EXECUTIVE SUMMARY

Even as the worst housing market correction in more than 60 years appeared to turn a corner in 2009, the fallout from sharply lower home prices and high unemployment continued. By year's end, about one in seven homeowners owed more on their mortgages than their homes were worth, seriously delinquent loans were at record highs, and foreclosures exceeded two million. Meanwhile, the share of households spending more than half their incomes on housing was poised to reach new heights as incomes slid. The strength of job growth is now key to how quickly loan distress subsides and how fully housing markets recover.

THE FLEDGLING RECOVERY

With the economy finally adding jobs and house prices down dramatically, two essential conditions for a sustained recovery in single-family starts and sales had fallen into place by spring 2010. But even in mid-2009—well before employment growth turned positive—existing home sales had revived as bargain hunters snapped up distressed properties in some of the hardest-hit areas **(Figure 1).** According to the National Association of Realtors®, more than a third of existing home sales last year—about 1.8 million units—were short sales or foreclosures.

Improved affordability for first-time homebuyers and a federal first-time buyer tax credit were vital to this early rebound. Indeed, even though tighter lending standards sapped some strength from the market, the increase in sales to first-time buyers drove all the gains in existing home sales in 2009. As a result of lower home prices and interest rates, mortgage payments on a median-priced home (assuming a 90 percent loan-to-value ratio) dropped below 20 percent of median household income—the lowest level on records dating back to 1971.

By the second quarter of 2009, new home sales began to pick up as well. While large in percentage-point terms, the gain through the third quarter was a modest 68,000 units (on a seasonally adjusted annual basis) from a base of just 338,000. Both new and existing home sales stalled again in the final quarter of the year and did not turn up until March 2010, sparked by another round of tax credit-supported homebuying and signs that labor markets were on the mend.

Home prices also showed signs of stabilizing in the spring of last year, only to slide again in late 2009 and the first two months of 2010. In the nation as a whole, however, median home prices followed sales higher in March and April. But two major indices provide conflicting news about the direction of home prices. After sliding sharply for several months, the FHFA purchase price index turned higher in February and March, while the S&P/Case-Shiller index showed steady declines from September 2008 through the

end of March 2010. Clear evidence of a home price recovery therefore had yet to emerge.

A number of other conditions are still weighing on the housing market. One of the biggest drags on the housing market is the high joblessness rate. With more than 7.8 million fewer establishment jobs than in December 2007, unemployment held at 9.9 percent in April 2010. If the past is any guide, the strength and sustainability of the housing recovery will depend most on the bounceback in employment growth **(Figure 2)**. Unfortunately, most economists predict that the unemployment rate will remain elevated as discouraged workers reenter the labor force amid slow gains in jobs.

The overhang of vacant units for rent, for sale, or held off the market (including foreclosed homes) is another serious concern. Despite production cuts of more than 70 percent since 2005, the overall vacancy rate hit a record in 2009. In addition, many current owners are effectively trapped in homes that are worth less than the amount owed on their mortgages. If these distressed owners want or need to sell, their only choices are to walk away from their homes or write a check at the closing table. This will inhibit a recovery in repeat home sales.

Finally, although picking up steam in the spring 2010 buying season, home sales will have to weather the expiration of the federal homebuyer tax credit. When the first round of credits expired in fall 2009, there was a noticeable falloff in sales. This time, though, the improving labor market may be enough to avoid a similar dip.

Barring an unexpected shock, mortgage interest rates should not be a major factor in either invigorating or undermining the recovery. Nonetheless, a one percentage point increase in mortgage rates would trim some of the recent affordability gains, while a comparable decrease would stimulate demand.

FIGURE 1

The Housing Market Struggled to Regain Ground Last Year

	Percent Change		
	2005–9	2008–9	Lowest Quarter in 2009 to 2010:1
New Single-Family Sales	-70.8	-22.7	5.7
Existing Single-Family Sales	-26.1	5.0	8.6
Housing Starts	-73.2	-38.8	16.6
Housing Completions	-58.9	-29.1	0.0
Median New Single-Family Price	-18.1	-6.3	2.0
Median Existing Single-Family Price	-28.5	-12.1	0.0
Home Equity	-56.6	-4.2	17.6
Mortgage Debt	5.6	-1.2	0.0
Residential Investment	-57.6	-24.1	0.7
Owner Residential Improvements	-19.6	-3.3	11.5

Notes: Percent change is calculated with unrounded numbers, with dollar values adjusted for inflation using the CPI-U for All Items. Starts and completions include single-family and multifamily units. Changes in home equity and mortgage debt are only through 2009:4.

Sources: US Census Bureau; National Association of Realtors® (NAR); Freddie Mac; Federal Reserve Board; Bureau of Economic Analysis.

HOMEOWNER STRESSES

Even as home sales and homebuilding improved last year, the foreclosure crisis intensified as the lagged impacts of huge job losses spread to the broader prime market. According to First American CoreLogic, falling home prices left 11.2 million homeowners underwater on their loans—with no home equity and unable to tap traditional markets—as of the end of the first quarter of 2010. Indeed, Freddie Mac reports that total real home equity cashed out at refinancing dropped 25 percent in 2009 and stood below $80 billion for the first time since 2000.

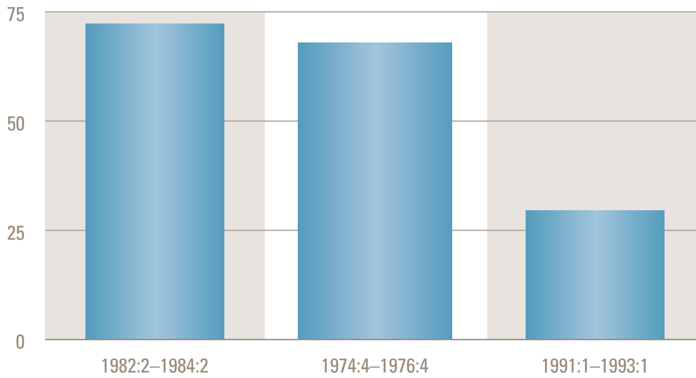
For its part, the government has focused on trying to prevent foreclosures. Under the Home Affordable Modification Program (HAMP), the federal government initially allocated $75 billion for sustainable mortgage modifications in an effort to reach 3–4 million homeowners by 2012. As of April 2010, HAMP had made 1.5 million offers that resulted in 637,000 currently active trial modifications and about 295,000 permanent ones. But even among those households able to qualify for this reduction in payments, the Treasury Department estimates that 40 percent will re-default.

The federal government also allocated about $6 billion to the Neighborhood Stabilization Program to deal with foreclosed properties, plus another $2.1 billion to housing finance agencies in states hardest hit by unemployment and house price declines. Preventing the millions of foreclosed properties from sitting empty, rehabilitating units in need, and placing them in the hands of responsible new owners—either as occupants or landlords—will be costly and difficult. With tighter underwriting standards limiting the ability of low-income borrowers

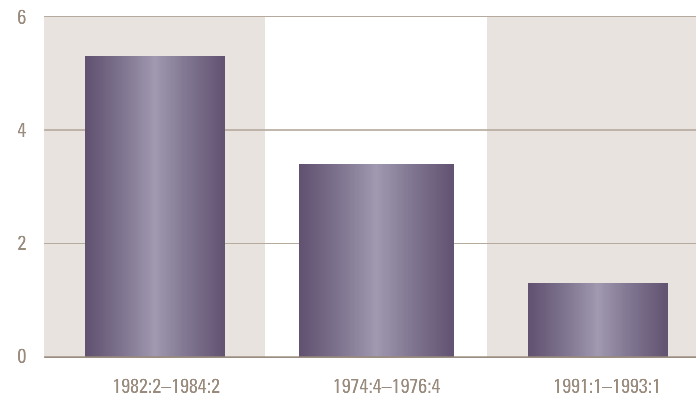
FIGURE 2

Strong Employment Growth, More than Falling Interest Rates, Has Been Critical to Sustained Housing Recoveries

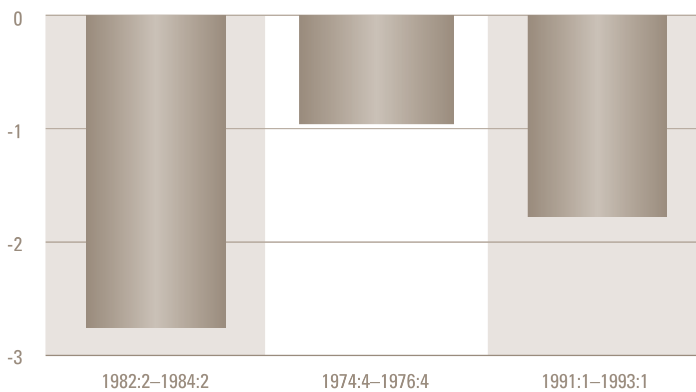
Change in New Home Sales (Percent)



Change in Employment (Percent)



Change in Mortgage Rates (Percentage points)



Note: Changes are from a trough in new home sales through the first eight quarters of a sustained recovery.
Source: JCHS tabulations of US Census Bureau, New Residential Construction Survey; Bureau of Labor Statistics, Current Employment Statistics; and Freddie Mac, Primary Mortgage Market Survey.

to qualify for loans, only a significant expansion of funding will prevent many communities—particularly many low-income minority neighborhoods where subprime loans were concentrated—from facing an uphill battle to restore housing markets to health over the next several years.

THE LOST DECADE

After at least three decades of progress, real median household incomes will almost certainly end the 2000s lower than they started. At last measure, the median for all households was $49,800 in 2008, down from $52,400 in 2000. Even at their last cyclical peak in 2007, real median incomes were 1.2 percent below 2000 levels.

Meanwhile, household wealth ballooned through the middle of the decade but ended about where it had started at around $54 trillion. On a per household basis, however, real household wealth slid from $503,500 to $486,600 over the decade. While growth in stock wealth has already started to pick up, housing wealth will take a slower path to recovery. Indeed, despite some painful foreclosure-driven deleveraging, mortgage debt has never been higher relative to home equity. After an $8.2 trillion plunge in housing wealth since the end of 2005, mortgage debt entered 2010 at 163 percent of home equity.

HOUSEHOLD GROWTH UNKNOWNS

Despite all the attention paid to the recession's impacts on household growth, it is difficult to judge how big those effects have actually been. All three major federal surveys indicate that household growth slowed substantially in the second half of the decade, but the estimates range widely **(Figure 3).** The low estimate puts the cumulative slowdown in household growth over the last four years at 1.0 million while the high estimate indicates a drop of 2.8 million. The reality could, however, be even worse because household growth estimates depend heavily on net immigration, which is particularly difficult to assess in and around an economic recession.

It is also challenging to sort out how much of the slowdown is due to reduced immigration and how much to lower household headship rates caused by doubling up. On the one hand, the Current Population Survey shows a much sharper decline in the number of foreign-born households under the age of 35 from March 2007 to March 2009 (338,400) than in same-age native-born households (2,100). On the other, the survey also indicates that headship rates among young adults as a whole declined in the late 2000s, consistent with the expected effects of soaring unemployment within that age group. At the same time, the survey also shows some dropoff in headship rates in older age groups.

FIGURE 3

Household Growth Has Clearly Slowed, But Estimates of the Degree Vary Widely

Average Annual Household Growth (Millions)

Notes: ACS estimates are from 2005 to 2008 only. To adjust for rebenchmarking, CPS and HVS estimates for 2002–3 are assumed to equal the average in 2000–5.

Sources: US Census Bureau, American Housing Survey; Current Population Survey; and Housing Vacancy Survey.

In any case, headship rates may not remain depressed for long given dramatic improvements in affordability for first-time buyers who have jobs, softening rents due to high rental vacancies, and the expectation that household growth will return to long-term trend levels when employment growth quickens. But assuming headship rates remain at their slightly lower 2008 levels and that net immigration recovers to its 2000–5 pace, household growth will average about 1.48 million annually in 2010–20. Even if immigration falls to half the Census Bureau's currently projected rate, household growth will still average about 1.25 million annually **(Table A-7).** This low-end estimate puts household growth in the next 10 years on par with the pace in 1995–2005, and should support average annual housing completions and manufactured home placements of well over 1.7 million units. The higher-end estimate would likely support production exceeding 1.9 million units per year on average over the coming decade.

DIVERSITY AND HOUSING DEMAND

At last measure in 2007, minorities accounted for fully 35 percent of first-time homebuyers and 20 percent of repeat buyers even in the middle of the housing bust. The immigrant share of first-time buyers was 19 percent and of repeat buyers 12 percent. The increasing presence of minorities and the foreign born in the rental market is even more striking. From 2000 to 2009, rapid growth of Hispanic households helped to lift the total minority share from 39.3 percent to 45.1 percent.

Even if immigration ground to a halt today, past inflows and higher fertility rates ensure that minorities and the foreign born will increasingly drive growth in housing demand. Both the echo-boom generation (born 1986–2005) and the so-called baby-bust generation (born 1966–85) already have much larger minority shares than the baby-boom generation **(Figure 4).** The sheer size of these generations—with the baby bust heavily augmented by the foreign born, and the even larger echo boom just now reaching the ages when immigrants will bolster its ranks—points to strong household growth in the years ahead.

In 2009, minorities accounted for 37 percent of householders aged 25–44 and 39 percent of those under age 25. Even under the Census Bureau's zero-immigration scenario, the minority share of the working-age population aged 25–64 would thus rise from 29 percent in 2000 to just under 35 percent in 2020.

Importantly, minority households have lower median incomes than white households. For example, the median income for 35–44 year-old minority-headed households was $45,000 in 2008, compared with $72,900 for whites. The gaps in personal income are even wider. If these disparities persist and overall income growth among younger generations remains weak, the social security system will come under increasing pressure as the baby boomers enter retirement.

The oldest baby boomers are just turning 64, with millions soon to follow. Indeed, the number of persons aged 55–64 rose by 10.4 million over the past decade—a 42.8 percent increase compared with total population growth of just 9.4 percent. Despite their losses in wealth caused by the correction in home and stock prices, the baby boomers will drive demand for senior housing suited to active lifestyles as well as for assisted living facilities.

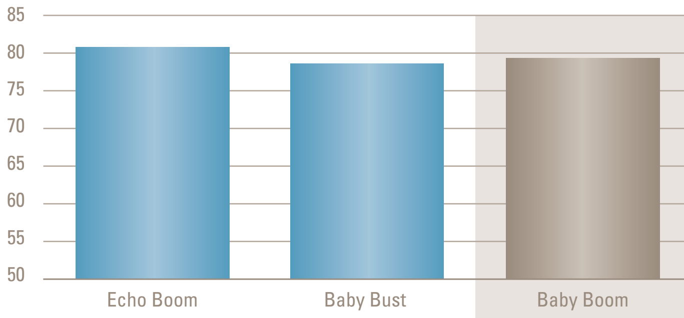
POLICY PRIORITIES

As the nation looks forward to a housing recovery, homeowners and renters alike are under duress. When home prices move consistently higher, some of the equity that owners lost over the last decade will be restored. But rising prices will also put additional strain on the already large number of households with daunting affordability challenges. Tackling these issues while leveraging the potential of housing to anchor neighborhood revitalization and achieve energy savings will be national priorities in the decade ahead.

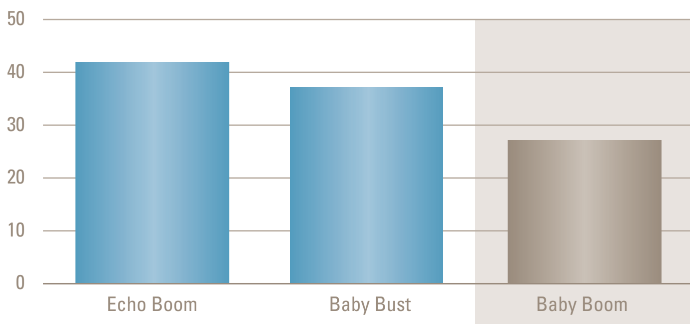
FIGURE 4

The Generations Following the Baby Boomers Are Large and More Diverse

Number of People in 2009 (Millions)



Minority Share of Generation in 2009 (Percent)

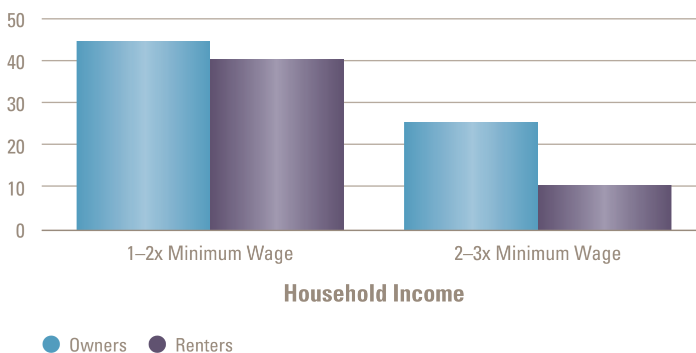


Note: Members of the echo-boom generation are aged 5–24 in 2010; the baby-bust generation are aged 25–44; and the baby-boom generation are aged 45–64.
Source: JCHS tabulations of US Census Bureau, Current Population Survey.

FIGURE 5

Even Households Earning Multiples of the Minimum Wage Cannot Afford Housing

Share of Working-Age Households with Severe Cost Burdens, 2008 (Percent)



Notes: Working-age households are aged 18-64. Minimum wage is $7.25 per hour. Full-time minimum wage job equivalent income is based on working 35 hours per week for 50 weeks. Households with severe cost burdens spend more than 50% of pre-tax income on housing.
Source: JCHS tabulations of US Census Bureau, 2008 American Community Survey.

All told, 40.3 million households spent more than 30 percent of their incomes on housing in 2008, while 18.6 million of these households spent more than half—up from 13.8 million in 2001. Of those with such severe housing cost burdens, fully 45.1 percent are renters in the bottom income quartile. Indeed, many householders with incomes that are one to three times the full-time minimum wage equivalent still have to devote at least half their incomes to housing **(Figure 5).**

Meanwhile, the acute housing affordability problems of very low-income renter households (with incomes half or less of area medians) has long been a focus of national housing policy. Yet despite federal support for rental assistance of about $45 billion per year, only about one-quarter of eligible renter households report receiving housing assistance.

Efforts to impose fiscal austerity may take a toll on programs to cope with these challenges. President Obama's FY2011 budget trimmed US Department of Housing and Urban Development funding by 5 percent, although an additional $2.2 billion was shifted into core rental assistance programs, yielding a net increase in the number of needy households served **(Table W-5).** Attention has also begun to focus on making the rental housing system more efficient and to placing the public housing stock on more secure footing by tying rents and rent increases to the market. In addition, HUD is extending revitalization efforts beyond distressed public housing by incorporating non-housing investments and by coordinating with other programs and services to achieve better employment, health, and safety outcomes for residents.

Also underway are efforts to reduce the nation's energy consumption and carbon footprint through improvements to the housing stock. In 2009, the American Recovery and Reinvestment Act extended energy efficiency tax credits for homeowners and funded low-income home weatherization programs. Longer-term federal commitments include HUD's new Sustainable Communities Initiative to encourage more energy-efficient and transit-friendly development patterns on a local level. Finally, homeowners and builders alike continue to make homes more energy efficient, led by regional certification programs as well as national green building standards. At stake are potentially large savings in the energy consumed to heat and cool homes, as well as in the number of vehicle miles traveled and related carbon emissions.