

Three Major Trends Shaping the U.S. Housing Market

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Zillow, the popular online real estate database, hosted its fifth housing forum, "The Big Picture: A Longer Term Perspective on Housing," at the Newseum in Washington, D.C. over the summer. Forum speakers and panelists discussed the future of housing, citing major trends which included interest rate lock-in, the influx of Millennials, and new urbanism. Panel discussions indicated that in recent years, there has been movement away from home buying, as incoming Millennials (defined at the event as individuals ages 18-34) show a preference for renting homes, rather than buying them. Additionally, current homeowners appear to be hesitant to buy again due to the risk of losing their low mortgage rates. The State of the Nation's Housing 2014, a report published by Harvard University's Joint Center for Housing Studies, corroborates claims put forth at the Zillow forum, noting the recession, along with other financial burdens, expanded the number of low-income households which subsequently led to a larger renting market.

Interest Rate Lock-In

In November 2012, the average 30-year mortgage rate fell to 3.5 percent, its lowest point in four decades. Many homeowners took advantage of such rates by refinancing their existing loans. However, the return to higher rates (consistently above four percent and reaching as high as 4.33 percent since September) has created what economists refer to as mortgage or interest rate lock-in. Also known as mortgage lock or rate lock, interest rate lock-in occurs when homeowners with non-assumable or non-transferable mortgages are reluctant to sell their current home due to the fear of losing the low interest rate on their home's mortgage. Under these circumstances, homeowners simply looking to buy a new home of an identical price would be forced to take a higher interest rate, and therefore a higher monthly payment. Furthermore, these homeowners, combined with owners experiencing equity lock-in due to the 2005 collapse, contribute to a large stagnant population within the market. Equity lock-in occurs when the value of the home is lower than what is owed on the property's mortgage. When the market collapsed

in 2005, house prices declined by a third, leaving homeowners up an equity lock river without a paddle.

A study by the Institute for Housing Studies at DePaul University notes that a 10 percent increase in equity-locked homes resulted in a 13 percent reduction in the home turnover rate. The study also states that a 10 percent increase in the number of interest-locked homes in turn caused a 29 percent decline in turnover. In an attempt to hold onto their low mortgage rates, homeowners who are forced to move or relocate due to unavoidable circumstances (such as for a job) often choose to lease their low interest rate property to renters, while taking on a lease of their own to rent a home in their new location. Housing turnover, or home sales, is considered crucial for a healthy housing market, as it not only spurs consumer spending, but also makes starter homes available to new buyers as the original owners trade up. Therefore, interest rate lock-in has the potential to disrupt the natural flow of consumer spending and the housing market as a whole, making it especially difficult for new buyers to enter.

Millennials

Millennials are the first generation to make moving back into Mom and Dad's basement a new norm, with 20 to 26 percent of women and of men ages 25 to 29 still living at home. This figure, reported by the Washington Post, is the highest percentage of returnees this age group has seen since 1940. But is it really all their fault? It is unlikely that a significant portion of adults in their mid-to-late twenties want to regress, moving back into their parents' homes following a taste of independence. This generation is getting married later, having children later, and moving around the country much more often than previous generations. Such trends urge Millennials to rent for longer periods of time, prolonging entry into the housing market. However, moving home for a short time and saving money can be considered an investment in the future, rather than an avoidance of reality.

Challenges Facing Millennials Entering the Housing Market

• New strict lending regulations

In the aftermath of the 2005 housing crisis, the 2010 Dodd-Frank Act imposed strict regulations on lenders intended to limit the possibility of homeowners defaulting on their home loans in the future. For new buyers entering the market, there is a higher standard of credit required prior to loan approval. Many who are just starting out may not have built enough credit to qualify under the new regulation.

- **High student loan debt**

In 2012, 71 percent of students graduating from a 4-year university reported student loan debt, with an average debt level of \$29,400. This debt places early financial burden on graduates, committing them to monthly payments and making it more difficult to save for an eventual down payment on a home. Furthermore, student loan debt makes it much more difficult to qualify for a mortgage, as new regulations demand a 43 percent debt-to-income ratio.

- **Job instability and unemployment**

While the economy has improved in the last few years, Millennials were affected the most by the recession. Upon graduating they were faced with a bad economy and many were burdened with a delayed start in the job market, eventually settling for prolonged unemployment or underemployment. As of July 2014, five years after the recession, individuals aged 20 to 24 still suffered from an unemployment rate of over 10 percent.

- **Lock-in**

The secondary effect of owners being hesitant to sell current homes means there is no opportunity to trade up, thus no opening of starter homes to first time buyers. If no suitable homes are available in the locations new buyers desire they will continue to rent rather than spend their hard-earned money on a home that does not meet their needs.

Despite these concerns, Millennials continue to say they see buying a house in their future. Commenting on results from a recent National Housing Survey by Fannie Mae, Sarah Shahdad, strategic analyst with the company, stated, "Though they see a tough road to affording Homeownership, younger renters [those between the ages of 18 and 39] still are very likely to say that it's in their future plans... The vast majority still plan to own someday; about half plan to buy a home the next time they move."

And they know what they want. Above all else Millennials want cost-efficiency in homeownership. On top of the traditional home desires, such as a good neighborhood and strong local school system, many also want walkability. Multiple panelists at the Zillow forum, representing real estate firms as well as research centers, confirmed that Millennials value location above all other qualities in a home and are willing to compromise on size and luxury if it means they are not dependent on a car to commute.

Millennials are quickly making their mark on the housing market. While many argue that lack of commitment is to blame for low homeownership rates of the generation, it is clear there are some economic obstacles faced by Millennials that did not similarly impact other generations.

New Urbanism

New Urbanism is a neighborhood development movement which promotes a wide range of features meant to improve the quality of life for residents within these areas. According to NewUrbanism.org, the fundamental principles of the movement include:

Walkability
Connectivity
Mixed-Use and Diversity
Mixed Housing
Quality Architecture and Urban Design
Traditional Neighborhood Structure
Increased Density
Green Transportation
Sustainability
Quality of Life

Advocates of New Urbanism claim the movement toward such residential layouts is already underway due to the market's responses to new homebuyers' aversion to automobile dependency. The new neighborhoods would resemble small urban hubs, with a variety of attractions within a 10-minute walking distance. A major challenge to the movement is current separate-use zoning standards, put in place following World War II. These regulations segregate residential areas from commercial and industrial zones, separating where people live from where they work and shop. New Urbanists argue this planning has outlived its usefulness and is out of date for a society that is particularly focused on reducing energy use and costs.

The movement also hopes to relieve the high cost of housing in metropolitan areas by providing buyers and renters with living arrangements that offer similar attractions to that of a large city.

Examples of cities reflecting New Urbanist qualities include:

Playa Vista, Los Angeles, CA
Highlands' Garden Village, Denver, CO
Southwood, Tallahassee, FL
Salamanca, Miami, FL
Kentlands, Gaithersburg, MD
Sandy Spring, Sandy Spring, MD
Mashpee Commons, Mashpee, MA
Bayfront, Jersey City, NJ
University Heights, Newark, NJ
Rocketts Landing, Richmond, VA
Providence, Sun Prairie, Wisconsin ◀