Demographics & Demand

Market Movers

How the emergence of Generation Y, the aging of baby boomers, and immigration trends will impact the multifamily industry in the next decade.

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ILLUSTRATION BY RANDY POLLAK

NUMBERS MAY NOT LIE, BUT SOMETIMES they can make a liar out of conventional wisdom.

Throughout the recession, demographics have served as a beacon of hope to apartment owners. "Things may be bad now," went the refrain, "but just wait until Generation Y comes along."

Turns out, we didn't have to wait long. The demographic trends that will shape the next decade arrived this year, with absorption rates so strong they turned conventional wisdom on its ear. A hefty 77,000 apartment units were absorbed in the first half of 2010, the strongest demand in a decade. But where did all of those renters come from?

Traditionally, the answer would be found in employment—the more jobs, the more renters. But given the anemic job market (unemployment was hovering at 9.5 percent in the third quarter of 2010), there had to be another explanation.

After all, 2009 was brutal. Household formation totaled about 930,000 in 2009, the lowest mark in 30 years. Young adults increasingly doubled up, moving in with roommates or back in with their parents to ride out the recession. The number of those aged 18 to 34 living with parents increased by 2.2 million from 2005 to 2009, reaching 20.3 million, the highest number in 25-plus years, according to the Census Bureau.

What's more, baby boomers are returning to rentals in droves, thanks to the housing bust, during which many boomers lost their homes. In fact, the homeownership rate—which fell to 66.9 percent in the second quarter, down 1.6 percent since the beginning of 2006—is projected to keep falling. "It doesn't sound like a lot, but 1.6 percent translates to 3.4 million households that are now renting," says Mark Obrinsky, chief economist of the Washington, D.C.-based National Multi Housing Council. "That's another burst of absorption that has very little to do with employment growth right now."

Yet once the economy settled down, the tide of layoffs was stemmed, and inklings of job growth emerged, there was a sociological effect. Young adults who had doubled

up started to decouple, or "unbundle," as they felt more confident signing a lease. And boomers began to look for higher-quality properties in more upscale buildings.

"Demographics can move markets, and we've seen evidence of that in the first half of 2010," says Hessam Nadji, managing director of research for Encino, Calif.-based Marcus & Millichap. "One of the things that confirms this short-term demographic release is that studios and one-bedrooms have led the recovery."

While job growth will always be the key driver of demand, it looks as though these days demographic trends have become an influential co-pilot, allowing the apartment market to outperform the economy. Specifically, the demands of Gen Y, boomer, and immigrant renters, whose population growth and specific needs will shape the next decade of apartment development, design, and day-to-day operations.

"We're seeing a lifeboat of demographic data that will get us through the soft patch," Nadji says. "Even if the economy slows way down, the worst that can happen is for demand to run out of steam. And that's not bad for a worst-case scenario."

>> Youth Movement

Leading the way are young adults. Generation Y—those between 18 and 34—totals about 77.4 million, already larger than the baby boomers, which number about 76.2 million, according to the Census. And since new immigrants tend to enter the country as young adults, Gen Y will only keep growing.

The size of this "Echo Boom" generation is a sharp contrast to Generation X, which demographers sometimes label the "Baby Bust" generation, given its small size. People aged 20 to 34 hit a low point in 2005, when the group grew by fewer than 200,000 people. That year, the youngest members of Generation X turned 18.

In 2009, the number of 20- to 34-year-olds grew by more than 800,000. Next year, it peaks with another 964,000 coming; and in 2012, 856,000 new young adults will join the prime renter age group, according to the Census Bureau and Moody's Analytics.

But there are numbers, and then there's behavior. Beyond its sheer size, Gen Y's impact is bolstered by cultural trends. Mainly, it's taking longer for these young adults to settle down. Gen Y stays in what demographers call "emerging adulthood" for longer periods of time than its predecessors.

"People are putting off getting married and having children, and the more you elongate that interval, the greater the potential pool of renters," says Ryan Severino, an economist for New York-based Reis. "In the past, it might be into the mid-20s, but now it's probably into the early 30s."

20.3 million

No. of 18- to 34-year-olds living at home in 2009—the highest level in more than 25 years

Source: Census Bureau

Indeed, young adults are marrying and having children later in life. For the first time in more than a century, more than half of those aged 25 to 34 have never been married, according to Chicago-based research firm Council on Contemporary Families. And birth rates continue to trend downwards.

If the denizens of Gen Y are waiting longer to settle down, that means they're not worried about finding that good school in the suburbs. The average age of first-time home buyers is now around 34—at least six years older than it was in 1980—according to a study by the Washington, D.C.-based National Association of Home Builders.

Household composition is also evolving in a favorable way for apartment demand. There's a lingering perception that the typical household is a married couple with 2.5 children, but that hasn't been true for some time. Less than a quarter of U.S. households today fit that bill. Instead, the fastest growing segment has been single-person households. And going forward, married couples without children will grow at a faster rate than single-person households, according to the Boston-based Joint Center for Housing Studies of Harvard University.

But is Gen Y really so different from previous generations? The prevailing wisdom is that Gen Y has a less rosy view of homeownership given the strife of the past few years. That's wrong. A recent survey of 1,241 Gen Yers conducted for the Washington, D.C.-based Urban Land Institute suggests the opposite. "A surprising percentage of Gen Yers own homes already—as high as 36 percent," says M. Leanne Lachman, a demographic analyst for the real estate industry who conducted the survey. "I think these young people really aspire to ownership in the same way their parents did."

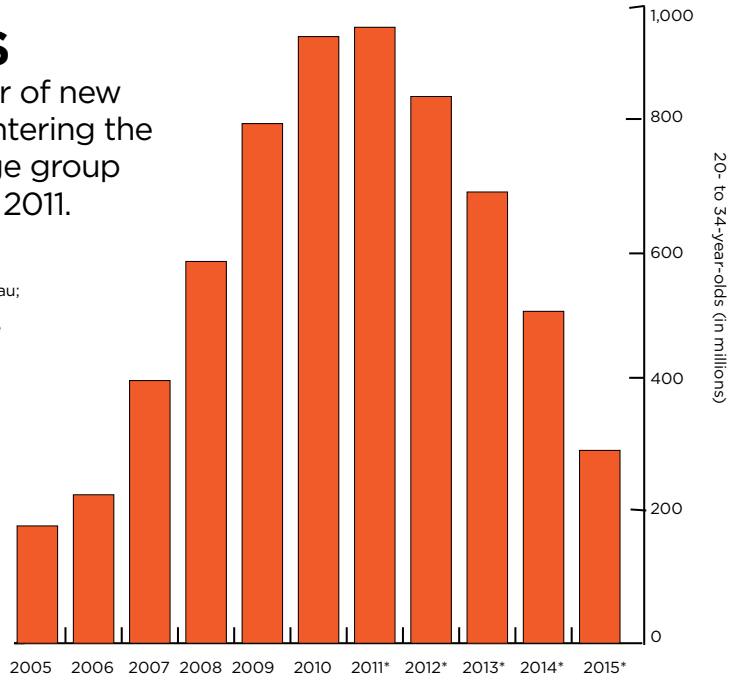
The good news? They're taking longer to do it.

>> Blooming Boomers

Joining Gen Yers in the new rental pool are baby boomers, who will soon

GEN Y WAVES

The number of new Gen Yers entering the 20 to 34 age group will peak in 2011.



* *Projected*
Sources: Census Bureau; Moody's Analytics; Prudential Real Estate Investment Research

create a senior citizen population unprecedented in size. Three-quarters of retiring boomers said they want to live in mixed-age and mixed-use communities, according to a 2009 survey by Washington, D.C.-based real estate market research firm RCLCO. The survey suggests that, much like Gen Y, seniors seem attracted to amenity-rich centers, walkability, and access to public transport, as opposed to being sequestered in a gated community.

The impact of the baby boom generation on seniors housing is only just beginning to be felt. The oldest boomers are turning 65 this year, the first trickles of an eventual flood. The number of people aged 55 to 64 increased by 10.4 million over the past decade, a whopping 43 percent increase, compared with total population growth of just 9.4 percent, according to the Census.

And contrary to popular belief, not all baby boomers own homes. About two-thirds of renter growth in the past decade was among households aged 45 to 64, and renter households over age 55 will increase by more than 3 million in the coming decade, according to the Harvard Joint Center's *State of Housing 2010* report.

"Looking at the numbers is easy," Obrinsky says. "The hard part is figuring out what kind of housing they want."

Indeed, as more Americans remain active later in life, the demand for seniors housing—particularly independent living facilities—may grow more slowly than the raw numbers suggest. "People are going into independent living later and later, so the real growth is in assisted living," Lachman says. "People are healthier longer now, and we're going to have more boomers working longer. I wouldn't get totally excited about independent living."

In the near term, the independent living sector—which is more of a lifestyle choice as opposed to need-based assisted living—has taken a hit due to the depressed single-family market. Among all seniors housing sectors, independent living has shown the lowest occupancy rates throughout the recession, in the mid- to high-80 percent range, as opposed to occupancy levels at assisted living facilities in the mid-90 percent range.

Continuing Care Retirement Communities (CCRCs) often require entry fees, which is a taller order these days. "The readiness and willingness of a senior

SUNNY SIDE UP

Here are four markets poised for growth.

Austin. Talk about a tech-heavy, diverse economy—Dell, IBM, and Freescale Semiconductor (formerly Motorola) are major employers in Austin, Texas. It also happens to be the nation's No. 1 market of the past year for household and population growth. The metro will see population gains of more than 2.5 percent for at least the next four years, while household income is projected to grow more than 3 percent by 2014, according to Reis.

San Antonio. In all of the key metrics—population growth, employment trends, household income, household formation—San Antonio continues to rank among the fastest growing cities in the Sun Belt. The metro is forecast to see employment growth of 3.5 percent next year, and household income should rise at about the same levels through 2014. The city adds at least 2 percent annually in population, which should continue for the next four years.

Fort Lauderdale. Fort Lauderdale has a great long-term balance between supply and demand, perhaps the best in all of Florida. The market has an overhang of about 42,000 units, in line with near-term job forecasts, meaning they will burn off their excess inventory in about two years. Meanwhile, household income growth is expected to be in the 5 percent to 6 percent range though 2013.

Raleigh-Durham. Like Austin, Raleigh-Durham is a tech-heavy, youth-oriented market that continues to grow in size. It's not called The Research Triangle for nothing—Duke University, North Carolina State University, and the University of North Carolina at Chapel Hill anchor the area—and many tech and life sciences companies have big presences. The area is projected to add 75,000 new households in the next four years.

EYE FOR DESIGN

Gen Y, in particular, will have an impact on the type and location of apartments built.

UNLIKE THE RAPID suburbanization that characterized the post-World War II years, the coming decade will likely be what the Urban Land Institute calls "a great re-urbanization." The increasing gentrification of city centers like New York, Philadelphia, Chicago, Seattle, and Denver has made city living more palatable.

"There's definitely a shift toward urbanism both by young professionals and renters by choice," says Ryan Severino, an economist at New York-based Reis. "Many cities have gentrified. They're cleaner and safer, and the amenities that have always been there are now much more attractive."

In fact, more than three-quarters (77 percent) of Gen Yers want to live in urban cores, according to a survey by Washington, D.C.-based research firm RCLCO. "They want to be close to it," says Mark Obrinsky, chief economist of the Washington, D.C.-based National Multi Housing Council. "They're willing to give up space, but they don't want to give up amenities."

Indeed, amenities are a big deal to Gen Yers. That third space—not work, not home—is an important social destination. "They don't necessarily spend a lot of time within the units," says Greg Willett, vice president of research and analysis for Carrollton, Texas-based M/PF Research. "Nobody used the business center, gym, or movie theater in the past, but Gen Yers do. The leasing center clubhouse has become like Starbucks."

But urban areas are also more expensive than outer rings, and renters today don't earn as much—for the first time since 1970, median household incomes for all age groups will end the decade lower than they began. And the unemployment rate for Generation Y is by some estimates as high as 30 percent. So the trend is toward smaller, more affordable units and greater social connectivity.

Up next? The children of Gen X, dubbed Generation Z—a smaller group, but just as social. Stay tuned.

household to make this transition depends upon the salability of their home," says Sam Chandan, global chief economist at New York-based market research firm Real Capital Analytics. "An improvement in overall housing outcomes should support a larger number of people making the transition to independent living."

There's also a seniors component to the doubling up trend. More families are taking in older relatives due to the recession, which has cut into the historically strong need-based sector. "It used to be you had waiting lists to get into assisted living," Lachman says. "That's no longer true."

In fact, the vast majority of seniors prefer to age in place. They are often rooted in their communities. And given advances in medial science, the refrain that "50 is the new 40" has become a cultural cliché. The question is, will these coming seniors behave as their parents did? "They're a very active group, and I'm not sure we have the right models for them yet," Lachman adds.

>> Immigration Nation

For all the talk of Gen Y and baby boomers, the people not yet in America loom just as large as a demand influencer.

The foreign-born component of renter households increased to 19.6 percent in 2009, up from 17.4 percent at the start of the decade. The number of Hispanic renters has more than tripled in the past 30 years, up to 7 million from just 1.9 million in 1980, according to the Harvard Joint Center.

"The challenge looking further out is that endogenous population growth in the U.S. will not support significant growth in apartment demand," Chandan says. "We'll rely on the continued openness of U.S. immigration policy as a significant factor."

Yet the pace of immigration has slowed. There was a sharp decline in the amount of foreign-born households under the age of 35 from March 2007 to March 2009 (338,400), a much bigger decline than in same-age native-born households (2,100), according to the Census.

As city centers become more desirable for both Gen Y and baby boomers, the closer-in suburbs are also undergoing a transformation. "More immigrants are ending up in first-ring suburbs, instead of the urban core," says Greg Willett, vice president of research and analysis for Carrollton, Texas-based M/PF Research. "The urban core markets have gotten so gentrified that it pushes them out of the price range."

Just as Gen Y's movement into city centers signals a trend toward smaller units, the immigration movement toward outer rings necessitates larger units. Many developers in gateway cities with large immigrant populations believe that they'll need to build bigger, more child-friendly configurations—such as more three-bedroom units—to accommodate this trend.

After all, there are many more multigenerational households today than at any time in the past 60 years, a trend driven by immigration. In 1980, 28 million Americans lived in multigenerational households; by 2008, that figure was up to 49 million, according to the Census. One of the defining characteristics of minority households is their size. Minority renter households aged 35 to 44 had an average of 3.2 people, compared to 2.6 for whites, and the average number of children per minority household is 1.1, versus just 0.6 per white household, according to the Harvard Joint Center.

Still, regardless of whether demand is driven by Gen Yers, boomers, or immigrants, the market's unexpected strength today appears to be just an appetizer. Over the next decade, the total number of renters is expected to rise by up to 5 million (with high immigration levels), according to the Harvard Joint Center. Compare that to a mere 3.1 million new renter households in the previous decade (1999 to 2009). And the simultaneous lack of new supply—in 2009, the industry started fewer than 100,000 multifamily units, less than the natural loss of units annually—should position the multifamily industry for a great run.

Marcus & Millichap, for one, is forecasting a decline in the national vacancy rate to 6 percent by the end of 2012; the firm sees rent growth in the 4 percent to 6 percent range in 2011 and 2012. As Nadji says: "By then, it's going to be very popular to add space." ■

FUTURE CASTING

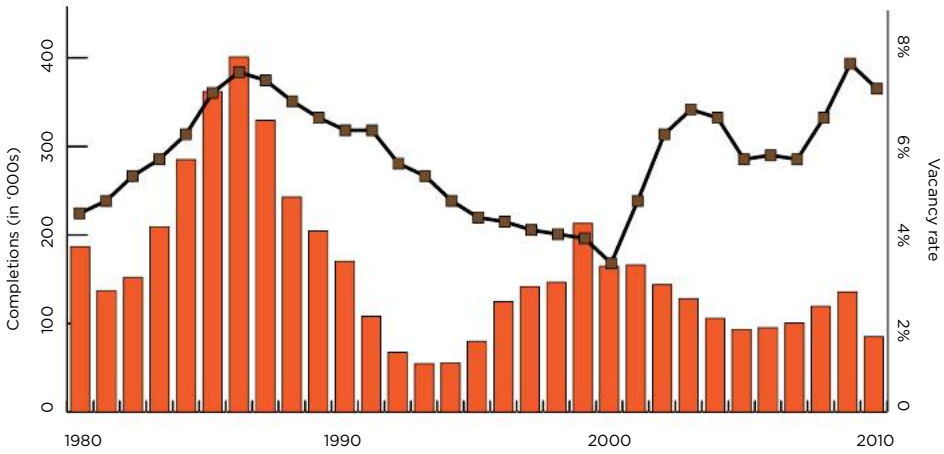
By 2015, U.S. renter households will rise significantly.

	Homeownership Rate		Rental Rate
2010	66.4%	vs.	33.6%
2015*	64%	vs.	36%

* *Projected*
Source: Prudential Real Estate Investors

SUPPLY AND DEMAND

Considering the numbers of units being delivered and the vacancy rates seen in the country, the future of multifamily looks strong.



Sources: Marcus & Millichap; Reis