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Apartment Construction Is Slowing, and Investors Are Betting on Higher Rents

The rise in interest rates pushed construction-loan costs up and property values down

By
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The annual pace of multifamily-building starts in July was down 41% from an April 2022 peak, according to the U.S. Census Bureau. PHOTO: ALEX WELSH FOR WSJ

For more than a year, apartment renters in many cities have been getting some relief from price increases because of the enormous amount of new supply being delivered by developers.

Now, big investors are betting that downward pressure on rents from new supply is coming to an end and the market is shifting back in landlords' favor. At the heart of their reasoning: the critical metric of new construction starts, which began slowing last year and now are falling even further.

Apartment developers are stepping on the brakes, especially compared with the building frenzy in the early years of the pandemic. Across the country some rental-construction projects are getting stalled, as developers struggle to obtain the financing needed to complete them. Other investors are pivoting to more lucrative alternatives.

In July, the annual pace of multifamily-building starts was down 22% from the same month a year earlier, according to the U.S. Census Bureau, and down 41% from an April 2022 peak. Property-data company CoStar, which uses a different method to count starts, said they fell to less than 61,000 units in the second quarter, the lowest level in the past decade.

Some of the largest investment firms in the country are buying billion-dollar portfolios, partly betting that slower times for rental builders will mean better times for companies that own existing properties.

“The influx of new supply is likely to taper off after 2025, at which point we are optimistic about rent growth,” said an April report from private-equity firm KKR, which earlier this summer paid $2.1 billion for more than 5,200 apartments. Other large asset managers such as Brookfield and Blackstone have also bought billion-dollar portfolios so far this year.

On the westside of Houston, Hamilton Point Investments bought a 360-unit complex in April. A supply surge in that part of town forced the previous landlord to offer discounts to keep units full, said Matt Sharp, co-founder and managing principal of Hamilton Point. It is a trend that he is expecting won’t last much longer.

“Our view is all the new construction is going to finish in the next few months, and nothing new is going to come online for the next two or three years,” Sharp said.

Rents soared nationally in 2021 and 2022, but suburban rental homes and Sunbelt apartments saw some of the highest price increases as population growth increased demand in those areas. New development quickly followed.

Buildings containing some 610,000 apartment units are expected to complete construction this year, more than in any year since the 1980s, CoStar said. The supply surge has caused values and rents to sag in many markets.

But due to the declining construction starts, CoStar projects annual completions will drop to less than 350,000 units in 2025 and about 275,000 in 2026.

Lower numbers of new buildings going up is expected to give a boost to rents and lagging property values.

Austin, Texas, where asking rents have fallen more than anywhere else, is also the city dialing down construction the most, CoStar said.

The national decline in rental-construction starts is the result of a collision of factors making development a less profitable endeavor. The rise in interest rates pushed construction-loan costs higher and property values lower. Rent growth for new apartment leases is also running close to flat in much of the country, with an oversupply of new apartments in the Sunbelt cited as a major cause.

All of this discourages builders and their investors from getting started on more buildings soon, even if an interest-rate cut this month brings down borrowing costs.

“I think there will be a little bit more hesitation to jump back into overbuilt markets,” said Omar Rihani, executive vice president at Project Management Advisors, a development consulting firm.

Construction is slowing more in Austin, Texas, than in any other U.S. city, CoStar says. PHOTO: BRANDON BELL/GETTY IMAGES

The decline in apartment starts coincides with a presidential campaign in which the country’s affordable-housing shortage has come into greater focus. Vice President Kamala Harris has said she wants to address the problem by subsidizing starter homes and increasing federal funding for low-income rental construction. Former President Donald Trump has talked about giving the president more say over interest rates, which are set independently by the Federal Reserve and can affect mortgage rates.

Most apartment developers today build high-end units for middle- and upper-income households, which have little impact on the affordable-housing shortage. Lower-cost rentals—the kind most in need by low- and moderate-income households—remain scarce and are rarely built without a government subsidy.

“When you talk about these big housing-shortage numbers…it’s not the stuff that’s getting delivered necessarily and not necessarily in the locations it needs to be delivered in,” said Tom Shapiro, president of investor and developer GTIS Partners.

GTIS for now has a limited appetite for new rental projects. The firm decided earlier this year to convert a rental tower that it is building with Related Group in Miami into for-sale condominiums, a move that will more than double the project’s profitability, Shapiro said.

“It’s going to take rent growth moving back into consistent positive numbers for people to feel comfortable with development again,” said Jay Lybik, CoStar’s director of multifamily analytics.