The Impact of Demographics and Millennials on Commercial Real Estate

Commercial Real Estate Strategies Conference

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Marquette University

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Presentation Outline

I. Forecast update – 2014 Takeaways

II. Who we are?
   • Demographics

III. What and “How” are Millennials doing?
   • Millennial facts, figures and perceptions

IV. How do we pay for where we live?
   • Financial Environment

V. Demographics, Millennial perceptions/realities, and post Great Recession financial conservatism’s impact on homeownership
   • Takeaways
the takeaways [in 2014] being . . . .

• Significant shift away from Class A in primary markets

• Investors are turning to new markets in search of yield

• Multifamily continues to shine
The “renter society” or “sharing economy” or “collaborative consumption” or “Netflix Economy”

Source: *Economist*, March 9, 2013
Demographics
Who are we? We are less frequently married and we are often without children.

Source: U.S. Census and Marquette University.
Who are we? We are becoming overwhelmingly minority, the current white, non-Hispanic birth rate is 1.8 per woman.

Change in household formation 2010-2030 (in millions)

Who are we? In number our households are becoming younger.

Change in Households over the decade (in millions)

Who are we? We are workers with wages barely keeping pace with inflation.

Who are we?

We are a nation of households . . . .

A. 20% of us are married with children in the household
B. Our growth is overwhelmingly minority
C. We are replacing older households with younger ones
D. We make no more money than the previous generation

These trends all skew multifamily (as opposed to homeownership).
Millennials: How old were you when you first got your drivers license?

Millennials: More women than men are getting college degrees, 25% more in 2009

Source: PBR and the Census.
Millennials: Continue to boomerang.

Millennials: As Millennials boomerang we are slow to form new households (there is a pent up growth of 1.7 million households)

Source: Census, American Communities Survey and Marquette University.
Millennials: 71% of college graduates borrow, 40% of that debt is held by Masters Degree holders

Millennials: Only 59% of bachelor degree seekers graduate, 32% of bachelor degree seekers graduate from for-profit schools.

Percentage of Borrowers who Defaulted on Loans up to Six Years after Enrollment

<table>
<thead>
<tr>
<th>Category</th>
<th>Default Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrowers who graduated</td>
<td>3.7</td>
</tr>
<tr>
<td>Borrowers who dropped out</td>
<td>16.8</td>
</tr>
<tr>
<td>Borrowers who graduated with a certificate from for-profit, less-than-four-year institutions</td>
<td>19.2</td>
</tr>
<tr>
<td>Borrowers who dropped out of for-profit, less-than-four-year institutions</td>
<td>29.4</td>
</tr>
</tbody>
</table>

Millennials: Marry much later in life.

Source: U.S. Census.
Millennials: Plan to marry and have kids.

Millennials: Are better educated and getting paid less for it.

Source: NYT, August 2, 2015, p. 3.
Millennials: Career wage growth has weakened

Wage Growth between the ages 23 and 28 for College Educated Workers

Millennials: Some facts

Millennials . . . .

A. Are not as interested in driving
B. Boomerang
C. Women Millennials are winning the brain game
D. Have student loans but generally pay them back
E. Marry later, but plan to marry and have kids
F. Are more degreed but making less
G. Have lower income growth prospects

Millennial households will rent longer than past generations
Real Estate Finance, and Credit Availability
Finance: Homeownership remains very affordable

Source: Federal Reserve Economic Data, NAR, and Marquette University.
Finance: Homeownership rates are at 48 year lows and dropping

Source: Federal Reserve Economic Data.
Finance: The share of first-time home buyers (33%) is the lowest in 28 years

Homeownership Rates by Age, 1995-2014

Source: Joint Center for Housing Studies, Harvard, Rachel Borgardus Drew, February 2015.
Finance: FICO scores increased during and since the Great Recession

Source: Housing Finance at a Glance: June 2015, Urban Institute, Goodman et al.
Finance: Young adults have weak credit scores

FICO Score Distribution by Age Group in 2013

Finance: More broadly credit availability has not eased

Finance: Both the memory and reality of negative equity haunts prospective homeowners

Single-Family Houses with Negative Equity

Source: Housing Finance at a Glance: June 2015, Urban Institute, Goodman et al.
Finance: Negative equity and huge legal penalties and new regulations have curbed lender enthusiasm

Source: Economist, August 8, 2015, p. 13.
Finance: Single-family mortgage origination has not picked up with employment gains

First Lien Mortgage Origination Volume

Finance: Mortgage delinquency problems are behind most lenders and the GSEs

Serious Delinquency Rates—Multifamily GSE Loans

Percentage of total loans

Sources: Fannie Mae, Freddie Mac and Urban Institute.
Note: Multifamily serious delinquency rate is the unpaid balance of loans 60 days or more past due, divided by the total unpaid balance.

Source: Housing Finance at a Glance: June 2015, Urban Institute, Goodman et al.
Real Estate Finance, and Credit Availability

Finance . . . .

A. Homeownership is very affordable
B. Homeownership rates continue to fall
C. Credit scores and credit availability are tight
D. Negative equity remains resident for borrowers and lenders
E. Default rates are low

Haunting memories of the financial crisis keeps young adults and lenders from entering, in earnest, the housing market
So what does it all mean?
Fannie Mae research completed by Patrick Simmons provides some insight:

Compared homeownership rates after controlling for . . . .

- Age: 30-32 aged householder
- Income: top quartile, >$95,245
- Race: non-Hispanic white only
- Marriage: all married couples
- Kids: all had at least one child

He found . . . .

Source: Patrick Simmons, Fannie Mae, Housing Insights, Vol. 4, No. 4., p. 3.
Fannie Mae research completed by Patrick Simmons provides some insight:

. . . . homeownership rates in 2012 were:

- 8.6% lower than the top of the homeownership market in 2006
- 6.0% lower than in a normative homeownership market in 2000

In short, he found that in the most affordable homeownership market in recent history (2012), more households rented by sizable margins than in earlier years.

Source: Patrick Simmons, Fannie Mae, Housing Insights, Vol. 4, No. 4., p. 3.
Results of the detailed Census analysis by Goodman and others reveals 544,000 to 722,000 new renter households per year will be created for the next 15 years.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Observed (o) or Projected (p)</th>
<th>Change</th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2010o</td>
<td>2020p</td>
<td>2030p</td>
<td>2020s</td>
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<tr>
<td>Slow scenario</td>
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<tr>
<td>Households</td>
<td>116,716</td>
<td>127,350</td>
<td>136,411</td>
<td>10,634</td>
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<tr>
<td>Homeownership rate</td>
<td>65.1%</td>
<td>62.3%</td>
<td>60.3%</td>
<td>-2.8%</td>
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<tr>
<td>Homeowners</td>
<td>75,986</td>
<td>79,390</td>
<td>82,263</td>
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<tr>
<td>Renters</td>
<td>40,730</td>
<td>47,960</td>
<td>54,148</td>
<td>7,229</td>
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<tr>
<td>Fast scenario</td>
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<td>116,716</td>
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<td>87,640</td>
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<tr>
<td>Renters</td>
<td>40,730</td>
<td>47,855</td>
<td>53,296</td>
<td>7,125</td>
</tr>
</tbody>
</table>

Sources: Decennial Census 2010 (o) and Urban Institute projections (p).

Since 1960 an average of 360,000 rental housing units were started, since 1990 that number is 252,000

Source: Federal Reserve Economic Data.
The conversion of single-family owner-occupied homes into rentals, created over three million rental units in the 2006-2012 period addressing market demand.

Source: Urban Institute, Three Charts that Explain the Renters Next Door, Taz George, February 26, 2015.
Takeaways:

- Demographic impacts of:
  - Changing household makeup (20% are married with children)
  - Minority household growth (80+% off household growth minority)
  - Size of the Millennial cohort (about 4,000,000 people per year)

- And the Millennial behaviors/preference of:
  - Later marriage (6-7 year later than 50 years ago)
  - More degrees but making less and smaller wage growth

- And the changes in housing finance of:
  - Tighter underwriting (increased FICO scores)
  - Perceptions and realities of negative housing equity

- Will create demand for multifamily housing of 500,000-600,000 units per year for the foreseeable future.
For an update on this research and new insights next year
Please save the date for the:

2016 Commercial Real Estate Strategies Conference
Thursday, September 8th, 2016