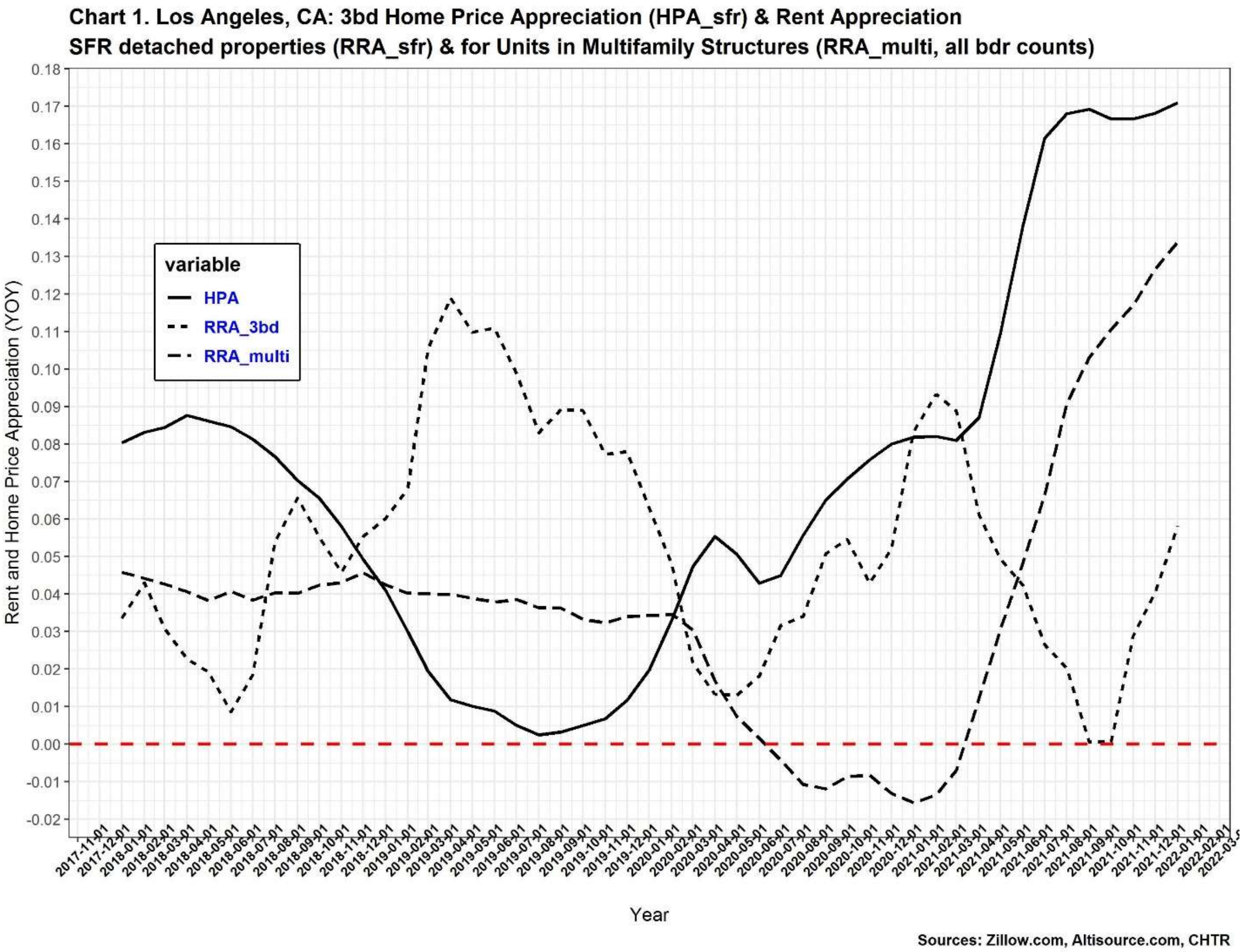
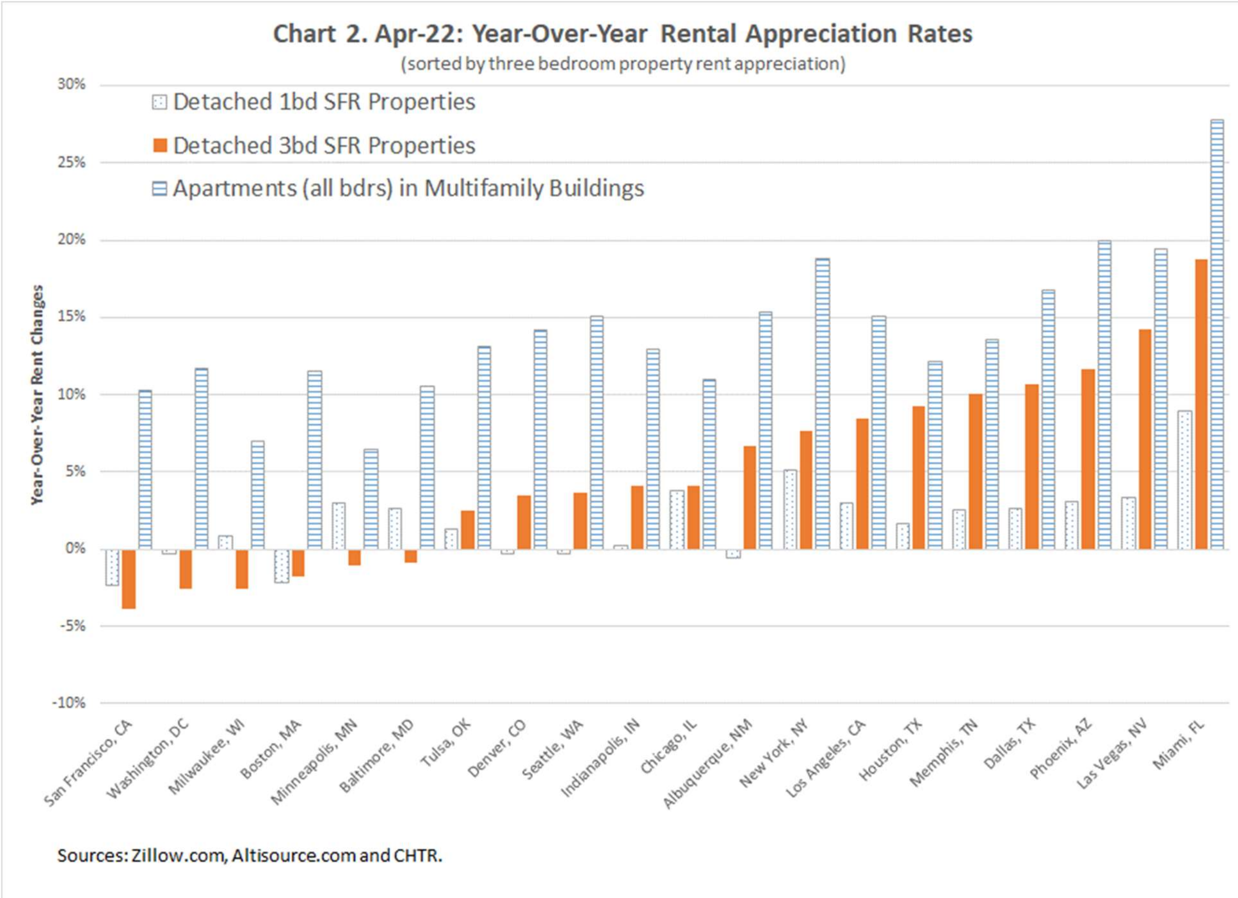
Jun-22: Los Angeles, CA

Rising mortgage rate are beginning to slow home price appreciation across the nation (see Jun-22 blog). The solid line in Chart 1 shows home prices still rising quickly in Los Angeles, CA, but now at a slower pace. Chart 1 also shows how rent appreciation in multi-unit structures (RRA_multi, dashed lines) in Los Angeles, CA have almost kept pace with price appreciation since the start of 2022.



In Chart 2, we see rent appreciation for apartment units and SFR properties in Los Angeles, CA relative to nineteen other major Core Business Statistical Areas (CBSAs). Chart 2 also shows the current observations of rent appreciation for one- and three-bedroom single family residential properties (RRA_1bd, and RRA_3bd), and rent appreciation for apartments in multi-unit structures (RRA_multi) for 20 CBSAs. The data for Los Angeles, CA is identical in both charts.

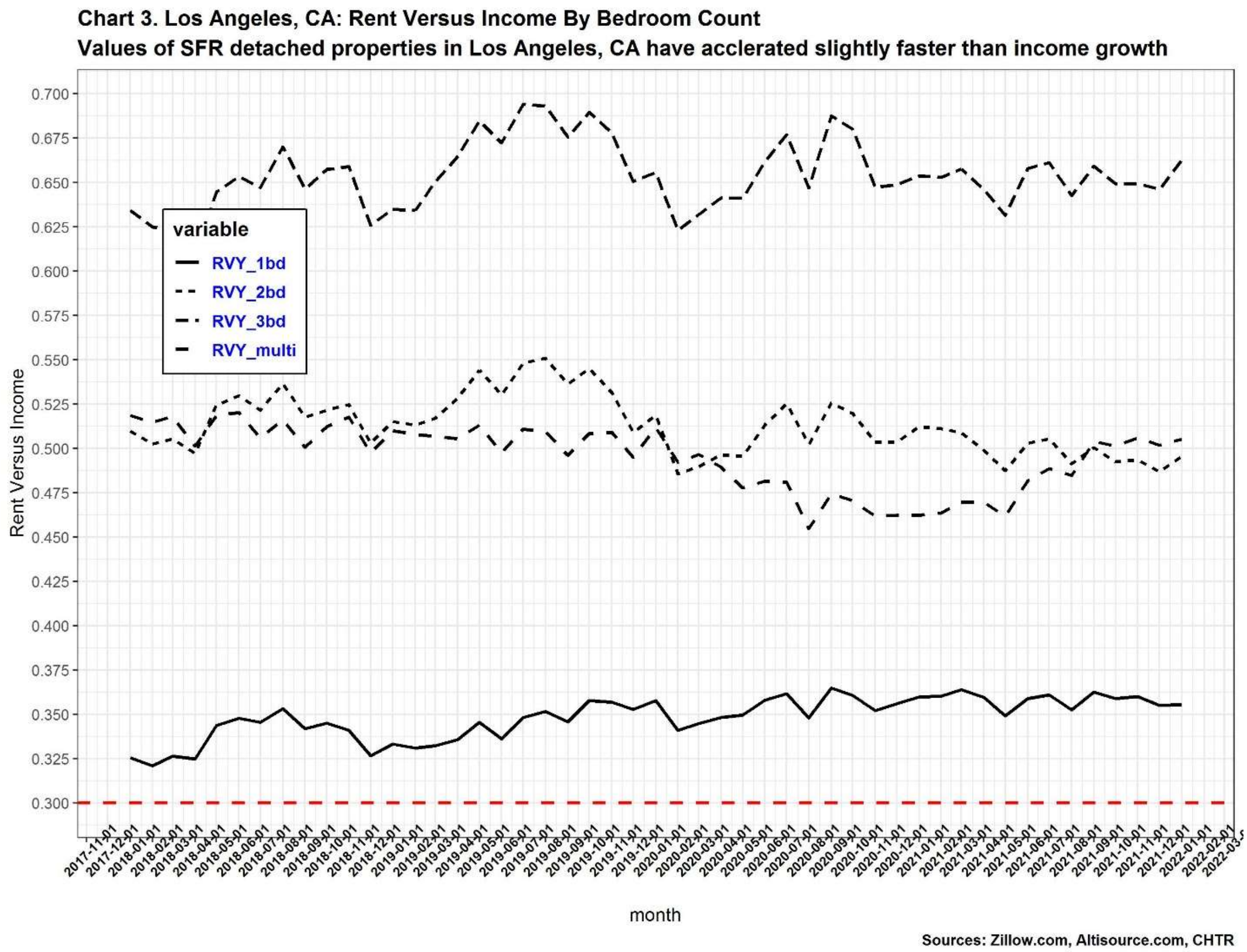
Chart 2 shows that Los Angeles, CA saw mid-range home price and apartment rental price increases relative to other CBSAs. In Chart 1 we can see that the increases in RRA_multi were less than for HPA_3bd, but still strong.



This is what is surprising about Charts 1 and 2: the big increases in home price appreciation (HPA) have been matched by the large increases in rents in apartments (RRA_multi). One might have guessed that the increased demand for SFR detached properties to buy or to rent would have slowed demand for apartment rentals more. The large rent increases we see for apartments in multi-unit rentals, however, does not show up in rents of 3-bedroom SFR detached properties.

There appear to be three renter classes and we therefore see three trends: 1) Renters of single family properties (who would need to have strong incomes) chose to substitute away from renting and towards purchasing a home (thus RRA_3bd slowed down). 2) The second group are renters of apartments with strong incomes but have not found a home to purchase. For this group, as home prices rise, higher home costs price out these renters who would otherwise buy. And because the home sales market has gotten so hypercompetitive, many frustrated renters in the market for a home have simply given up because the process is so exhausting and demoralizing. Now mortgage rates are rising. This group of renters also have high incomes relative to other renters — they are in the bubble of being able to buy a house, but could not find one — so the home sales market is keeping high-income tenants in the rental market longer than they want to be because they cannot buy a house (RRA_multi). 3) Finally, some renters cannot afford to buy and must resort to renting. Thus, rents continue to rise.

Rents versus income



How have these changes impacted relative affordability in Los Angeles, CA? If incomes in a CBSA increase as fast as home prices or rents have increased, then the denizens of that CBSA who already own their homes are better off as their wealth has increased. Renters, however, are worse off because they transfer larger amounts of wealth to the property owner each time rents increase. In Chart 3, we show the cost of renting (R) relative to income (Y) for three different bedroom counts and for apartments in multi-family buildings (all bedroom counts). This yields a RVY ratio for each property type. It is a measure of income flow and affordability.

A rough rule of thumb is that RVY for new homebuyers should be around 30%. Renter of apartment in Los Angeles, CA allocate about 65% of their income to renting. This is one of the highest in the nation. In Chart 3, four out of four RVY ratios are above 30%, but all four RVY ratios seem stable. Thus, the very large increases in home prices and rents for SFR properties have been matched by increases in incomes in Los Angeles, CA. This suggest that renters of SFR detached properties are not much worse off than they were before the pandemic. However, one has to suspect that renters of both single family detached properties and apartments are credit constrained. The worsening of the RVY ratio makes it harder for renters to accumulate wealth. It, in turn, makes it harder to accumulate the downpayment to potentially make a purchase in the future.