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Executive Summary



After several false starts, there is reason to believe that 2012 will mark the beginning of a true housing market recovery. Sustained employment growth remains key, providing the stimulus for stronger household growth and bringing relief to some distressed homeowners. Many rental markets have already turned the corner, giving a lift to multifamily construction but also eroding affordability for many low-income households. While gaining ground, the homeowner market still faces multiple challenges. If the broader economy weakens in the short term, the housing rebound could again stall.

SIGNS OF RECOVERY IN THE FOR-SALE MARKET

The for-sale housing market remained depressed for much of 2011. House prices in most areas continued to slide, sales were lackluster, and single-family construction hit a record low. But as the year ended, steadier job growth and improving consumer confidence boosted sales of both new and existing homes (**Figure 1**). With demand reviving and inventories of homes for sale depleted, home prices may well find a bottom this year. Moreover, stronger sales should pave the way for a pickup in single-family construction over the course of 2012.

Nevertheless, a number of conditions may keep the recovery in the owner-occupied market relatively subdued. The backlog of roughly two million loans in foreclosure means that distressed sales will remain elevated, keeping prices under pressure. Another 11.1 million homeowners owe more on their mortgages than their homes are worth, which dampens both sales of new homes and investment in existing units. And despite recent declines, the number of vacant homes is still well above normal, limiting demand for new construction in many markets.

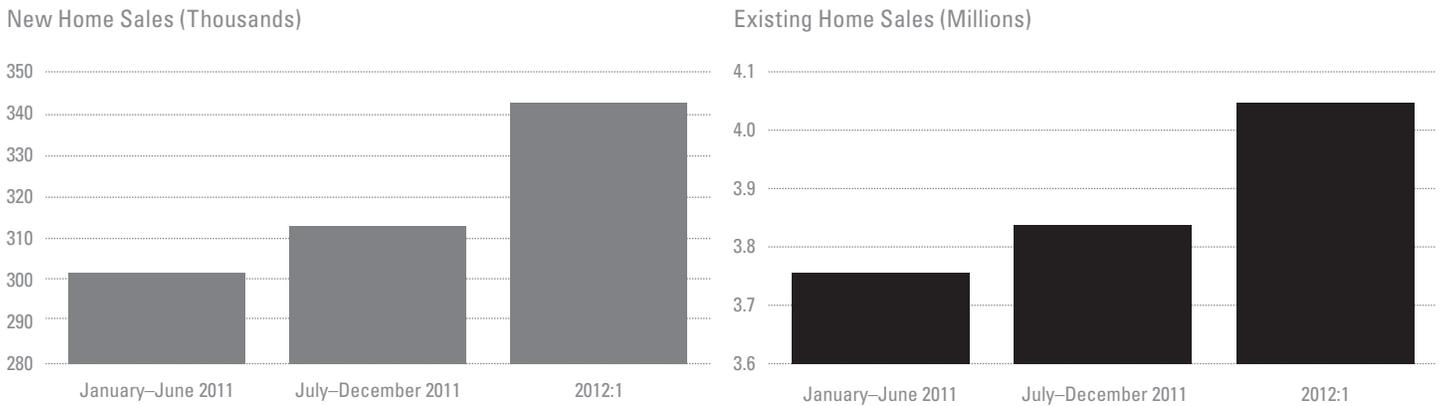
What the for-sale market needs most is a sustained increase in employment to bring household growth back to its long-term pace. But the persistent weakness in homebuilding has in itself hindered a strong rebound in hiring. From 2006 through 2010, residential fixed investment pulled down growth in gross domestic product (GDP) in all but three quarters, two of which benefited from targeted tax credits. Since 2011 began, however, home construction and improvement spending have made a positive contribution to GDP in four out of five quarters. With multifamily construction already on the rise, even modest increases in the number of single-family starts—together with stronger sales of existing homes and associated investment in improvements—will bolster economic growth and, in turn, the housing sector.

THE RENTAL MARKET REBOUND

The bright spot continues to be the rental market, where demand has spiked. Indeed, the number of renters surged by 5.1 million in the 2000s, the largest decade-long increase in the postwar era. In part, this growth reflects disproportionate

FIGURE 1

Sales of Both New and Existing Homes Picked Up Sharply in Early 2012

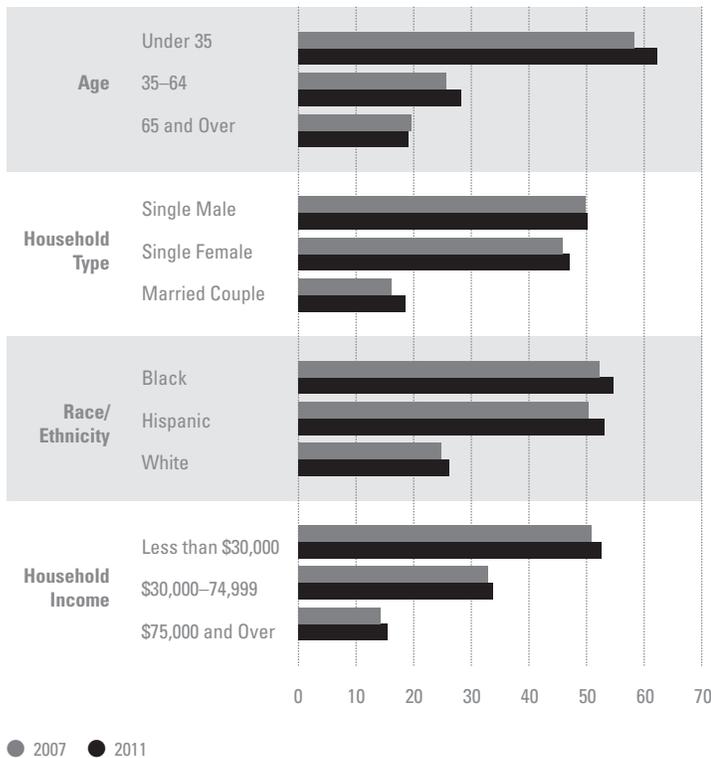


Note: Sales figures include only single-family homes and are at seasonally adjusted annual rates.
Sources: US Census Bureau, New Residential Construction; National Association of Realtors®, Existing Home Sales via Moody's Economy.com.

FIGURE 2

A Wide Range of Households Has Boosted Rental Demand Since the Housing Downturn

Rentership Rate (Percent)



Notes: White and black householders are non-Hispanic. Hispanics can be of any race. Household incomes are for 2006 and 2010, and adjusted to 2010 dollars by the CPI-U for All Items.
Source: JCHS tabulations of US Census Bureau, Housing Vacancy and Current Population Surveys.

shares of young, minority, and lower-income households, who are traditionally more likely to rent. But the foreclosure crisis and the aging of the population have also spurred increases in renting among the middle-aged, as well as households that are white, married, and have moderate incomes (Figure 2).

Moreover, rental markets have yet to benefit fully from the presence of the large echo-boom generation. The recession helped to dampen the rate at which young people begin to live independently, contributing to a decline in the number of households under age 25—the years when renting is most common. But once the economy recovers and the echo boomers increasingly strike out on their own, rental markets will receive another significant lift.

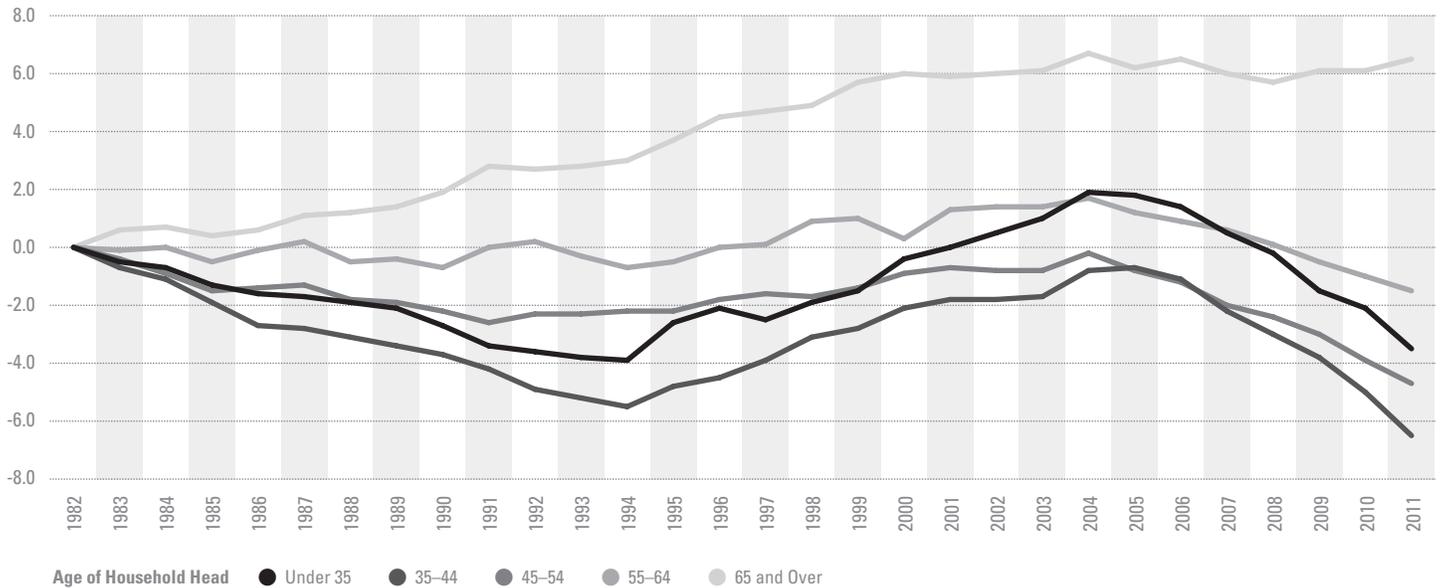
Rapidly rising demand has pushed rental vacancy rates down across the country, sparking widespread rent increases. According to MPF Research, rents on investment-grade multifamily properties outpaced inflation in 38 of the 64 markets it tracks. Of the remaining metros, all but one (Las Vegas) posted at least nominal rent increases in 2011. Adjusting for inflation, San Francisco led the nation with a double-digit rise, but real rents in metros in the Northeast (Boston and New York), South (Austin), and West (Denver) were also up 3.0–5.0 percent. Even in several markets associated with the foreclosure crisis (including Detroit, Cleveland, and Ft. Myers), real rents are climbing.

Rental market tightening has stabilized multifamily property values after a sharp drop rivaling that in the single-family market. As measured by NCREIF's Transaction Based Apartment Price Index, prices were up 10.0 percent in the fourth quarter of 2011 from a year earlier and 34.4 percent from the 2009 low. With vacancy rates falling and owners' financial positions strengthening, multifamily starts more than doubled from the

FIGURE 3

With Their High Rates of Homeownership, Older Households Have Prevented an Even Larger Fall-off in the Overall Rate

Change in Homeownership Rate (Percentage points)



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

trough to a 225,000 unit annual rate in early 2012. While still well below the nearly 340,000 annual average in the decade before the bust, multifamily starts are providing a welcome boost to the construction industry.

CONTINUING SLIDE IN HOMEOWNERSHIP

Declines in the national homeownership rate accelerated in 2011 as increasing numbers of households opted—or were forced by foreclosure—to rent. The national homeownership rate dipped to 66.1 percent, down 0.7 percentage point from a year earlier and 2.9 percentage points from the 2004 peak. Despite the drop in rates for all age groups under 65, however, the overall rate stands well above the 64 percent prevailing in the 1980s and first half of the 1990s. Indeed, the national rate remains relatively strong both because the ranks of households with heads aged 65 and over are growing and because homeownership rates among this age group are near record highs (**Figure 3**). While rates for younger households may fall further in the next few years, the aging baby boomers will help to mitigate the impact on the national homeownership rate.

Thankfully, homeowner distress has begun to abate, with the share of loans 90 or more days delinquent falling steadily from 5.1 percent of mortgages at the end of 2009 to 3.1 percent in the first quarter of 2012. At the same time, though, the backlog of loans in the foreclosure process has only edged down from 4.6 percent to

4.4 percent. Since nearly three-quarters of these borrowers have not made a mortgage payment in more than a year (and 42 percent have not done so in two years), most will ultimately forfeit their homes. In the near term, the recent settlement between large loan servicers and the federal and state governments could also drive up foreclosures as long-pending cases are pushed to resolution.

Despite this drag, recovery in the owner-occupied market could strengthen if positive job numbers and tightening markets encourage more households to buy. Although young households have increasingly opted to rent in recent years, most still aspire to homeownership. The late-2011 Fannie Mae National Housing Survey found that 86 percent of renters aged 18–34 believe they will ultimately own homes. In addition, close to 70 percent of respondents to both the Fannie Mae survey and the University of Michigan Survey of Consumer Attitudes felt that it was a good time to buy. In fact, the monthly mortgage payments for the typical home currently compare more favorably to rents than at any time since the early 1970s (**Figure 4**). So far, though, the weakness in the economy and continued uncertainty may be deterring many would-be buyers from taking advantage of today’s home prices and low mortgage interest rates.

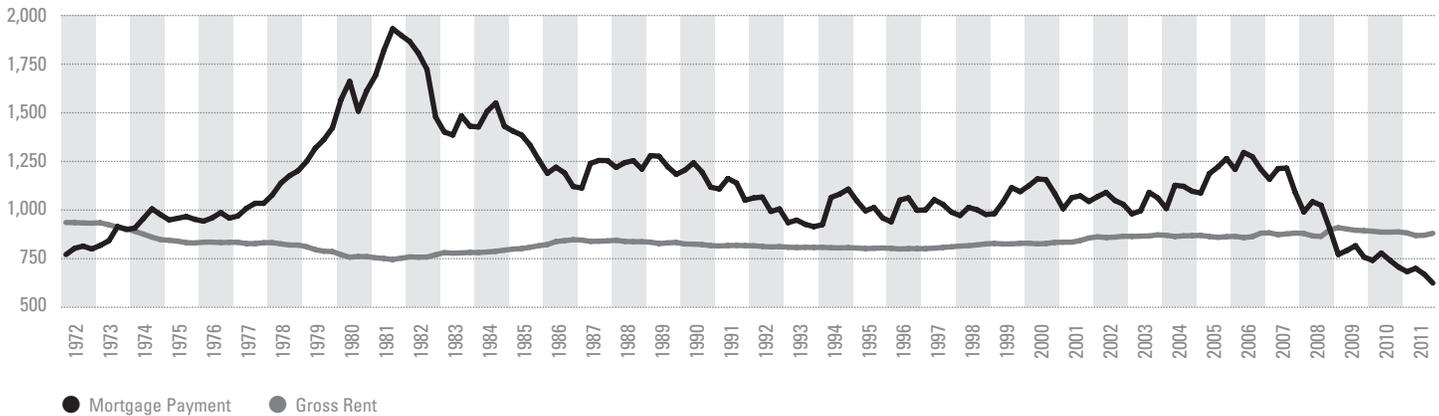
THE PROSPECTS FOR HOUSEHOLD GROWTH

Given that the number of new homes added in 2002–11 was lower than in any other ten-year period since the early 1970s, it

FIGURE 4

Mortgage Payments Have Become More Affordable Relative to Rents

Monthly Housing Costs (2011 dollars)



Notes: Monthly mortgage payments are based on the median existing home price from the National Association of Realtors® and assume a 20-percent downpayment and a 30-year fixed-rate mortgage at the average rate for the quarter reported by Freddie Mac. The monthly gross rent is the median gross rent from the 2010 American Community Survey indexed to the Consumer Price Index for Rent of Primary Residence. Both series are adjusted for inflation using the CPI-U for All Items.

Sources: JCHS tabulations of Freddie Mac, Primary Mortgage Market Survey; National Association of Realtors®; US Census Bureau, 2010 American Community Survey; and US Bureau of Economic Analysis, Consumer Price Indices.

is difficult to argue that overbuilding is dragging down the housing market. Instead, the excess housing supply largely reflects the sharp slowdown in average annual household growth in 2007–11 to just 568,000—less than half the pace in the first half of the 2000s or even the 1.15 million averaged in the late 1990s (**Figure 5**).

Two factors are responsible for this drop: a decline in the rate at which individuals (particularly those under age 35) form independent households, and a sharp drop in immigration. While a variety of forces contributed to these trends, the severity of the economic recession clearly played a significant role. As 2012 began, the ingredients needed to spark more normal household growth were still not in place. In particular, the unemployment rate remained elevated, and in fact would have been even higher if so many discouraged workers had not exited the labor market.

But over the longer run, the most important drivers of household growth are the size and age structure of the adult population. Assuming the economic recovery is sustained in the next few years, the growth and aging of the current population alone—including the entrance of the echo boomers into adulthood—should support the addition of about 1.0 million new households per year over the next decade. The biggest unknown is the contribution of immigration to overall population growth. But even assuming net inflows are roughly half the level in the Census Bureau’s 2008 projection, the Joint Center for Housing Studies projects household growth should still average 1.18 million a year in 2010–20.

Another key question about future housing demand relates to the aging of the baby boomers. The leading edge of this group reached 65 in 2011, entering the phase of life when they are less likely to move to different homes. And if they do move, many are apt to downsize. The baby boomers should therefore play a smaller part in setting the pace of housing demand in the coming years. In fact, the baby-boom generation’s dominance of the new home market had already receded by the time of the housing boom. In 2010, the baby-bust cohort (aged 25–44 in that year) occupied nearly half of the homes built since 2000, while the baby boomers lived in only 34 percent of these newer units (**Figure 6**).

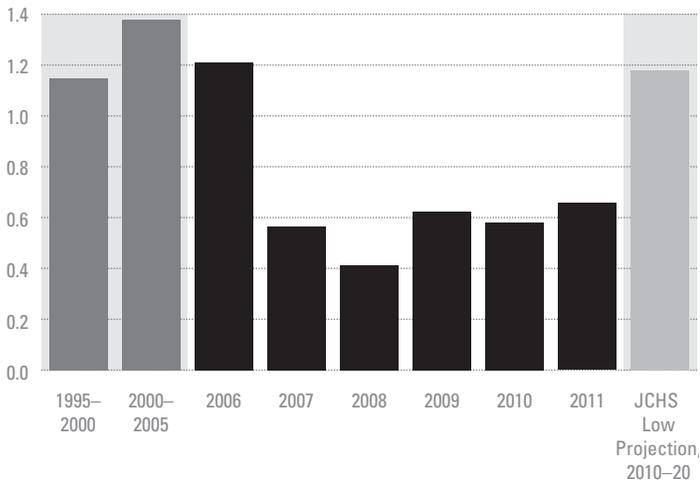
Over the next 20 years, the echo boomers have the potential to spur new home demand to an even greater extent than their parents did beginning in the 1970s. The good news for housing production is that this new generation already outnumbers that of the baby boomers at the same ages. With even a modest lift from immigration, the echo-boom generation will grow even larger as its members move into the prime household formation years.

Because the echo boomers are much more racially and ethnically diverse than previous generations, a larger share of tomorrow’s young households will be minorities. Indeed, the Joint Center projects that minorities will account for more than 70 percent of net household growth in 2010–20. Both the housing industry and the mortgage market will need to find ways to adapt to this impending shift in housing demand.

FIGURE 5

Household Growth Has Yet to Stage a Strong Recovery

Annual Household Growth (Millions)



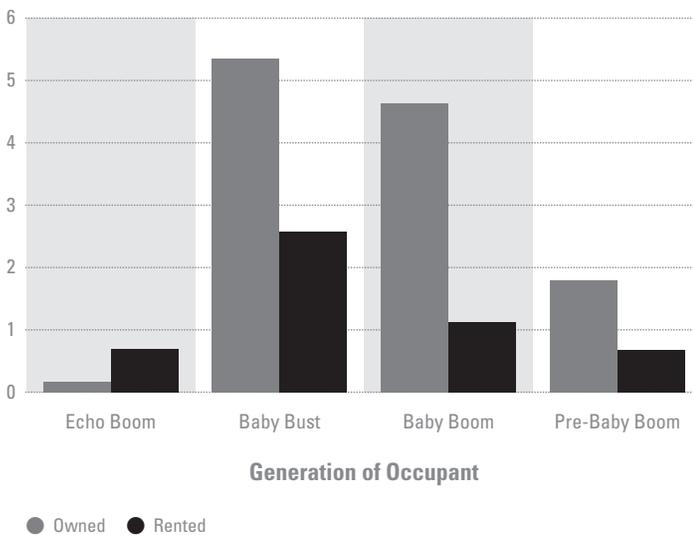
Note: JCHS low projection assumes that immigration in 2010–20 is half that in the US Census Bureau's 2008 middle-series (preferred) population projection.

Sources: US Census Bureau, Housing Vacancy Survey; JCHS 2010 household growth projections.

FIGURE 6

The Baby Boomers No Longer Dominate the New Home Market

Units Built in 2000–10 (Millions)



Note: Echo boomers were under age 25 in 2010, baby-bust householders were 25–44, baby boomers were 45–64, and pre-baby boom householders were 65 and over.

Source: US Census Bureau, 2010 American Community Survey.

THE INCREASING PREVALENCE OF COST BURDENS

The recession took a toll on household incomes but did little to reduce housing outlays for many Americans. Between 2007 and 2010, the number of US households paying more than half of their incomes for housing rose by an astounding 2.3 million, bringing the total to 20.2 million (Figure 7). While renters accounted for the vast majority of the increase, the number of severely cost-burdened owners also rose by more than 350,000 as many households locked into expensive mortgages were unable to refinance. Moreover, the recent jump in the number of severely cost-burdened households comes on top of a 4.1 million surge in 2001–7.

For households paying large shares of income for housing, making ends meet is a daily challenge. Among families with children in the bottom expenditure quartile, those with severe housing cost burdens spend about three-fifths as much on food, half as much on clothes, and two-fifths as much on healthcare as those living in affordable housing. Providing assistance to cost-burdened households not only helps to ensure a decent place to live, but also frees up resources to meet life's other necessities. In addition, affordable housing makes it more feasible for low-income households to set aside some savings as a cushion against emergencies or as an investment in education, business, or other advancement opportunities.

But the prospects for meaningful reduction in housing cost burdens remain bleak. As more renters than ever before struggle to pay for housing, the federal response has been limited. Funding for the Housing Choice Voucher Program, one of the principal sources of rental housing assistance since the early 1990s, has increased only modestly since the recession. But with renter incomes falling and rents rising, the amount of assistance needed per renter has climbed—making higher funding imperative just to serve the same number of recipients.

At present, the only significant growth in subsidized rental housing comes through the Low Income Housing Tax Credit (LIHTC) program, which continues to add about 100,000 affordable units each year. Still, only about a quarter of very low-income households receive assistance. If calls for significant cuts to domestic spending (including the voucher program) or to financial support provided through the tax code (including LIHTC) are successful, the nation would move even further away from its longstanding goal of ensuring decent, affordable housing for all Americans.

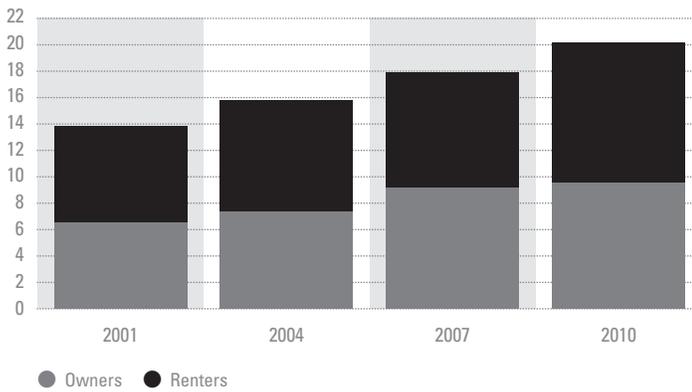
THE ROAD AHEAD

With moderate gains in multifamily construction, improving sales of existing homes, and modest increases in single-family starts, housing should make a stronger contribution to economic growth in 2012 than it has in years. But while the rental market rebound is on track, the owner-occupied market still faces a number of pressures that may make the turnaround more muted than in recent cycles.

FIGURE 7

The Incidence of Severe Cost Burdens Has Risen Sharply in the Recession's Aftermath

Number of Households Paying More than Half of Pre-Tax Income for Housing (Millions)



Source: JCHS tabulations of US Census Bureau, American Community Surveys.

In particular, sales of distressed properties are holding down home prices, and millions of owners are unable to sell because they are underwater on their mortgages. These conditions are impeding a more robust recovery in existing home sales as well as in improvements spending, which usually increases right after a home purchase. Enhancements to the Home Affordable Modification Program, the recently completed National Mortgage Servicing Settlement, and servicers' own efforts to clear foreclo-

sure backlogs may, however, provide some relief by increasing loan modifications and expediting disposition of properties where homeownership cannot be maintained.

The greatest potential for recovery in the for-sale market lies in its historic affordability for well-positioned homebuyers. The dive in home prices and record-low mortgage rates have made owning more attractive than in years. But the availability of mortgage financing for young buyers with limited cash, other debts, and less than stellar credit is far from certain. Since the market meltdown, underwriting has become much more restrictive. So far, FHA and state housing finance agencies have served a vital role in supporting low-downpayment loans for homebuyers with all but the lowest credit scores. But even FHA is now raising its premiums to shore up its financial position and to encourage the return of private capital to the market. With key mortgage lending regulations still undefined, it remains to be seen to what extent and under what terms lenders will make credit available to lower-income and lower-wealth borrowers.

While restoring the housing market to health will benefit many households, it will also increase the cost pressures on many others. Rising rents have already added to the affordability problems of lower-income families. In addition, even as the recovery takes hold in a broad range of markets across the country, the damage to foreclosure-ridden neighborhoods will take years to heal. At a time when all levels of government are under financial duress, mustering the resources to address these challenges is increasingly difficult. But in making the hard decisions about scarce public funding, policy makers must bear in mind the fundamental importance of affordable housing to the well-being of every individual and the communities in which they live.