BY TIM SABLIK

Boosting the Supply of Rural Rental Housing

Rental housing has become less affordable across the country, but rural markets face additional difficulties

The housing market has emerged as one of the sectors of the economy where post-pandemic price pressures are most visible. The combination of a long-running slump in new construction following the Great Recession and the huge shocks to supply and demand stemming from the COVID-19 lockdowns have contributed to growing housing affordability challenges across the country. In the span of just two years, from June 2020 to June 2022, the S&P/Case-Shiller U.S. National Home Price Index increased by nearly 40 percent. The cost of the average 30-year fixed-rate mortgage has also increased at a fast pace, more than doubling from 2.67 percent interest at the end of 2020 to 7.79 percent in October 2023.

Policymakers concerned about housing affordability have tended to focus their attention on the ownership market. There are good reasons for doing so, as homeownership is widespread and is one of the most common ways to build wealth over time. But renting is also an important piece of the overall housing picture and can be attractive for a variety of households. Renters are largely spared maintenance hassles and may have access to amenities in the rental community. Individuals just starting out in their careers may rent while saving for a down payment on a home. Indeed, in the current environment, the cost of buying a home is rising faster than the cost of renting. According to a recent report from commercial real estate firm CBRE, the average monthly payment for new mortgages was 52 percent higher than the average apartment rent — a wider gap than during the real estate run-up before the Great Recession of 2007-2009.

Although renters make up a smaller share of households in rural places compared to cities — in the Fifth District, 31 percent of rural households rent compared to 35 percent of urban households — the rental market still plays a key role in meeting the housing needs of rural residents. And there are some indications that demand for affordable rural rental housing is poised to grow in the coming years, even as the supply faces serious headwinds. Signs of supply problems are evident in the Fifth District. Between 2011 and 2016, nearly every state in the district added rural rental units, but from 2016 to 2021, all states saw a decline. (See chart.)

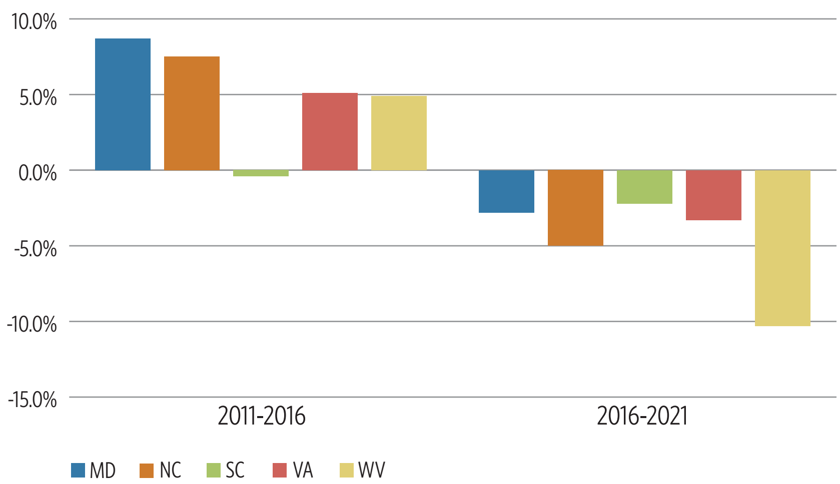
THE RURAL RENTAL MARKET

According to Richmond Fed research, rural renters in the Fifth District are much more likely to be low-to-moderate income (LMI) than rural homeowners. In a September Regional Matters blog post, senior research analyst Sierra Latham found that 63 percent of rural renters in the Fifth District earn 80 percent or less of the area median income. In contrast, 25

IMAGE: KRBLOKHIN/GETTY—ISTOCK

Rural Rental Supply in the Fifth District

Percent Change in Rental Units



NOTE: Rental units include occupied units, vacant units for rent, and units that are rented but not occupied. Counties with USDA Rural-Urban Continuum Codes (RUCC) of 3 through 9 are considered rural.
SOURCE: American Community Survey, U.S. Census Bureau

percent of rural homeowners with a mortgage meet the same criterion. Incomes in rural places are typically lower than incomes in metropolitan areas to begin with, and the median income of rural renters is less than half that of rural homeowners with a mortgage in each Fifth District state.

This highlights the important role the rental market plays for LMI households in rural places, and demand from these households is projected to grow. A 2016 report by the Urban Institute estimated that as rural households age, the need for affordable rental housing will increase. Seniors facing mobility or other health challenges may prefer to downsize from their single-family-owned homes to smaller apartments. Because many seniors face diminished income in retirement, the report predicted that the number of LMI rural renters will increase by 20 percent between 2014 and 2040.

At the same time, researchers also expect more middle- and higher-income households to turn to renting due to the rising cost of purchasing a home. As higher-income households enter the market, rents will rise, shrinking the availability of units affordable to lower-income households. According to a 2022 report by the Joint Center for Housing Studies of Harvard University, higher-income households accounted for nearly 70 percent of total renter growth between 2009 and 2019. Over the same period, units renting for less than $600 a month fell from 32 percent of the total rental stock to 22 percent — a decline of 3.9 million units.

While these figures include both urban and rural markets, there is evidence of the same trend playing out specifically in rural places. According to the 2022 Statewide Housing Study commissioned by the Virginia General Assembly, the supply of apartments in rural markets renting for less than $600 a month fell between 2010 and 2019. At the same time, prevailing incomes for rural renters have remained low. Nearly half of renters in small and rural markets in Virginia earned less than $25,000 a year, compared to under a quarter of renters in large markets.

In addition to meeting the demands of their existing residents, rural communities hoping to grow also need rental housing for new arrivals. Although it is true that rural places in general have grown more slowly than cities in recent decades or have even lost population, some small towns may be looking to reverse population decline. A lack of affordable rental housing can impede those goals.

"There are places where there's just no rental, everything is owned. So, if you want to come there for work and see if it's somewhere you want to put down roots before buying a home, you don't have that opportunity," says Mel Jones, co-director of the Virginia Center for Housing Research at Virginia Tech. The center conducts research and helps Virginia communities address housing challenges, with much of its rural work focused on the Appalachian region.

BARRIERS TO ENTRY

In general, multifamily rental projects are rare in rural places. The 2022 Harvard Joint Center for Housing Studies report found that only 4 percent of new multifamily permits issued in 2020 were in nonmetro areas. Some of this has to do with lower population density. The expected return on investment for a multifamily project rises with the number of rentable units, assuming the property manager can keep most of those apartments occupied by paying tenants. It's harder to fill a large apartment complex in rural areas with smaller populations.

Still, a lack of supply of multifamily rental housing doesn't always mean there's no demand for it.

"It's hard to measure demand when there's no supply," says Michael Rocks, president of Allen & Rocks Inc. and Rocks Engineering Company, a family-owned developer and builder of residential and commercial properties that primarily operates along the Baltimore, Washington, D.C., and Richmond corridor. His company is currently developing Lakeside at Trappe in Talbot County, a rural county of about 38,000 people on the Eastern Shore of Maryland. The project will include single-family homes for rent and purchase, apartments, and 40 acres of mixed-use commercial space. Rocks says they've garnered interest from in-state and out-of-state residents attracted by the natural amenities of Talbot County and its proximity to both the Eastern Shore and the Baltimore-Washington metro area. But even with indications of demand and financing in place, developers face plenty of additional hurdles.

Woodlawn School in Carroll County, Va., closed in 2013 and has since been converted into 51 affordable apartments. The county owned the land and was able to donate it to the developers.

IMAGE: WOODLAWN SCHOOL APARTMENTS — DEVELOPER LANDMARK ASSET SERVICES, INC.

"Permitting and zoning are a huge barrier to development," says Rocks. "In rural communities, it can be a challenge to achieve the density to support all the development costs associated with new housing construction."

The current economic environment is affecting builders in all markets, not just rural. The pandemic disrupted supply chains, raising the cost of materials. Higher interest rates have made financing more expensive. And a tight labor market has affected the supply of construction workers, a sector that never fully recovered from the Great Recession.

"We took an industry that was already unable to respond to demand and then we kicked it again with COVID," says Jones. In a world of scarcer and costlier resources, builders are even likelier to choose more lucrative projects in urban markets over smaller developments in rural places.

STRAINED SUPPORT

Another factor that makes it difficult to produce affordable rural rental is the income of households in those markets. Affordability is typically measured by the share of income households spend on housing, and median incomes in rural places are lower than in cities. If prevailing incomes are sufficiently low, it may simply be impossible for a developer to make a profit on a new property with rents that would be considered affordable.

In a 2020 report examining rural counties with persistent poverty, government-sponsored lender Freddie Mac found that a disproportionately high share of the multifamily rental market in those areas was comprised of units built with support from the Low-Income Housing Tax Credit (LIHTC) program, which provides a credit for developers of LMI rental housing.

"Part of the reason for this is that household income in these regions is very low; LIHTC is often the only economically viable way of providing affordable housing," the report's authors wrote.

Securing subsidies, and funding in general, can be a challenge for small communities. LIHTCs are administered at the state level and are not limited to rural jurisdictions, so those communities must compete with urban developers of LMI housing as well. Some states do set aside a portion of LIHTC funding for rural and tribal lands, but even so, local developers may find it exceedingly difficult to piece together sufficient funding to get projects off the ground. For example, a recent project to redevelop two empty buildings in downtown Pulaski, Va., into commercial and retail spaces with apartments on the upper floors took a combination of loans from multiple lenders, financing through Virginia Housing's REACH Virginia Program, and a state historic tax credit to complete.

In places that do have affordable rental housing, age also poses a problem for federal support. According to data from the Census Bureau's American Community Survey, 50 percent of rental units in the Fifth District were built between 1970 and 1999, anywhere from about a quarter century to more than a half century ago, and only about 13 percent were built after 1999. (For metro counties in the Fifth District, those shares were 46 percent and 23 percent, respectively.)

In addition to increasing the likelihood of repairs, age can affect whether a property is subject to rent caps that the developer had signed on for. The U.S. Department of Agriculture's Section 515 Rural Rental Housing Loans have 50-year terms at 1 percent interest for developers building multifamily rental units specifically for rural LMI households. Since the program's start in the 1960s, it has funded the construction of over half a million affordable rental units in rural markets.

But federal funding for the program has declined in recent years. Practically no new Section 515 units have been built since 2011. Moreover, once the loans on existing units mature or are paid off, property owners are no longer obligated to abide by affordability standards. The National Low Income Housing Coalition, an advocacy group, estimates that between 2028 and 2032, more than 16,000 Section 515 rental homes will move outside these affordability rules as their loans mature. That number is projected to rise to 22,000 annually after 2032.

This looming crisis has spurred bipartisan support to reform federal programs and preserve these sources of affordable housing. Sen. Tina Smith, D-Minn., and Sen. Mike Rounds, R-S.D., introduced the Rural Housing Service Reform Act of 2023, which would make it easier for nonprofits to acquire Section 515 properties and would allow residents to maintain eligibility for other forms of assistance tied to Section 515 even if the units exit that program.

FINDING SOLUTIONS

In the face of these challenges, what can rural communities do to preserve and expand their supply of rental housing?

A crucial first step is building local support for growth. Not every small town is necessarily looking to grow, and a growth mindset is one of the first things developers like Rocks consider.

"There are places that are really excited about more development. They want more people, they want to expand, because with development comes amenities like grocery stores, drug stores, restaurants, all of which need a critical mass of people," he says. "Pro-growth areas are where developers can focus on meeting the housing demand and challenges."

The pandemic has presented a unique opportunity for rural communities to attract teleworkers from metropolitan areas with their scenic natural amenities and lower cost of living. The Ascend West Virginia program, which launched in April 2021, offers incentives to out-of-state workers looking for a change of scenery. (See "Paid to Relocate," *Econ Focus*, Third Quarter 2022.) Of course, without a plan in place to expand the housing supply, a sudden influx of newcomers can end up exacerbating affordability issues for both owners and renters.

"Market-rate housing becomes more expensive, then that shifts individuals ultimately into potentially lower-quality housing. Renters end up paying more for lower-quality housing and it starts straining the market, especially if you don't have the ability to grow or expand that market due to some other variables," Danny Twilley explained on a recent episode of the Richmond Fed's *Speaking of the Economy* podcast. Twilley is the assistant vice president of economic, community and asset development for the Brad and Alys Smith Outdoor Economic Development Collaborative at West Virginia University and one of the architects of the Ascend West Virginia program.

Some localities have gotten creative with repurposing existing buildings to both expand their supply of affordable rental housing and garner community support by preserving a landmark of historical significance. Carroll County, Va., located on the border with North Carolina and home to about 30,000 people, saw such an opportunity in Woodlawn School. The school began life as a private institution before becoming the first public high school in the county and one of the first public high schools in the state in 1907. After it closed in 2013, county officials were determined to repurpose and preserve it.

Carroll County partnered with Landmark Asset Services Inc., a developer with experience in adaptive reuse in rural communities, to convert the school into 51 affordable apartments. Because the county owned the land and the property, it was able to donate it to the developers, which was crucial to making the project financially viable. The county was also able to retain the school gym and athletic fields to host public activities.

"It's a way to welcome new people into the community by preserving a building that locals know and love," says Jones. She notes that such school conversions have become increasingly popular in rural places. While she says the apartments in these projects are often earmarked for local seniors, they can also serve as an entry point for newcomers.

Another source of rental growth in recent years is single-family build-to-rent homes. Developers create neighborhoods where the homes are rented out rather than sold. Construction of such homes has nearly doubled since the pandemic, although it still accounts for a small share of the overall market — about 5 percent of total new housing starts. Most rural renters live in single-family homes, which would seem to make build-to-rent a natural fit. The vast majority of rural single-family rental homes are owned by small-scale landlords, however, rather than the large developers behind many build-to-rent projects. Still, such developments require a lot of land, which can sometimes be easier to come by in rural places than in cities. The Lakeside at Trappe project in Talbot County is one example of a rural development that includes single-family build-to-rent.

A WIDESPREAD ISSUE

In opening remarks at a Fed research seminar in September on rental housing affordability, Fed Gov. Michelle Bowman noted that the completion of new multifamily units has started to ease price pressures for renters, but rents are still above pre-pandemic levels. And most of this new construction activity has been in urban and suburban markets. Rural communities and small towns face additional hurdles to improving rental affordability on top of national headwinds. As part of its economic mission, the Fed continues to learn about conditions in the housing market and the solutions communities are employing to improve affordability.

"Access to stable, affordable housing is critical for economic well-being," Bowman said, "and it provides an important foundation for an individual to fully participate in the economy." **EF**

READINGS

"America's Rental Housing 2022." Joint Center for Housing Studies of Harvard University, 2022.

Dumont, Andrew M. "Rural Affordable Rental Housing: Quantifying Need, Reviewing Recent Federal Support, and Assessing the Use of Low Income Housing Tax Credits in Rural Areas." Federal Reserve Board of Governors Finance and Economics Discussion Series No. 2018-077, July 19, 2018.

Scally, Corianne, Brandi Gilbert, Carl Hedman, Amanda Gold, and Lily Posey. "Rental Housing for a 21st Century Rural America: A Platform for Production." Urban Institute and Housing Assistance Council Research Report, October 2018.

"Spotlight on Underserved Markets: LIHTC in Rural Persistent Poverty Counties." Freddie Mac Multifamily, Dec. 10, 2020.