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This is the first in a series of condensed analyses of crucial real estate and economic issues offered by the UCLA Anderson Forecast and the UCLA Ziman Center for Real Estate. Here, UCLA Ziman Center and UCLA Anderson Forecast Senior Economist David Shulman examines the potential for a recovery in the housing sector.

Rebuilding the Housing Economy

The Multi-Family Boom Will Lead to a Rebound in Homeownership

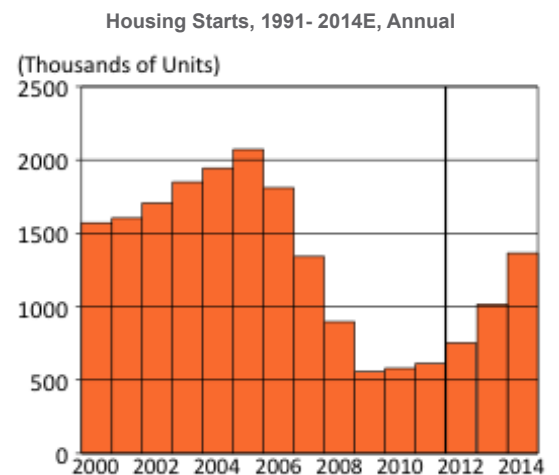
By David Shulman, Senior Economist, UCLA Anderson Forecast and the UCLA Ziman Center for Real Estate

After an agonizing six-year decline where nearly \$7 trillion of wealth was destroyed, the housing economy is now in the process of rebuilding. With average home prices declining by one-third, it has been a searing experience for most homeowners who never believed that housing prices would ever fall. As a result with existing homeowners being foreclosed upon and potential homeowners either unable to meet more stringent purchase requirements or fearful of continued price declines, the homeownership rate declined from a peak of 69% in 2004 to 66% in 2011 and is forecast to drop to 65% by the end of this year.

Nevertheless there are many indicators that offer evidence that the housing market has bottomed and a recovery is underway. Despite a regulatory logjam in the process, foreclosures appear to have peaked. Concomitantly existing home sales are now on the rise. After peaking at 7.1 million home sales in 2005, the series declined to 4.1 million units in 2008 and is expected to exceed 5.0 million units in 2013. To be sure about one-third of existing home sales are accounted for by either foreclosures or “short sales,” the steady rise in activity is indicative of recovery.

Nonetheless the recovery will continue to be gradual and uneven. Though improving, the job market remains far from healthy and higher down payment and credit score requirements are working against the stimulative effects of low interest rates. New this cycle is the impact of exploding student loan debt that will keep potential buyers out of the housing market for years to come.

Peaking at nearly 2.1 million units in 2005, housing starts plummeted by 73% by 2009 to 554,000 units. After remaining at roughly that level in 2010 and 2011 housing starts are expected to reach 755,000 units this year and exceed one million units in 2013. **Although this looks like a steep recovery, at one million units, housing activity would have only recovered from depression levels to recession levels.** Remember that from 1991–2010 housing starts averaged 1.42 million units a year.



Source: [U.S. Department of Commerce](#) and [UCLA Anderson Forecast](#)

The Dramatic Rise of Multi-Family

We are now in the midst of a boom in multi-family construction, especially in rental apartments. Like housing starts in general, multi-family starts collapsed from its peak in 2005 of 354,000 units to a nadir of 112,000 units in 2009. Since then starts will have more than doubled to the 260,000 units forecast in 2012. Indeed we would not be surprised to see multi-family starts exceed 400,000 units in 2014. After all the flip side of a falling homeownership rate is a rising rate of home renting.

The coming boom in multi-family starts is underpinned by a very low vacancy rate (below 5%), rising rents and a flood of institutional money coming into the sector. Although not reflected in the consumer price index where the rent regulated cities of New York and Los Angeles are over weighted, rents on renewals are now rising at 4% and many of the publicly traded real estate investment trusts are reporting year-over-year rent increases on the order of 5% to 7%.

With 10-year U.S. Treasury yields below 2%, institutional investors are seeking out higher yielding alternatives and they are finding rental apartments to be increasingly attractive. Rising rents offer the prospect of higher future income and capital appreciation.

Of course this boom in multi-family construction will have within it the seeds of its own destruction. As rents rise, consumers will shift out of rental into ownership units. **The American Dream of homeownership maybe comatose, but it is not dead, and the wake-up call will come in the form of higher rents.**

By 2014, supply will begin to outpace demand. New physical supply will be augmented by the renting of existing single family homes by a growing number of investor groups. Although much of that supply is on the urban fringe, many observers forget that sub-prime lending financed and refinanced homes in central core areas. As rents increase those areas will become ripe for gentrification and become competitive with traditional rental housing.

When outlining our thesis to several real estate investors, we heard the common objection: "Sure the money is there, but you'll never get the zoning." Our counter to that argument is that the planning and zoning world has changed. **Instead of discouraging density, governmental planners now encourage it.** As examples we point to passing of California's [SB 375](#) which more strictly links transportation with land use planning and the "transit village" concept now being employed in New Jersey. Yes, there will still be neighborhood fights, but there will be far fewer supply constraints than heretofore.