WALL STREET JOURNAL

A New Lease on Luxury

They've got the money to buy trophy homes—but for now, they'd rather rent. Hoping to keep cash liquid while watching the direction of the market, more people are paying big sums for temporary digs.

By CANDACE JACKSON and LAUREN SCHUKER BLUM

Candace Jackson joins Lunch Break to discuss why both luxury developers and high-income home shoppers are flocking to luxury rentals now. Photo: dbox.

When real-estate developer Don Peebles moved his family to Manhattan from Coral Gables, Fla., he decided to combine two adjacent ninth-floor apartments to create a 4,750-square-foot, seven-bedroom, nine-bathroom home with glass walls on the Upper West Side overlooking the Hudson River. His wife, Katrina, spent two months decorating the apartment with abstract paintings from their art collection, whimsical wallpaper in the kitchen and tufted couches in the living room.

Though the Peebleses invested significantly in their home, they don't own it. Instead, they are paying $35,000 a month to lease it. Renting also gives them the flexibility change their minds about what neighborhood they want to live in if they decide to move. "Our primary residence doesn't need to be an investment," he says.

A growing number of people who can afford to buy trophy homes are instead opting for a more temporary solution: the trophy rental. Some renters say they want to avoid tying up their money in steep down payments and instead are investing their money in the financial markets or their own businesses. Still, they're willing to spend tens of thousands of dollars a month on a rental to get the lifestyle they want.

As a result, the highest end of the rental market has seen significant growth. In New York, apartments and townhouses priced at $15,000 per month and up represented 1.3% of the market in December, up from 0.5% a year prior, according to Jonathan Miller, president of appraisal company Miller Samuel. Prices are rising quickly as well: the median price for the $15,000-and-up sector is up 23.1% from a year ago. The uptick in rentals mirrors an overall trend nationwide in which the rental vacancy rate fell to 4.5% in fourth quarter of 2012, down from 5.2% a year earlier, according to real-estate research firm Reis Inc. REIS +7.38% —and the lowest since 2001's third quarter.

Astrid Pillay, a broker with Halstead in Manhattan, found two $35,000-a-month rental apartments for clients in December and says another recently offered a seller $1 million for a two-year lease on a townhouse currently for sale. A number of her rental clients, she says, are recent sellers of trophy homes who have "just cashed out" and want to wait until the market dips again to buy. Other brokers say limited inventory of houses for sale has also helped the rental market. "At this price point, you're not just going to settle for whatever is available," says Noble Black, a broker with Corcoran.

New to the rental market in New York are three penthouses ranging in price from $30,000 a month to $50,000 a month in New York by Gehry, a new high-rise building in Lower Manhattan where one-bedrooms on high floors start at $5,500 per month. The largest unit in the building is a 3,800-square-foot, 76th-floor penthouse that includes a nearby studio apartment for nannies, maids or in-laws. Annual cost would top $600,000 a year.

In California, luxury rents are increasing by 5% to 10% each year, says Bill Witte, president of developer Related California. In San Francisco, where Related California has one luxury rental building and several in the works, rents are already 10% higher than their peak before the recession hit, he says. At the Paramount, the developer's 40-story rental tower downtown, rents are now more than $4.50 a square foot, up from their prerecession peak of $4 a square foot. Related recently rented a 1,190-square-foot two-bedroom apartment there for $6,850 a month.

In San Francisco's financial district, Millennium Tower, a 60-story high-rise where venture capitalist Tom Perkins owns a penthouse and retired quarterback Joe Montana rents two apartments, there's a two-bedroom just under 2,300 square feet available for $15,000 a month.

In Los Angeles, billionaire developer Rick Caruso recently opened 8500 Burton Way, an 87-unit apartment building near Beverly Hills and just last week unveiled its crown jewel: a three-bedroom, fully furnished penthouse unit with a monthly rent of $40,000. Mr. Caruso put $2.1 million into building and decorating the unit—which includes custom-made macassar ebony bookshelves and Hèrmes wallpaper in the bathrooms—and says it is the priciest rental in Southern California. (A penthouse unit at 1221 Ocean Ave., a luxury building that overlooks the Pacific in Santa Monica where Britney Spears once lived, doesn't even come close, at $27,000 a month).

In Miami, rentals that were going for $25,000 a month a year ago are now renting in the $40,000 range, says Greg Mirmelli, a principal and founder of GM Real Estate in Miami. A home on Sunset Island, for example, now rents for roughly $40,000, up from $30,000 two years ago.

Daniel de la Vega, a managing partner of One Sotheby's Realty in Miami, says he's got six listings for condos or homes above $30,000 a month or more, which are leasing much faster than usual, mostly to foreigners who will eventually buy something. A private gated home on the beach recently rented for $90,000 a month; it is also available for sale for $14.9 million.

The rise of the trophy rental comes as many Americans continue to abandon ownership in the wake of the country's housing crisis and credit crunch. The U.S. homeownership rate was 65.3% in the third quarter of 2012, its lowest level since 1996, according to the Census Bureau. In the midst of the housing boom, in 2004, the homeownership rate reached 69.4%.

"We are definitely seeing gravitation toward higher leases," says Billy Rose, president and co-founder of the Agency, a real-estate firm in Beverly Hills. "A lot of the private-equity guys we see who used to buy are choosing to rent places for $10,000 or $15,000 a month now because they would rather play the market than buy a house," adds Mauricio Umansky, Mr. Rose's partner and Agency co-founder.

Jonathan Moore, a 25-year-old entrepreneur, currently leases a two-bedroom at the Ritz-Carlton Residences at LA Live in downtown Los Angeles for $6,200 a month. Mr. Moore, who runs an alternative investment-management company called GCM Capital Management, says that right now he would rather keep his money in his business rather than plunk it down on a large down payment, especially when he doesn't plan to stay in one place for more than five or 10 years. "I am an illiquid millionaire, so it would be hard for me to unwind my stake in my business," he says. "But this way, I get all the benefits of being a homeowner, and all the luxury amenities, without the financial downsides."

Renting, of course, does have its drawbacks. Renters may be subject to landlords raising fees or refusing to renew a lease, for example. With homeownership, "you have some security with respect to the ability to control your own destiny," says Stuart Gabriel, the director of the UCLA Ziman Center for Real Estate. Still, ownership typically only makes economic sense for those looking for stay put for several years. Property values need to appreciate enough to cover closing costs and other fees. "You're speculating on housing prices and included in that speculation is the cost of buying and selling, which can be substantial," he says.

Real-estate brokers say their listings for the largest, most-expensive rental apartments tend to go very quickly—sometimes exceeding their asking prices. Bo Poulsen, a broker with Town Residential in New York, says he recently had four offers for a TriBeCa apartment asking $18,500 a month shortly after it hit the market. It ended up renting for $21,000. "That definitely was not happening a year ago," he says.

According to real-estate tracker Streeteasy.com, the median amount of time a New York rental property above $15,000 a month spent on the market was 10 weeks, down from 12 weeks in 2011.

The relatively low inventory and high demand means unsolicited rental offers on for-sale properties have become commonplace. Restaurateur Jeffrey Chodorow recently received an offer of $75,000 a month to rent his 3,700-square-foot Manhattan condominium, which is on the market for $18.8 million, says his broker, Oren Alexander.

Limited availability of homes for sale is also driving buyers to the rental market. "If you want to live in a brand new apartment, there just isn't anything available right now—every building is full," says Gregg Lynn, a luxury broker at Sotheby's International Realty in San Francisco. "You have to wait until 2015 for new construction."

Some of the newest high-end rental buildings were originally designed as boom-era condominiums and converted when sales were slow. In many cases, owners opted to rent the units because they didn't want to sell them at distressed prices.

In Hollywood, the Avenue was converted into rental apartments from condos when its backer fell into bankruptcy. The building now features $7,000- to $11,000-a-month penthouses with 25-foot ceilings. It is already 95% leased. "When we took over the project, it was a half-done busted condo deal," says Rob Goodman, chief executive of Resmark Cos., which opened the Avenue.

Ken Kahan, founder of real-estate company California Landmark, is currently building three luxury rental buildings in Los Angeles. One of those projects, the bw in Brentwood, was originally designed as a condo project that Mr. Kahan converted to a rental development after the recession hit because it became too difficult to secure financing for condominiums.

The new demand for luxury rentals has spurred the expansion of several national companies, including AKA, which has rental buildings in New York, Philadelphia, Washington and London. Later this month, AKA is completing the finishing touches on a luxury rental in Beverly Hills, where furnished apartments under 2,000 square feet rent for $12,000 to $16,000 a month. That development offers amenities such as a 50-seat screening room and a private entrance to Spago, an upscale Beverly Hills restaurant that will also deliver room service to residents.

Related Cos., a major apartment developer, just launched their priciest rentals ever in New York in a Midtown building called One MiMA Tower. After seeing condos renting in another development for over $20,000 a month, "we thought, let's go here because we can actually cater to this submarket that exists, but no has been addressing," says Daria Salusbury, a senior vice president with the company who oversees leasing. The smallest units in One MiMA, junior one-bedrooms, start at $4,800 a month. Three-bedroom penthouses with 2,200 square feet are priced as high as $25,000 a month.

The company also broke ground last month on its long-stalled billion-dollar project on Grand Avenue in downtown Los Angeles. But rather than beginning with the planned first phase of the project, which involved building 390 condos in two structures, the company is instead building luxury rental apartments. "We knew we could take a run at a rental building with the rental market strengthening," says Related California's Mr. Witte, "whereas condo prices, while they are beginning to creep back up, aren't high enough to justify new construction."

Wealthy individuals are also getting into the game, buying condo units expressly to rent out as a steady investment vehicle. Last fall, the El Royale, a 56-unit Art Deco tower near Hollywood, sold for $29.5 million to investors looking for rental properties. At $527,000 per unit, it is one of the highest prices ever paid for an older building in Southern California. Likewise, the Frank in Venice sold last year for $56.7 million, or $810,000 per unit, one of the highest prices ever paid per unit in Los Angeles.

"The huge tenant demand for luxury rentals in coastal gateway markets has made them the most attractive real-estate investments right now," says Ron Harris, who brokered both of those sales.