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Buy versus rent: Investment in apartmentst on the increase

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Almost a year ago, I wrote an article about why there was increase in apartment dwellers versus home buyers. In general, it was clear that young people, who would normally be buyers, were living in an uncertain world, nomads seeking jobs in far away areas, cohabitating with friends and complete strangers. The younger tier market had problems of affordability, lack of down payments, lack of credit, and no confidence in housing appreciation.

Investment in apartment buildings was on the increase, not only because it represented a reasonable cash flow (anything over 1%), but it was clear that landlords could raise rents because of renter lack of options. On the supply side, there were few new apartment projects being built, and little banking interest to support it. High demand and constrained supply, what could be better.

It seems now, once again, the times are a'changing. The rental market may be slowing a little, and housing may have reached a tipping point towards purchasing again. As you've all read, report after report indicate an improved housing market, both in the pace of sales and sales prices. While pricing is still significantly below the 2006 peaks, in some cases 30%, there are fewer foreclosures, lower supply and more buyers entering the market. It has been six years since the market started to crash, and young people who might have been buyers then, couldn't or wouldn't. Now some have been quietly establishing credit and saving some money. Many have lived at home to save money, and many of those are now putting down roots and/or starting families.

Added to all this, the indefatigable Bernanke who has once again vowed to keep interest rates low, is newly committed to purchasing \$40 billion per month of mortgage-backed securities to ensure high demand for these notes and thus lower interest rates. As a result, there has been pent-up demand coupled with historically low rates, coupled with more incentives for banks to lower credit requirements. In addition, there has been very modest employment growth, significant stock market growth, and small increases in consumer confidence.

But, the most compelling reason for buying versus renting is the actual cost analysis, combined with a small but new confidence in home appreciation or even inflation. Rents have been driven up significantly, in some cases 15% per year over the last two years. As an example, a tenant paying \$3,000 per month for a two bedroom apartment (not atypical in many areas) can now afford a \$250,000 mortgage (approximately \$1,300 per month) a property tax bill of \$500 per month, a home insurance bill of \$300 per month, a few hundred per month left over for repairs and improvements, and end up paying less than rent.

If this is the bottom of the market, as almost everyone believes, there should by definition be price

appreciation. Further, given what our government is doing to keep interest rates low, thereby devaluing the dollar, there will probably also be inflation in the future. If homes prices inflate, and buyers have fixed cost debts for the next 15 years, there will be significant financial leverage. In addition, if buyers enter the market now, their assets will keep pace with inflation, and they will be able to trade to different locations if they have to move or, for larger houses with modestly more capital. As one Wall Street Journal article points out, current rates compared to a year ago allow buyers to take out 12% more in debt, without any increase in payments. This factor alone is a significant motivator from one year ago for renters to change to buyers.

As we think about the increased rate of sales and increased pricing, we know anecdotally that some of the buyers are coming from younger people forming more stable house-hold formations. According to statistics, the strongest end of the purchase market is at the low end, where many buyers would usually be former renters. If things continue this way, the rental bubble of a year ago will start to deflate, and younger people will once again fuel the buying market.

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