CLARION PARTNERS

View our new Rental Housing video at www.clarionpartners.com/insights

The endurance of U.S. rental housing investments

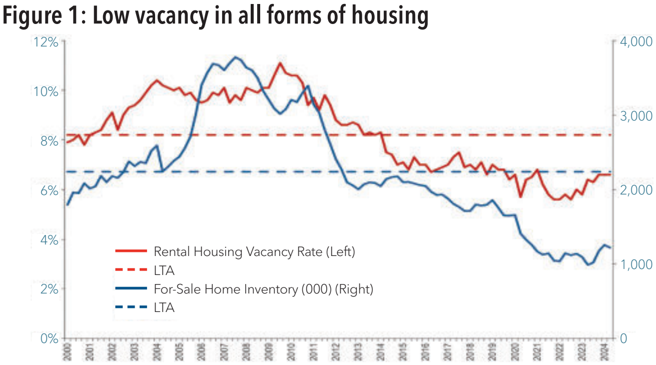
During the past decade, U.S. multifamily has been among the most sought-after sectors by institutional investors due to its necessity characteristic, the underlying strength of property-level fundamentals, and high historic risk-adjusted total returns. It has remained an integral part of commercial real estate (CRE) investment portfolios, with a portfolio weighting of 29.1 percent in the NCREIF Fund Index–Open End Diversified Core Equity (NFI-ODCE).[1] Clarion Partners believes that well-located, high-quality rental housing will continue to be a strong performer over the long term due to a variety of macro, demographic and financial factors.

Macro drivers sustaining rental housing demand

The national housing shortage – Following a decade of underbuilding, there continues to be a national housing shortage. Both the U.S. for-sale housing inventory and the rental housing vacancy rate have remained very low in many markets in recent years (Figure 1). Clarion Partners estimates a total current shortfall of 2.8 million housing units, representing a shortfall of 1.3 million for-sale units and 1.5 million for-rent units.[2] This view is consistent with other industry estimates of the U.S. housing shortage that generally range between 2 million and 5 million units, depending on the methodology.[3]

This shortfall is expected to grow as disruptions in the capital markets are leading to fewer multifamily starts, and demographic trends support continued demand. The deficit is even more pronounced in the low and middle price-point markets, as much of the new construction targets the high-end segment.

Figure 1: Low vacancy in all forms of housing



Sources: U.S. Census Bureau, Moody's Analytics, Clarion Partners Investment Research, Q2 2024. Note: Rental housing includes non-institutional and institutional-quality multifamily and single-family rental houses

Favorable demographics: Robust renter base in all generations – The increasingly onerous cost of owning a home has led to many in all age groups remaining in the renter cohort. While the overall U.S. homeownership rate is now near its long-term average, the rate among first-time buyers is still historically low.[4]

While more Millennials (~72 million) are buying homes, Gen Z (~70 million) has started to enter the workforce and will remain in the renter cohort for the next decade or so. Furthermore, more Gen Xers and Baby Boomers (~133 million combined) are choosing to rent for lifestyle reasons.[5]

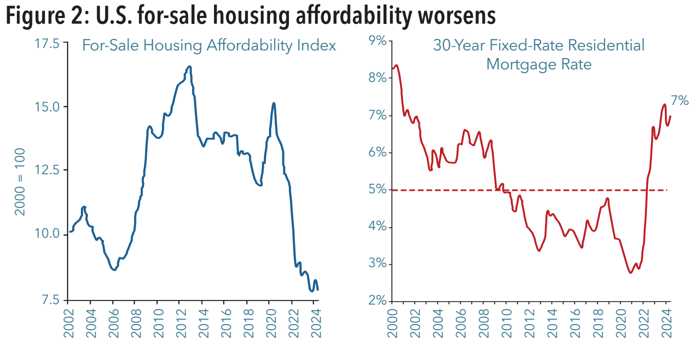
Additional key factors likely to sustain future rental housing fundamentals include strong ongoing job and wage growth, elevated construction and replacement costs, and tighter lending conditions for new construction, which will likely suppress future new supply.

Financial headwinds: Acute for-sale housing affordability challenge persists

Cheaper to rent than to own in most metros – U.S. for-sale housing affordability is now at a record low (Figure 2). It is now cheaper to rent than to buy in most of the largest U.S. metros.[6] Since Q4 2019, monthly rents have risen by 28 percent, while mortgage payments have climbed by 92 percent.[7]

U.S. for-sale housing price has continued to climb – Over the past decade, the U.S. median home price has risen swiftly, up by almost 100 percent from $207,000 to $403,730.[8] During this time, the national average income grew by 42 percent.[9] Housing prices in many secondary markets in the South and West regions approached new highs, with prices in a few rivaling the levels of some high-cost major markets. However, overall home prices are still significantly lower in much of the Sun Belt.

Figure 2: U.S. for-sale housing affordability worsens



Sources: Moody's Analytics, Clarion Partners Investment Research, Q2 2024. Note: For-sale housing affordability index based on Moody's Analytics model that factors in three variables: 30-Year Fixed Rate Mortgage Commitment Rate–National, FHFA Purchase-Only Home Price Index, and Median Household Income. LTA = long-term average.

Explosion in renter households – The widening gap between the cost to rent and own has led to a rapid rise in renter households. In Q2 2024, the number of renter households in the United States grew three times faster than the number of owner households.[10]

Ongoing shift: Sun Belt lure and suburban boom

Higher for-sale housing costs have shifted residential mobility patterns and the geography of housing demand. Recent domestic migration and population growth trends have continued to heavily favor the Sun Belt and suburbs, which have had a significant impact on CRE demand overall in these areas.

Sun Belt lure – During the pandemic, Sun Belt markets saw a surge in in-migration, often at the expense of major markets. Looking ahead, Clarion Partners anticipates that the Sun Belt boom will continue given the relative cost of living, quality of life and job opportunities. Overall, the Sun Belt markets' rental housing costs still offer a sizable discount relative to the six major markets at about 45 percent.[11] During the next five years, the top markets for population and employment growth are largely forecast to be in Texas, Florida, North Carolina, Nevada, Utah, Arizona and Tennessee.[12]

Suburban boom – At the same time, with a robust inflow of Gen Z and Millennials into the central business districts (CBDs) of major markets, we expect steady demand there as well in the years ahead. However, as Millennials reach middle age, cost pressures mount and growth industries are more diversified by region, we expect strong rent growth performance in the urban fringe and suburbs to persist. More young adults are choosing to live in suburbs to have families, more living space and access to better public schools.

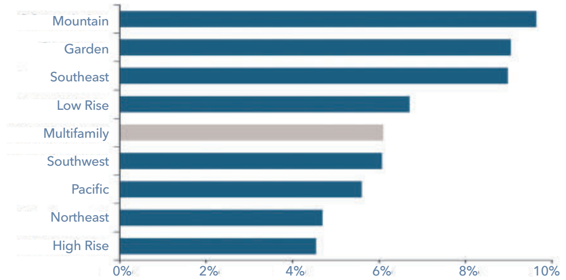
Multifamily investment performance strong, especially in select segments

During the past decade, the NCREIF Property Index multifamily subindex (stabilized and unlevered) has performed very well (Figure 3). The short- and long-term total returns have also indicated strong outperformance in the Mountain, Southeast and Southwest regions, along with the two lower-density multifamily formats – garden-style and low-rise apartments. Given the recent population, migration and job growth trends, Clarion Partners believes that CRE investors should align investment strategies accordingly in the future.

Going forward, we believe there are several other considerations to bear in mind as a multifamily investor:

- Political risks (e.g., rent control and environmental mandates/policies);
- High-growth industry clusters (e.g., tech, life sciences and health care);
- Climate change risks;
- The high cost of living, including food, electricity, transportation and caregiving; and
- The potential endurance of remote and hybrid work; physical office occupancy now averages about 50 percent of pre-COVID levels, which may influence future living arrangements.[13]

Figure 3: NCREIF multifamily investment performance: 10-year total returns by segment: Q1 2014 to Q1 2024



Sources: NCREIF Property Index, Clarion Partners Investment Research, Q2 2024.
Note: Past performance is not indicative of future results.

Elevated new supply levels from 2022 to 2024 have caused an uptick in the historically low rental housing vacancy rate; however, we expect rental demand to remain strong given the acute housing shortage theme.[14]

Last, but not least, multifamily housing landlords can adjust rent more quickly than those in other sectors. Therefore, multifamily investments can potentially serve as a hedge against rising inflation, a desirable characteristic in today's inflationary environment.

Investment focus

During the past decade, U.S. rental housing fundamentals have remained very healthy overall. U.S. multifamily rents are at all-time highs, and most of the largest markets report vacancy rates under 5.5 percent.[15] Furthermore, most major markets reported positive rent growth in 2023. Year-to-date in 2024, U.S. rent growth has also remained positive.[16] Clarion Partners is focused on the following acquisition and development investment strategies:

- Sun Belt metros with a concentration of high-growth industries, strong population growth, and a low cost of living;
- High-quality class A and B apartments in top suburban and urban fringe submarkets of major and secondary markets;
- Large employment hubs with a high share of renters by necessity; and
- Assets targeting renters by choice in top lifestyle markets/submarkets.

[1] NCREIF Property Index, Q4 2023. Note: The NFI-ODCE is a capitalization-weighted, gross of fee, time-weighted low leverage return index with an inception date of Dec. 31, 1977; [2] Clarion Partners Investment Research Q2 2024; [3] As of 1H 2024, there was a wide range of housing shortfall estimates based on varying methodologies from various sources: Rosen Consulting Group for the National Association of Realtors®, Harvard's Joint Center for Housing Studies, Realtor.com and National Low Income Housing Coalition; [4] National Association of Realtors®, U.S. Census Bureau, 2024; [5] U.S. Census Bureau, 2024; [6] Moody's Analytics, Clarion Partners Investment Research Q2 2024; [7] Moody's Analytics, Real Page, Clarion Partners Investment Research Q2 2024. Note: Based on effective rents; [8] Moody's Analytics 2023. Note: 10-year change is from Q1 2014 to Q1 2024; [9] Ibid. based on the U.S. average hourly earnings of all employees in the private sector; [10] U.S. Census Bureau, Q2 2024; [11] CBRE-EA Q2 2024; [12] Moody's Analytics, Clarion Partners Investment Research Q2 2024. Calculation used forecast cumulative data from Q2 2022 to Q4 2027; [13] Kastle Systems August 2024. Note: Based on the 10-city back-to-work barometer measuring physical office occupancy relative to pre-COVID levels; [14] CBRE-EA Q2 2024; [15] CBRE-EA, Clarion Partners Investment Research Q2 2024; [16] Ibid.

CONTRIBUTORS

Indraneel Karlekar
Managing Director, Global Head of Investment Research

Joey Valenzuela
Senior Associate, Investment Research

CORPORATE OVERVIEW

Clarion Partners has been a leading U.S. real estate investment manager for more than 40 years. Headquartered in New York City, the firm has offices in major markets throughout the United States and Europe. With $74.2 billion in total assets under management as of June 30, 2024, Clarion Partners offers a broad range of both debt and equity real estate strategies across the risk/return spectrum to its approximately 500 domestic and international institutional investors.

CORPORATE CONTACT

Hugh Macdonnell, Head of Client Capital Management | clarionpartners@clarionpartners.com | +1 212-883-2500 | www.clarionpartners.com