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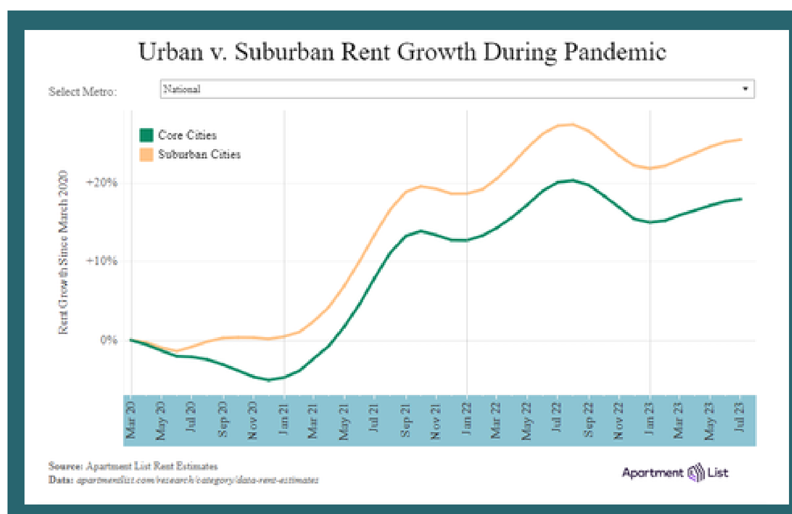
Although rents are declining, the pace of decline is slower in the suburbs

The rental market is taking a deep breath in 2023. Double-digit annual rent growth persisted in 2021 and 2022, but has swiftly fallen to -0.7% as of our most recent estimates for July, meaning apartments are renting for less today than they did one year ago. This is the first year-over-year price drop the rental market has experienced since the early days of the COVID-19 pandemic.
One of the defining features of the pandemic rental market is a gap that emerged between core and suburban cities.

Since 2020, rapid rent increases have been concentrated in America's suburbs, which saw huge influxes of new residents that in turn placed extreme pressure on existing housing supply. Core cities got more expensive as well, but there, rent increases came later and moved slower. Between March 2020 and July 2022, suburban rents increased 27 percent compared to 20 percent in core cities. One year later, pandemic rent growth sits at 25 and 18 percent respectively, following a modest drop in rent.



The Urban-Suburban Gap Is Widening Even As Rents Fall

A quick glance at the national data shows that even though rents are down year-over-year, an affordability windfall is not reaching the suburbs. In fact, the urban-suburban gap has widened steadily for the past eight months because rent drops have been slower in the suburbs than in core cities.

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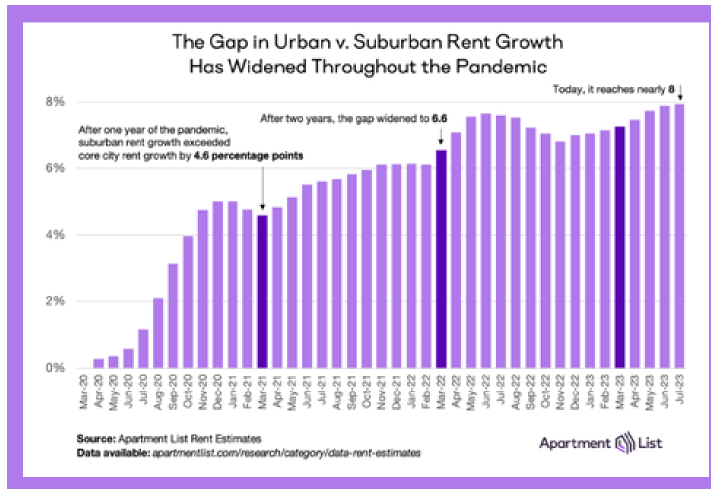
The data here span 33 metropolitan areas: 33 core cities and 387 suburbs in total. Today, year-over-year rent declines have reached -1.7 percent in core cities and -1.2 percent in suburban ones. This means that over the course of the pandemic, suburban rent growth has outpaced core city rent growth by nearly 8 percentage points, the highest it has ever been. Most of the gap emerged within the first 12 months of the pandemic, but has widened steadily since then.



In some metropolitan areas, the urban-suburban gap is more than twice the national average. This includes a handful of dense, coastal metros like Seattle WA; Los Angeles, CA; and Washington, DC; where core cities experienced deep rent cuts early in the pandemic are just now returning to pre-pandemic prices.

New York City metro notably breaks this trend, and is one of just five metropolitan areas where the gap is reversed. There, pandemic rent growth is actually higher in the urban core than in the surrounding suburbs. Outside New York, this trend is most common in large but lower-density metros like Tampa, FL and San Jose, CA.

Metropolitan Area	Rent Growth, Core City	Rent Growth, Suburbs	Gap
Portland, OR	1.7%	22.8%	21.1%
Seattle, WA	2.0%	19.0%	17.0%
Detroit, MI	9.2%	26.0%	16.8%
St. Louis, MO	10.4%	26.5%	16.1%
Atlanta, GA	16.0%	31.2%	15.3%
Nashville, TN	19.7%	34.6%	14.9%
Chicago, IL	13.8%	28.4%	14.7%
Los Angeles, CA	6.9%	20.5%	13.6%
San Francisco, CA	-11.8%	1.7%	13.5%
Washington, DC	3.8%	16.7%	12.9%

What's Next for Suburban Rental Markets?

Rent growth should continue to cool in the coming months, as fewer moves take place during the winter and a strong construction pipeline creates new apartment vacancies. But it remains to be seen if forthcoming rent drops will remain concentrated in urban centers or if they will proliferate outwards to the suburbs.

As more workers return to downtown offices, some apartment demand should shift inward towards core cities. And a recent study found that the majority of last year's new building permits were issued in suburban areas. These trends suggest that we are moving in the direction of better supply-demand balance in the suburbs. Nevertheless, rents in many suburbs are over 20 percent higher today than they were in 2020, so strong supply growth must be maintained for years to reclaim some of the affordability that was lost during the pandemic.

Evergreen Final Thoughts

For Evergreen Capital, the cooling rental market presents both opportunity and uncertainty. While slower year-over-year declines in the suburbs create near-term headwinds for existing investments, a wider urban-suburban gap indicates potential for value in select suburban markets. A focus on areas with strong job growth, planned construction pipelines, and lower rent-to-income ratios could offer attractive entry points in the medium term. However, continued monitoring of future rent trends and a potential shift in demand back towards core cities remain crucial for optimizing portfolio allocation and mitigating downside risks. Diversification across both urban and suburban assets, with an emphasis on long-term fundamentals and tenant screening, will be key to navigating this shifting landscape.

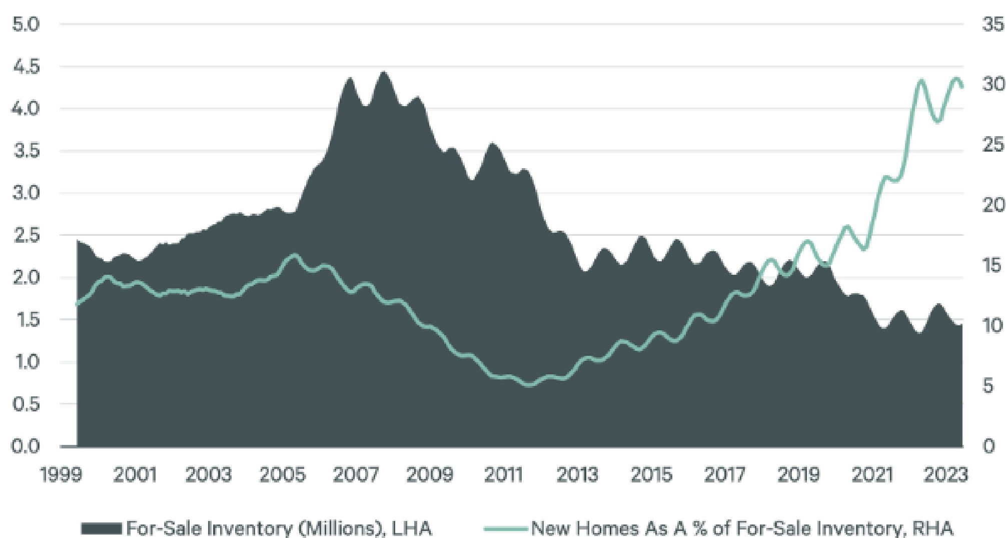
Housing market factors may favor local retail and multifamily development.

The housing market is in uncharted territory as affordability is worse than it was at the height of the mid-2000s housing mania while the for-sale inventory is at a multi-decade low. The affordability challenges have been exacerbated by surging mortgage rates—now at 20-year highs—while the supply crunch has been caused in part by severely constrained new construction since the Global Financial Crisis.

Given this dynamic, existing home sales have plummeted as a share of for-sale inventory (though they still account for 70% of overall home sales). In many markets, selling an existing home today often requires an owner to accept a valuation well below the level homes in their area recently commanded. Homebuilders are thriving in this market as the competition from existing home sales has lessened sharply. Assuming long-term interest rates will be slow to decline, this dynamic could be around for a while.

So, what does this mean for commercial real estate? The expansion of suburban rooftops is a tailwind for neighborhood and community retail centers, which have benefited from even less new development over the past decade-plus than the residential home sector. The shortfall of for-sale home inventory and ongoing mortgage affordability challenges may also bode well for multifamily properties, which likely will see fewer residents moving out to purchase their own home.

Figure 1: The Share of For-Sale Home Inventory Delivered by New Construction and Total For-Sale Inventory



Source: U.S. Census, National Association of Realtors, CBRE Econometric Advisors.

Final Thoughts:

For Evergreen Capital, the current housing market presents an intriguing landscape. The confluence of historic affordability woes and record-low inventory signals a shift in focus for investment strategies. While existing home sales are likely to remain sluggish, the opportunity emerges in alternative sectors primed for tailwinds. Suburban retail centers, historically overlooked in development compared to their residential counterparts, stand to benefit from the expanding suburban population. Additionally, multifamily assets poised to house renters priced out of the single-family market should see sustained demand. Diversifying into these resilient asset classes, particularly in high-growth suburban markets, could offer Evergreen Capital attractive returns amidst the uncharted territory of the current housing market. However, ongoing monitoring of affordability trends and potential interest rate fluctuations will be crucial for navigating this complex and evolving landscape.

US Rental Markets Show Signs of Stabilization Amidst Ongoing Crisis

With the rental crisis continuing to affect renters across the United States, a recent study by researchers at Florida Atlantic University, in collaboration with other institutions, suggests that some rental markets may offer relief based on long-term pricing trends.

According to data from the Waller, Weeks, and Johnson Rental Index as of July, rental markets in western states are witnessing a decline in rental premiums or are returning to their historical pricing trends. A few markets are even offering rentals at a slight discount compared to their historical trends as rent growth slows nationwide.

Boise, Idaho, leads the way with rentals at a 0.04 percent discount relative to historical trends, followed by Sacramento, California, at 0.02 percent discount. On the other hand, Las Vegas, Nevada, and Spokane, Washington, stand out with premiums of 0.39 percent and 0.40 percent, respectively.

Dr. Ken H. Johnson, a real estate economist at FAU's College of Business, states that these markets are the most favorable for renters, as rents are in line with or below long-term historical trends, ensuring renters aren't overpaying.

However, researchers caution that lower rental premiums do not necessarily mean affordability for renters. It indicates a return to typical rent levels based on historical norms.

In contrast, markets in Florida and on the East Coast are still grappling with high premiums. Charleston, South Carolina, has the highest premium at 10.72 percent, followed by Knoxville, Tennessee, at 10.31 percent. Two Florida cities remain among the most overpriced rental markets in the country.

Despite the positive trend in lowering premiums, researchers emphasize that renters will continue to face affordability challenges until incomes rise and more rental units are constructed. They suggest that recent legislation may encourage the development of multifamily housing, potentially improving the situation in the near future.

Evergreen Insights:

For Evergreen Capital, the stabilizing rental market presents a complex puzzle with both opportunities and uncertainties. While Western markets offering discounts compared to historical trends show potential for value-add investments, high premiums in the East and Florida could still hold risks. Diversification across geographic regions and asset types, like multifamily units benefiting from potential supply increases, may be crucial. Closely monitoring regional rent trends, tenant affordability constraints, and legislative developments will be essential for maximizing returns and mitigating downside risks in this evolving landscape. Ultimately, long-term investments focused on affordable housing solutions, particularly in high-growth areas, could align with Evergreen Capital's values and offer both financial and societal benefits.