# 1 Executive Summary

The long-awaited housing recovery finally took hold in 2012, heralded by rising home prices and further rental market tightening. While still at historically low levels, housing construction also turned the corner, giving the economy a much-needed boost. But even as the most glaring problems recede, millions of homeowners are delinquent on their mortgages or owe more than their homes are worth. Worse still, the number of households with severe housing cost burdens has set a new record.

## THE HOUSING MARKET REVIVAL

A broad range of housing market indicators showed marked improvement last year. After modest gains in 2011, existing home sales accelerated to their fastest pace since 2007. New home sales posted their first year-over-year increase since the downturn began, up 62,000 or some 20 percent from 2011's historic low. With a record-low inventory of new homes on the market to meet strengthening demand, single-family starts shot up 24 percent. Multifamily starts also climbed sharply for the second year in a row, bringing total 2012 starts to 781,000. With these increases, residential construction made its first positive contribution to GDP in seven years, adding more than a quarter-point to economic growth.

The turnaround in home prices was widespread **(Figure 1).** As of December 2011, 81 of the 100 metropolitan areas tracked by CoreLogic still reported year-over-year price declines. Just one year later, prices were on the upswing in 87 of these markets. The momentum continued into 2013, lifting the number of markets with rising prices to 94. On the strength of these gains, the national median house price was up 11.6 percent in March 2013 from a year earlier.

Multiple factors have bolstered house prices, including record-low mortgage interest rates and steady, if not spectacular, employment growth. Low inventories of properties for sale are also a key driver, with supplies of both new and existing homes well below the six-month level that traditionally indicates a balanced market. Institutional as well as mom-and-pop investments in distressed single-family homes have also served to firm prices in certain markets, particularly Phoenix, Las Vegas, and Atlanta. The influence of investors is also evident in the different rates of price appreciation across submarkets. In metros where investors have been most active, prices for homes in the bottom tier were up 22 percent in March 2013, while those for homes in the top tier rose 13 percent, according to the S&P/Case-Shiller index.

A sustained rebound in house prices will soothe many of the housing market's ills. Rising home equity provides owners a greater sense of security about spending, especially on big-ticket items such as home improvements. Even modest price apprecia-

tion over the next year should also put some of the four million households that have limited equity or are only slightly underwater in a better position to sell. This would, in turn, expand the supply of homes for sale and give further impetus to the market. Rising prices could also encourage many owners with substantial equity who have wanted to move to finally put their homes on the market. Indeed, 26 percent of respondents to Fannie Mae's March 2013 survey agreed that it was a good time to sell—almost twice the 14 percent share a year earlier, although still less than half the historical average.

### ACCELERATING HOUSEHOLD GROWTH

After holding near 600,000 for the previous five years, household growth picked up to almost 1.0 million in 2012 **(Figure 2)**. Stronger immigration helped to boost the pace of growth, with the foreign-born population registering its largest increase since 2008. Now exceeding the Joint Center's low-immigration projection, the gains in 2012 signal improvement in this fundamental measure of housing demand.

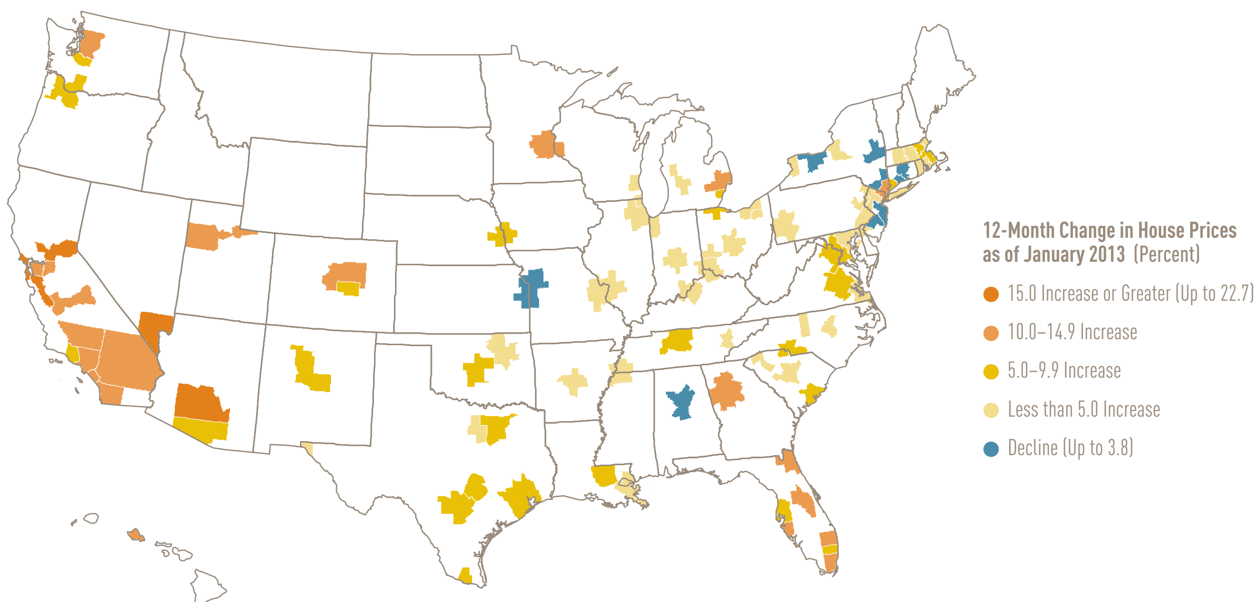
So far, many young adults prevented by the Great Recession from living on their own have still not formed independent households. As unemployment rates rose during the downturn, the share of young adults living independently dropped significantly even as the population under age 35 climbed. As a result, the number of households headed by young adults remained stable. As the economy continues to recover, however, expanded job opportunities should help to release some of the pent-up housing demand within this age group.

While economic conditions drive household growth in the short run, the size and age structure of the adult population are more important factors in the long run. Based on the Census Bureau's latest population projections and recent estimates of headship rates, demographic drivers support household growth of approximately 1.2 million a year over the remainder of the decade—similar to the rates in the 1990s as well as in the years preceding the Great Recession.

But while the overall pace may be similar to the past, the composition of household growth is changing—and with it, the direction of housing demand. Over the next decade, the number of households aged 65 and over is projected to increase by 9.8 million. Most of these households will opt to age in place and may therefore need to modify their homes to accommodate their changing needs. But a large number will look for different housing opportunities, creating demand for new types of units in communities where they currently live as well as in areas that traditionally attract retirees. Even if the relatively low

FIGURE 1

## House Prices Across the Country Were on the Rise in 2012

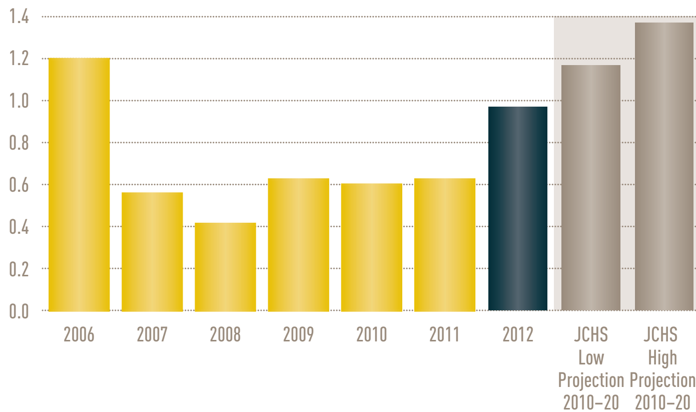



Source: JCHS tabulations of CoreLogic®, Home Price Index.

FIGURE 2

**Household Growth Approached the One Million Mark in 2012**

Change in Households (Millions)

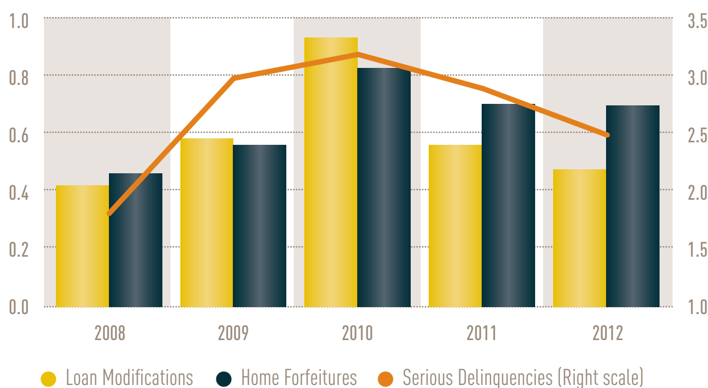



Note: JCHS low (high) projection assumes that immigration in 2010–20 is 50% (100%) of the US Census Bureau's 2008 middle-series population projection.
Sources: US Census Bureau, Housing Vacancy Survey; JCHS 2010 household growth projections.

FIGURE 3

**Loan Modifications Have Declined More Quickly than Serious Delinquencies and Home Forfeitures**

Number of Loans (Millions)




Notes: Home forfeitures are completed foreclosures or short sales. Serious delinquencies are loans 90 or more days delinquent or in foreclosure.
Source: US Office of the Comptroller of the Currency, Mortgage Metrics Reports.

mobility rate for seniors does not increase, the sheer size of this age group means that the number of mover households aged 65 and over is likely to increase from 1.2 million per year to 1.6 million annually over the decade.

Minorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make downpayments. For example, among renters aged 25–34 in 2010, the median net wealth was only $1,400 for blacks and $4,400 for Hispanics, compared with $6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-downpayment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.

### PERSISTENT SLIDE IN HOMEOWNERSHIP

The national homeownership rate fell for the eighth straight year in 2012, from 66.1 percent to 65.4 percent. This drop reflects not only the addition of 1.1 million renters, but also a net loss of 161,000 homeowners for the year. The rollback was especially pronounced among African-Americans, whose homeownership rate has now dropped 5.8 percentage points from the peak and is back to its lowest level since 1995. The decline among Hispanics was a more modest 3.3 percentage points. And given their strong homeownership gains over the previous two decades, their rate still exceeds 1990s levels.

How much farther homeownership rates will fall is an open question. For each 10-year age group between 25 and 54, the share of households owning homes is already at its lowest point in records that began in 1976. Indeed, the overall homeownership rate is only as high as it is because households over age 65 now have the highest rates on record and account for an ever-larger share of the population.

But monthly housing costs have rarely been more favorable for homebuyers. When combined with the sharp drop in home prices, today's low mortgage interest rates have made owning a home more affordable than at any time since the 1970s. So far, though, these conditions have failed to boost first-time homebuying. But with steady job growth helping to bolster household finances and rising home prices signaling a market turnaround, 2013 may well be the year that homeownership rates stabilize. A key issue is whether tight credit conditions will continue to limit the ability of would-be homebuyers to take advantage of today's affordable conditions.

Although the number of distressed properties remains elevated, the good news is that mortgage delinquencies steadily declined in 2012 to their lowest levels since 2008. Together with low mortgage interest rates, improvements to the Home Affordable Refinance Program (HARP) also allowed 1.1 million underwater and low-equity homeowners to reduce their monthly payments by refinancing in 2012. These reductions not only lowered the risk that these borrowers would become delinquent, but also put more money into their pockets for other expenses.

Still, millions of loans were seriously delinquent or in foreclosure last year **(Figure 3).** According to the Office of the Comptroller of the Currency, servicers implemented 478,500 loan modifications in 2012—about a quarter of them through the Home Affordable Modification Program (HAMP). But the volume of modifications was down nearly 50 percent from the 2010 peak while serious delinquencies fell only 22 percent and home forfeitures (including foreclosures and short sales) just 16 percent. In recognition of the compelling need for remedies short of foreclosure for the millions of homeowners still struggling to retain their homes, the Treasury Department has extended HAMP through the end of 2015.

#### CONTINUED STRENGTH IN RENTAL MARKETS

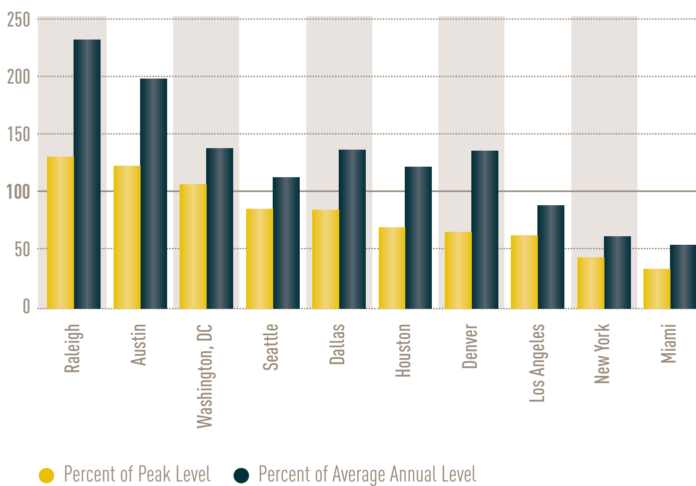
The rental housing recovery that began in 2010 continued to gain steam. Fueled by the growing share of households opting to rent, the national rental vacancy rate fell for the third straight year to 8.7 percent in 2012, the lowest level since 2001. As measured by the consumer price index, rents rose 2.7 percent for the year, slightly outpacing overall inflation. Market conditions for professionally managed apartments were even stronger, with MPF Research reporting average vacancy rates of 4.9 percent and rent increases of 3.7 percent in this market segment.

With the number of renter households growing briskly, construction of new rental units rose to 258,000 units in 2012—the highest level since 2004. Building permits for multifamily units, which account for most newly built additions to the rental stock, were up sharply in many markets. Indeed, multifamily permitting in 34 of the 100 largest metro areas surpassed average levels in the 2000s, while activity in Austin, Raleigh, and Bridgeport approached all-time highs.

FIGURE 4

**Multifamily Permitting in Most of the Top Ten Markets Is Still Below Recent Peaks**

Multifamily Permits in 2012 as a Share of 2000–09 Levels (Percent)




Source: JCHS tabulations of US Census Bureau, New Residential Construction.

The sharp rebound has raised concerns that developers may be overshooting demand. But given the low permitting levels in 2008 and 2009, the recent outsized increases in top markets put total permitting in the past five years in line with historical averages **(Figure 4).** And on a national level, construction of new rental housing last year ran about 50,000 units below the average volume in 1997–2003 when renter household growth was at a fraction of its current pace.

The tightening in the apartment market does, however, appear to be losing momentum. According to national measures from MPF Research, rent increases decreased each quarter after the 2011 peak, in tandem with slower absorption of new units. Given the long lags from planning to completion of apartment buildings, supply could outstrip demand when this new housing is ready for occupancy. But with the generally healthy level of demand, it is also possible that these new units will be absorbed without a substantial rise in vacancies.

In fact, with the addition of 1.1 million renter households last year, much of the increase in rental demand has been met not by new apartments, but by conversion of single-family homes to rentals. Between 2007 and 2011, on net 2.4 million homes switched from owner-occupied to renter-occupied—several times more than the 900,000 rental units started during this period. Tenure switching has been an important safety valve for the single-family market, absorbing the excess owner-occupied housing coming on line as the foreclosure crisis unfolded.

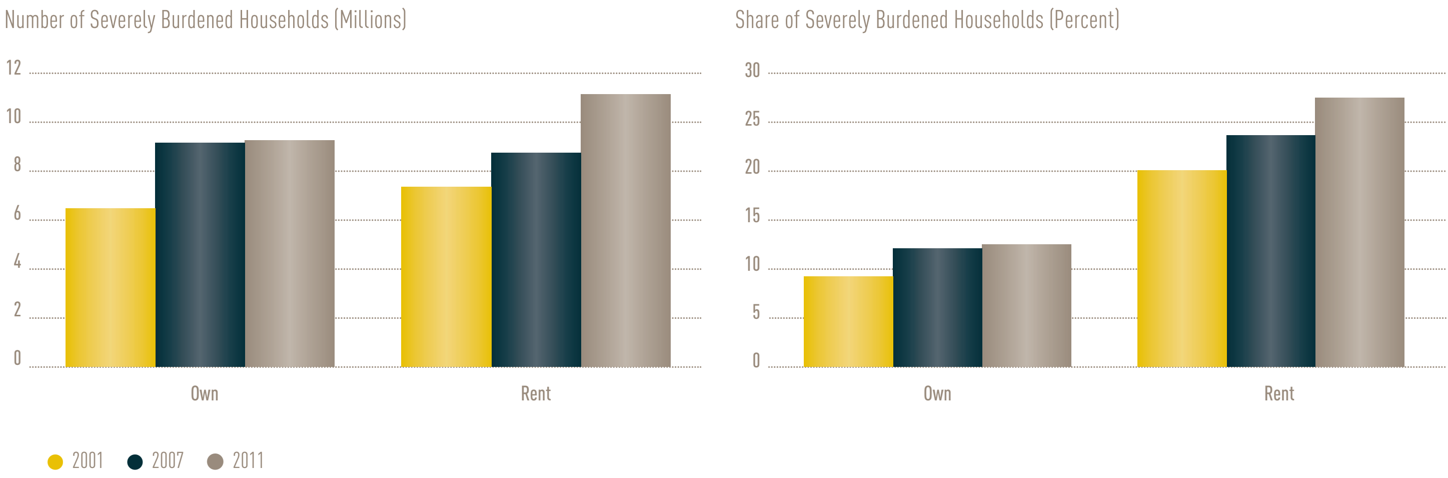
If homeownership rates revive in the coming years and renter demand for single-family units cools, transition of these homes back to the owner-occupied market could thus prevent disruption of the apartment market. Indeed, tenure switching of single-family homes is typical in the housing market. Even between 2007 and 2011, the net additions of single-family homes to the rental market resulted from 3.6 million homes switching from renter- to owner-occupied and 6.0 million homes switching from owner- to renter-occupied.

#### THE SPREAD OF HOUSING COST BURDENS

In a decade of enormous ups and downs in the housing market, one fact remains constant: the number of households with housing cost burdens continues its inexorable climb. At last count in 2011, over 40 million households were at least moderately cost burdened (paying more than 30 percent of their incomes for housing), including 20.6 million households that were severely burdened (paying more than half of their incomes for housing). The latest increases in the number of severely burdened households represent a jump of 347,000

FIGURE 5

## More and More Households Pay Excessive Shares of Income for Housing




Notes: Severely cost-burdened households spend more than 50 percent of pre-tax income on housing costs. Incomes are in constant 2011 dollars, adjusted for inflation by the CPI-U for All Items.
Source: JCHS tabulations of US Census Bureau, American Community Surveys.

from 2010, 2.6 million from 2007 when the recession began, and 6.7 million from a decade ago.

While the overall number of cost-burdened households has risen steadily, trends vary by tenure. The most recent increases were almost entirely among severely burdened renters, whose numbers soared by 2.5 million from 2007 to 2011, pushing the share to 27.6 percent **(Figure 5).** While up only 173,000 over this period, the number of cost-burdened homeowners had already surged by 2.7 million in 2001–07 amid the sharp rise in house prices and the widespread availability of easy mortgage credit.

What is remarkable on the owner side is that the incidence of cost burdens has not fallen much more dramatically, given the substantial decline in home prices and low interest rates. Indeed, the share of severely burdened owners rose from 12.1 percent in 2007 to 12.6 percent in 2011. The lack of progress reflects the difficulties that many owners locked into excessive mortgage debt face in attempting to refinance and the still-weak state of the economy. In fact, the overwhelming majority of underwater homeowners continue to make payments on mortgages that exceed the present value of their homes.

While increasingly prevalent at all income levels, severe housing cost burdens are much more common among households with the lowest incomes. Nearly seven out of ten households with annual incomes of less than $15,000 (roughly equivalent to year-round employment at the minimum wage) are severely burdened. With income inequality worsening over the past decade, the share of households with these low incomes has continued to grow.

Meanwhile, the stock of low-cost housing that these households can afford continues to shrink. Between 2007 and 2011, the number of renter households with extremely low incomes (less than 30 percent of area medians) increased by 2.5 million. Over the same period, the number of available housing units that households at this income level could afford to rent declined by 135,000. As a result, the gap between the supply of affordable housing and demand from extremely low-income renters doubled in just four years to 5.3 million units. Given that the typical unit completed in 2012 rented for $1,100 per month, new housing development is unlikely to alleviate this affordability gap.

While the number of low-income households eligible for federal rental assistance has been growing, the number of assisted units has not. According to recent HUD estimates, only one in four of those eligible for rental assistance obtain this help. Funding for the Housing Choice Voucher Program has increased, but with rents rising and incomes falling, the subsidy needed per renter has also increased—leaving the number of assisted households almost unchanged. Other programs—including public housing, the HOME program, and the Community Development Block Grant program—have faced outright cuts. And at a time when the need has never been greater, federal budget sequestration will further limit the number of households receiving rental assistance.

Gaining access to assisted housing has important implications for quality of life. Low-income households with severe housing cost burdens have little left over each month to pay for other necessities. According to the latest Consumer Expenditure Survey, severely burdened families in the bottom expenditure

quartile (a proxy for low incomes) spend a third less on food, half as much on pensions and retirement, half as much on clothes, and three-quarters less on healthcare as families paying affordable shares of their incomes for housing. Extending housing assistance to more eligible households would thus provide a much broader range of benefits than just decent and affordable shelter.

### LOOKING BEYOND THE INITIAL RECOVERY

While evidence of a housing market recovery continues to accumulate, significant fallout from the downturn remains. Chief among these concerns is that millions of borrowers are still seriously delinquent on their mortgages. Given this continued need, HAMP—the federal program supporting nearly one in three loan modifications that have kept many troubled loans out of foreclosure—has been extended through 2015. In addition, more than 10 million owners owe more on their mortgages than their homes are worth. Since 2009, HARP has helped some 2.2 million low-equity and underwater borrowers with Fannie Mae- and Freddie Mac-backed mortgages take advantage of today's low interest rates, but millions more borrowers with non-government backed loans have had no such opportunity. More generally, both market and regulatory uncertainties surrounding the mortgage lending business have kept credit standards tight and prevented a more robust housing market recovery.

Meanwhile, reform of the housing finance system slowly advances. The Consumer Financial Protection Bureau (CFPB) filled in one key piece in January 2013 by defining standards for the qualified mortgage, intended to ensure borrowers' ability to meet their mortgage obligations. Another critical milestone will be definition of the qualified residential mortgage, which will establish rules for risk retention by issuers of mortgage-backed securities. Until these standards are defined, however, private capital is unlikely to make a strong return to the mortgage market. And finally, the fate of Fannie Mae and Freddie Mac, as well as the broader role for federal backstops of mortgage markets, continues to hang in the balance.

These decisions have direct bearing on the types, costs, and availability of future mortgage products. In making these choices, policymakers must reconcile the goal of reducing the systemic risk at the root of the Great Recession against the goal of allowing a broad range of lower-income and lower-wealth households to access mortgage financing. The outcomes have implications for rental markets as well, given that the government guarantees an enormous share of multifamily loans. Of particular concern is the availability of long-term, fixed-rate financing for affordable housing developments—funding that is rarely available without federal backing.

On top of these immediate pressures is the persistent spread of housing cost burdens. As it is, housing assistance reaches only a small share of those eligible while targeting the most vulnerable Americans—the disabled, the elderly, and single-parent families with very low incomes. Meanwhile, the foreclosure crisis has exacerbated the distress in many low-income neighborhoods, spreading blight and straining the ability of local governments to invest in these areas. Indeed, governments at all levels face difficult choices between bringing budgets into balance in response to short-term economic woes and addressing longer-term structural challenges. In making these choices, however, policymakers cannot lose sight of the important role that housing plays in ensuring the health and well-being of the nation's households and communities.