STATE OF HOUSING REPORT

2022

KNOXVILLE AREA
ASSOCIATION OF REALTORS®

STATE OF HOUSING

The *State of Housing Report* is published annually by the Knoxville Area Association of REALTORS® to provide its members, community stakeholders, and policymakers a comprehensive analysis of East Tennessee's housing market using the latest available data. The report explores emerging demographic and housing market trends to help real estate practitioners and industry leaders better understand the region's housing challenges and how to address them.

ABOUT THE KNOXVILLE AREA ASSOCIATION OF REALTORS®

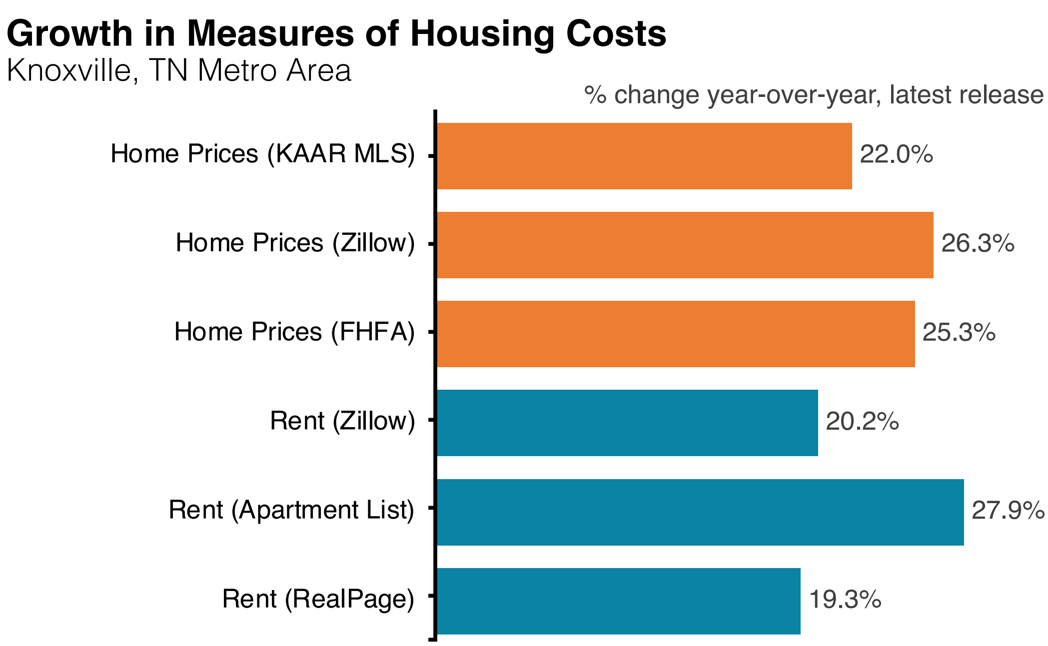
Founded in 1912, the Knoxville Area Association of REALTORS® has been serving the real estate interest of its members and the public for more than 100 years. The purpose of the Knoxville Area Association of REALTORS® is to unite and serve its members and to enhance the ability and opportunity of its members to conduct their business ethically, professionally, and successfully and to promote the preservation of the right to own, transfer and use real property.

INTRODUCTION

Improving economic conditions, low mortgage rates, and increased migration in 2021 pushed the demand for all types of housing in the Knoxville area to record-breaking levels, leading home prices to appreciate faster than any other time on record and pushing housing inventory to an all-time low. As a result, housing costs grew by double-digits from the previous year and have continued to rise through the early months of 2022.

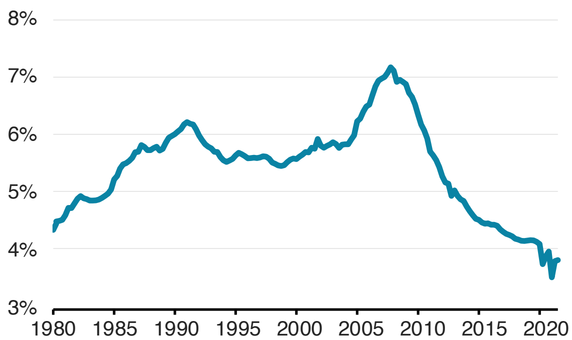
The extent of the current supply-demand gap – and the price growth it has spurred – is truly unprecedented. Only about 40% of U.S metro areas experienced more than 10% annual home price growth at the height of the financial crisis in 2006. But, in 2021, nearly 80% of metros experienced price growth of 10% or more and a full quarter of metros experienced price growth of 20% or more.

Fortunately, unlike the years preceding the Great Recession, the current housing market is not plagued by manipulated demand and loose lending standards. In fact, lending standards are higher than ever before with a disproportionate share of loans going to borrowers with strong credit history and sizable down payments. Home buyers are more qualified than ever too, with mortgages going to borrowers with a median credit score of 778 as of Q4 2021.[1]



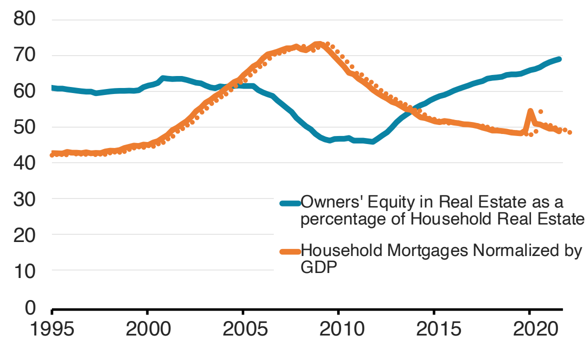
In addition to higher standards, risky lending practices aren't pervasive. Unconventional and adjustable-rate mortgage (ARM) products, which have a much higher risk of default, comprised around 40% of mortgages during the height of the housing bubble in 2006 but today represent just 2% of all mortgage products.[2]

Homeowners Aren't Overburdened With Debt
Mortgage Debt Service as a % of Disposable Personal Income



Source: Board of Governors of the Federal Reserve System (US)

Mortgage Debt and Equity in Real Estate
Owners' Equity in Real Estate vs. Value of Mortgages



Source: Board of Governors of the Federal Reserve System (US); BEA

Consequently, mortgage debt service payments as a percentage of disposable personal income fell to 3.8% in Q3 2021 – well below its peak of 7.2% in Q4 2007 – which suggests homeowners aren't overburdened with mortgage debt.[3] Households share of equity in real estate has also continued to climb. As of Q4 2021, owners' equity in real estate increased to 69%, indicating that 69% of the value of the average house is owner equity while 31% is owned by a financial institution. Unlike in the years preceding the Great Recession, when the rising value of mortgages was accompanied by a decline in the share of owners' equity, the sharp rise in the value of mortgages in Q2 2020 and the sharp decline since have had little impact on the share of owner equity.

Under these conditions, the exorbitant home price growth of the past two years should be recognized as the result of a substantial supply and demand imbalance – not a temporary or burst-able bubble. Confronting an acute housing shortage across all housing types, the challenge now facing East Tennessee whether to enable more housing production and preserve relative affordability, or to continue a status quo that will push homeownership out of reach for an ever-growing portion of the population.

ECONOMIC CONDITIONS

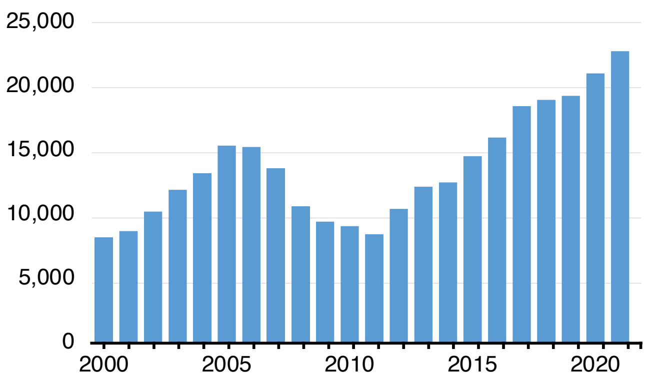
The onset of the COVID-19 pandemic in March 2020 represented an enormous challenge for Knoxville's economy. Over the preceding 5 years, from 2015 to 2019, the metro area's real gross metropolitan product had grown at an annual rate of 2.1% and added an average of roughly 5,700 new jobs each year. Facing the possibility of a protracted recession and considerable uncertainty, economic conditions declined in the initial months of the pandemic, but Knoxville's economy and real estate industry proved remarkably resilient.

In 2021, Knoxville's employment base expanded 3.1% – a net gain of 12,500 jobs – and inflation-adjusted economic output rose 4.6%. By December, total employment in the metro was more than 10% higher than the same month in 2011 and 1.1% above pre-pandemic levels. [4] As a result, Knoxville's unemployment rate in December 2021 declined to 2.9% – down 2.1 percentage points from the previous year and 10.9 percentage points from its peak of 13.8% in April 2020.

HOUSING MARKET

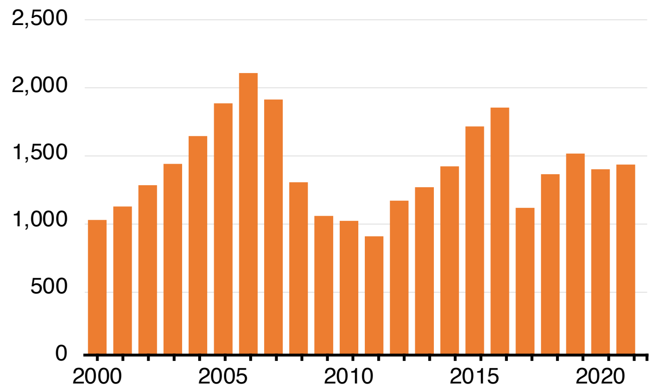
Despite an ongoing pandemic and unprecedented economic conditions, Knoxville's housing market didn't slow down in 2021. Supported by low mortgage rates and high migration levels, housing demand remained historically strong throughout the year with the Knoxville area registering more home sales in 2021 than any other year on record.

Home Sales
Annual Single-Family Home Sales: Knoxville Area



Source: Knoxville Area Association of REALTORS

Condo Sales
Annual Condominium Sales: Knoxville Area

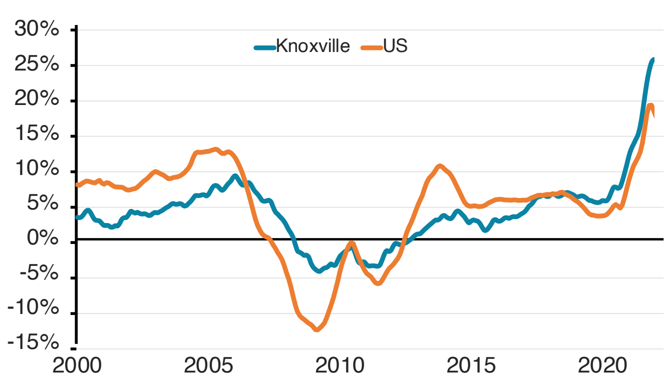


Source: Knoxville Area Association of REALTORS

Total residential home sales in the Knoxville area rose 7.9% from total sales of 22,416 in 2020 to 24,189 in 2021, the largest year-over-year increase since 2017. Single-family home sales rose 8.3% from the previous year, while condo sales rose 2.5%. In dollar terms, total residential sales volume rose from $5.6 billion in 2020 to $7.9 billion in 2021, a staggering increase of more than 40% from the previous year.

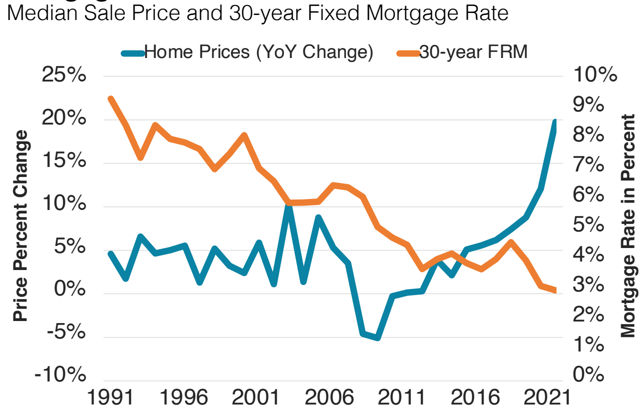
The median sale price in the Knoxville Area increased 19.7% on an annual basis in 2021 – placing Knoxville and East Tennessee among the fastest growing housing markets in the United States in terms of price growth.

Knoxville Home Prices Outpacing U.S. Average
Annual House Price Growth: Knoxville vs. U.S.



Source: Freddie Mac House Price Index, December 2021

Mortgage Rates and Home Prices Since 1990
Median Sale Price and 30-year Fixed Mortgage Rate

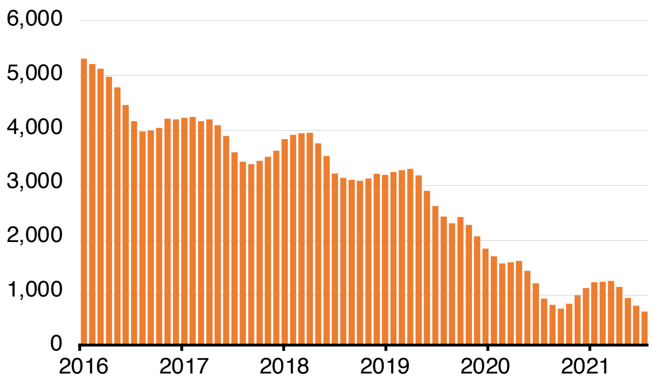


Source: Knoxville Area Association of Realtors; Freddie Mac

SUPPLY

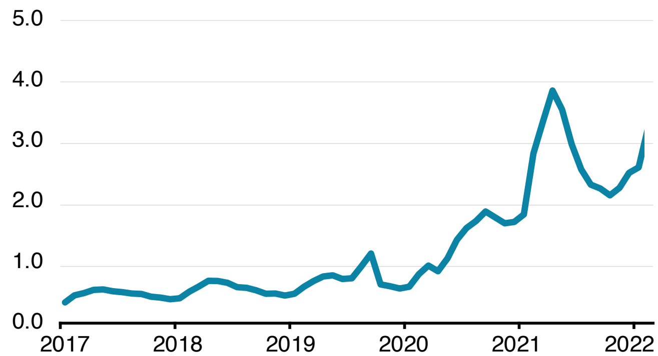
Housing inventory in the Knoxville area remains near a record low. While it was initially uncertainty and fear surrounding the pandemic that suppressed new listings, historically tight inventory conditions have further discouraged would-be sellers. A self-reinforcing cycle, fewer existing homeowners are willing to put their homes on the market than in previous years given the limited number of homes for sale and concerns about finding their own next home.

Housing Inventory
Active Listings: Knoxville, TN Metro



Source: Realtor.com; Knoxville Area Association of REALTORS

Housing Inventory
Pending Ratio: Knoxville, TN Metro



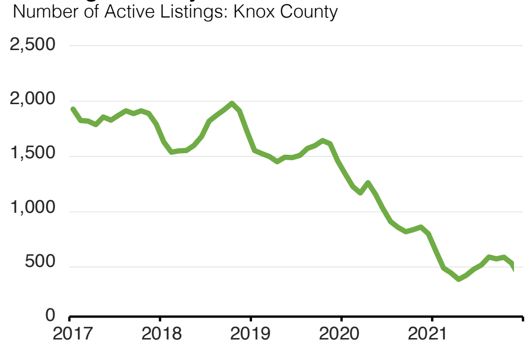
Source: Realtor.com; Knoxville Area Association of REALTORS
Note: Pending Ratio is a ratio of pending listings to active listings

As of December 2021, active listings in the Knoxville metro area were down 36% from the prior year and down 69% from pre-pandemic levels. On average, there were 2.7 times more pending listings than active listings at any given time during 2021.

SPOTLIGHT: KNOX COUNTY

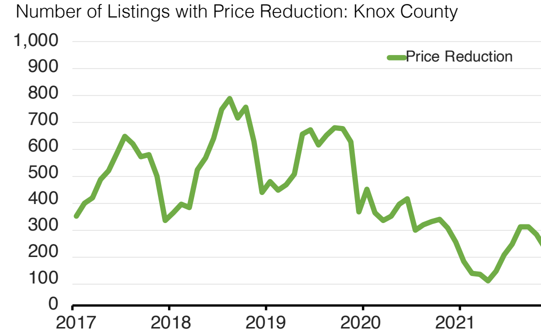
Available housing inventory in Knox County declined 76% from pre-pandemic levels – down from 1,332 active listings in 2019 to just 324 by the end of 2021. Similarly, monthly new listings fell to a record low by the end of 2021.

Housing Inventory
Number of Active Listings: Knox County



Source: Realtor.com

Price Reductions
Number of Listings with Price Reduction: Knox County



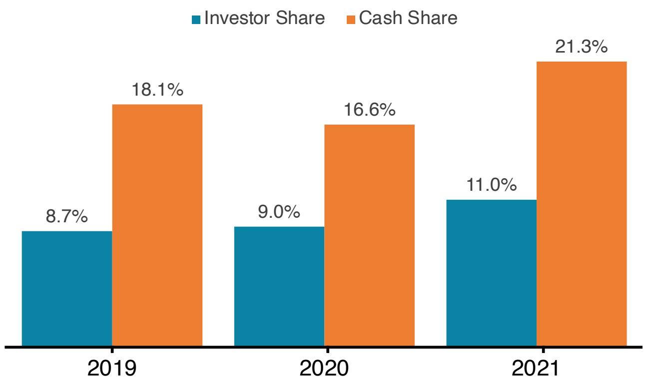
Source: Realtor.com

INVESTOR ACTIVITY

Growing interest in the single-family housing market among institutional investors has attracted significant national media attention over the past year, as the strong financial performance has made single-family rental properties a more attractive investment in recent years. A recent Redfin report found that, nationally, investor entities purchased a record-high 18.4% share of all homes sold in Q4 2021 – up from 12.6% a year ago – with single-family homes representing 3 in 4 investor purchases.[5] Of those purchases, 75.3% were paid for with all cash.

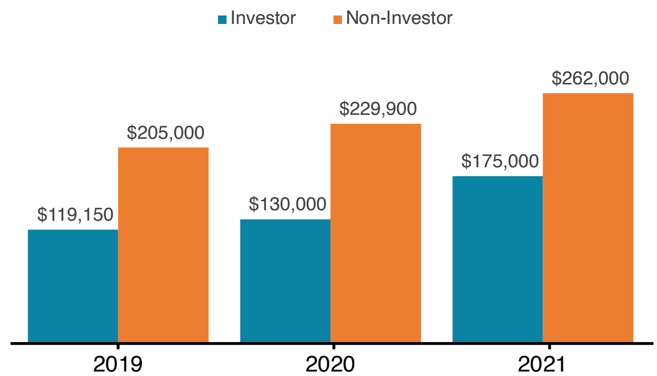
Despite the national trend, the rise in investor demand at the local level was nominal. In Knox County, the share of investor purchases remains relatively low compared to the nationwide average with investor purchases representing just 11% of Knox County home sales in 2021 – up from 9.0% in 2020 and 8.7% in 2019.[i]

Investor Market Share and Cash Sales
Share of homes purchased by investors/with cash financing



Source: Knoxville Area Association of REALTORS; Knox County Register of Deeds

Price of Investor vs. Non-Investor Purchases
Median Price by Investor Status: Knox County, TN



Source: Knoxville Area Association of REALTORS; Knox County Register of Deeds

However, the pandemic housing market did shift the type of homes investors were looking for. While historically favoring low-priced homes, mid- and high-priced homes have grown increasingly more attractive for investors since the onset of the pandemic.

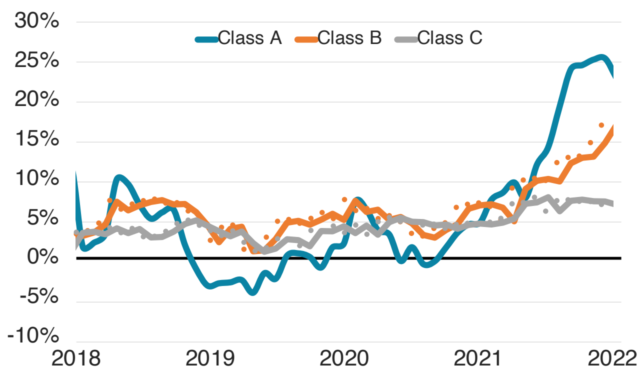
[i] For this analysis, investor purchases are defined as county sale records where the grantee's name includes at least one of the following terms: LLC, Inc, Trust, Corp, Partners, Homes, Acquisition. As a result, this data could overlook investor purchases made by independent investors using their own name to purchase the property or include home purchases made through a family trust for personal use. Properties with sales prices of less than $25,000 or more than $1,000,000 are excluded. This methodology is based on a similar analysis conducted by Redfin, a national real estate brokerage.

The median price of investor purchases in Knox County rose 47% from 2019 to 2021, compared to just 28% among non-investor purchases. While a sizable majority of investor purchases were properties within the bottom quartile of the market in previous years, the share of investor purchased properties in the top three price quartiles rose considerably in 2021 – meaning investors competed with middle-class home buyers more often than before.

RENTAL HOUSING

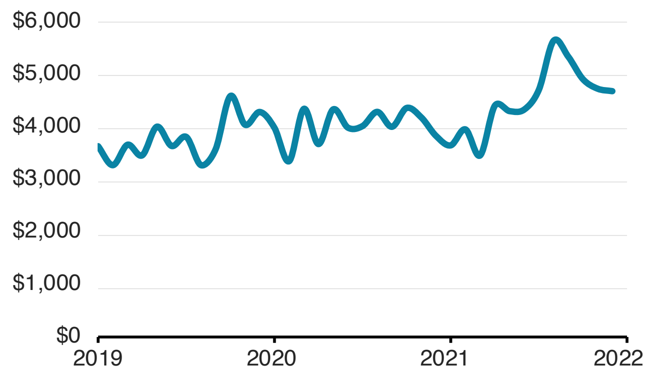
After an initial downturn in the first year of the pandemic, Knoxville's rental housing market experienced robust growth in 2021. Growth in rental demand can be attributed to multiple factors, such as renters who delayed moving due to the pandemic, two years' worth of college graduates entering the market for the first time, and young professionals choosing to live on their own.[6] A lack of inventory in the for-sale market and growth in the number of higher-income households turning to the rental market also contributed to the demand surge.

Rent Growth Highest Among Class A Units
YoY Effective Rent Change by Asset Class: Knoxville, TN



Source: RealPage Analytics

Growth In High-Income Renters
Average Monthly Income for Renter Households: Knoxville, TN

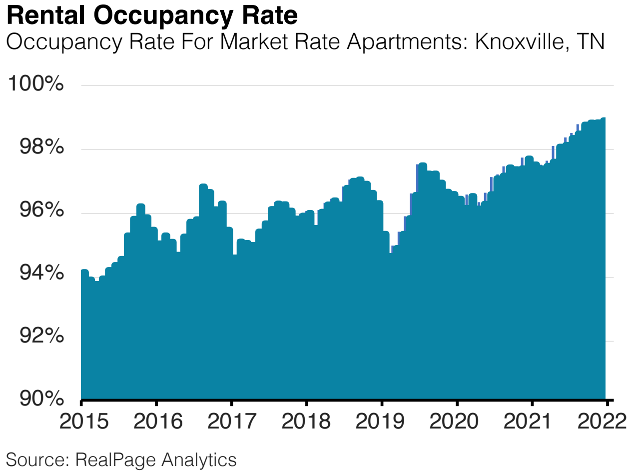


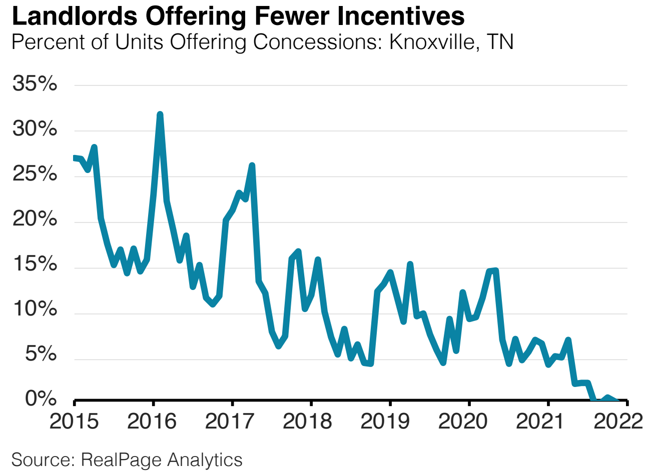
Source: RealPage Analytics

Increased demand placed upward pressure on rents and occupancy, with rents growing at nearly three times the historical average and vacancy rates plummeting to a record low. By December 2021, effective rents rose 19.27% from the previous year – an 18-year high – but varied across asset class. Annual effective rent change was highest among Class A units with 26.4% growth in 2021, compared to 14.3% among Class B units and 3.7% among Class C units.

SUPPLY-DEMAND GAP CONTINUES TO GROW

Much like the for-sale housing market, demand for rental housing exceeds the available supply to a significant degree, with demand outpacing supply by an average of 17 percent over the past five years. And the supply-demand gap only widened in 2021 with average annual demand exceeding average supply by more than 50 percent. Consequently, the market-rate rental occupancy rate grew to 98.9% in Q4 2021 – the highest level on record.





In addition to a surge in new demand, a record number of renters choosing to renew their current lease also contributed to tight inventory conditions. Both application rates and resident retention rates are at an all-time high, evidenced by the declining share of rental properties offering concessions or incentives (e.g., one-month free rent) to current and prospective tenants.

INDEPENDENT VS. INSTITUTIONAL LANDLORDS

The pandemic's impact on the rental market was uneven. Smaller landlords experienced larger declines in rental collection rates and were less equipped to weather revenue shortfalls than institutional landlords.

Existing disparities also widened. The rental collection rate for independently managed properties was just 3.5 percentage points below that of professionally managed properties going into the pandemic, but that gap widened to 12.5 percentage points by August 2020.[7] Consequently, a disproportionate share of independent landlords whose tenants stopped paying rent were forced either to sell their property or face bankruptcy.[8]

While the collection rate spread narrowed in 2021, the most recent data suggest collection rates for independent landlords continue to lag behind professionally managed properties. As of November 2021, collection rates for independent landlords were 85.2% compared to 93.1% among professionally managed units – a gap of 7.9 percentage points.[9]

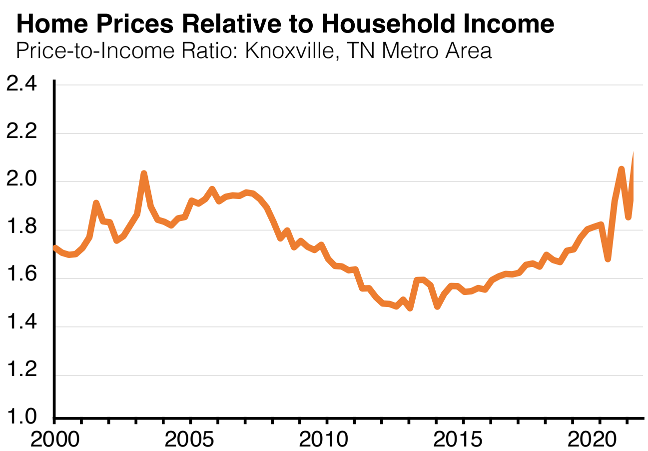
HOUSING AFFORDABILITY

Before the pandemic, more than 83,500 households in the Knoxville, TN metro area – and 48,000 households in Knox County – spent more than 30% of their income on housing. With both home prices and rents growing at some of the fastest rates on record, housing affordability worsened significantly since the pandemic and continued to decline in the early months of 2022.

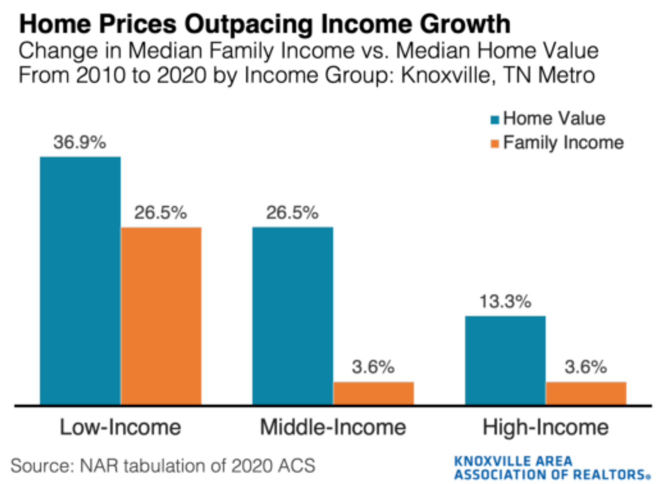
Although price appreciation is showing signs of moderation, housing affordability remains a salient concern among households of all ages, education levels, and races. In a public opinion poll commissioned by the Knoxville Area Association of REALTORS® in March 2021, more than 1 in 3 registered voters — 34 percent — indicated housing affordability in the Knoxville area was a big problem, while 28% said the same about housing availability.

HOMEOWNERSHIP AFFORDABILITY

Home prices in the Knoxville area are nearly 35% higher than in 2019, meaning the typical home is almost $70,000 more expensive than pre-pandemic. Even though mortgage rates plummeted to record lows and average weekly earnings grew 13% during the same period, higher incomes and lower borrowing costs were still not enough to offset the impact of higher home prices. As of Q4 2021, the month mortgage payment for a typical home in Knoxville was more than 27% higher than a year ago.[10] As a result, prospective homebuyers must spend more of their budget on housing than in previous years.



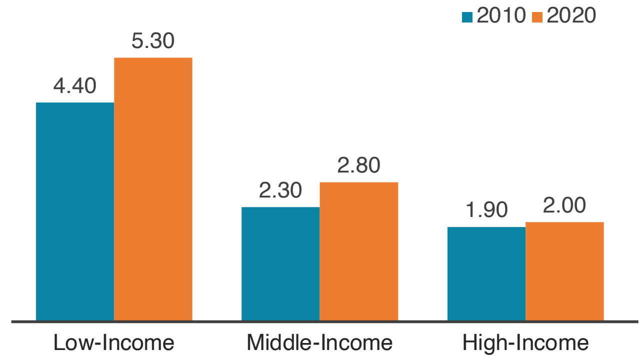
Source: Moody's Analytics



Source: NAR tabulation of 2020 ACS

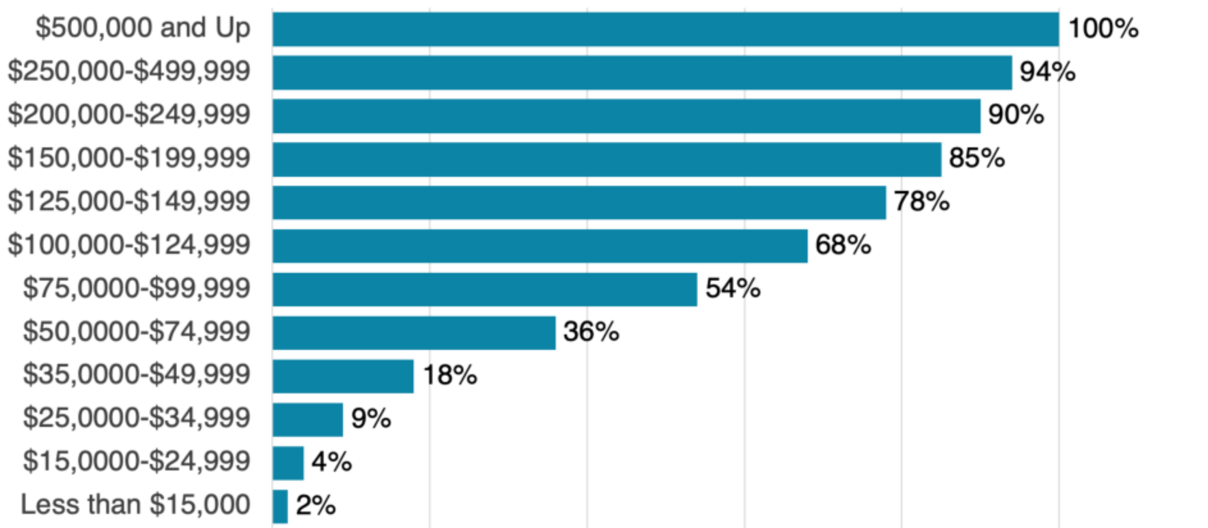
A new report by the National Association of REALTORS® found that a family earning between $50,000 and $75,000 in Knoxville (MSA) could afford to buy just 36% of the active housing inventory during December 2021.[11] Conversely, that same household could have afforded to buy 42% of the homes for sale during the same month in 2019, meaning affordability for households in the income bracket $50,000 to $75,000 has dropped 6 percentage points since the onset of the pandemic.

Price-to-Income Ratio Up Across Income Groups
Price-to-Income by Income Group: Knoxville, TN



Source: NAR tabulation of 2020 American Community Survey

Majority of Residents Can Afford Only Small Portion of Listings
Share of Listings That Are Affordable, By Income Level: Knoxville, TN metro



Source: National Association of Realtors

In addition to higher home prices, housing inventory reached a historic low in 2021 – down nearly 69% compared to 2019. Thus, not only can people afford a smaller portion of homes, but the actual number of homes listed for sale that are affordable has decreased even further. These factors created robust competition among buyers where nearly 2/3 of the population could afford just 1/3 of active listings (or fewer) on any given day.

Affordability concerns also center around the price distribution of the housing supply. Inventory in the lower price range remains the most constrained segment of the market, which is reflected by the declining share of homes sold for $200,000 or less.

Homes priced under $200,000 represented just 27% of total single-family home sales in 2021, compared to 40% in 2020 and 66% in 2015.

By the end of Q3 2021, the price-to-income ratio in the Knoxville metro area rose to 2.24 – the highest level since the 1970s and an increase of more than 16% from 2019. While conventional wisdom suggests that affordable markets maintain a price-to-income ratio 2.6 or less, meaning Knoxville remains relatively affordable, the ratio varies considerably across income groups. As of 2020, the average price-to-income ratio was above the affordability threshold for both the low- and middle-income homeowner groups, at 5.3 and 2.8 respectively.

In the segments of the Knoxville metro area with the highest demand, home prices grew at even starker rates relative to income. For example, home prices in Blount County grew at 3.6 times the rate of wages in Blount County and more than 2.2 times the rate of wages in Knox County.

With less affordable home prices and stagnant wage growth since the Great Recession, homeownership rates over the past decade declined across income groups. Median home values outpaced income growth to a substantial degree from 2010 to 2020, with the largest gap among middle-income homeowners.[ii] Home prices appreciated at the fastest pace relative to income among the middle-income group, with median property value growth of 26.5% over the past 10 years compared to income growth of just 3.6%.

As a result of worsening affordability and a limited supply of entry-level homes, there are 20,000 fewer low-income homeowners in the Knoxville metro area than ten years ago.

[ii] Per NAR's report, low-income households are defined as those who earn 80% or below the area median income; middle-income households those with income of over 80% to 200% of the area median income; high-income households are those who earn above 200% of the area median income.

OWNING VS. RENTING

Owning a home remains more affordable than renting in most of East Tennessee.

According to Attom Data's 2022 Rental Affordability Report, owning a median-priced three-bedroom home (assuming a 3% down payment) was more affordable than the average rent on a three-bedroom property in all counties within the Knoxville metro area for which data was available.[12] Although renting is often more affordable in more densely populated areas, the report found Knox County, TN, was among the largest mid-sized counties where owning was still more affordable than renting. The report also identified Roane County as the 2nd most affordable rental market in the United States.

PERCENT OF WEEKLY WAGES TO RENT VS OWN (2021)

County	Own	Rent
Anderson	20.4%	27.4%
Blount	30.8%	33.8%
Campbell	24.4%	35.2%
Knox	29.9%	32.9%
Monroe	25.4%	30.1%
Roane	14.1%	20.5%

Source: Attom Data
Note: Data unavailable for Cumberland, Fentress, Loudon, Morgan, Scott, and Union counties.

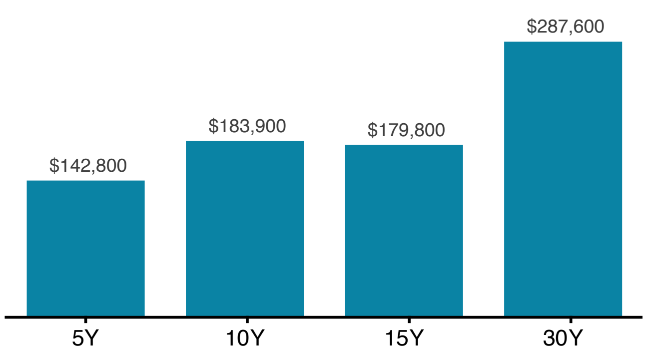
HOUSING WEALTH

Homeownership brings an array of financial and social benefits for individual homeowners, and it remains the primary source of wealth creation for most families.[13] The wealth benefits were especially tangible over the past decade, as homeowners experienced exceptionally large housing wealth gains due to strong home price appreciation.[14]

In dollar terms, aggregate housing wealth in the Knoxville metro area grew to $63 billion in 2020 from $42 billion in 2020 – an increase of more than $20 billion.

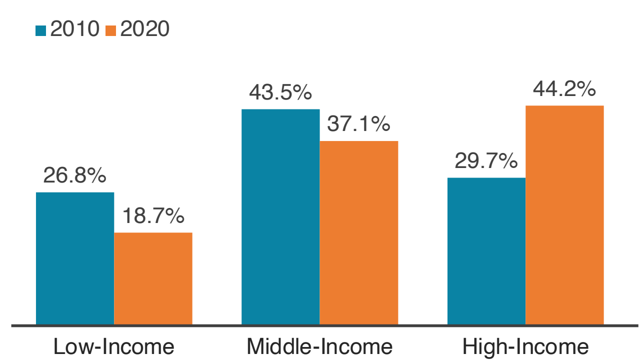
Unfortunately, these housing wealth gains are unequally distributed and highly concentrated among the most affluent homeowners – leaving low- and middle-income homeowners with just a fraction of the overall wealth gains and a smaller piece of the housing wealth pie. For example, high-income households accounted for 74% of the more than $20 billion in housing wealth gains in Knoxville from 2010 to 2020, while low and middle-income households together accounted for just 26 percent.

Housing Wealth
Housing Wealth Gains on a Typical Existing-Home Purchased 5,10,15, 30 Years Ago (as of Q4 2021): Knoxville, TN



Source: National Association of REALTORS

Housing Wealth Across Income Groups
Share of Housing Wealth by Income Group: Knoxville, TN Metro



Source: NAR tabulation of 2020 American Community Survey

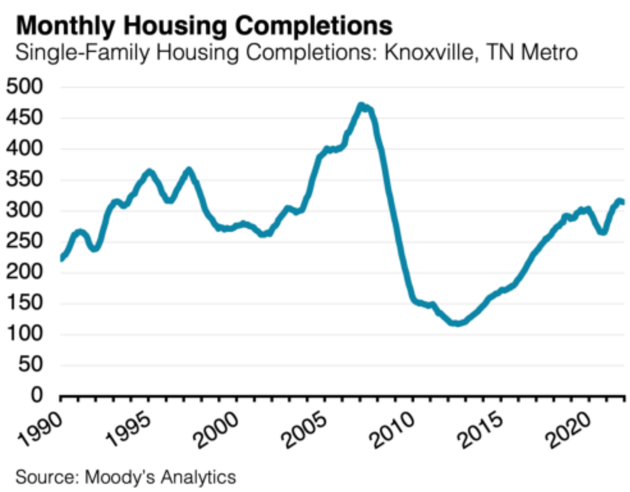
Still, however, wealth gains among the bottom portion of the income distribution were not insignificant. As of Q4 2021, a homeowner who purchased a typical single-family home in Knoxville ten years ago is likely to have accumulated $189,900 in housing wealth, while those who purchased a home 30 years ago have accumulated an average of $287,600.

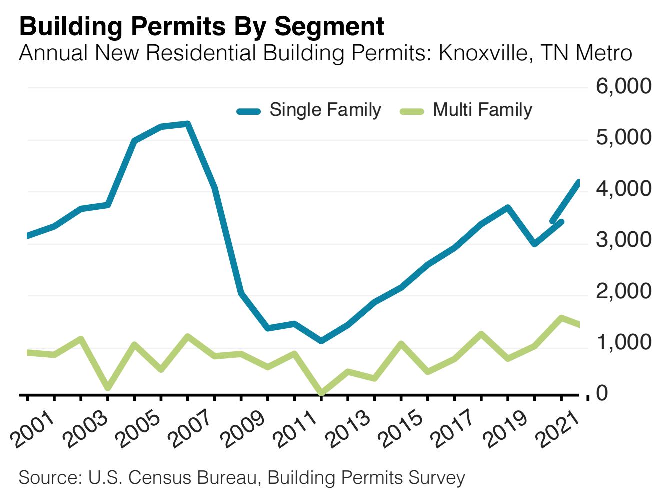
HOUSING SUPPLY & PRODUCTION

Meeting rising demand for housing is likely to remain an enduring challenge for the region, especially as home builders continue to face broad-based challenges. Though some of the current inventory trends are pandemic-related, the current housing deficit is the manifestation of more than a decade of under-building.

PRODUCTION

Single-family building permits rose 22% from 2020 to 2021 in the Knoxville metro area, outpacing the average increase of 12% in Tennessee and 14% nationally.[15] Only Johnson City experienced a larger annual increase in single-family permits than Knoxville. The above-average increase in single-family permits is illustrative of the growing demand for homes located in more rural and suburban areas, although this trend has eased as pandemic concerns have begun to subside.





Despite record-low vacancy and a boom in multifamily construction across the United States, multifamily building permits in the Knoxville metro area *declined* 13% from the previous year – falling well below the average *increase* of 24% in Tennessee and 31% nationally. Knoxville was one of only three Tennessee metros with a year-over-year decline in multifamily permits.

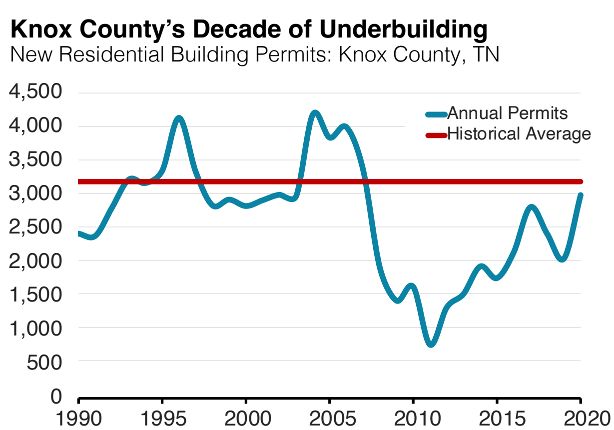
NEW HOME AFFORDABILITY

Affordability is also an enduring challenge in the new construction market. According to research by the National Association of Home Builders (NAHB), the median price of a new home in the Knoxville, TN metro area was $359,502 at the beginning of 2022, meaning the average new home is affordable only to households with an income of $81,161 or more.[16] As a result, approximately 70% of households (250,442) in the Knoxville area cannot afford the median priced new home and, for every $1,000 price increase, an additional 481 more households are priced out of the market.

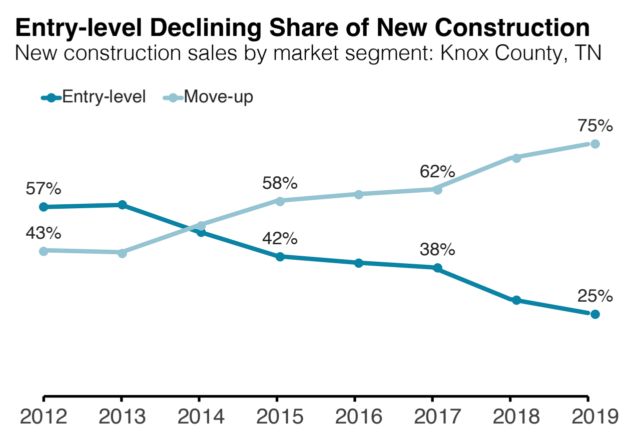
"We will continue to see that low double-digit growth in new homes prices as we move through 2022," says Robert Dietz, chief economist of the National Association of Home Builders. "It's going to be a tough year for housing affordability."

SPOTLIGHT: KNOX COUNTY

In Knox County, annual new building permits have remained below the long-run historical average in every year since 2008. While permits exceeded 30,000 in the 1990s and 2000s, total permits fell to just over 21,000 in the 2010s.



Source: Knoxville Area Association of Realtors; U.S. Census Bureau



Source: AEI Housing Center

As a result of this decade-long trend, Knox County has a cumulative deficit of some 17,000 housing units based on historical trends – a deficit that will take years of above average housing production levels to overcome. Beyond lower overall production, the entry-level share of new construction sales has fallen precipitously in recent years and contributed to the limited supply of homes at the lower end of the market.

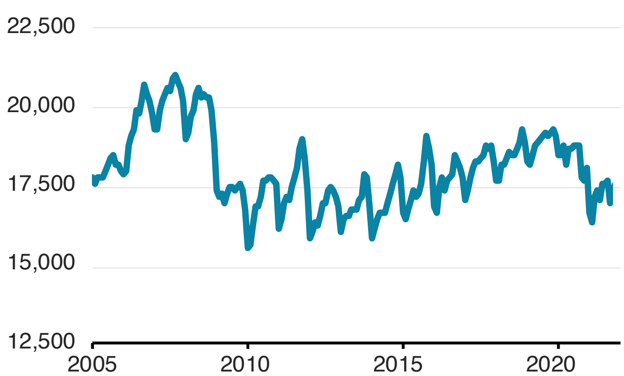
CHALLENGES

Housing production continues to lag behind employment and population growth, leading an already substantial housing supply gap to grow even larger. In the past three years, total employment in the Knoxville, TN metro area grew at 1.7 times the rate of building permits. Even in a market characterized by robust demand and growing potential for profits, an array of factors continue to hold back housing production.

LABOR SHORTAGE

COVID-19's impact on labor markets remains evident, as many workers who dropped out of the labor force in the early days of the pandemic have yet to return. The impact has been especially problematic for home builders, an industry decimated by the 2008 financial crisis and still recovering from the loss of thousands of skilled workers who permanently exited the industry.

Construction Industry Employment
Mining, Logging, and Construction: Total Employment



Source: Bureau of Labor Statistics (Data for Knoxville, TN as of Dec 2021)

Although the labor shortage is an issue in cities across the United States, the shortage is particularly acute in the Knoxville area – where construction employment represents a smaller percentage of the overall labor force and average hourly wages are approximately 17 percent less than the nationwide average.[17] Per the latest data from the U.S. Bureau of Labor Statistics, total construction industry employment in Knoxville (MSA) remains down nearly 10% from pre-pandemic levels.

RISING LAND COSTS

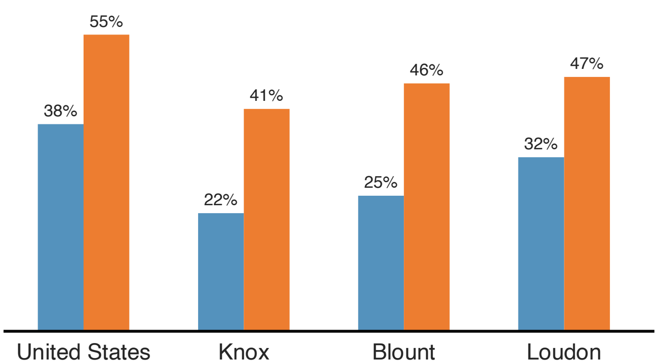
Limited developable land, in part due to urban sprawl and low-density zoning, has led to a considerable rise in land costs and the share of a home's value attributable to the land it sits on. For instance, the average land share of a property's value in the Knoxville MSA rose from 26.2% in 2012 to 44.3% in 2020, an increase of 18.1 percentage points.

AVERAGE LAND SHARE OF PROPERTY VALUE

County/Region	2012	2020	Net Change
United States	38.2%	54.7%	+16.5 pp
Anderson	27.5%	48.2%	+20.7 pp
Blount	25.0%	45.7%	+20.7 pp
Campbell	32.8%	53.4%	+20.6 pp
Cumberland	22.8%	37.8%	+15.0 pp
Knox	21.8%	41.0%	+17.7 pp
Loudon	32.1%	46.9%	+14.8 pp
Monroe	23.5%	44.5%	+21.0 pp
Roane	38.2%	52.0%	+13.8 pp

Source: AEI Housing Center

Rising Land Costs
Average Land Share of Property Value: 2012 vs. 2020



Source: AEI Housing Center

Why is the land share of property value important? Aside from the impact of rising land prices on housing affordability, a growing body of research suggests that:

(1) House prices tend to be more volatile in areas where the land accounts for a larger share of property value.[18]

(2) Change in the land share of property value is a robust predictor of house-price risk.[19]

For example, a study examining land values in the Washington, D.C. metro area found that areas with the largest increases in land prices in the years preceding the Great Recession tended to experience the sharpest home price declines during the bust. As a result, policymakers should be cognizant of the risk associated with rapid appreciation of land prices and take proactive measures to stabilize land values, particularly in areas of relative baseline affordability and high migration levels.

CONSTRUCTION MATERIAL COSTS & DELAYS

Bottlenecks throughout the supply chain have also yet to subside, pushing up material prices and thus the price of new homes. Even in a market saturated with demand, home builders remain cautious as higher material costs and delays in obtaining materials have added weeks to construction timelines, according to the National Association of Home Builders/Wells Fargo Housing Market Index (HMI).[20]

Building material prices rose 15.9% across 2021 with double-digit price increases in almost every category.[21] Beyond elevated prices, price volatility presents another challenge in and of itself with the prices of some materials rising nearly 25% in a single month.

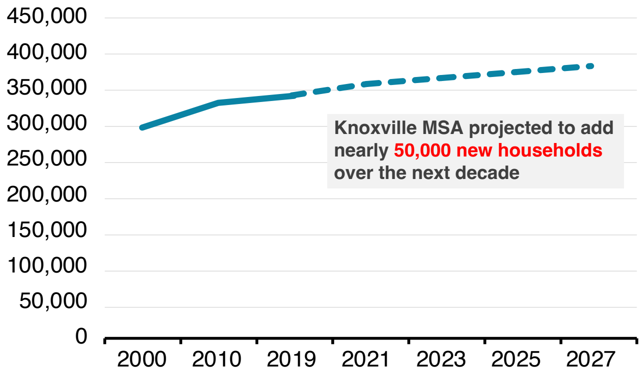
INFLATION

Accelerating inflation, which reached a 40-year high of 7.5% in February, also presents a unique challenge for builders and developers. Because home building is largely a debt-financed industry, higher interest rates resulting from tighter monetary policy are likely to raise the cost of financing and thus push construction costs even higher in 2022.

DEMOGRAPHIC DRIVERS

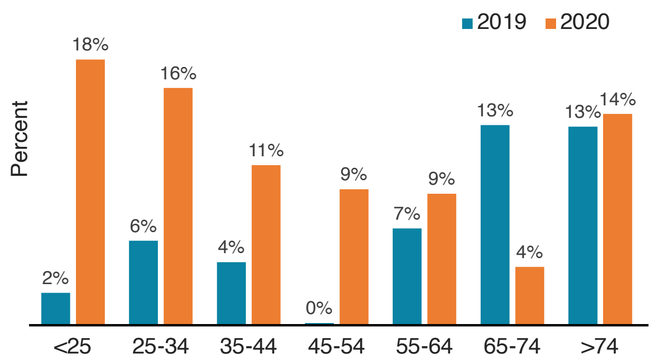
A significant portion of the growth in housing demand across the past two years can be traced back to favorable demographic patterns, including increased household formation and strong net migration. Other factors, such as record-low mortgage rates and generational trends, also contributed to the surge in housing demand.

Household Formation Projected To Rise
Total Households: Knoxville, TN Metro Area



Source: U.S. Census Bureau; KAAR estimates

Millennials Driving Housing Market Growth
Home purchase year-over-year growth by age group



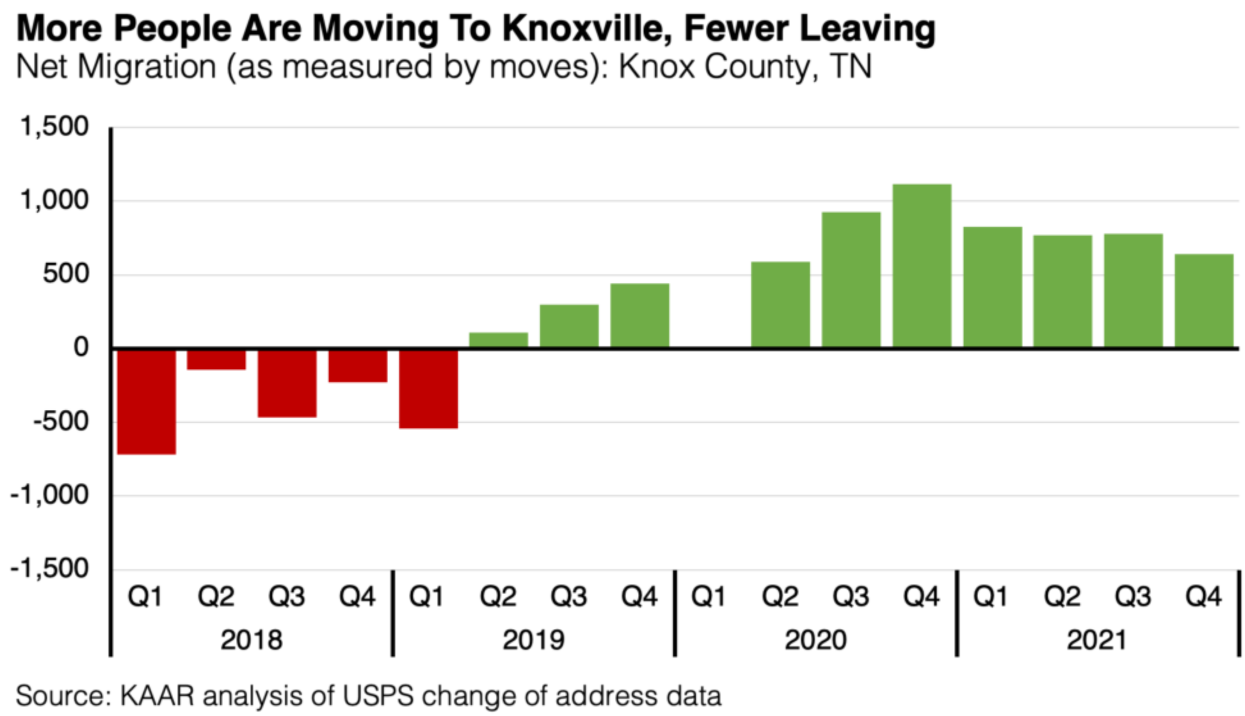
Source: KAAR analysis of 2018-2020 HMDA data

NET DOMESTIC MIGRATION

Since the onset of the COVID-19 pandemic, there's been a sharp rise in the number of people moving to the Knoxville area and a decline in the number of people leaving.

Above and beyond the population growth captured by the most recent census, the National Association of REALTORS® (NAR) found that nearly 10,000 people moved to the Knoxville metro area in 2020, a rate which only increased during 2021. According to NAR's analysis of USPS data, Knoxville was among the top 10 U.S. metro areas with the most net migration gains in the first half of 2021. Similar mid-sized cities—such as Greenville (SC), Asheville (NC), Raleigh (NC), and Huntsville (AL)—also appeared on the report's list of the highest migration metro areas.

In Knox County, USPS change-of-address data shows an influx of new people moved to the area in the months following the onset of the pandemic. Net migration to Knox County rose dramatically until peaking in the Q4-2020. However, the pandemic-influx did not completely subside with the county recording positive net migration gains in each quarter of 2021. USPS data indicates Knox County added between 2,500 and 3,000 new movers in 2021, which could translate to roughly 4,000 to 5,000 new residents.



Data suggests a sizable portion of the net migration is from households moving to Knoxville from outside of Tennessee. More than half of users (53.1%) searching for properties in the Knoxville, TN metro area were from other states, according to Realtor.com search data for Q4-2021, with properties in the area receiving 1.7 times more views on average than the U.S. overall. Knoxville also ranked No. 13 on United Van Line's list of U.S. metro areas with the highest percentage of inbound migration.

While migration appears to have eased slightly, the East Tennessee region is likely to experience sustained positive migration in the coming years.

HOUSEHOLD FORMATION

The average number of people per household has steadily declined since the 1960s, a trend that has created additional overall housing demand. One of the key drivers of this trend is the growth in sole-person households. According to Freddie Mac, sole-person households in the U.S. have doubled over the past 40 years and are expected to increase by another 15% by 2030.[22] Growth among this demographic is expected to have an enduring and significant impact on housing markets, boosting demand for smaller, less expensive homes.

FORECAST

HOUSING MARKET OUTLOOK

After two years of expansive growth, housing market activity is bound to moderate.

But even so, home prices aren't at risk of decline and upward pressure on housing costs isn't expected to subside over the near term. Strong underlying fundamentals, favorable demographic trends, and continued migration indicate the broader East Tennessee region is primed to outpace many other markets across the U.S. in 2022. And as mortgage rates trend upward, the Knoxville's status as a relatively affordable market could make the region even more attractive to out-of-town buyers.

However, higher home prices and elevated borrowing costs associated with rising mortgage rates are expected to further erode affordability – a prospect that, if realized, would have an outsized effect on lower-income households and could soften demand among certain demographics. In addition, a lack of inventory is likely to have a material impact on demand and slow the rate of home sales.

While the pace of home sales could slow in 2022, most REALTORS® remain optimistic about home prices. Among those who participated in KAAR's Q1 2022 *Market Pulse Survey*, 88% of Knoxville Area REALTORS® reported that they expect home prices to increase over the next year, with 36% reporting they expect home prices will rise by 11 percent or more.[23]

KAAR's Annual Housing Market Forecast predicts total residential home sales are expected to grow between one and three percent and home prices to grow between five and eight percent in 2022, compared to 7.9% home sales growth and 19.7% home price growth last year.[iii]

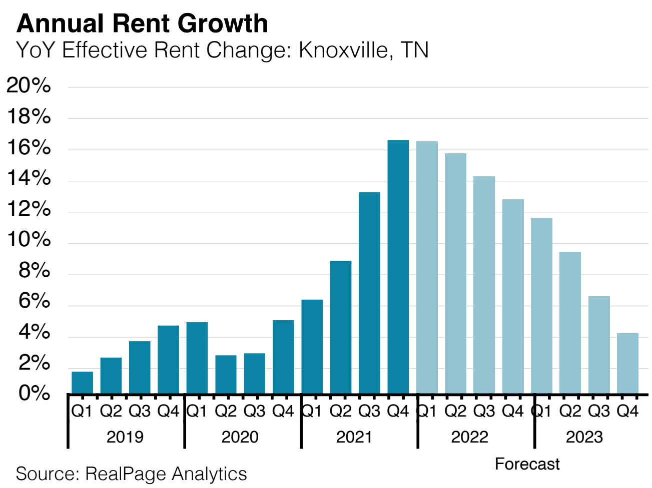
RENTAL MARKET OUTLOOK

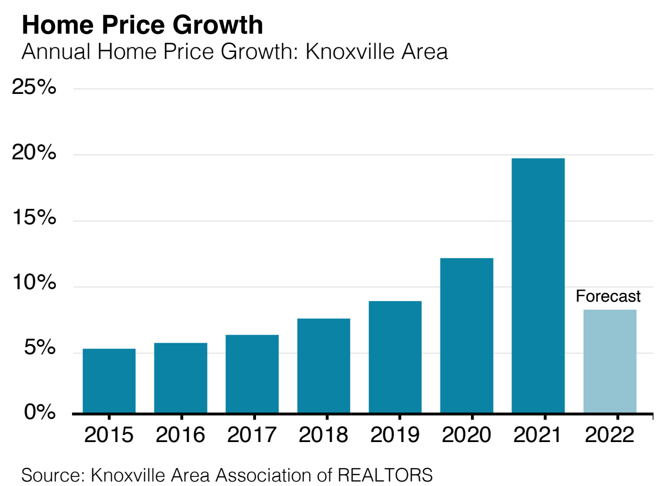
Moderating demand and new units scheduled to come online suggest occupancy rates could taper slightly in 2022, but inventory should remain tight throughout the year. Rents are projected to grow by double-digits on an annual basis, albeit at a moderating pace.

[iii] The Knoxville Area Association of REALTORS® housing market forecast is intended provide a market-level prediction of housing market trends for the Knoxville, TN metro area and East Tennessee region. Home sales and price growth vary considerably by submarket; thus, we recommend potential home buyers and sellers contact a Realtor® to provide a more context-specific, individualized assessment of your local market.

According to a recent survey conducted in January 2022 by Avail, an online rental management platform, 65% of landlords said that they would increase rents within the next 12 months, with the majority expecting to raise rent by between 5% and 10%.[24]

Overall, inventory growth is projected to remain close to the Knoxville metro's average. More than three-quarters of new supply delivered in the past five years was in West Knoxville, but the bulk of new supply slated for delivery in 2022 is in the Downtown and South Knoxville areas. As a result, rent growth is expected to be particularly strong in the West Knoxville and Southwest Knoxville, areas where inventory is not expected to grow substantially.





POLICY CONSIDERATIONS

As home prices and rents have grown over the past decade, Knoxville is nearing an inflection point. Should housing production levels and home prices continue at their current pace, Knoxville could cede its status as an “affordable” place to live in just a few years. Therefore, addressing the chronic undersupply of housing and declining housing affordability is critical to the region’s future. Measurable progress on the issue will require local leaders and elected officials adopt an “all-of-the-above” strategy that spans across industry and sector. This section identifies a wide variety of policies, initiatives, programs, and incentives that have the potential to address the growing challenge of housing affordability.

BUILD MORE HOMES WHERE PEOPLE WANT TO LIVE

Housing of all types is in short supply, particularly in places people want to live. In many localities, including Knoxville, overly restrictive or subjective land use policies prevent housing construction in high-productivity places – thereby reducing economic output by limiting the number of individuals who can live in areas with the most economic opportunity and preventing land from being redeveloped for its best and highest uses.[25] Yet, the places where new housing is most desired and most cost-effective (in terms of taxes per square foot) are simultaneously the places where new housing development faces the most opposition, via land use regulation or community opposition.

DEVELOP A LIGHT TOUCH DENSITY OR MISSING MIDDLE HOUSING PLAN FOR INFILL DEVELOPMENT

One of the most important yet overlooked opportunities to increase the housing supply is through Light Touch Density (LTD). LTD, as defined by the American Enterprise Institute, is “single-family development with accessory dwelling units, small-lot single-family development, attached single-family development, and duplexes, triplexes, and fourplexes.” By embracing designs with a lower perceived density, LTD development can accommodate multiple units without compromising the character of an existing neighborhood while reducing both the public and private costs of development.

LTD is particularly useful as a strategy for infill development, which is typically more cost effective for local government since infrastructure already existing and does not need to be extended as is often the case with greenfield development. According to one study, the required infrastructure cost of one unit of housing on an infill site cost approximately $50,000 less than the same development on a greenfield site.[26] As a result, infill development is almost always more cost-effective for local government, even when the infrastructure surrounding the infill site isn't completely sufficient.

Policymakers should consider developing a plan specifically for infill development, which could include zoning changes to support desired development and the creation of pre-approved building plans that comply with local government regulations.

More information about Light Touch Density is available at https://www.aei.org/light-touch-density/.

ENSURE FUTURE LAND USE REFORM MAKES DEVELOPMENT DECISIONS FAIR, PREDICTABLE, AND "BY-RIGHT"

For homeowners and developers to ensure their property lives up to its highest and best use, local government must make sure development decisions are predictable, fair, and cost-effective.[27] This requires moving away from conventional zoning codes that utilize discretionary approval processes, such as planned development, and moving forward with a "by-right" zoning code that ensures all projects that comply with zoning standards receive approval. A by-right zoning code or review process can effectively lower the cost and lower the risk of development, while eliminating many of the issues that unnecessarily pit developers and neighborhood advocates against one another.

More information on by-right zoning is available at https://opticosdesign.com/blog/how-to-get-by-right-zoning-right/

ALLOW ADUS IN ALL RESIDENTIAL ZONING DISTRICTS

It is time to end "one-unit-per-lot" zoning and allow accessory dwelling units (ADUs) in all residential zoning districts. ADUs can be several different housing types, from a garage apartment to a stand-alone backyard cottage, but they are generally defined as an independent unit that is located on the same lot as a single-family home. For example, an adjustment was made to zoning rules in Tacoma, Washington in 2019 to allow for one ADU to be added to a property located in a former single-family residential zone, and they have seen a 94.6% increase in permits issued within one year of the new rules being in effect. Adjusting zoning rules to allow ADUs could bring more affordable housing opportunities to our community without sacrificing the appearance or character of existing communities.

CREATE A "GREEN TAPE" PROGRAM FOR LAND DEVELOPMENT REVIEW AND APPROVAL[28]

Research suggests that regulatory costs account for a quarter of the cost of single-family housing and a third of the cost of multifamily housing. Local governments should consider working to reduce regulatory costs, especially for desirable development, through the implementation of a "Green Tape" program.

(1) *Expedited review process for desirable proposals:* Policymakers should consider adopting a separate and expedited review process for qualifying projects. Lengthy and complicated review processes are among the most difficult challenges for home builders and developers alike. Such regulatory delay is not cost-effective and can lower return on investment, thereby disincentivizing desirable housing development. Qualifying projects could include lower market-rate or entry level housing, infill housing, mixed-use developments, housing located in target locations, redevelopment, etc. An expedited review process for qualifying projects bears the potential to incentivize and increase the production of affordable market-rate housing.

(2) *Expedited review based on pre-approval:* Policymakers should consider establishing a certification program whereby certified development professionals, such as architects and engineers, can self-certify that plans comply with local codes and standards. Plans submitted by certified professionals could receive automatic approval (with periodic auditing) or go through an expedited review process. Other local governments that employ this strategy typically require individuals seeking certification to meet a set of professional requirements and complete a series of courses of local laws, codes, and standards.

DEVELOP MORE ROBUST FINANCIAL LITERACY AND HOMEOWNER EDUCATION IN PUBLIC SCHOOLS

Sticker shock is a problem for all types of home buyers but specifically for first-time or first-generation buyers. A recent poll of approximately 3,000 adults by realtor.com found nearly half of homeowners — 44% — weren't aware of the costs associated with purchasing a home. Even more, new research by Fannie Mae finds the largest contributors to housing costs are consistently *non-mortgage* costs.[29] Alas, one significant barrier to homeownership is pre-existing knowledge about the buying process and the cost of homeownership – access to what one might call "preparatory" information that allows prospective buyers to understand and plan for additional buying costs (i.e. closing costs, home inspection, document fees, property taxes, home insurance, title fees, and moving expenses) as well as non-mortgage expenses like utilities, property taxes, and home improvement expenses.

Local government should consider working with industry partners to provide more robust financial literacy and homeowner education in public schools. Such a program could be hugely beneficial for students, lowering the social barriers to homeownership and promoting upward mobility.

ASSEMBLE A DATABASE TO IDENTIFY AND ADDRESS VACANT, ABANDONED PROPERTIES

Vacant, abandoned, deteriorated properties (VADs) have a long history of negatively affecting communities. Research shows these properties can undermine neighbors' quality of life, depress the sales prices of nearby properties, induce higher crime rates, and decrease opportunities for economic growth. One study even found that the concentration of blighted properties could be used to predict where future homicides are most likely to occur.[30]

To better identify vacant and abandoned properties, local governments should consider assembling a database to keep track of their prevalence and location. Such a database could aid law enforcement efforts while simultaneously help to bring these properties, especially those without readily identifiable owners, back into productive use. With limited developable land and rising land costs, vacant and abandoned property remediation is one tool local government could use to alleviate the housing shortage.

EXPAND REGIONAL PUBLIC TRANSPORTATION

Public transportation is critical to housing affordability and availability. For many families, expanding public transit means expanding acceptable housing locations and thus what and how much housing is available. Public transit can also reduce transportation costs. According to estimates from the Center for Neighborhood Technology, average annual transportation costs amount to $12,909 for households in the Knoxville metro area, meaning transportation costs alone amount to a significant portion of monthly earnings for a typical household in East Tennessee.

EXPLORE WAYS TO INCENTIVIZE CONVERSION OF OLDER OR UNDERUTILIZED COMMERCIAL SPACES FOR ADAPTIVE REUSE AND RESIDENTIAL USE THROUGH TAX CREDITS AND OTHER MEANS.

Following a decade of structural shifts in the national economy, in addition to the unequal economic impact of the COVID-19 pandemic, many parts of the country have a sizable stock of vacant or underutilized commercial spaces.[31] Adapting these older or underutilized commercial spaces for use as housing could be a viable way to narrow the residential under-building gap and increase the supply of housing. Local government should explore programs at the local level to remove land use barriers and incentivize the conversion of these properties, especially buildings that are no longer in use and are unlikely to be functional again.

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