CoStar PORTFOLIO STRATEGY™

Client Update

By Jeff Myers | April 5, 2018

Apartment Investors May Find A Silver Lining in Rising Rates

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APARTMENT INVESTORS MAY FIND A SILVER LINING IN RISING RATES

Source: CoStar Portfolio Strategy Client Update

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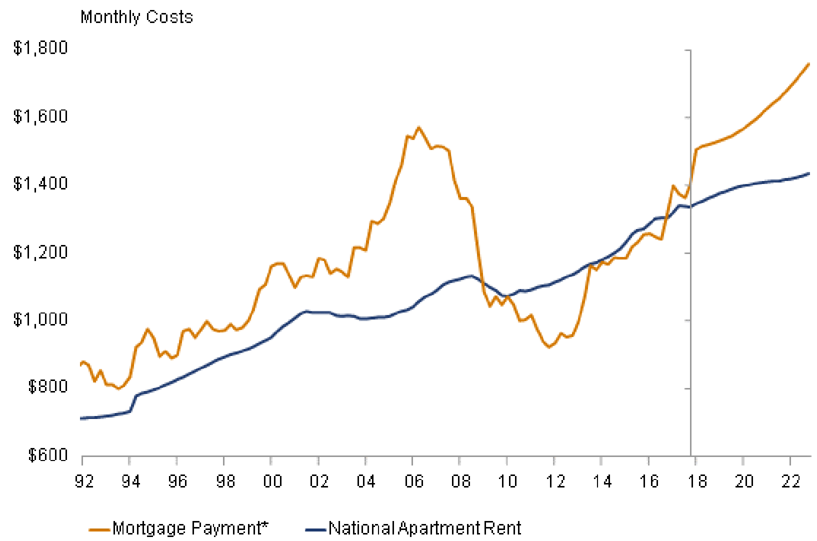
Rising interest rates may make investors nervous. Concerns about increased borrowing costs, downward pressure on values, and elevated construction prices are certainly valid. But there may be a silver lining for multifamily investors in that rising rates also impact households, and could do so in manner that benefits apartment demand.

Exhibit 1: Home Mortgage & Apartment Rent Costs Over Time



Sources: U.S. Census Bureau; NAR; Moody's Analytics; CoStar Portfolio Strategy

As of 17Q4

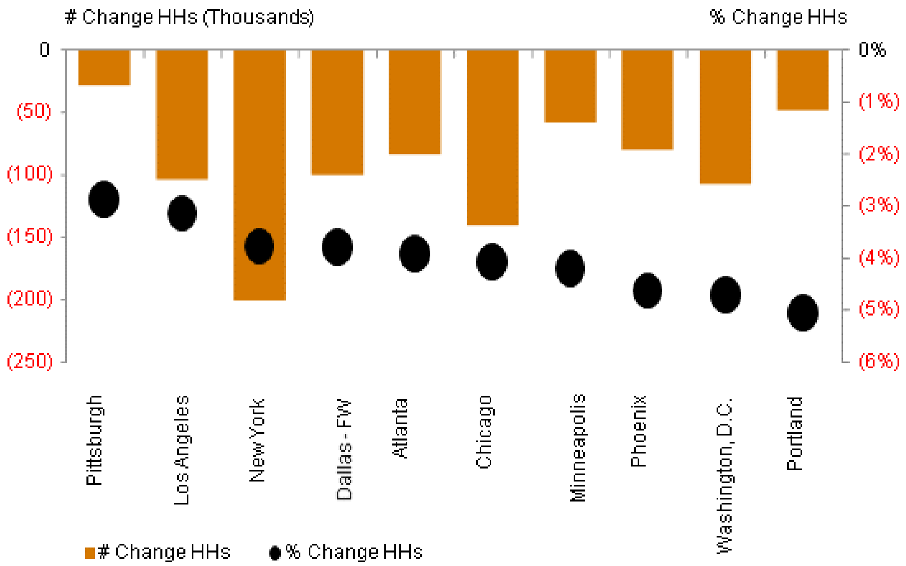
*Monthly mortgage payment includes mortgage, insurance and taxes

The 30-year fixed mortgage rate moves almost in lock step with the 10-year Treasury. As interest rates have risen, so have mortgage rates, leaving fewer households able to afford a mortgage. Combine this with home price increases, and the monthly cost to mortgage a home expanded by 46% over the past five years. Moving forward, growth in the price of ownership will likely outpace apartment rent increases. (See Exhibit 1.) The net effect of this will be a solidifying of the demand base for apartment communities across the country.

Assuming that up to 30% of a household's income can be designated for monthly mortgage payments, a 100-basis-point increase in the 30-year fixed rate would reduce the nation's potential homebuyer pool by approximately 4.2%, or 5.3 million households. Given variations in home prices and income distribution, the impact of rising rates will vary from metro to metro.

As shown in Exhibit 2, in metros like Pittsburgh where home prices are relatively affordable, the impact of rising rates is less pronounced. Only 2.8% of households will fall out of the homeownership pool, a little under 30,000 households. However, the same rate increase in Portland will result in 5% of households (50,000) no longer qualifying to buy homes. Apartment investors in Portland may be able to rest a little better knowing that their tenants are less likely to be able to afford to leave given the increasing mortgage costs. All things being equal, landlords in such markets may be able to push rents more aggressively than in a metro in which for-sale housing remains obtainable.

Exhibit 2: Impact of 100 BP Mortgage Rate Increase on Ability of HHs to Afford Home



Sources: NAR; Freddie Mac; Neustar; Moody's Analytics; CoStar Portfolio Strategy
As Of 2017

*Assumptions based on existing median home price, 10% down payment, tax/insurance payment, and 30% of income dedicated to mortgage.

For More Information

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