RESEARCH BRIEF
HOUSING COST INFLATION

IPA INSTITUTIONAL PROPERTY ADVISORS

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Inflation Calculations Late in Reflecting Moderated Rent Growth

Shelter costs elevate inflation results. January's consumer price index (CPI) was up 3.1 percent from the same month a year prior, topping the generally anticipated annual inflation level of 2.9 percent. A larger-than-expected bump in housing costs influenced the CPI results. Shelter expenses climbed 6 percent year over year, according to the report, and the pace of price growth during the month of January ticked up a hair from December's reading. Many housing market experts immediately questioned the validity of the latest findings.

Real-time rent measures show softening pricing pressure. After multifamily rents climbed sharply in 2021-2022, growth has slowed to levels below the long-term norm. Nationally, rents for new apartment leases increased at a modest pace of 1.2 percent in 2023, and preliminary readings show essentially flat rates during the first two months of 2024. In some areas where new supply is coming on stream at especially aggressive levels, new-lease rates are now moving backward. Rents for single-family homes are rising a little faster than for apartments across most locations, but the pace of increase is still running below the historical norm for the single-family rental sector.

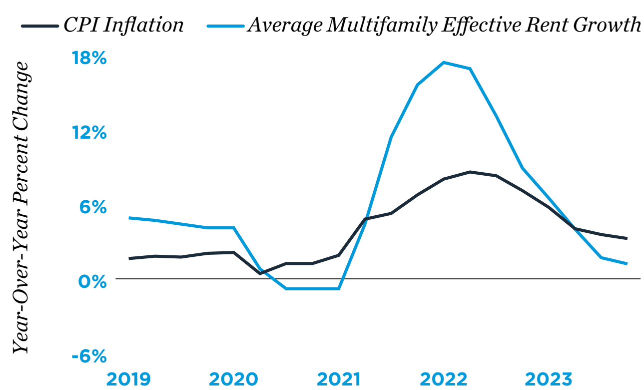
Shifts in housing costs lag in inflation calculations. CPI shelter costs attempt to measure pricing changes not only for those making home purchasing decisions or executing new leases but for all households. In turn, the widely reported shifts in apartment and single-family rent momentum for those actively moving – both upward and downward – generally do not become apparent in the overall shelter inflation calculations until a year or so after the actual inflection point for the new-mover numbers. The 6 percent CPI shelter cost inflation reported in January, while down from the year-ago peak of just over 8 percent, still overstates the current experiences of most households.

Methodologies are not ideal. About 25 percent of the CPI's shelter cost measurement comes from a calculation known as the owner's equivalent rent, which many view as flawed. To determine the owner's equivalent rent, the Bureau of Labor Statistics asks individual homeowners how much they believe their homes would rent for, unfurnished and without utilities. This calculation, then, only reflects movements in perceived values and is not based on shifts in the actual home prices or rents that are determined by the market.

Housing less impactful to policy-influencing PCE inflation . While shelter costs have a sizable impact on CPI, they have little to no impact on the personal consumption expenditures index (PCE). This alternative inflation gauge covers a broader range of households and expenditures than CPI and aims to reflect movement in consumer confidence and behaviors. The PCE index reported year-over-year growth of 2.4 percent through January, running well below the CPI reading of 3.1 percent. It is the PCE result that the Federal Reserve values more highly when making interest rate adjustments.

Housing affordability challenges favor rentals. Actual shelter cost growth should remain muted by historical standards during the near term, influenced by the high barriers to homeownership and the substantial flow of new multifamily units arriving in the fastest-growing rental markets. Demand for apartments should hold up well, however, in part because the outflow of renters into homeownership is likely to stay far under past norms. Exiting last year, the typical mortgage payment for a median-priced home ran nearly $1,300 over the average apartment rent, translating to a record purchase premium of about 70 percent. Even when compared to the mean Class A apartment rate, mortgage expenses reach approximately 37 percent higher. Only about 25 percent of households could qualify for a Freddie Mac home mortgage at the end of 2023, compared to about 48 percent a decade ago.

Slowing Rent Growth Yet to Hit Inflation



CPI inflation and multifamily rent growth reported quarterly. Typical mortgage payment based on quarterly median home price for a 30-year fixed rate mortgage, 90% LTV, taxes, insurance and PMI. Sources: IPA Research Services; National Association of Realtors; Moody's Analytics; RealPage, Inc.; U.S. Bureau of Labor Statistics

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