% to 7% according to the National Association of Realtors.[8] While home ownership will remain the ultimate goal of most, the benefits of continuing to rent simply could not be more attractive right now for the would-be first-time buyer.

A great alternative for many potential first-time buyers is to consider renting a single-family, build-for-rent (BFR) home. John Burns Research and Consulting finds that the home ownership premium is below the $1,030 per month national average in 15 of the top 20 most popular markets for single-family rentals.[9] What this means is an ideal scenario in these popular markets whereby renting is far more affordable than ownership, while at the same time single-family housing prices are affordable enough to provide an adequate yield to landlords to justify investment. Such a scenario bodes well for the continued proliferation of BFR communities. These homes represent an attractive value proposition for both landlords and renters, and they will serve as an ideal steppingstone for renters to trade up to a single-family residence while still benefitting from rental affordability.

THE VALUE OF RENTING HAS NEVER BEEN BETTER – AND MAY REMAIN THAT WAY

The confluence of several unique factors in the economy means, as the Wall Street Journal headline stated, "There's Never Been a Worse Time to Buy Instead of Rent."[10] Possibly just as important, the lack of housing supply, limited rental housing increases and other factors in the current market could maintain the heavy skew in favor of renters for a prolonged period.

These circumstances point to an obvious conclusion that is somewhat overlooked amidst all the discussion of rising mortgage rates: With renting as the far more attractive option currently as compared with home ownership, families will necessarily respond by joining or remaining in the rental market for longer periods. Both multifamily properties and BFR communities provide a far more compelling living option when a family in the average market can save $1,030 per month by renting rather than buying. This bodes well for the strength of the rental market now, and the factors maintaining the imbalance between buying versus renting means this rental market strength can be expected to continue for the foreseeable future.

Sources

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