Housing-Market Report 2017

Apartments & Condominiums: Affordability Crisis Hits Home

Looking to rent an apartment or buy a condominium? Changes in supply and pricing could make the effort challenging, particularly if you want a newer apartment or condominium.

By Dan Rafter
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Developers are building plenty of apartment buildings. However, 75 percent of these units target the country's wealthiest renters, according to apartment-listing company RentCafé. That leaves few new market-rate, or affordable, apartments for renters who earn a moderate or low income.

The rents for most new units are so high that they'll consume more than 30 percent of the annual income of an increasing number of renters, according to apartment-search website Abodo. (It long has been a financial golden rule that you shouldn't spend more than 30 percent of your income on rent.)

Want to buy a condominium, or condo? The challenge here: finding new-condo construction. Developers are focused on apartments, because consumer demand is significant today. (The national apartment-vacancy rate stood at about 4 percent over the past 2 years, according to commercial real-estate company Marcus & Millichap Real Estate Investment Services.)

So, new condo buildings are difficult to find, particularly in the urban centers of cities. Therefore, you should prepare to settle for older construction or suburban living.

Even if you find a condo that you like in the middle of the city, it might not remain a condo for long. Developers increasingly turn condo buildings into apartment buildings, which is known as *deconversion*. Of course, this also has implications for current condo owners: Even if you don't want your condo to become a rental, you might not have a choice.

BUDGET-BUSTING. Joint Center for Housing Studies at Harvard University says the share of all U.S. households that rented rose to 37 percent in 2015 from 31 percent in 2005. That's the highest that the percentage has been since the middle of the 1960s.

According to the results of a survey by NHP Foundation, which is a nonprofit provider of affordable housing, a majority of millennials delayed or rethought their pursuit of the "American Dream" to **own a home**.

So, the rising rents for apartments come at an unfortunate time.

ApartmentList.com reports that in November 2016, the national median rent was $1,100 for a one-bedroom apartment and $1,250 for a two-bedroom unit. Each figure is 1.3 percent higher than it was in December 2015.

The apartments that have the highest median rents tend to be clustered in big cities and urban centers. ApartmentList.com reports that the median rent in December 2016 for a one-bedroom apartment in Los Angeles stood at $1,880, and at $2,600 for a two-bedroom apartment. Those figures also represent an increase of 1.8 percent from the same month 1 year earlier. In Seattle, the median monthly rent for a one-bedroom unit stood at $1,680 in December 2016, while that figure for a two-bedroom unit was $2,240. These figures jumped 4.1 percent since the same month in 2015.

RentCafé reports that the average national apartment rent jumped 4.7 percent in September 2016 compared with September 2015, in conjunction with the fact that most new apartments tend to cater to the high-end rental market.

Defining what is and isn't a high-end apartment can be tricky. Nadia Balint, who is a spokesperson for RentCafé, says the company defines high-end units by using the 30-percent formula: An apartment is considered to be affordable when its rent consumes 30 percent or less of the median monthly income of residents who are in the rental market. In Chicago, RentCafé considers an apartment to be high-end when it has a monthly rent of at least $2,500.

According to RentCafé's research, 75 percent of apartments that were built in 2015 fall into the high-end category.

That percentage is rising, too. RentCafé reports that the ratio of high-end apartments to other apartments that were built in 2015 increased by 63 percent from the numbers that were reported in 2012.

It's clear, then, that finding **an affordable apartment** won't get any easier.

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"Unfortunately, on the new-construction markets, there is not much to offer at the mid and low end," Balint says. Renters who earn mid-to-low incomes are left with older and lower end buildings, she adds Also, you might have to sacrifice your desire for higher end amenities or extend your search to suburban areas.

(If you can afford the rent, the amenities that are in today's high-end apartment buildings can be impressive. For instance, at a building that's under construction just south of Chicago's downtown, renters can expect an outdoor swimming pool, sauna, yoga studio, basketball court, 3,000-square-foot gym, dog run and business center. An apartment building that's in the same area that opened in 2015 boasts a 20,000-square-foot outdoor terrace, indoor/outdoor pool, rooftop running track and a virtual golf simulator and putting area.)

INFLUENCING COSTS. The number of people who rent by choice is increasing. RentCafé says about 1.2 million wealthy households became renters in the United States in the past 10 years. According to Balint, the number of renter households that earn at least $150,000 per year increased by 217 percent from 2005 to 2015. Landlords can boost their rent when renters have more income to spend, Balint says.

How much stress do these higher rents cause? Department of Housing and Urban Development considers renters who spend more than 30 percent of their income on rent to be *housing-cost burdened*. In November 2016, Abodo reported that in 99 of the 100 metropolitan areas that have the most renters, 40 percent of renters spent more than 30 percent of their income on rent. In 47 of the 100 areas, 50 percent of renters spent more than 30 percent.

Sam Radbil of Abodo says the two main steps that renters can take to find an affordable apartment involve some sacrifice. For individuals, “The one-bedroom apartment is getting very expensive,” Radbil says.

Of course, larger units tend to be more affordable if you split the cost with roommates.

If you get a three-bedroom apartment with friends, that is often the best financial option available to renters, Radbil tells Consumers Digest. If you want to live downtown, that might be your only real option, he adds.

CRISIS LEVELS? Stockton Williams, who is the executive director of the nonprofit Urban Land Institute’s Terwilliger Center for Housing, tells Consumers Digest that the United States is experiencing its worst housing-affordability crisis in the past 50 years.

Developers are “simply not building Class-B or Class-C apartments—so-called workforce apartments,” Williams explains.

Williams isn’t surprised. Land prices are high, and labor costs have increased.

This doesn’t mean that renters should give up hope. Williams says government bodies are working increasingly with developers on tax incentives and other programs that will provide affordable rental housing.

For example, in San Francisco, Bay Area Transit-Oriented Affordable Housing Fund has financed developments that comprise at least 900 affordable apartments.

The purpose of Denver Regional Transit-Oriented Development Fund is to create and preserve at least 1,000 affordable housing units along transit corridors in the city and county of Denver.

National Low Income Housing Coalition studied all of the states and 70 major cities across the country in 2014. It found 242 state programs and 71 municipal programs that are designed to boost low-income rental.

“[Taken] in concentration, these can make a difference,” Williams says.

Even with the new affordable units that organizations such as these provide, the demand for cheaper rental living still is too high for what’s available.

"We can't ignore that," says Cris White, who is the executive director and CEO of Colorado Housing and Finance Authority. "That is the fundamental mismatch."

People who make as much as $50,000 a year are getting priced out of the metropolitan Denver area, says Aaron Miripol, who is the president and CEO of Urban Land Conservancy in Denver. He tells Consumers Digest that if a renter called him and was looking for something affordable in the Denver metro area, he would have to turn him/her away because of a lack of availability.

CONDO CHALLENGES. Developer Ben Shaoul, who is the president of Magnum Real Estate Group, says new condo construction experienced a "tremendous" slowdown in the past 4 years. He estimates that condo-building construction in New York City sank 70 percent to 80 percent during that time.

The perception is that an oversaturation of condos exists, Shaoul says. Banks aren't making construction loans for condo developments, and builders aren't building condos. This means that in the New York City market, a lot of the condo inventory is being gobbled up quickly. He predicts that by the third quarter of 2017, we'll read about a shortage of condos in that market.

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This problem isn't limited to New York City. An April 30, 2016, article by The Seattle Times pointed to a condo shortage in that city. The article reported that developers expected to build 7,090 apartments in 2016 but only a handful of condo developments.

In a May 23, 2016, editorial in The Denver Post, the editors of that newspaper lamented the effect that the slowdown in condo construction in Colorado had on the state's residents.

In addition to the increased demand for apartments, developers are constructing more apartment buildings than they are condo buildings, because the former are more lucrative for them today than the latter are. National Association of Realtors (NAR) reports that the median condominium and co-op price in the United States stood at $225,100 in the third quarter of 2016, which is up 4.6 percent from the same quarter 1 year earlier. However, developers can make more money via apartment rents, NAR says.

Furthermore, condo prices aren't rising quite as high in major metro areas and actually are falling in many. For example, condo prices rose just 0.6 percent in the third quarter of 2016 in the Washington, D.C., area compared with the same quarter a year earlier. In New Orleans, they dropped 7.2 percent. In Newark, New Jersey, they dropped 1.8 percent; and in the New York, Jersey City and White Plains areas of New York, they dropped 3.1 percent.

Brian Graham of commercial real-estate brokerage Colliers International traces the slowdown in condo construction to as far back as 10 years ago. That's when the apartment market first "went on fire," Graham says.

Graham, however, says he doesn't expect the construction slowdown in the condo market to last much longer. He believes that developers will begin construction soon on new condo buildings in the center of cities, including Chicago, Cincinnati, Los Angeles and New York.

The apartment market catered to millennials who wanted to live in the urban core, Graham says, "but I think this will all change. I think that we will begin to see new condominium construction again in the downtown urban cores as the millennials get older."

What if you don't want to wait? What if you want to buy a condo today? What if your budget is minimal? Unfortunately, you probably will have to search in the suburbs or settle for older construction that might not have the amenities that you want.

Graham echoes the views of other experts whom we interviewed: Little market-rate multifamily housing exists in the center of cities. "There are maybe a handful of projects [in any urban area] that cater to the middle [income] range." He says you might see some developers acquire projects that are 20 years old, put capital into those and turn them into more-modern units.

Condo buyers face another big challenge: It can be difficult today to qualify for a mortgage loan. Lenders don't just vet buyers and their financial health. They also look at the financial stability of their purchase.

To gain approval for conventional mortgage financing—a loan that's insured by Fannie Mae or Freddie Mac—consumers have to buy into a condo building in which no more than 15 percent of the building's unit owners are at least 60 days past due on their homeowners-association fees. Fannie Mae and Freddie Mac also require that at least 50 percent of the units that are in a building have to be occupied by owners, not investors.

Consumers who want to buy a condo in a building that doesn't meet the requirements of Fannie Mae or Freddie Mac have to take out a portfolio loan with a private lender. Portfolio loans are those that lenders keep on their books rather than sell to other entities. These loans usually come with higher fees and interest rates, because they are considered to be riskier.

DECONVERSION. If you find a condo that you like, no guarantee exists that it won't be converted one day into an apartment for which you'd have to pay rent—or have to leave.

David Bloomberg, who is a principal at the Chicago law firm Chuhak & Tecson, says the deconversion process works this way in Illinois: In a condo building of at least four units, developers or investors have to earn the approval of at least 75 percent of the unit owners to convert a building to rental apartments. What if you aren't part of that 75 percent? You're out of luck. Your building will turn into a rental regardless of whether you like it.

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Deconversion rules can vary from state to state. If you plan to buy a condo, you should make sure that you research how deconversion works in your area.

One of the most anti-condo-owner states is Florida. The majority ownership of a condominium building can decide to dissolve a condominium association. It then can give individual condo owners a percentage share of the property once it's been converted to an apartment complex, or it can buy the units from those owners at fair-market value.

The amount of money that condo owners get when they sell their units back to the developer usually is based on the size of the condo and its current market value. If you owe more on your mortgage than what your building's new owner offers, you might owe your lender a check before you have to leave the building.

Bloomberg says unit owners can ask for an appraisal of their condo unit if they aren't happy with the price that they get from the deconversion—if they don't vote in favor of the deconversion. A recent **update to a kitchen** or **bathroom**, for example, could result in a higher price.

A deconversion doesn't always have to be a bad thing for condo owners. If you are *underwater* on your mortgage—you owe more on your mortgage than what your condo unit is worth—the owner of your building might offer you a high-enough sales price to pay off that underwater mortgage.

Of course, it could work the other way, too. Let's say you owe $80,000 on your mortgage and your building owner offers you just $70,000 based on an appraisal of your unit: Bloomberg says you have to accept the offer and write a check for the balance to your lender.

It can be painful to leave a condo and enter the rental market. Let's say you have a monthly mortgage, including **condo insurance** and property taxes, of about $1,700 per month. If you live in the center of a city, it might be difficult to rent for that low of an amount, particularly if you want a high-end unit that comes with plenty of amenities.

What's the best bet for condo shoppers who want to decrease the chances that their building will go through the deconversion process? They should look to buy into a condo building in which most of the unit owners are residents and not investors.

"In buildings in which most people are using the units as homes instead of investments, developers or investors are far less likely to get that 75 percent vote to convert the building," Bloomberg explains.

Buyers who want to avoid deconversions also can aim for larger condo buildings. Bloomberg says it's more difficult for investors or developers to earn that 75 percent approval in condo buildings that have at least 35 units. The more owners who are involved, he says, the less likely that it is for a deconversion plan to gain acceptance.

Dan Rafter is a freelance writer who specializes in the real-estate industry. He also is the editor of commercial real-estate trade magazine Midwest Real Estate News.