3 Demographic Drivers

Household formations were already on the decline when the recession started to hit in December 2007. Annual net additions fell from 1.37 million in the first half of the decade to only 1.06 million in 2005–8. While a prolonged downturn could curtail immigration, preventing rather than delaying some households from forming, household growth should remain solid. Indeed, the aging of the echo boomers will underpin housing demand over the next 20 years.

Housing Demand Drivers

Household incomes and wealth, headship rates, and homeownership rates are among the primary determinants of housing demand. All of these drivers exhibit a predictable pattern, starting out low in young adulthood and peaking sometime in middle age or the early retirement years. In combination with changes in the size and age distribution of the adult population, these age-specific drivers determine the quantity and quality of homes demanded. For example, when the baby boomers first started to form households in the 1970s, they increased the demand for rentals and small starter homes. And when they entered middle age in the 1990s, their higher average incomes and wealth boosted demand for larger, more amenity-filled primary homes, as well as for second homes.

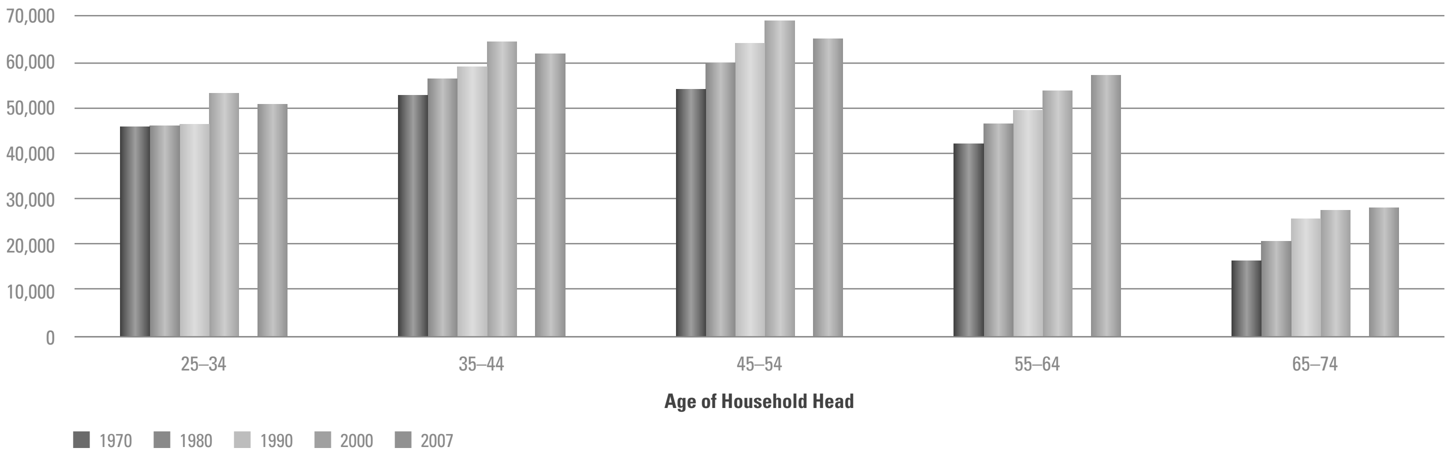
These demand drivers are, in turn, influenced by three factors. First, economic and market conditions—including unemployment rates, interest rates, availability of credit, and the relative costs of owning and renting—govern whether the incomes, headship rates, and homeownership rates of adults match those of the preceding generation over time. Second, longer-term social trends such as rising female labor force participation rates, divorce rates, and age at first marriage can place each generation on a different trajectory that persists well into middle age. And third, immigrant and minority shares have an impact because both groups have lower average incomes and wealth, as well as lower headship and homeownership rates, than native-born whites.

In today's severe recession, all age groups will see at least a temporary drop in income, wealth, and homeownership rates—and perhaps in household headship rates as well. The echo-boom generation now reaching adulthood faces a scarcity of entry-level jobs (especially well-paying ones) and will therefore start off on a lower trajectory than the baby-bust generation before them. In addition, with the tight grip on credit, even sharply lower home prices may not be enough to help the echo

Figure 12

For the First Time in Generations, Households Under Age 55 Are on a Path to End the Decade with Lower Real Incomes than Their Predecessors

Median Household Income (2007 dollars)



Note: Dollar values are adjusted for inflation by the CPI-U for All Items.
Source: US Census Bureau, Current Population Survey.

boomers match the headship and homeownership rates of their predecessors by the time they reach their 30s and 40s.

Income Gains at Risk

As each generation has come to maturity since 1970, business cycles have had far less impact on household income than longer-term changes in labor productivity, educational attainment, and female labor force participation rates. From 1970 to 2000, each 10-year birth cohort had a higher real median income than the preceding cohort despite temporary setbacks during recessions. Although household income generally peaks around age 50, the early lead achieved by each succeeding cohort has persisted well into older ages. These advances are all the more remarkable given the growing shares of minorities and immigrants among more recent cohorts.

The current recession threatens this long-term progress. Real median household incomes in all age groups under 55 have not increased since 2000 **(Figure 12).** In fact, for the first time in at least 40 years, there is a chance that the real median household income for these age groups will be lower at the end of the decade than at the start. Moreover, the severity of today's economic contraction could hold down incomes and wealth for years to come.

Headship Rates under Pressure

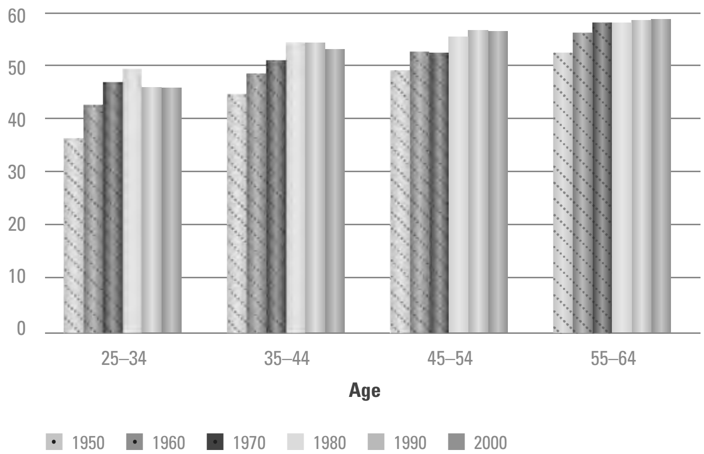
Each 10-year cohort born between 1916 and 1945 started out with higher household headship rates than its predecessor and maintained that lead well into middle age, when rates converged. From the postwar years through 1980, long-term social trends gave headship rates an especially large boost. Higher female labor force participation rates, later age at first marriage, higher divorce rates, and lower remarriage rates all contributed to growth in the number of single-person households and therefore to higher age-specific headship rates **(Figure 13).** The mere three percentage point rise in headship rates among 25–34 year-olds (from 47 percent in 1970 to 50 percent in 1980) alone raised the number of household heads in this age group by fully 1.1 million.

Once these social trends stabilized after 1980, however, they provided less of a lift to household headship rates. The increased pace of immigration also added downward pressure, especially among younger age groups, because the foreign-born are more likely to double up with others when they arrive in this country. The net effect is that headship rates for those over age 35 have been relatively flat since 1980. If the current economic downturn substantially dampens immigration in the short term, however, headship rates could increase slightly because a larger share of the population age 15–44 would be native born. But a prolonged

Figure 13

Household Headship Rates Increased Steadily Across All Age Groups Until the 1980s

Share of Population Heading Independent Households (Percent)

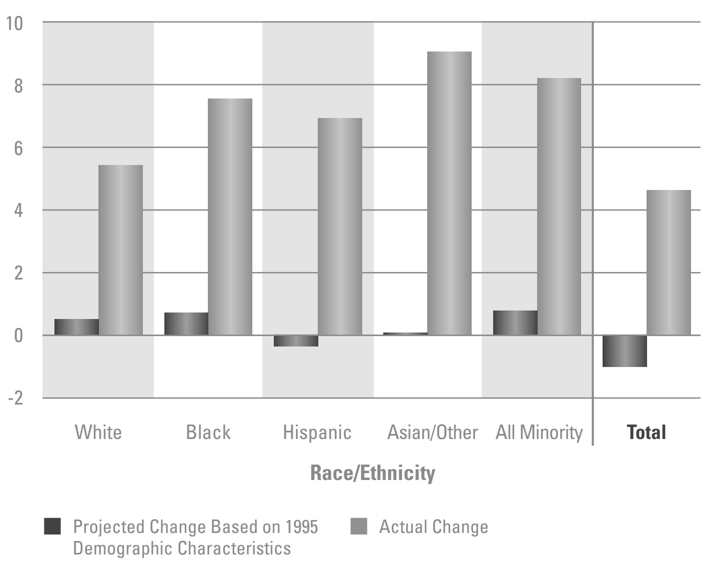


Source: US Census Bureau, 1950–2000 Decennial Censuses.

Figure 14

Market Conditions Rather than Demographic Forces Lifted Homeownership Rates During the Boom

Change in Homeownership Rates, 1995–2005 (Percentage points)



Notes: Whites, blacks, and Asians/others are non-Hispanic. Hispanics may be of any race. Projected 2005 homeownership rates are calculated by applying 1995 rates by age, household type, and race/ethnicity to 2005 household counts.

Source: JCHS tabulations of the 1995 and 2005 Current Population Surveys.

recession could drag headship rates down even if immigration were to slow because more native-born adults would double up.

Homeownership Reversals

The national homeownership rate fell during the 1980s and early 1990s among households under age 55, primarily because of predictable demographic forces. Rising prices for existing homes and high interest rates were also factors. But household income growth and low interest rates, together with mortgage industry changes, then helped to drive homeownership up 4.6 percentage points between 1995 and 2005 **(Figure 14).** Demographic forces—especially the shift toward minorities, who have much lower ownership rates than whites—in fact worked against homeownership gains. Indeed, if homeownership rates by age, race/ethnicity, and household type had remained at 1995 levels, demographic trends alone would have reduced the homeownership rate by a full percentage point over this period.

But with the help of a strong economy, easy access to mortgage credit, and the lure of appreciating home prices, the lagging homeownership rates among those who were born in the 1960s caught up with and then exceeded those of people born in the 1950s. Thus, while a birth cohort may start out on a lower homeownership trajectory, its members can later catapult ahead of their predecessors.

The low downpayment requirements prevailing for most of the 2000s allowed buyers to risk little money to acquire homes with price appreciation potential. Many marginal borrowers took advantage of this opportunity, although (starting in 2003–4) often with loans with payment reset risks and high debt-to-income ratios. When prices began to fall, payments to climb, and job losses to mount, much of the homeownership gain proved unsustainable. While expected to rebound as the economy improves and credit markets thaw, the national homeownership rate is unlikely to return to its recent peak anytime soon.

Housing and Net Household Wealth

Plummeting home and stock prices have decimated household balance sheets. The Federal Reserve estimates that real home equity fell by a dizzying $2.5 trillion in both 2007 and 2008. Still, these declines combined are less than last year's $5.3 trillion plunge in the real value of stocks and mutual funds held by households.

But because home equity is more evenly distributed than stock wealth, the drop in home values has taken a toll on far more households **(Figure 15).** Some 43 percent of bottom income quartile households, for example, had equity in their homes in 2007 while just 17 percent held stocks. Indeed, the median value of home equity for homeowners was nearly 10 times the median value of stock wealth for stockholders.

Home equity has fallen both because of sagging house prices and because owners have tapped their housing wealth as never before. According to Freddie Mac, households with conventional prime loans extracted $1.8 trillion in real home equity through refinances in 2001–7, up from less than $440 billion in 1994–2000 after adjusting for inflation. Given the combination of lower home values and higher loan balances from cashing out equity, Moody's Economy.com estimates that more than 14 million households owned homes that were worth less than their outstanding mortgages in March 2009.

Home price declines have hit minority households especially hard. Even before the recession began, the share of minority homeowners with equity cushions of less than 5 percent of the home's value was twice as high as that of whites (6.9 percent versus 3.4 percent). Because minorities are more likely to live in neighborhoods with heavy foreclosures (where prices have dropped the most), a larger share of these households has seen the value of their homes fall below the amount they owe on their mortgages.

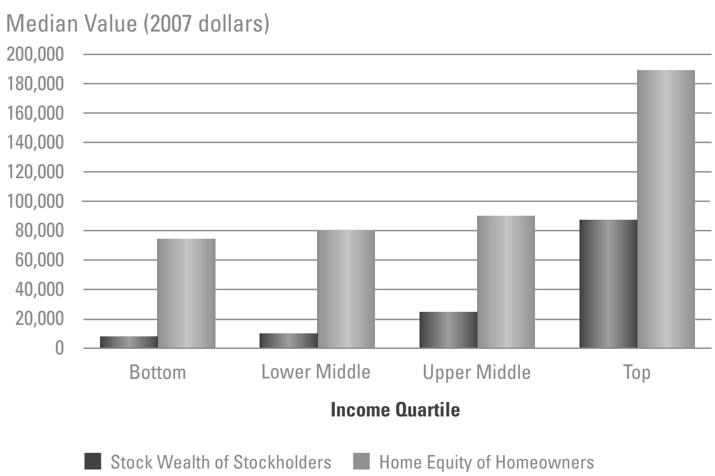
Among seniors, home equity makes up a large portion of portfolios, accounting for 26 percent of household wealth among all elderly and 59 percent among the low-income elderly in 2007. Since 80 percent of senior homeowners had either no mortgage debt or an equity cushion of at least 75 percent, most have managed to retain substantial (albeit diminished) equity stakes despite the large drop in home values.

Younger homeowners, in contrast, had less capital at risk but likely saw most if not all their equity erased. Even before the recession, 2 percent of homeowners under age 35 reported negative net equity in 2007 while 24 percent reported net equity of 10 percent or less. These shares have no doubt risen significantly since then.

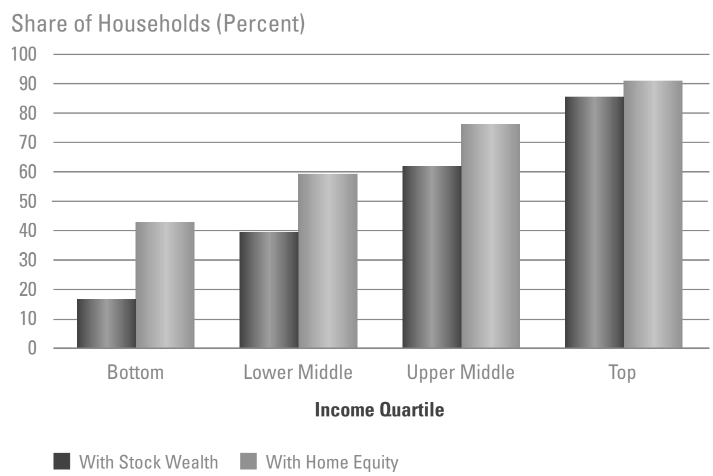
Homeowners who have defaulted on their loans—or worse, gone into foreclosure—have impaired credit records that will prevent them from buying once the market turns around. To the extent that minorities are overrepresented in this group, the already wide white–minority wealth gap will increase **(Table W-5).** Regardless of the recession, this gap is already set to expand for purely demographic reasons. Some 13 percent of white householders were age 75 and older in 2007, and will soon pass their wealth on to younger generations. Fewer minority families are likely to receive such bequests, not only because such seniors make up only 4 percent of minority households, but also because they have much less wealth to pass on. In 2007, white households age 75 and older had net wealth of more than $688,000 on average, while their minority counterparts had less than $167,000.

Figure 15

Home Equity Is Much More Important to Household Wealth than Stocks …



… And More Evenly Distributed Across Households

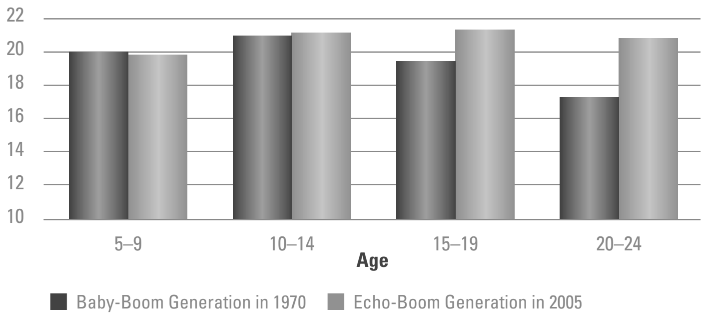


Note: Income quartiles are equal fourths of all households sorted by pre-tax income.
Source: JCHS tabulations of the 2007 Survey of Consumer Finances.

Figure 16

The Echo-Boom Generation Is Even Larger than the Baby-Boom Generation

Population (Millions)



Notes: Members of the baby-boom generation were born 1946–64. Members of the echo-boom generation were born 1981–2000.
Source: US Census Bureau, 1970 Decennial Census and 2005 population estimates.

Household Growth Projections

Because of the uncertainty around the length and depth of the recession, the Joint Center has prepared two household growth projections: one assuming a relatively swift recovery and a return to strong immigration, and the other assuming a prolonged recession and weaker immigration **(Table A-7).** The high projection is based on the latest Census Bureau population projection, which assumes that annual net immigration will increase from 1.1 million in 2005 to 1.5 million in 2020, and exceed 2.0 million by 2050. The low projection cuts these immigration assumptions by half.

In the two scenarios, the difference in household formations in 2010–20 is 2.3 million. Even in the low series, however, household growth would average more than 1.25 million annually over the next decade, thanks to the aging of the echo boomers. This is comparable to average annual household growth in 1995–2005, and reflects the expectation that the number of echo boomers aged 25–44 will eclipse the number of baby boomers when they were those same ages by more than 5.9 million.

These impending population shifts have important implications for housing demand over the next decade. First, as members of the echo-boom generation enter the prime household formation and homebuying ages, they will reverse declines in the 25–44 age group created by the much smaller baby-bust generation. With the number of households in this age group projected to increase by between 2.0 million and 3.4 million, the demand for rentals and starter homes will surge. Meanwhile, with their longer life spans and sheer numbers relative to the preceding generation, the baby boomers will add dramatically to the number of households over age 65. This will lift demand for retirement communities as well as services and home improvements that help seniors age in place.

As the more diverse echo-boom generation reaches adulthood and immigration continues to augment other generations, household growth among Hispanics and Asians will accelerate. Even under low immigration assumptions, Hispanic household growth will increase from 3.5 million in 1998–2008 to 4.5 million in 2010–20, while Asian household growth will increase from 1.5 million to 2.5 million. White household growth, in contrast, will slow sharply from 4.3 million to 3.3 million, and black household growth will slip from 2.4 million to about 2.2 million.

Married couples without children (including empty-nesters) will be the fastest-growing household type, followed closely by single-person households. While the number of married couples with children will fall by nearly a million among whites, it will increase by more than a million among Asians and Hispanics.

The housing now occupied by many older white baby boomers will be well suited to the needs of younger and generally larger minority households. With their lower incomes, however, minority households may be unable to afford these homes when they come onto the market. Indeed, the ongoing adjustment in house prices across the country may help improve affordability in the short term, but it is unlikely to bridge the gap completely.

The Outlook

While the economic crisis has dampened household growth, the sheer size of the echo-boom generation will give a powerful boost to long-run housing demand **(Figure 16).** A severe and prolonged recession may, however, reduce immigration—a key driver of household growth—or lead to an extended period of lower headship rates. And the depth of the downturn may, for the first time in at least 40 years, reduce the real median household incomes of each 10-year cohort relative to its predecessor by 2010.

Rapid growth in the population under age 45 and over age 65, as well as the rising minority share, will shift the composition of housing demand over the next 20 years. These changes in the age distribution will mean greater demand for both starter homes and rentals, and for seniors housing. In addition, as the baby boomers and older generations begin to turn over their homes to younger households, adjustments to the existing stock are likely, both through remodeling and pricing. The first wave of change will occur in the inner suburbs of large metropolitan areas where people now in their 70s and 80s are concentrated, then fan out to the outer suburbs as the baby boomers start to downsize.