Rental prices: On the rise after a nice slumber (for renters)

A tight rental market is likely to be a wake-up call for rents that have been mostly flat for some years.

Mary Rippe, president of the Minnesota Multi Housing Association, said that some MMHA members "see rent levels at roughly the same level as 10 years ago," after considering inflation and annual maintenance costs. Many are viewing the current environment as a chance to catch up on postponed capital investments, she said.

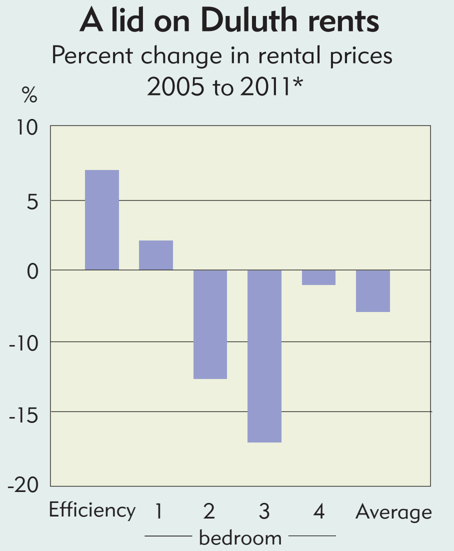
Nationally, rent levels were down about 6 percent (combined) in 2008 and 2009, and have increased about 7 percent over the subsequent two years, according to Mark Obrinsky, from the National Multi Housing Council. "There has been a clear tick up in rents, but [owners] are trying to recapture growth that was lost" right after the recession. Rents now, he said, are only about 1 percent higher than before the recession, and that doesn't factor in inflation. "Renters don't care about inflation adjustments."

But property managers do, because inflation eats into operating margins if rents aren't also rising. Macro data on median rental prices from the American Community Survey (conducted annually by the U.S. Census Bureau) show that on an inflation-adjusted basis, many Ninth District markets saw median rents actually decline from 2006 to 2010 (see Chart 1).

Local data and anecdotes support the stagnant rent trend suggested by the ACS. The city of Duluth, Minn., does an annual rental survey involving more than 2,000 units. It shows that rents in 2011 have mostly declined since 2005 on an inflation-adjusted basis, increasing only slightly for the smallest units (see Chart 2).

In Marquette, in the Upper Peninsula of Michigan, Look Realty manages about 140 rental units. Owner Steve Pelto said he consistently has a vacancy rate of 1 percent to 2 percent, though it's higher regionwide—between 5 percent and 8 percent, depending on the timing of new rentals that have been consistently opening in a western township. Those new units are one reason rent increases have been marginal.

Chart 2



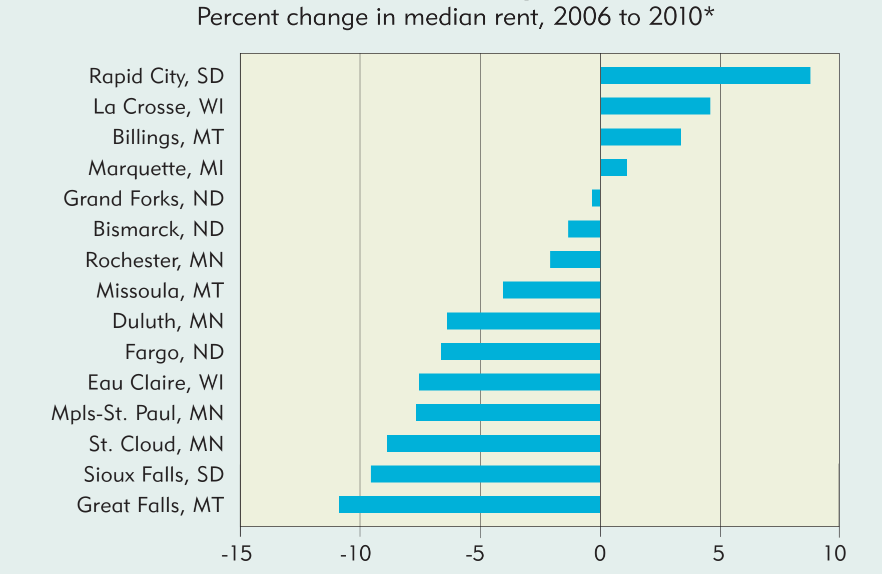
*In 2011 dollars
Source: City of Duluth 2011 Housing Indicator Report, April 2012

"I might raise the rent from $640 to $650 or $655," said Pelto, and that increase gets eaten up quickly by property maintenance and upgrades, like new windows, carpet replacements and decent appliances, which he said help him retain renters.

At the same time, low vacancy rates are allowing property owners in some markets to finally reel in the rent subsidies and other incentives that were often required to attract and retain tenants over the past decade. For example, in the Twin Cities, so-called asking rents increased a little over 2 percent last year, according to Marquette Advisors, a real estate services firm. But as vacancies have declined, effective rents (asking rents minus any cash-like perks) are slowly closing the gap (see Chart 3). Last year, effective rents in the Twin Cities increased by 4 percent, with a similar increase expected this year, according to Marquette Advisors.

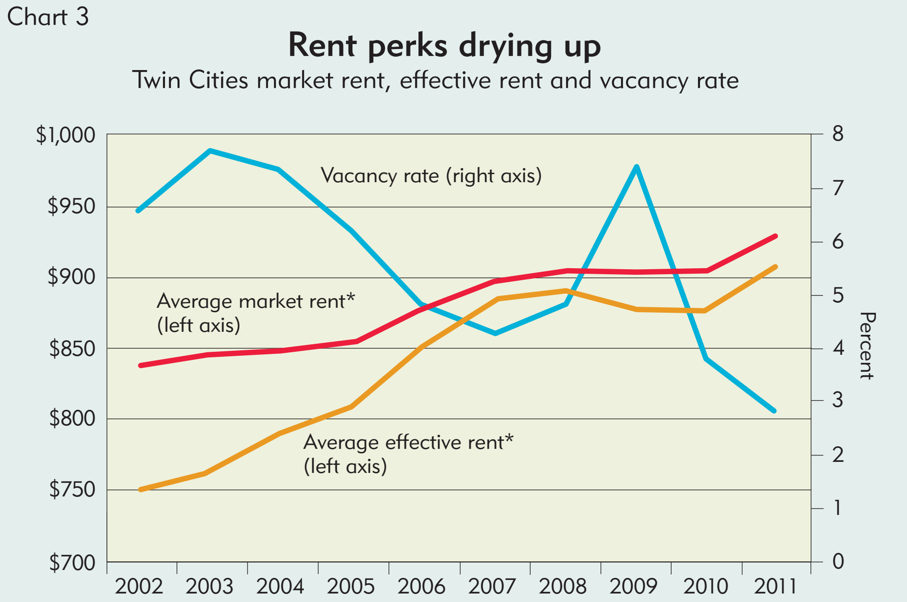
—Ronald A. Wirtz

Chart 1



*In 2010 dollars
Source: American Comunity Survey, U.S. Census Bureau

Chart 3



*Not adjusted for inflation
Source: Marquette Advisers

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Many believe that renting will grow over the next few years. A report by the Urban Land Institute called existing apartment owners "golden." All signs, it said, "point to more Americans renting and a further decline in homeownership as defaults on mortgages and foreclosures continue." Tighter lending standards with high down payments will also keep prospective home buyers in their apartments.

Local sources concurred. "I think there's a shift in the mood" toward renting, said Rippe, from the MMHA. "Now, first-time home buyers are reassessing whether that's what they want."

That opinion is popular, but not universal. Steve Pelto, owner of Look Realty in Marquette, Mich., said he believes that home buying is a "trend that seems to be coming back. People are reaching the conclusion that to own a home is cheaper than you can rent." At prevailing rates, the mortgage payment on a $130,000 home would be less than $600 a month. Some have complained about the difficulty of qualifying for a mortgage, but Pelto said he has one client looking at an average house, "and I have two bankers fighting over the mortgage."

Falling home prices might eventually pull many renters back into the ownership market, "but not right now," said Obrinsky, from NMHC. "There's no reason to rush back into the market." He pointed out that homeownership-to-rent ratios don't correlate very well with prices. When home prices are going up, affordability goes down, but people keep buying because they don't want to wait to buy and have to pay more. The inverse is also true: As prices fall, affordability improves, "but no one is buying a house" because there is little danger in waiting, Obrinsky said.

> **"Renting is becoming the new big thing," said Brent Hayden of Renter's Warehouse, who is 28 years old. "Right now, it's not cool to be a homeowner. My generation isn't a homeowner. It's foolish to own a home if you're going to leave in less than five years" because you won't leave with any equity.**

Siefken, from the South Dakota MHA, is himself a long-time renter and property owner, and has long believed in the value proposition of renting. "I was the odd man out for a lot of years," he acknowledged. But there's more than meets the eye in a low mortgage payment.

"[Renters] seem to understand that for $750 in rent, you're not going to get a house for that" because there are myriad other costs to ownership, including property taxes, insurance, upkeep and in some cases utility bills that were previously included with rent. The cost relationship "was not always clear in the past, and it didn't need to be" because homeowners could just sell at a profit if things ended up being too expensive, Siefken said. Those days are gone, and would-be buyers have been chastened by the glut of underwater homeowners who can't get out from underneath their mortgage.

That mindset is a large part of the business model for Brent Hayden, CEO and founder of Renter's Warehouse, of Golden Valley, Minn., which was named the largest and fastest growing property management company in Minnesota by *Inc.* magazine.

The company was started in 2007 and manages about 1,500 rental units on behalf of property owners, all within about a 75-mile radius of the Twin Cities. The large majority are single-family homes, condos and town homes, according to Hayden—many of them "unintentional accidental" owners who bought a house and now need to sell it, but can't find a buyer. So they turn to Renter's Warehouse, where they find willing (and screened) renters.

"Renting is becoming the new big thing," said Hayden, who is 28 years old. "Right now, it's not cool to be a homeowner. My generation isn't a homeowner. It's foolish to own a home if you're going to leave in less than five years" because you won't leave with any equity. Hayden expects rents to go up this year and that market conditions "will be the best they've been in 10 years." He believes the rental market is on a five- to seven-year growth cycle. "It's the best time to be a landlord."

Many others are optimistic, but less willing to look quite that far out. "This year and next will be very good years," Obrinsky said. Two years from now, he said, "is sort of wait and see," depending on job growth and the market's reaction to tight vacancies. "Many believe we'll start to see new units pick up in a substantial way."

On the question of how far ownership rates might fall, "we see the same division [of opinion] in our industry," Obrinsky said. "We're inclined to think there is potential for a long-term shift. It's not going to go to two-thirds rental, but small changes can mean big things" for the industry.

Some have suggested that the national rate of homeownership might go to 60 percent. "I'm skeptical it will go that low, even on an interim basis, but I can't rule it out. Things that you thought couldn't happen before have." f