



Homeownership

Homeownership rates slid again in 2010 as foreclosures mounted and the weak economy, house price volatility, and overall uncertainty chilled demand from potential buyers. Tighter lending standards are also preventing interested homebuyers with limited savings or impaired credit from taking advantage of improved affordability. Meanwhile, the changing government role in the mortgage market opens up many questions about future lending costs and product availability.

FALLING HOMEOWNERSHIP RATES

The decline in the national homeownership rate accelerated last year, down another 0.5 percentage point to 66.9 percent. The current rate now stands 2.1 percentage points below the 2004 peak, and 0.5 percentage point below the rate in 2000. The drop from the peak is the largest posted in annual records dating back to 1960, and the more precise estimates from the 2010 Decennial Census may reveal that the decade-long decline was even more severe.

Although lower for all age groups, homeownership rates among younger households took the largest hit. Indeed, rates among 30–34 year-olds fell by some 5.8 percentage points since the peak, compared with just 0.2 percentage point among households aged 75 and older. But while rates for householders under age 40 have dropped the most, those for each five-year age group between 40 and 59 have also reached their lowest levels since data collection began in 1982. With steep declines in home prices and rising rates of loan defaults, millions of middle-aged households have either turned to renting after losing their homes or have forgone the move to homeownership altogether.

The drop in homeownership rates reflects both a net loss of owners and a substantial gain in renters (**Figure 17**). The number of homeowner households declined by 805,000 in 2006–10, while the number of renters rose steadily for six consecutive years, up 3.9 million since 2004. Many households switch between owning and renting in any given year (**Figure 18**). But fewer younger renters are now moving to homeownership, and more older homeowners are becoming renters. This is particularly true among 45–54 year-olds, where the number of owner-to-renter moves climbed 42 percent from 2005 to 2009.

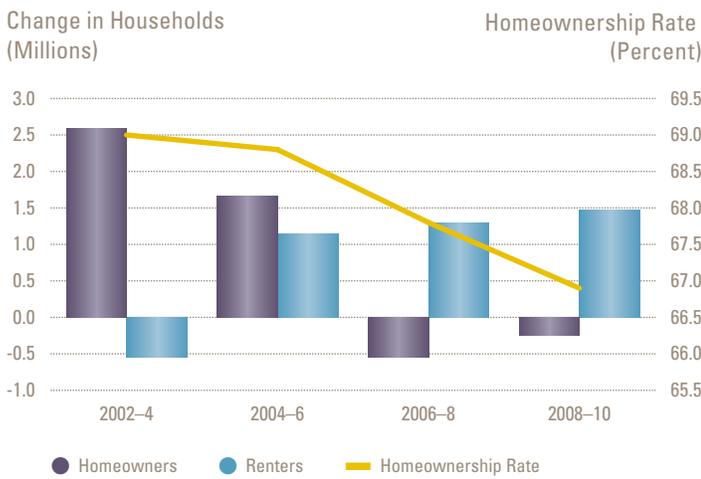
The foreclosure crisis is behind much of the trend among middle-aged householders. Some 3.5 million foreclosures were completed in 2008–10, and another 2.2 million home loans—a record 4.2 percent—were in the foreclosure process at the end of last year. Yet another 2.0 million loans were 90 or more days delinquent but not yet in foreclosure.

Government and private-sector interventions have staved off foreclosure of many distressed borrowers. In 2010, more than

500,000 troubled loans were permanently modified under the Housing Affordable Modification Program (HAMP), and an even greater 1.2 million private-sector modifications were completed. But even borrowers able to qualify for loan modifications remain at high risk of default.

FIGURE 17

Falling Homeownership Rates Reflect a Sharp Turnaround in Owner and Renter Household Growth



Source: JCHS tabulations of US Census Bureau, Housing Vacancy Surveys.

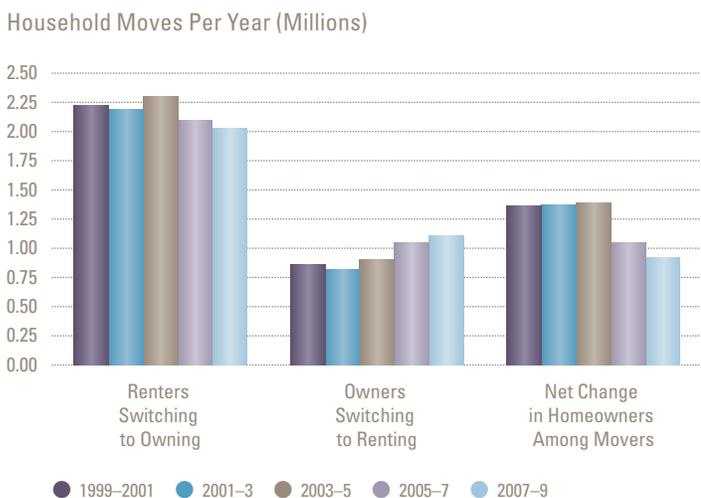
With the volume of distressed loans still so high, foreclosures will continue to drag down homeownership rates in 2011. One longer-term factor working in favor of homeownership, however, is the aging of the US population. Homeownership rates rise significantly with age and do not begin to fall until householders are in their 70s. In fact, the shifting age distribution of the population has prevented the national homeownership rate from falling even more sharply. If age-specific homeownership rates had remained constant in 2005–10, the aging of the population alone would have pushed the overall homeownership rate up 0.8 percentage point compared with the 2.2 percentage point decline that actually occurred.

A key question is whether the foreclosure crisis will reduce the appeal of homeownership. Even after one of the worst housing crashes in US history, though, Americans still appear to strongly prefer owning their homes. According to the Fannie Mae National Housing Survey for the first quarter of 2011, householders under age 35 remain optimistic about homeownership, with 65 percent responding that now is a good time to buy a house, 62 percent believing that owning a home is a safe investment, and 57 percent viewing homeownership as an investment with a lot of potential.

Despite a greater appreciation of the financial risks, preferences for homeownership among renters remain strong. Even though the share of renters responding that owning makes more financial sense than renting slipped last year, it was still high at 68 percent in the fourth quarter of 2010. Indeed, the share rebounded sharply to 74 percent in the first quarter of 2011. Considering the fact that the most common reasons cited for buying homes are nonfinancial—including a good place to raise and educate children, feelings of safety, and greater control over one's living environment—the continued appeal of homeownership is not surprising.

FIGURE 18

Fewer Renters Are Moving into Homeownership, and More Owners Have Turned to Renting



Notes: Mover households reported having changed residence in the two years since the previous survey. Estimates do not include newly formed households.
Source: Table A-7.

REGIONAL AND STATE PATTERNS

Many of the areas that experienced the largest increases in homeownership during the housing boom are now posting the largest declines. The most dramatic shift occurred in the West, where homeownership rates climbed by 5.0 percentage points in 1995–2004 and then fell 2.8 percentage points in 2004–10. The decline in the Midwest, while much more modest, has left the regional homeownership rate below 2000 levels.

Homeownership rates in states hit particularly hard by the foreclosure crisis—such as California, Nevada, and Arizona—have also dropped sharply. In these states, the typical peak-to-trough decline is twice that in the US overall. As of 2010, homeownership rates in 28 states stood below 2000 levels, with rates in Virginia, New Mexico, Iowa, and Nevada more than 4 percentage points below. In contrast, rates in Massachusetts, New Hampshire, and Washington, DC, are up more than 4 percentage points from 2000.

The retreat in homeownership has also been relatively greater in principal cities than in suburban and rural areas. With a much lower peak of just 54.2 percent in 2005, homeownership rates in principal cities fell by 2.1 percentage points by 2010. This decline was almost as large as in suburbs, where homeownership rates were off 2.4 percentage points from a much higher peak of 76.4 percent.

WIDENING HOMEOWNERSHIP GAPS

While all household types have been affected, the decline in homeownership rates among families with children has been particularly large. Between the post-2000 peak and 2010, the homeownership rate for married couples was down 2.1 percentage points while that for single-parent households was down 2.4 percentage points. Meanwhile, the rate for single-person households—especially single male-headed households—fell only modestly.

Homeownership rate declines for black (3.8 percentage points) and Hispanic households (2.1 percentage points) have outpaced those for white households (1.5 percentage points), erasing most of the improvement in the white-minority gap made over the last two decades (Figure 19). The disparity was back to 25.5 percentage points in 2010, up from an all-time low of 24.4 percentage points in 2008.

Differences in age and income between whites and minorities explain only part of this disparity. Even after controlling for these factors, the homeownership rate gap between

whites and blacks widened by 1.4 percentage points, and between whites and Hispanics by 0.4 percentage point, in the last five years alone.

The homeownership rate for low-income whites fell 3.7 percentage points to 56.2 percent between 2005 and 2010—a decline of 700,000 owner households. Homeownership among low-income blacks was down by nearly as much, dropping 3.5 percentage points to just 29.9 percent in 2010. Declines among low-income Hispanics, Asians, and other minorities were more modest. In fact, the number of low-income owners among these groups increased slightly, although not nearly as much as the number of renters.

Given the vital role of homeownership in generating household wealth, white-minority gaps in homeownership rates are a public policy concern. A major stumbling block for minority households is that they have significantly lower wealth than white households—a product of differences in current economic circumstances and the legacy of lower homeownership rates among previous generations. At last measure in 2007, the median minority renter had only \$300 in cash savings and \$2,700 in net worth, while the median white renter had roughly three times those amounts (Table W-2). As a result, proposed increases in downpayment requirements for qualified residential mortgages and for loans guaranteed by Fannie Mae and Freddie Mac will likely limit the pool of minority households able to secure financing. Attaining homeownership is important not only for individual minority families, but also for the market as a whole—especially as the minority share of the population continues to increase.

WIDESPREAD AFFORDABILITY GAINS FOR BUYERS

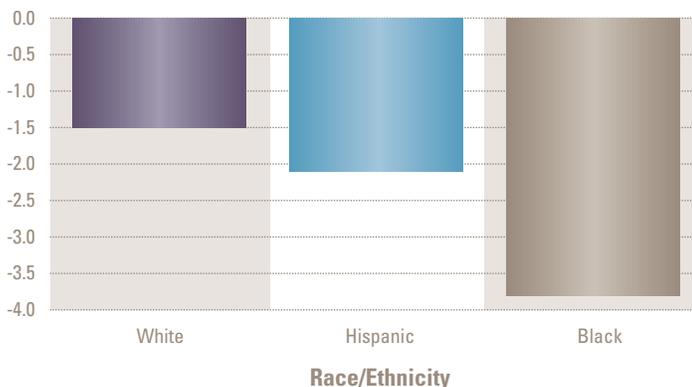
The ratio of house prices to household income is a common measure of homebuyer affordability. This metric improved again in 2010 as the median home price fell to about 3.4 times the median household income, the lowest level since 1995 and in line with the 1980–2000 average (Figure 20). Meanwhile, the Freddie Mac 30-year mortgage interest rate slipped from 5.00 percent in the first quarter of last year to 4.41 percent in the fourth. Indeed, the October reading of 4.23 percent was the lowest level since the series began in 1971.

Assuming a 30-year mortgage and a 10-percent downpayment requirement, monthly payments on a median-priced home dipped below \$900 last year. This is a substantial improvement from the \$1,362 posted as recently as 2007. Payments on the median-priced home as a share of median household income also hit a new low of 18 percent in the fourth quarter of 2010, down from 20 percent a year earlier and from 32 percent at the end of 2005. According to the NAR index, home price affordability was at an all-time high in the fourth quarter of last year. The number of households able to afford the monthly payments at 28 percent of income thus rose from 48.2 million in 2007 to 70.8 million in 2010 (Table W-1).

FIGURE 19

Homeownership Rates Have Fallen More Sharply Among Minorities than Among Whites

Change in Homeownership Rate, Peak to 2010 (Percentage point)



Notes: White and black households are non-Hispanic. Hispanic households can be of any race.
Source: Table A-3.

Estimated payment-to-income ratios suggest that the monthly carrying costs of owning a home improved across much of the country. In the fourth quarter of last year, payments on a median-priced home stood at less than 20 percent of median household income in more than 80 percent of metro areas covered by NAR. This was a marked improvement from the 69 percent share of metros at the end of 2009 and the 33 percent share in 2005. Price declines also helped to moderate conditions in the least-affordable coastal metros. For example, payments on a median-priced home dropped from the sky-high level of 69 percent of median income in Los Angeles to 30 percent between the third quarter of 2007 and the fourth quarter of 2010. The drop in San Francisco was equally dramatic, with payments falling from 76 percent of median income to 38 percent.

Payment-to-income ratios for a median-priced home purchase in the most distressed housing markets also plummeted. In Las Vegas, median payments declined from 39 percent to 13 percent of median income. Ratios in Florida also dropped to their lowest recorded levels at the end of 2010, led by the Cape Coral metro area where payments on the median home plunged from 38 percent of median income to 9 percent.

But improved payment-to-income ratios translate into increased affordability only for those households well-positioned enough to obtain mortgages. Would-be homebuyers face a number of financial stresses, including lower incomes, weakened credit scores, and depleted savings. At the same time, lenders have returned to more traditional underwriting standards for debt-to-income ratios and downpayments. Recent buyers are thus limited to households with

high enough wealth and income to qualify for loans or pay cash. Indeed, nearly 3 in 10 sales last year were cash purchases.

While highly qualified first-time homebuyers were thus able to take advantage of lower house prices and interest rates, affordability also improved for owners able to refinance last year. Borrowers refinanced their loans not only to reduce their payments, but also to shorten loan durations. Of loans transacted through Freddie Mac, some 31 percent of 30-year fixed-rate mortgages, plus 63 percent of 20-year fixed-rate loans, were refinanced with shorter terms.

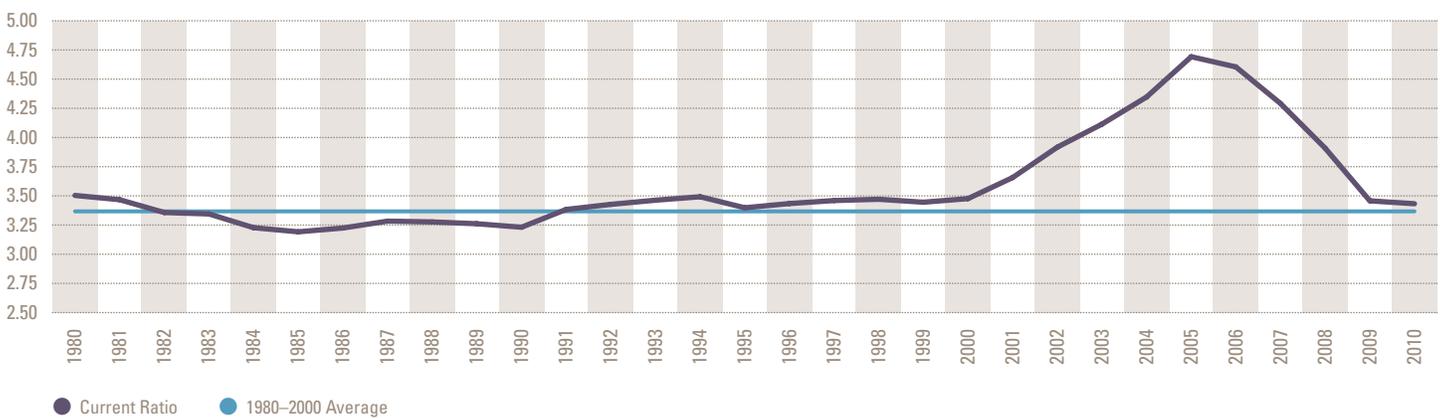
According to the 2009 American Housing Survey, however, many cost-burdened homeowners who would have benefited most from refinancing were unable to do so. In particular, owners in the bottom income quartile were only half as likely as owners in the top quartile to refinance to lower interest rates (**Figure 21**). The barriers to refinancing are substantial: unemployed homeowners cannot meet required payment-to-income ratios, while those with underwater mortgages lack the equity to meet required debt-to-value ratios.

The Obama Administration's Home Affordable Refinance Program (HARP), which has just been extended through June 30, 2012, provides underwater homeowners with loans owned or guaranteed by the GSEs some help with this challenge. Borrowers can refinance up to 125 percent of the home value if they have sufficient income to support the new loan. HARP also enables owners whose homes have lost value to refinance without having to pay mortgage insurance even if their equity is less than 20 percent. GSE programs offer additional loan modification options for distressed borrowers ineligible for HAMP.

FIGURE 20

The National Median Price-to-Income Ratio Has Returned to Its Long-Run Average

Ratio of Median Single-Family Home Price to Median Household Income



Source: JCHS tabulations of National Association of Realtors®, Existing Home Sales Prices; and Moody's Economy.com, Median Household Income.

FIGURE 21

High-Income Homeowners Were More than Twice as Likely as Low-Income Households to Refinance in 2008–9

Share of Non-Mover Households with Mortgages that Refinanced (Percent)



Source: JCHS tabulations of US Census Bureau, 2009 American Housing Survey, using JCHS-adjusted weights.

THE STATE OF MORTGAGE LENDING

The government footprint in the mortgage market was larger than ever in 2010. Inside Mortgage Finance reports that Freddie Mac, Fannie Mae, and FHA owned or guaranteed approximately 90 percent of single-family mortgage originations last year. Nevertheless, private lending activity without the benefit of a federal backstop has begun to pick up slightly, primarily in the form of jumbo prime loans that exceed the conforming limit. Extension of the temporary increase in the conforming loan limit (from \$417,000 to \$625,500, and up to \$729,750 in high-cost areas) until October 2011 will, however, keep the government in a dominant role until at least that time.

With Fannie, Freddie, and FHA cutting back on higher-risk loans, borrowers with low credit scores have found it increasingly difficult to obtain financing. The share of home-purchase mortgages originated to persons with credit scores below 600 thus dropped from 9.0 percent in 2006 to just 0.5 percent in 2010, while the share originated to persons with scores of 740 or higher increased from about 34 percent to about 44 percent. Even among FHA loans, both the volume and share of low-credit score borrowers fell in 2010 after a surge in 2008–9.

While FHA has filled an important need by lending to those with less cash and weaker credit histories, the cost of this credit has been increasing. After raising its mortgage insurance premiums in 2008 to shore up its insurance fund, FHA boosted the price of its loans again in 2010. In addition to a one-time, up-front premium of 1 percent of the loan, FHA charges an annual insurance premium of 1.10–1.15 percent of the mortgage balance, effectively raising borrowers' interest rates by that amount.

THE OUTLOOK

Many unknowns cloud the outlook for homeownership. How the foreclosure crisis will wind down is a major issue since it will determine the extent to which millions of distressed owners are forced to forgo homeownership. The longer-term question is whether these households will buy homes in the future and, if so, how long it will take them to do so. Also unclear is the impact of recent market conditions on younger householders and older renters, who may be less inclined to move into homeownership now that the risks are painfully obvious and financing is harder to come by. Nevertheless, renter attitudes about the financial benefits of homeownership improved in the first quarter of 2011, suggesting that concerns about the investment risks of owning may be easing.

While the shifting age distribution of the US population favors growth in homeownership, market conditions could continue to hold down homeownership rates just as they have for the past five years. JCHS projections suggest, however, that if homeownership rates for each five-year age group remain at 2010 levels, the number of homeowners should increase by 8.2 million in 2010–20. And even if homeownership rates fall substantially, overall household growth should restore growth in the number of homeowners over the coming decade.

Upcoming changes in the mortgage market will determine what, if any, role the federal government will play in guaranteeing loans and what restrictions are made on mortgage products and the way they are funded. These changes will affect the cost and availability of different types of mortgages for various segments of US society. While the financial crisis has made it abundantly clear that greater oversight of the mortgage market is necessary, the benefits of controlling risk must be balanced against the costs of closing the door to homeownership for those who, under the right conditions, would greatly benefit from this opportunity.