Optimism on the Rise

The State of the Rental Housing Market

SPRING 2025
SPECIAL REPORT

ARBOR

Key Findings

- The rental housing sector stands on the cusp of a new cycle supported by tailwinds from favorable demographic trends, normalizing credit markets, and a structural need for housing.
- The prospect of a federal pro-growth political agenda has boosted investor optimism despite projections that new tariffs could raise construction costs.
- A unique buying opportunity has emerged within multifamily real estate as private-market transaction prices and public-market valuations diverge.

The Outlook

Following a year of steady growth, the rental housing sector sits in an advantageous position, contributing to a budding sense of investor optimism. Structural housing strengths remain intact as tailwinds support new investment prospects, and signals of a cyclical turnaround have multiplied.

The new presidential administration's pro-growth political agenda has further boosted investor confidence in rental housing's short-term outlook. While the anticipation of robust growth could complicate the pathway to lower interest rates, credit markets will still benefit from a yield curve normalization, likely boosting capital availability.

On the cusp of a new cycle, commercial real estate investors are encountering a unique moment of opportunity. Divergent trends between private-market transaction prices and public-market valuations suggest that buyers have been finding attractive discounts.

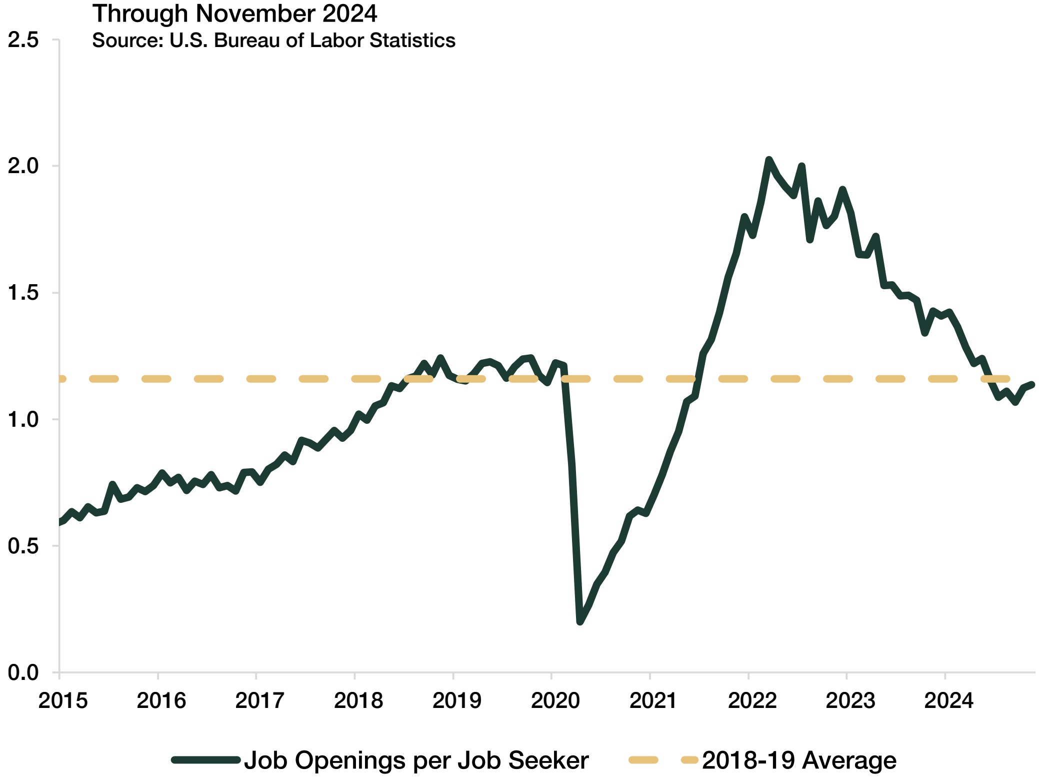
With substantial discussions taking place around regulatory, immigration, trade, and fiscal policy, opportunities should arise for well-positioned real estate investors. The rental housing market's resilience in 2023 and 2024 provides a solid foundation for growth as the page turns to the next real estate investment cycle.

Threading the Needle

The underlying consistency of the U.S. economy has been impressive. As recently as early 2023, economists projected a two-in-three chance of a near-term recession. At the time, the prevailing wisdom was that the Federal Reserve's focus on price stability could come at the expense of economic growth and a robust labor market. However, concerns about an impending recession were inflated.

Since then, the economy has seemingly threaded the needle. Excess hiring demand has eased, with the number of job openings per job seeker coming back in line with pre-pandemic norms *(Chart 1)*. At the same time, layoffs have remained in check, and GDP growth has held between 1.6% and 3.2% over the past four quarters. Simply put, debates over whether the "soft landing" was "soft" have given way to disagreement over whether it was even a "landing."

CHART 1
Job Openings per Job Seeker
Through November 2024
Source: U.S. Bureau of Labor Statistics



Make no mistake, the return to economic normalcy still has a distance to go. Driven primarily by shelter costs, the last mile of the inflation battle has proven stubborn. Additionally, the prospect of higher tariffs makes the Federal Reserve's job even more challenging. Nevertheless, the prevailing wisdom is that the combination of monetary tightening and accelerating inflation is firmly behind us. While challenges remain, the dynamism, diversification, and capital attractiveness of the U.S. economy have been unparalleled — a fact that will propel commercial real estate success over the next cycle.

Rental Housing's Risks and Opportunities

The newly established single-party control in Washington, D.C., means that policy agendas are likely to achieve more momentum than they would in a divided government — a fact that requires investors to pay closer attention to legislative priorities than they might otherwise. Tax cuts are one item on watch. Many features introduced in the 2017 Tax Cuts and Jobs Act are set to expire at the end of 2025. However, with a Republican trifecta in control, tax cuts are now likely to be extended.

The most significant source of optimism within the multifamily space is the likelihood of reduced regulatory burdens in the construction process. Rental housing affordability has drawn widespread concern in the aftermath of the pandemic, resulting in politicians on both sides of the aisle working toward legislative solutions.

The new administration has stated that deregulation is the preferred method for improving housing affordability. While it's unclear which construction regulations will be sunsetted in the next four years, new federal policies will likely include fewer restrictions and encourage more development to meet demand.

A 2022 joint analysis by the National Multifamily Housing Council and the National Association of Home Builders found that, in addition to regulatory compliance dramatically increasing construction costs, developers have sought to avoid new projects in jurisdictions with inclusionary zoning or rent control policies. The downstream effect is that many of the high-rent markets most in need of new housing have been passed over by developers, compounding affordability issues. Any federally coordinated effort that systematically reduces regulatory construction costs would greatly contribute to unlocking new affordable development.

This year, discussions of ending Section 1031 of the U.S. tax code will likely fade into the background. While the Biden administration's calls to end the program never found much traction in Congress, doing away with the 1031 exchange showed up repeatedly in the White House's budget proposals over the past four years. With more than $100 billion worth of commercial real estate assets passing through this section of the tax code per year, confirmed continuation of this program could support new tailwinds for the rental housing sector.

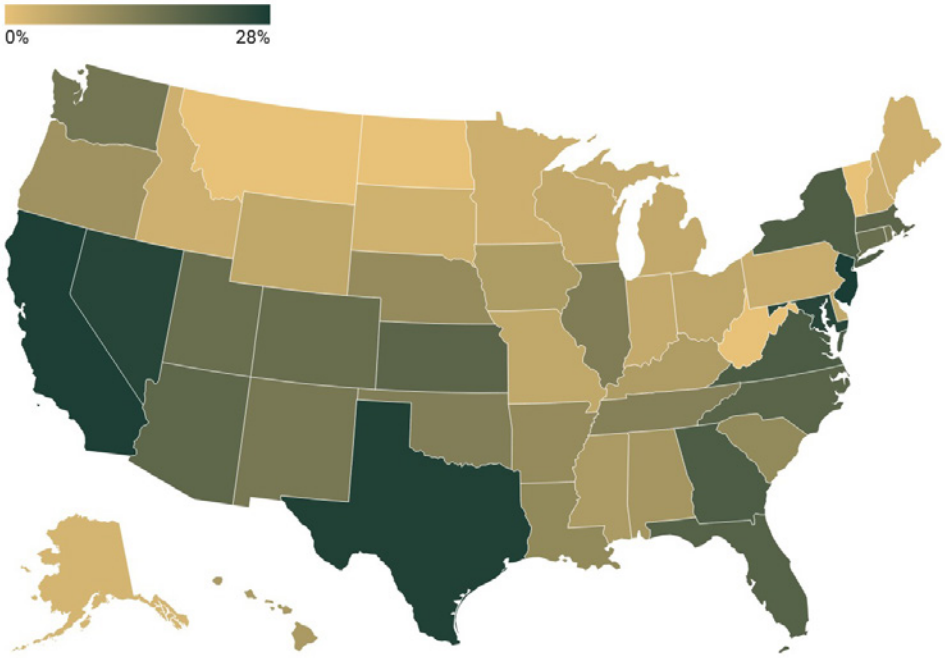
Nevertheless, clear-eyed investors should remain aware of the market risks posed by some of the proposed policy changes. The construction industry is one of the sectors most reliant on the informal labor force. According to a Chandan Economics analysis, non-citizen workers account for 17% of the construction labor force nationally, rising above 25% in a handful of states *(Chart 2)*. A large-scale effort to ramp up interior removals of undocumented workers could have a material impact on construction labor demand and wages — potentially undermining the administration's goal of lowering development costs.

CHART 2

Non-Citizen Share of Construction Labor Force

Through 2023

Sources: 2023 American Community Survey; U.S. Census Bureau; Chandan Economics; IPUMS



Additionally, proposed tariffs on Mexico and Canada could place upward pressure on construction input costs, especially for cement, steel, aluminum, and lumber. In a tail risk scenario, where tariffs and mass deportations occur alongside otherwise stimulative fiscal policies, inflation could be stoked from the supply and demand side of the equation, leading to higher-for-longer interest rates.

Looking forward, a potential shakeup of the federal government's conservatorships of Fannie Mae and Freddie Mac should also be on every multifamily investor's radar. Although the future of the government-sponsored enterprises (GSEs) has been debated before, no material changes have been made to these conservatorships since they were established in 2008. While there has been speculation about the future of these agreements, the new administration has not yet stated its position. Upcoming confirmation hearings of key appointments will likely provide greater clarity on whether exiting conservatorships will be a policy priority over the next four years.

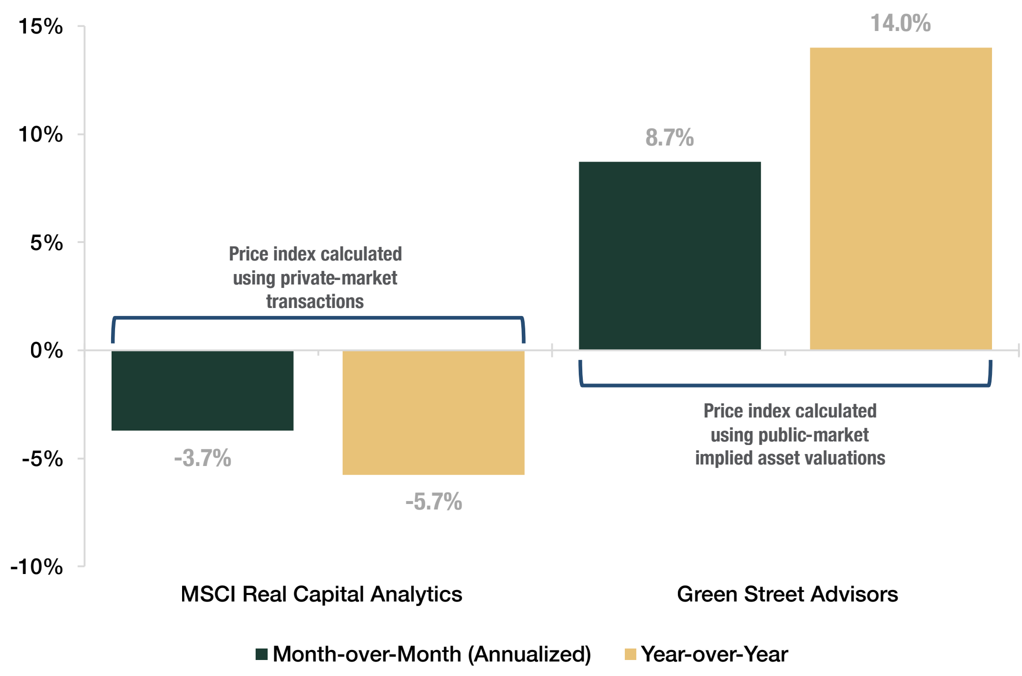
Multifamily: In the Starting Gate

Despite the prospect of fiscal and regulatory policy changes, the multifamily sector has gathered winds at its back. Recent financial market history shows that the best deals occur at the bottom of the cycle. For investors hoping to catch the multifamily market on the upswing with its assets still at a discount, a unique window of opportunity has opened.

The apparent divergence in pricing indices is a potential signal of the multifamily sector's impending turnaround. Transaction-based measures of asset valuations, such as the MSCI Real Capital Analytics CPPI, indicate that prices are stabilizing, though they have yet to inflect back up into positive growth. Meanwhile, price indices that rely on implied valuations of assets on REIT balance sheets, such as the Green Street CPPI, suggest that apartment valuations are already resurgent, growing by 14.0% over the 12 months ending in November 2024 *(Chart 3)*.

CHART 3

Apartment Price Returns:
MSCI Real Capital Analytics vs. Green Street Advisors
Through November 2024
Sources: MSCI Real Capital Analytics; Green Street Advisors



Historically, REIT-based asset valuations have proven to be a leading indicator of transaction-based asset pricing. As a result, the bifurcation between the two measures implies that apartment transaction prices, which have yet to reach a bottom, are likely to see positive momentum in 2025.

Beyond pricing insights, additional justifications for multifamily enthusiasm are abundant. According to ULI-PwC's Emerging Trends in Real Estate 2025, commercial real estate leaders are broadly upbeat about the investment prospects of single-family rentals and multifamily housing. The report cites favorable demographic tailwinds, affordability barriers to homeownership, and the longevity of work-from-home trends as factors supporting the rental housing sector's financial return profile.

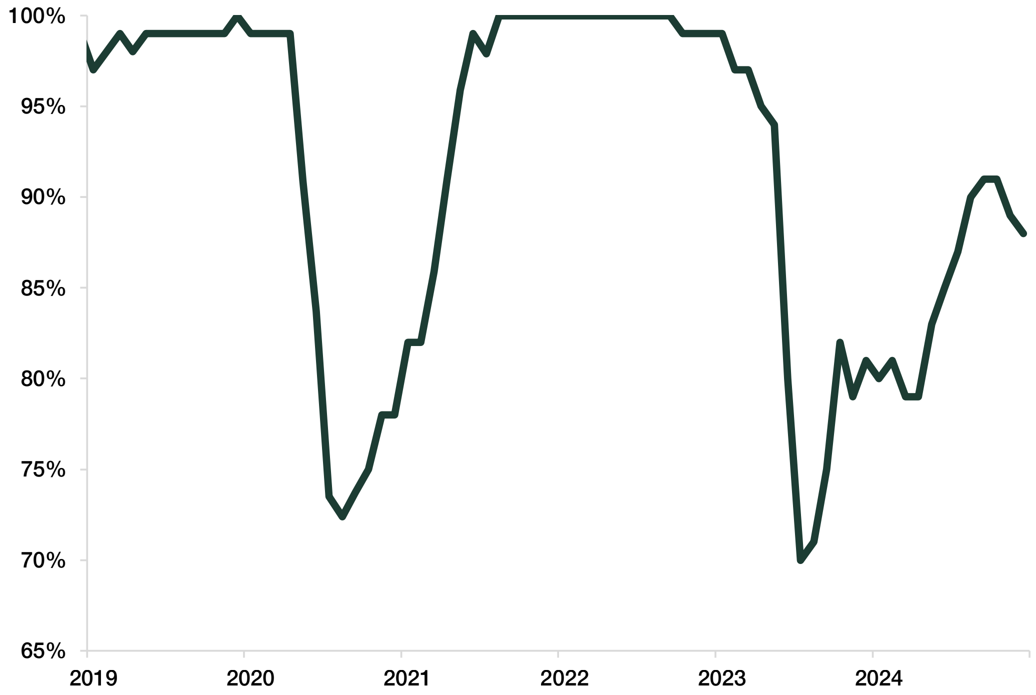
The stabilization of rental pricing has also been a source of confidence. While the November 2.4% annual rent growth rate reported by Zillow for multifamily units lagged the double-digit increases seen in 2021 and 2022, the current tally is impressive, especially given ongoing supply dynamics. According to the U.S. Census Bureau, 590,600 multifamily units finished construction in 2024 — more than any year since 1974. Despite this backdrop of supply infusion, annual rent growth has held between 2.4% and 2.6% for the past 10 consecutive months. Furthermore, among the top 100 U.S. metro areas, 88 have seen positive annual rent growth, up from 81 measured at the same time last year *(Chart 4)*.

CHART 4

Share of Top 100 Apartment Markets with Positive Annual Rent Growth

Through December 2024

Source: Zillow

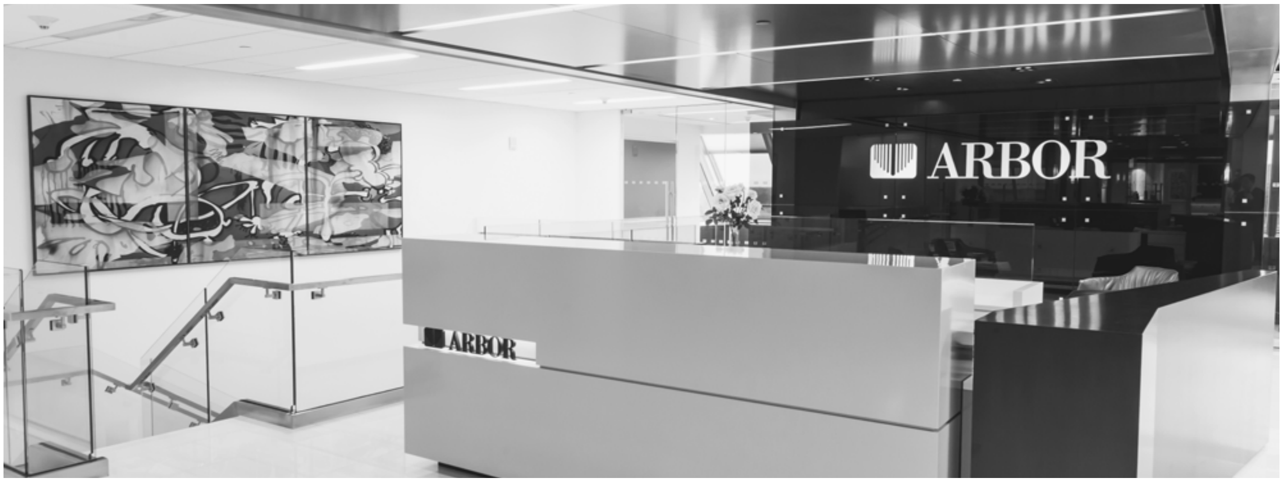


The Road Ahead

As we settle into a new year, a new president, a new Congress, and perhaps a new economic cycle, an abundance of tailwinds give strength to the rental housing sector. The U.S. Census Bureau projects that the population level of persons 25-44 years of age — a cohort that broadly overlaps with the prime age band for renters — will rise until at least 2035.

At the same time, on the other end of the age distribution spectrum, retirees are increasingly choosing lifestyle renting as they downsize and live off their equity nest eggs. Beyond demographics, headwinds created by an influx of supply deliveries should soon see some relief, as the pace of multifamily construction starts has more than halved in the past two years. Further, the interest rate outlook also calls for continued improvement.

While real estate investors are generally eager for pro-business policies to return to the Oval Office, tempering enthusiasm is prudent as ambitious changes to immigration and trade policies could have a mixed impact on commercial real estate. Investors will have to wait and see if campaign rhetoric will materialize as policy under a new administration. Although risk factors remain, rental housing sectors are in a position of strength in a moment of cyclical inflection — providing a unique moment of opportunity. ■



About Arbor

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