

COSTAR INSIGHT

The Time To Rethink Our Assumptions Over Who Rents Apartments Is Long Overdue

Extraordinary Increase in High-Income Rental Households Is Dramatically Altering the Makeup of US Apartment Renters



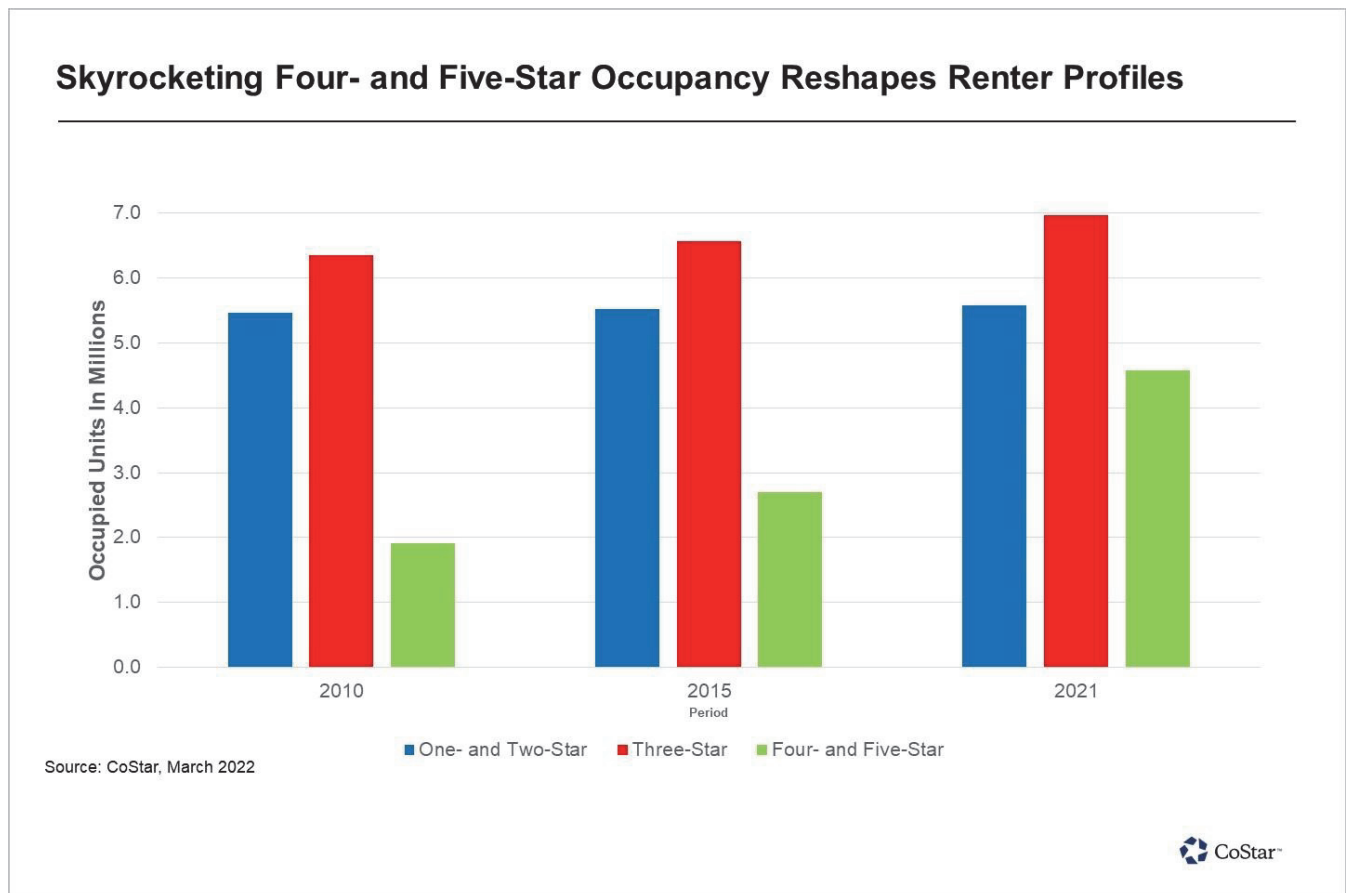
Significant rent growth seen in higher-quality four- and five-star apartments in 2021 was driven by skyrocketing demand from higher-income residents who can afford the rents and prefer to live in apartments. (Getty Images)

By Jay Lybik
CoStar Market Analytics

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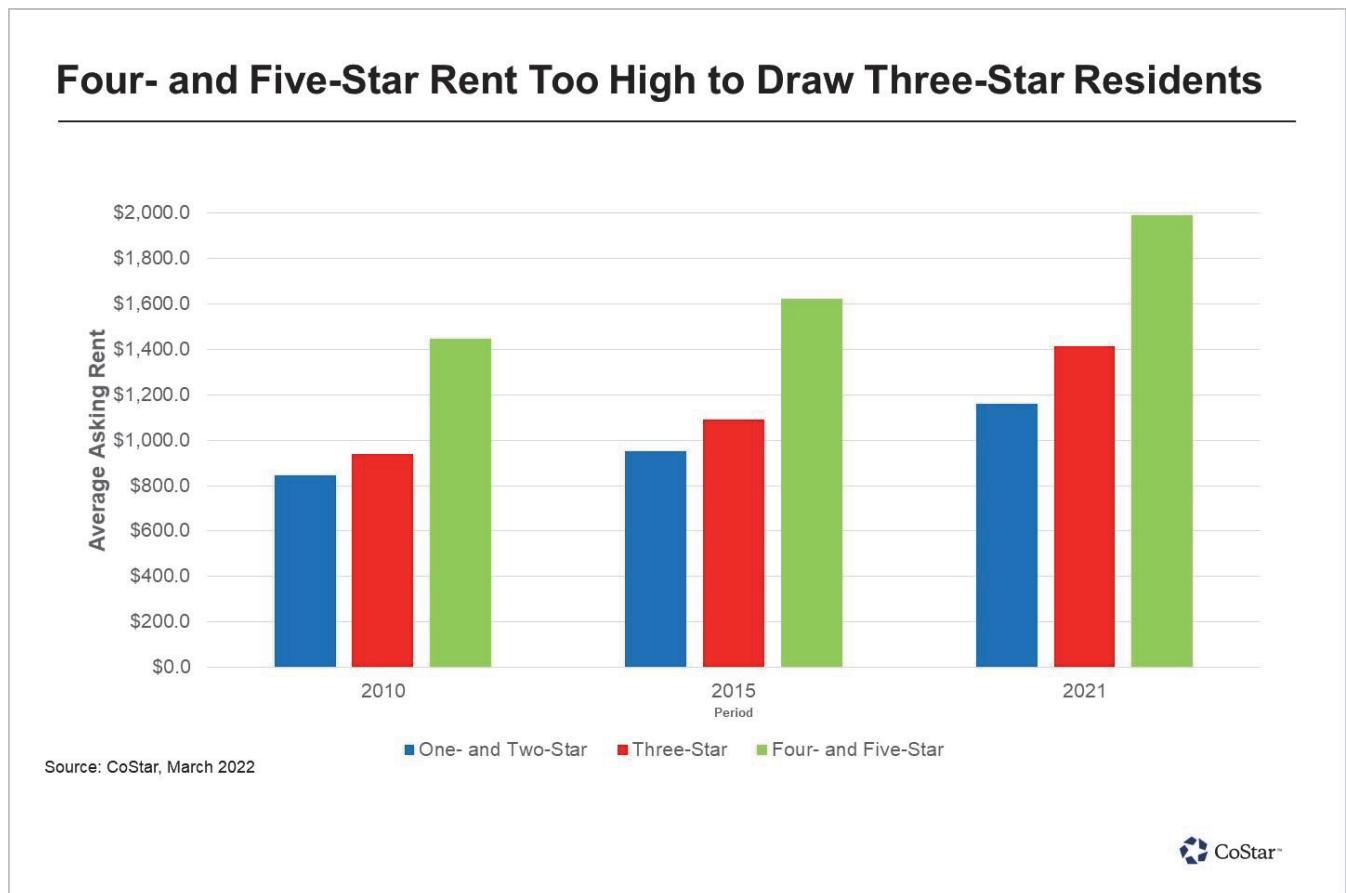
Twenty years ago, luxury apartment living was, in many ways, an oxymoron outside of Manhattan, Washington, D.C., or Chicago. But as higher-quality four- and five-star-rated developments made up mostly of mid- and high-rise complexes have dominated apartment construction pipelines across the nation recently, the composition of the multifamily market has transformed significantly.

The number of occupied four- and five-star apartments has increased by 2.6 million units, or 127%, since the start of 2010. Correspondingly, the percentage of high-income renter households increased from 14% in 2010 to 27% at the end of 2021. Thus the traditional view of renter households being either transitory or unable to afford single-family homeownership needs to be realigned to reflect the striking increase in four- and five-star renter households.



While the number of high-income renter households has increased, so too has the rent gap between luxury and midpriced properties. When suburban garden properties dominated the multifamily inventory, differences in rent between newly developed and existing properties were marginal. Today, however, four- and five-star rents average \$600 higher nationally than rents for three-star assets. This price gap challenges the belief that demand for new developments can be created through concessions to draw residents up from three-star-rated apartments into newly built four- and five-star properties.

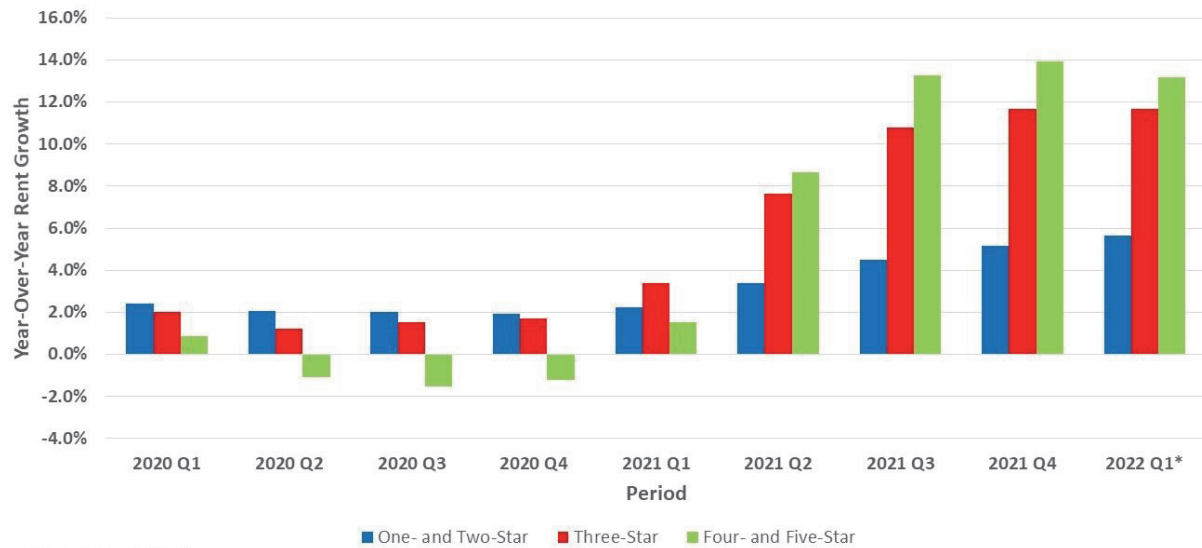
Residents living in three-star properties typically don't have the income levels to bridge the gap for the highest-priced properties, even after throwing in a couple of months of free rent. Instead, owners and operators must come to terms with the reality that the resident pool for newly developed properties is more finite. Offering concessions may only marginally increase the potential pool of renter households for the highest-priced properties.



The dramatic rebound and rise of four- and five-star rent growth in 2021 was driven by a skyrocketing demand and the ability of these higher-income residents to afford the rents.

And apartment owners don't appear too concerned about the sustainability of these sky-high rents, as four- and five-star residents don't spend as much of their gross income on housing compared to the traditional 28% of housing cost-to-income rule of thumb.

High-Income Households Drive Rent Growth



Source: CoStar, March 2022
*Quarter to date 03-21-22



Public real estate investment trusts and institutional owners with four- and five-star-focused portfolios have reported their tenants' rent-to-income ratios average in the low 20% range. These residents have a greater ability to increase their spending on housing than renter households that have rent-to-income ratios in the traditional high 20% to low 30% range. Furthermore, one public REIT that owns over 50,000 units recently reported average resident income of \$140,000 per year, or about double the national average, which radically changes the perception that rental households are typically lower or middle class.

The extraordinary rise of high-income rental households over the past 10 years dramatically alters the overall perception of U.S. apartment renters. One can no longer think of apartment renters and apartment properties as homogeneous. The multifamily industry has created a true luxury class of rental properties and filled them with households that previously were thought would prefer to be homeowners due to their high income levels.