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EXECUTIVE SUMMARY

With household growth finally picking up, housing should help boost the economy. Although homeownership rates are still falling, the bottom may be in sight as the lingering effects of the housing crash continue to dissipate. Meanwhile, rental demand is driving the housing recovery, and tight markets have added to already pressing affordability challenges. Local governments are working to develop new revenue sources to expand the affordable housing supply, but without greater federal assistance, these efforts will fall far short of need.

HOUSING RECOVERY SCORECARD

By many measures, the US housing market has recovered substantially from the crash. According to CoreLogic estimates, nominal home prices were back within 6 percent of their previous peak in early 2016, although still down nearly 20 percent in real terms. The uptick in nominal prices helped to reduce the number of homeowners underwater on their mortgages from 12.1 million at the end of 2011 to 4.3 million at the end of 2015. Delinquency rates also receded, with the share of loans entering foreclosure down sharply as well.

But at 1.1 million units, new home construction was still running near historic lows last year. A key factor holding back housing starts is the sustained falloff in household growth. Given the size and age of the adult population and under normal economic conditions, roughly 1.2 million net new households would have formed on average each year in 2007–2013. But the actual increase was just half that number as the weak economy made it difficult for young adults to live on their own and for immigrants to settle in the United States. In 2015, however, with the economy nearing full employment and incomes beginning to climb, household growth returned to its expected pace and new home construction was up by a healthy 11 percent (**Figure 1**).

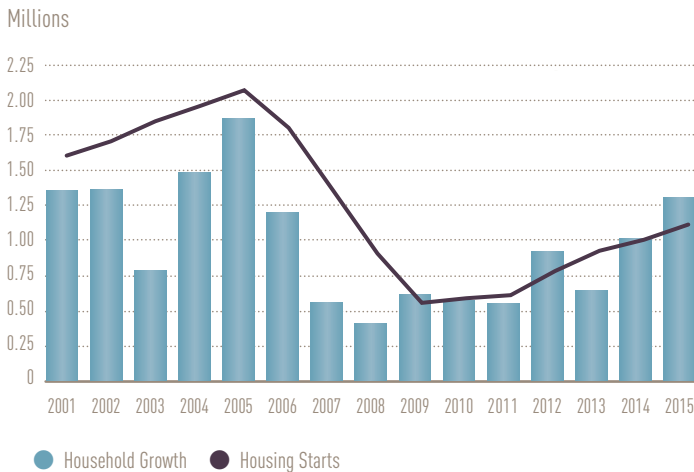
Now in its seventh year, the US economic recovery shows signs of flagging in the face of a strong dollar, a weakening global economy, and low energy prices. But as household growth continues to gain momentum, the housing sector should be an engine of growth. Factoring in the need to replace older units and meet demand for vacation homes and other uses, housing construction should average at least 1.6 million units a year over the next decade. This level of activity would provide an important spur to the economy. Indeed, residential fixed investment (including homeowner improvements) has accounted for just 2.8 percent of annual GDP so far this decade, significantly less than the 4.3 percent share averaged in the 1980s and 1990s, leaving plenty of room for growth.

HOMEOWNERSHIP DOWN BUT NOT OUT

The US homeownership rate has tumbled to its lowest level in nearly a half-century. The decade-long declines are especially large among the age groups in the prime first-time homebuying years (Figure 2). The falloff in homeownership has more than offset earlier gains, leaving age-specific rates for all but the oldest households significantly lower than in 1995.

FIGURE 1

Housing Construction Has Picked Up in Line with Household Growth



Source: US Census Bureau, Housing Vacancy Surveys and New Residential Construction data.

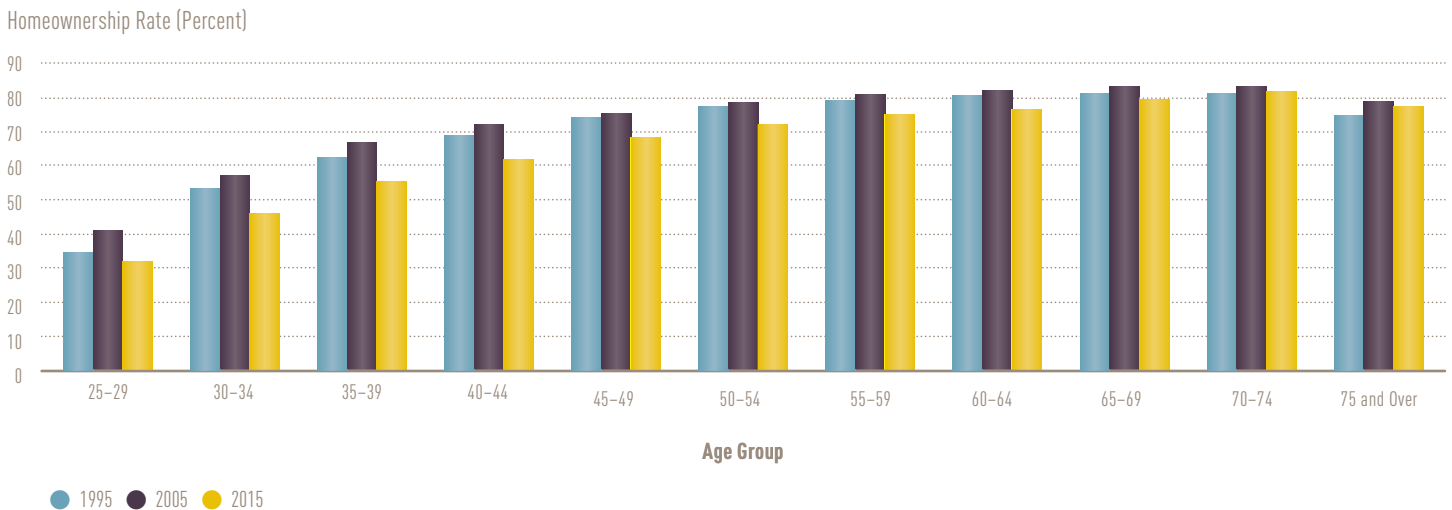
But a closer look at the forces driving this trend suggests that the weakness in homeownership should moderate over the next few years. A critical but often overlooked factor is the role of foreclosures in depleting the ranks of homeowners. Indeed, CoreLogic estimates that more than 9.4 million homes (the majority owner-occupied) were forfeited through foreclosures, short sales, and deeds-in-lieu of foreclosure from the start of the housing crash in 2007 through 2015.

Although completed forfeitures have slowed considerably, they remain elevated at 670,000 or about twice the annual average before the downturn. In addition, Mortgage Bankers Association (MBA) data indicate that the share of loans that are seriously delinquent (90 or more days past due or in foreclosure) has also fallen sharply, but is still nearly double the average in the first half of the 2000s. Given the current rate of recovery, foreclosures are likely to keep downward pressure on homeownership rates for the next two years.

Just as exits from homeownership have been high, transitions to owning have been low. Tight mortgage credit is one explanation, with essentially no home purchase loans made to applicants with subprime credit scores (below 620) since 2010 and a sharp retreat in lending to applicants with scores of 620–660 compared with the early 2000s. And given that the homeownership rate tends to move in tandem with incomes, the 18 percent drop in real incomes among 25–34 year olds and the 9 percent decline among 35–44 year olds between 2000 and 2014 no doubt played a part as well.

FIGURE 2

Homeownership Rates for Most Age Groups Have Fallen Well Below Pre-Boom Levels



Source: US Census Bureau, Housing Vacancy Surveys.

The good news for the owner-occupied housing market is that these constraints should ease as the mortgage market continues to wrestle with the fallout from the housing crash and adapts to a new regulatory environment. There are already indications from the Federal Reserve’s Senior Loan Officer Opinion Survey that credit standards may be loosening, particularly for loans backed by the government-sponsored enterprises (GSEs). The upturn in real income growth among younger households should also help.

Other structural shifts, however, could also have an impact on homeownership rates—in particular, the rising tide of student loan debt. The share of adults aged 20–39 with student loan debt soared from 22 percent in 2001 to 39 percent in 2013, while the average amount that borrowers owed jumped from \$17,000 to \$30,000 in real terms. Although student loan payments should not limit the homeownership options of most households, this may not be true for the nearly one-fifth of indebted young renters whose payments exceed 14 percent of monthly income, a level the Consumer Financial Protection Bureau considers highly burdensome.

Several long-term demographic forces are also at work. Ages at first marriage and the start of childbearing have been on the rise for some time, implying delays in first-time homebuying. The growing minority share of the population also has a dampening effect, given minorities’ much lower homeownership rates. At the same time, though, the aging of the baby-boom generation (born 1946–1964) is increasing the share of households over 50, the ages when homeownership is most common. On net, these countervailing trends are unlikely to move the homeownership rate much.

The bigger question is whether the housing crash diminished the general appeal of homeownership. The available evidence suggests that it has not. For example, a 2015 Demand Institute survey of more than 5,000 households found that 89 percent of respondents under the age of 30 owned a home, would buy a home on their next move, or would buy a home in the future. The shares of respondents with similar responses exceeded 80 percent in all other age groups as well. In addition, 63 percent of all respondents to the April 2016 Fannie Mae National Housing Survey also stated that they would buy homes on their next move.

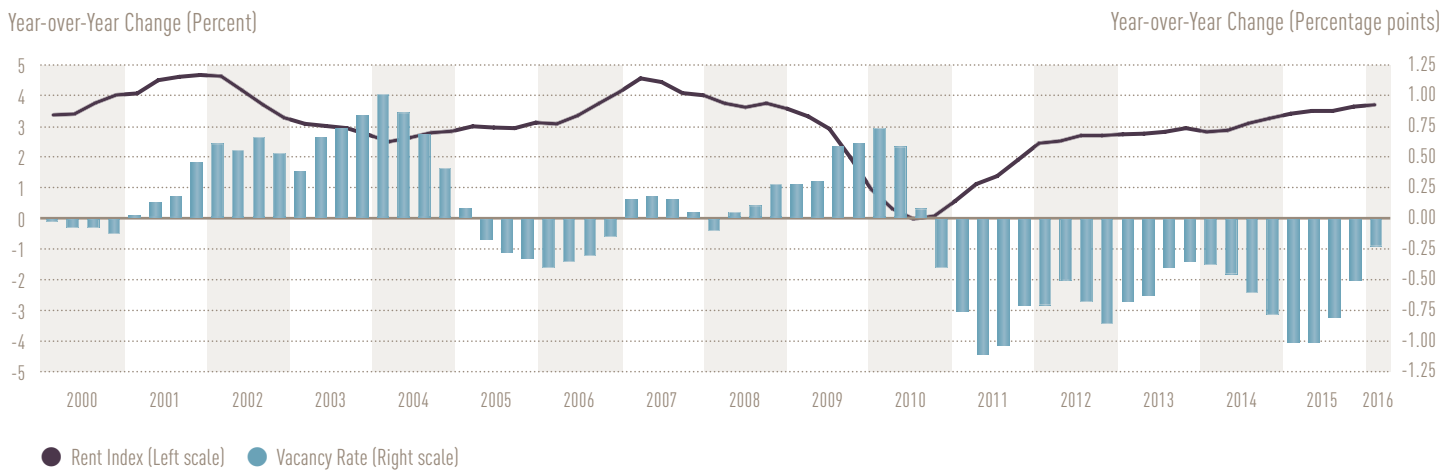
In short, the near-term direction of the US homeownership rate will depend more on whether households can finance their purchases than whether they have the desire to own. Over the next few years, homeownership will continue to face the headwinds created by a backlog of homes in foreclosure, tight credit, weak income growth, and impaired credit histories. But as these pressures ease, there is every reason to expect homeownership rates to show some increase.

RENTAL MARKET STRENGTH

The rental market continues to drive the housing recovery, with over 36 percent of US households opting to rent in 2015—the largest share since the late 1960s. Indeed, the number of renters increased by 9 million over the past decade, the largest 10-year gain on record. Rental demand has risen across all age groups, income levels, and household types, with large increases among older renters and families with children.

FIGURE 3

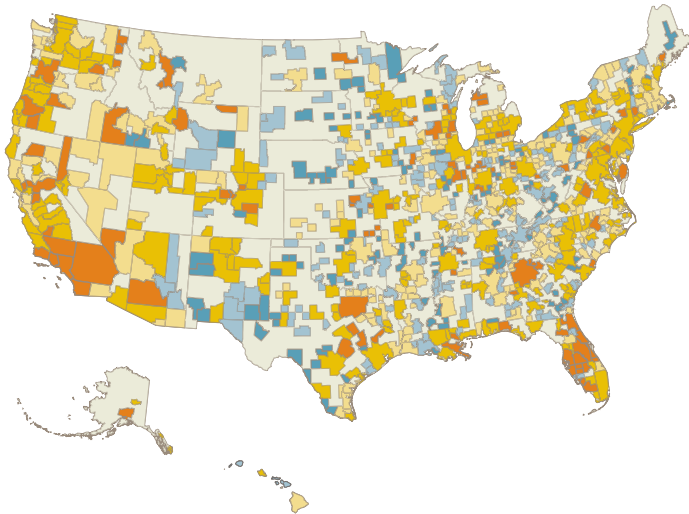
Vacancy Rates Have Fallen for Five Full Years, Pushing Up Rents



Notes: Rents are from the CPI rent index for primary residence. Changes in vacancy rates are based on a four-quarter trailing average. Source: JCHS tabulations of US Bureau of Labor Statistics, Consumer Price Indexes and Census Bureau, Housing Vacancy Surveys.

FIGURE 4

In Most of the Country, a Large Majority of Lowest-Income Renters Are Severely Cost Burdened



Share of Renters with Incomes Under \$15,000 with Severe Burdens (Percent)

● 25-49 ● 50-59 ● 60-69 ● 70-79 ● 80-99

Notes: Severely cost-burdened households pay more than 50% of income for housing. Data are for core based statistical areas (CBSAs).
Source: JCHS tabulations US Census Bureau, 2014 American Community Survey 1-Year Estimates.

Although conversion of formerly owner-occupied single-family homes to rentals met much of the initial surge in demand, construction of multifamily units is now taking on a growing share. But even with these additions to supply, rental vacancy rates have fallen steadily since 2010, dropping to just 7.1 percent by the end of 2015. Rents have climbed in response, with the Consumer Price Index for rent on primary residences up 3.6 percent in nominal terms last year (**Figure 3**). When adjusted for inflation, it has been three decades since either of these measures registered such tightness in the rental market.

A growing supply of new housing in the pipeline may help ease these conditions, although most new units are intended for the upper end of the market. The median asking rent on new apartments was \$1,381 per month in 2015, well out of reach for the typical renter earning \$35,000 a year. High rents reflect several market conditions, including a limited supply of land zoned for multifamily use and a complex approval process that adds to development costs. Perhaps most important, however, is growing demand from higher-income households.

Concerns are increasing that multifamily property valuations in some markets may be overinflated. The strong financial performance of rental properties and the relatively low yields from competing investments have driven up demand, pushing the Moody's/RCA price index for investment-grade properties 39 percent above the previous high. Capitalization rates are now below levels at the height of the housing boom. Valuations are particularly high in the New York metro area, where property values were 93 percent above their previous peak in the fourth quarter of 2015, and in San Francisco, where they were 85 percent above peak.

COST-BURDENED RENTERS AT HISTORIC HIGHS

The divergence between the rental and owner-occupied markets is evident in the number of cost-burdened households in each segment. On the owner side, the number of households facing cost burdens (paying more than 30 percent of income for housing) has fallen steadily as high foreclosure rates have pushed out many financially strained owners, low interest rates have allowed remaining owners to reduce their housing costs, and fewer young households have moved into homeownership. As of 2014, the number of cost-burdened owners stood at 18.5 million, down 4.4 million since 2008.

The decline has occurred across all age groups, but especially among younger homeowners. Homeowners age 75 and over, however, are among the most cost-burdened groups, with their share at 29 percent compared with 24 percent for households under age 45. With the aging baby boomers swelling the ranks of older homeowners and larger shares of households carrying mortgage debt into retirement, the problem of housing cost burdens among the elderly is likely to grow.

On the renter side, the number of cost-burdened households rose by 3.6 million from 2008 to 2014, to 21.3 million. Even more troubling, the number with severe burdens (paying more than 50 percent of income for housing) jumped by 2.1 million to a record 11.4 million. The severely burdened share among the nation's 9.6 million lowest-income renters (earning less than \$15,000) is particularly high at 72 percent. In all but a small share of markets, at least half of lowest-income renters have severe housing cost burdens (**Figure 4**). While nearly universal among lowest-income households, cost burdens are rapidly spreading among moderate-income households as well, especially in higher-cost coastal markets.

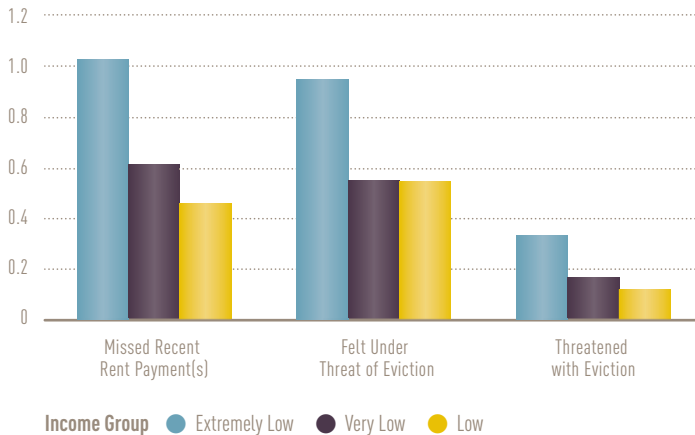
HOUSING ASSISTANCE STRUGGLING TO KEEP UP

Most federal housing assistance is targeted to very low-income households (earning 50 percent or less of area median). Some 18.5 million renters met this criterion at last count in 2013, up 2.6 million since 2007. Meanwhile, the number of renters receiving some form of assistance from the US Department of Housing

FIGURE 5

Extremely Low-Income Renters Are Especially at Risk of Eviction

Households Reporting Housing Insecurity in 2013 (Millions)



Notes: Extremely/very/low-income households earn up to 30%/31–50%/51–80% of area medians. Rent payments were missed within the previous three months.
Source: JCHS tabulations of US Department of Housing and Urban Development (HUD), 2013 American Housing Survey.

and Urban Development (HUD) actually fell by 159,000 from 2007 to 2013, with a loss of project-based units more than offsetting an increase in housing vouchers.

Only one in four income-eligible renters receives assistance of any kind, leaving millions to try to find housing they can afford in the private market. But units affordable to lowest-income households are often already occupied by higher-income households. Indeed, the National Low Income Housing Coalition estimates that only 57 units were affordable and available for every 100 very low-income renters in 2014. The shortfall for extremely low-income households (earning 30 percent or less of area median) is even more acute, with just 31 housing units affordable and available for every 100 of these renters.

The lack of a strong federal response to the affordability crisis has put new pressure on state and local governments to act. A number of cities have now developed plans to expand affordable housing options for a broad spectrum of renters, from those facing homelessness up to middle-income households. In addition to federal funds, these plans draw on a range of resources that include linkage fees on new commercial development, tax-increment financing, taxes on real estate transactions, and the use of publicly owned land.

Another increasingly common approach is the adoption or expansion of inclusionary zoning ordinances, either mandating

that a share of new units have below-market-rate rents or offering the opportunity for higher development densities in exchange for affordable set-asides. But cities can only go so far on their own. Recent estimates from the Lincoln Institute of Land Policy show that inclusionary housing programs produced just 129,000–150,000 affordable units nationwide from the 1970s through 2010, making a strong federal support system still essential.

CONSEQUENCES OF HIGH-COST HOUSING

The lack of affordable housing options forces cost-burdened renters to sacrifice other basic needs, settle for inadequate living conditions, and/or face housing instability—all with serious immediate and long-term consequences. The most significant cutback low-income households make is on basic sustenance. Compared with otherwise similar households able to find housing they can afford, severely burdened households in the bottom expenditure quartile spend \$150 (41 percent) less on food each month. They also spend substantially less on healthcare and put aside less for retirement.

Another tradeoff is between housing that is affordable and housing that is adequate. In 2013, 10 percent of low-income renters lived in units that lacked complete plumbing or kitchen facilities, experienced frequent breakdowns in major systems, or had other physical defects. Housing quality issues are prevalent in non-metro areas and tribal lands, where the housing stock is more likely to be substandard.

Housing cost burdens also expose renters to the risk of eviction, with all its damaging impacts on household finances, employment prospects, and school performance. In 2013, 2.1 million low-income renters reported that they had missed a rent payment in the previous three months, and a similar number stated they believed they were likely to face eviction in the next two months (Figure 5). Meanwhile, about 710,000 renters had been threatened with eviction in the previous three months, with nearly eight out of ten of these threats associated with a failure to pay rent or other lease violations.

The costs of housing instability are high not just for individual households, but also for the government programs ultimately needed to support homeless families. But recent research has found that providing assistance for permanent housing for homeless families can help reduce domestic violence and substance abuse, keep families together, and limit the number of school moves for children. Importantly, the provision of permanent housing is more cost-effective than helping these families through the shelter system.

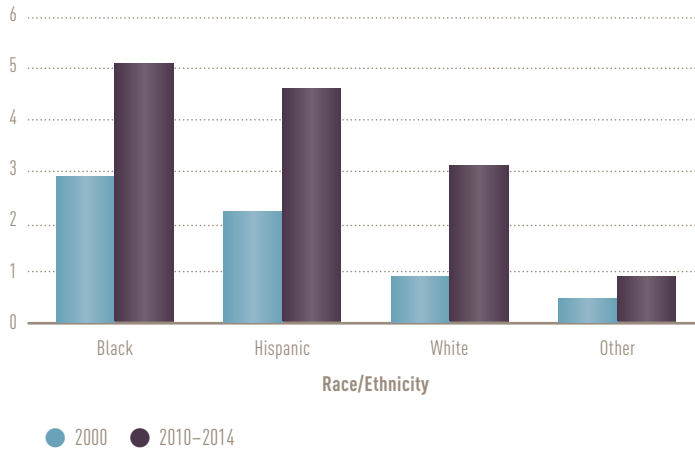
THE GROWING CONCENTRATION OF POVERTY

One enduring legacy of the Great Recession is the further concentration of poverty. In 2000, 6.5 million Americans lived

FIGURE 6

The Number of People Living in Concentrated Poverty Has More than Doubled Since 2000

Population Living in Census Tracts with Poverty Rates of 40 Percent or More (Millions)



Notes: White, black, and other households are non-Hispanic. Hispanic households may be of any race. Other includes Native Hawaiian and other Pacific Islanders, American Indians, Native Alaskans, and people of two or more races.
Source: JCHS tabulations of US Census Bureau, 2000 Decennial Census and 2010–2014 American Community Survey 5-Year Estimates.

in neighborhoods with poverty rates of at least 40 percent. In 2014, the population in these areas had more than doubled to 13.7 million, with substantial increases across all racial and ethnic groups (Figure 6). Even so, income disparities as well as still-high levels of racial segregation have consigned 25 percent of poor blacks and 18 percent of poor Hispanics to high-poverty communities, compared with only 6 percent of poor whites.

The consequences of this isolation are profound, particularly for children. Harvard University’s Equality of Opportunity Project has shown that neighborhood conditions deeply affect a child’s success in life, as well as the life expectancy of adults. Indeed, each year spent living in a low-poverty community increases the chances that a child will attend college and have higher lifetime earnings. In addition to these economic benefits, more inclusive communities benefit residents through safer and healthier environments, including improved air and water quality.

In recognition of these impacts, HUD strengthened its fair housing regulations by issuing a final rule on Affirmatively

Furthering Fair Housing in 2015. The rule requires state and local governments that receive HUD funds, along with all public housing agencies, to identify patterns of segregation in assisted housing and set priorities for addressing disparities. At the same time, a recent Supreme Court ruling on disparate impacts may help to increase the location of new Low Income Housing Tax Credit (LIHTC) units in higher-opportunity communities.

But efforts to broaden the availability of affordable housing in better communities must be viewed within the context of growing segregation by income in the private housing market. According to the Lincoln Institute of Land Policy, more than 500 local jurisdictions have implemented inclusionary housing policies, but the scale and intensity of these programs vary widely and have yet to reach the scale of federal programs.

THE OUTLOOK

While the rental market continues to expand at a robust pace, the owner-occupied market is still in the process of recovery. Home prices have rebounded sharply in several markets, but they also remain depressed in other areas, leaving millions of owners still underwater on their mortgages. Foreclosures have fallen steadily, but the share of owners seriously delinquent on their loans remains roughly twice what it was before the downturn. Household credit and balance sheets will take more time to fully heal. Growth in homeowner demand is therefore likely to remain moderate over the next few years as these headwinds finally abate.

But with household growth projected to average over 1.3 million annually over the coming decade, housing construction should continue to climb and help keep the overall economy on solid footing. In addition, the homeownership rate should at least stabilize in the next few years as foreclosures ebb, mortgage credit conditions improve, and household incomes rise.

As it is, however, the need for more affordable rental housing is urgent. The record number of renters paying more than half their incomes for housing underscores the growing gap between market-rate costs and the rents that millions of households can afford. Governments at all levels must redouble their efforts to expand the affordable supply. And with growing recognition that children’s lifelong achievement rests on stable, safe, and healthy living conditions, policymakers must also ensure better access of minority and low-income households to higher-opportunity communities.