Young-Adult Housing Demand Continues to Slide, But Young Homeowners Experience Vastly Improved Affordability

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"The *bad* news is that household formation and homeownership among young adults continue to decline, despite improvements in the economy. The *good* news is that housing affordability for young homeowners – as measured by the ratio of monthly housing costs to homeowner income – is at the best level in more than a decade."

Introduction

The Great Recession and housing bust hit young adults hard. The unemployment rate for 25-34 year-olds more than doubled between 2007 and 2010, and real median household income for this group fell by nearly 10 percent during the downturn. As economic conditions deteriorated, young-adult household formation and homeownership fell sharply.

In recent years, however, young Americans' economic circumstances have begun to brighten. Although economic conditions for young adults remain substantially worse than before the recession, the unemployment rate and employment-to-population ratio have improved modestly for 25-34 year olds, and their real median household income has stabilized following several years of decline.[1]

Have these economic improvements arrested the decline in housing demand among young adults? This *Housing Insights* uses newly released 2013 data from the Census Bureau's American Community Survey (ACS) to show that two key metrics of housing demand – the headship rate[2] and homeownership rate – continued to drop for young adults, despite their recent economic progress. Specifically, between 2012 and 2013, both the headship rate and the homeownership rate for 25-34 year-olds declined significantly, although the drop in the rate of owner-occupancy moderated from the preceding year. The cumulative declines in young-adult headship and homeownership rates since 2006 imply 1.5 million fewer young households and 2.4 million fewer young homeowners in 2013 than would be the case had these rates remained at 2006 levels.

The good news, however, is that the rate of housing cost burdens among young owner-occupants continues to plummet. In 2013, fewer than one in four young homeowners paid more than 30 percent of household pre-tax income for monthly housing costs[3], a rate of affordability problems that is 13 percentage points lower than in 2007 and more than 2 percentage points lower than in 2000, prior to the mortgage credit bubble.

The continued slide in household formation and homeownership among young adults suggests that more robust labor market improvements, among other factors, are needed for young Americans to get a stronger foothold in the housing market. The prolonged and substantial decline in homeowner cost burdens among young adults suggests that although the foreclosure crisis and mortgage credit tightening have contributed to a sharp decline in homeownership, they might also have helped to produce a cohort of young homeowners who have housing costs that are much better aligned with incomes.

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[1] U.S. Census Bureau, *Income and Poverty in the United States: 2013*, Current Population Reports, report number P60-249, September 2014. Employment data are from the U.S. Bureau of Labor Statistics, Current Population Survey.

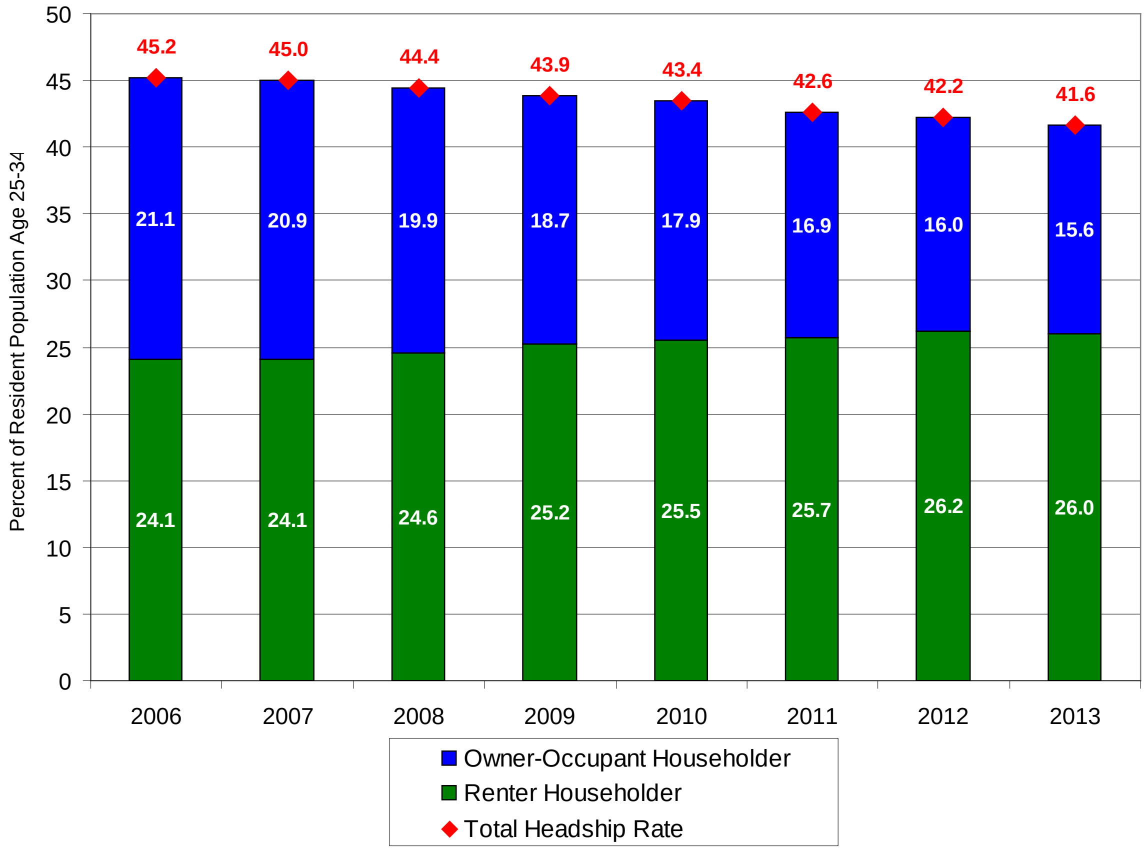
[2] The headship rate, a commonly used metric of household formation, is the proportion of the population in a given age group that is a householder, i.e., the person, or one of the persons, in whose name a housing unit is owned, being bought, or rented.

[3] For many federal housing programs, housing costs that exceed 30 percent of household income are deemed unaffordable. In addition, studies of housing conditions frequently use the 30 percent cutoff to identify households with housing cost burdens.

Young-Adult Housing Demand Continues to Fall

A fundamental indicator of housing demand is the headship rate, or the rate at which a given population group forms independent households. Marking a continuation of a long slide in young-adult housing demand, the headship rate among 25-34 year-olds declined in 2013 for the sixth consecutive year (Exhibit 1).[4] The 0.6 percentage point decline in the headship rate between 2012 and 2013 was not significantly different than the magnitude of the drop registered in the preceding year, indicating that the pace of decline in young-adult household formation is not yet abating.

Exhibit 1. The Long Slide in Young-Adult Household Formation Continues



Source: U.S. Census Bureau, American Community Survey 1-Year Estimates
Note: The decline in the total headship rate between 2006 and 2007 was not statistically significant.

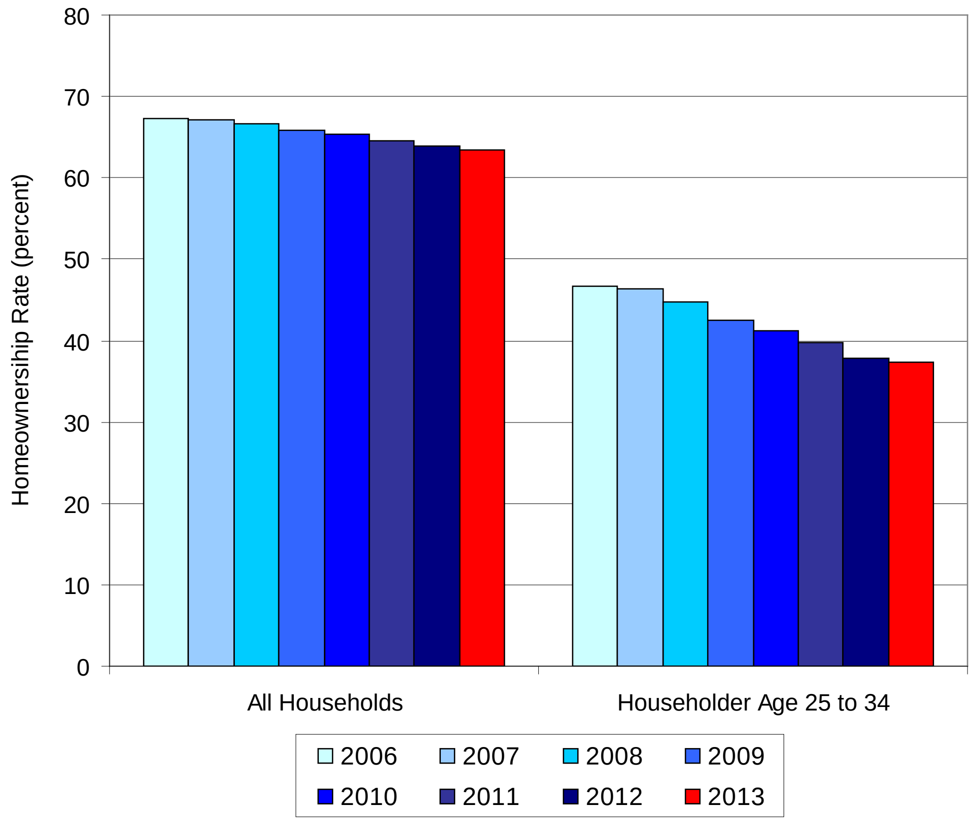
Increasingly, young adults who do form households tend to rent. As shown by the green bars in Exhibit 1, in 2006 every 100 persons aged 25-34 generated, on average, about 24 renter households, but by 2013 this number had increased to 26. Conversely, the number of owner households fell from 21 per 100 population in 2006, to less than 16 per 100 in 2013. Of note, however, is the fact that the renter headship rate did not increase between 2012 and 2013 for the first time since the onset of the Great Recession.[5]

[4] Unless otherwise noted, all differences or changes with respect to the housing conditions of young adults noted in the text are statistically significant at the 90 percent confidence level. The decline in the total headship rate between 2006 and 2007 was not statistically significant and is thus not counted as a year of declining headship.
[5] According to the American Community Survey, the median gross rent increased in 2013 at the fastest pace since 2009, possibly helping to explain the leveling off in renter headship rates among young adults.

Young-Adult Homeownership Continues to Decline, But at a Moderating Pace

As shown in the preceding section, one method for measuring homeownership attainment is to track the homeowner headship rate, also known as the per capita homeownership rate. Another, more traditional, method is to measure the proportion of householders (or households) who are owner-occupants. Paralleling the per capita homeownership rate, the traditional measure registered a decline in young-adult homeownership attainment in 2013 (Exhibit 2, right cluster of bars). The homeownership rate for householders aged 25-34 fell by 0.4 percentage points between 2012 and 2013, the same decline measured for all households. This was the first time since 2008 that the homeownership rate for young adults did not fall at a faster pace than the rate for all households. The homeownership rate decline for young adults in 2013 also was the smallest annual drop measured for this group since the beginning of the recession.

Exhibit 2. Homeownership Rates of Young Households Are Still Falling, But at a Moderating Pace



Source: U.S. Census Bureau, American Community Survey 1-Year Estimates

The Overlooked Housing Affordability Story: Young Homeowners Have Experienced Huge Declines in Housing Cost Burdens

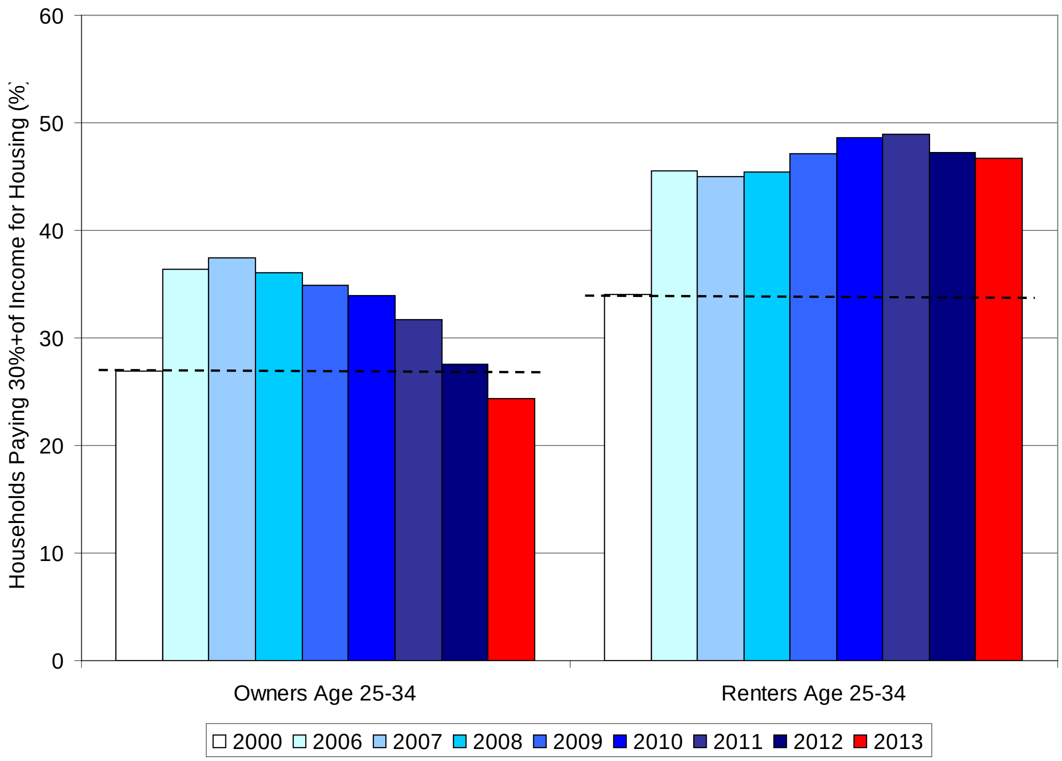
Recently, much attention has focused on mounting housing affordability problems, particularly among renters.[6] Indeed, the proportion of young renters with housing cost burdens (that is, the proportion of households paying at least 30 percent of household pre-tax income for monthly housing costs[7]), increased by more than three

[6] See, for example, Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2014*.

[7] For renters, the housing cost component of the cost-to-income ratio is measured by gross rent, which includes contract rent plus the estimated monthly cost of any utilities (electricity, gas, water, and sewer) and fuels (oil, coal, kerosene, wood, etc.) not covered by the contract rent. Units for which no rent is paid are excluded from the calculations. For owner-occupants, housing costs are measured by "selected monthly owner costs," which include payments for mortgages, deeds of trust, contracts to purchase, or similar debts on the property (including payments for first and subordinate loans); real estate taxes; fire, hazard, and flood insurance; utilities; fuels; and, if applicable, condominium fees. Costs for owner-occupied mobile homes also include, where applicable, installment loan payments, personal property taxes, site rent, registration fees, and license fees.

percentage points between 2006 and 2011, before falling modestly in both 2012 and 2013 (Exhibit 3, right cluster of bars). Despite the recent improvement, nearly half of young renters experienced housing cost burdens in 2013, compared with roughly one third in 2000.

Exhibit 3. Renter Cost Burdens Remain Elevated for Young Adults, But Owner Cost Burdens Have Plummeted



Source: U.S. Census Bureau, American Community Survey 1-Year Estimates and Census 2000 Public Use Microdata Sample. Dashed lines show rates of affordability problems in 2000.

Less frequently noted has been the prolonged, substantial decline in housing cost burdens among young homeowners.[8] Since peaking in 2007, the proportion of young homeowners with housing cost burdens has fallen each year, dropping by a cumulative 13 percentage points (Exhibit 3, left cluster of bars). And, unlike the case for young renters, the incidence of housing cost burdens among young homeowners is now *lower* than in 2000, prior to the housing credit bubble.[9] The decline in affordability problems among young owner-occupants likely reflects a combination of factors, including exits from homeownership by households who had high and unsustainable housing cost burdens, declining interest rates and house prices that reduced mortgage payments, and implementation of tighter mortgage underwriting standards after the housing bust.

The Outlook for a Turnaround in Young-Adult Housing Demand

Multiple factors – including labor market conditions, housing costs, the length of educational careers, decisions related to marriage and child bearing, student loan debt, mortgage credit accessibility and cost, and lifestyle

[8] As a measure of homeownership affordability, the housing cost burden metric differs from well-known home purchase affordability indices, such as the National Association of REALTORS®' Housing Affordability Index and the National Association of Home Builders/Wells Fargo Housing Opportunity Index. Whereas the housing cost burden metric assesses the actual affordability of the housing unit currently occupied by a homeowner, home purchase affordability indices measure the hypothetical ability of a "typical" (e.g., median-income) family to purchase a home given prevailing house prices and interest rates and assumed mortgage terms.

[9] Furthermore, the decline between 2006 and 2013 in the rate of cost burdens among 25-34 year-old homeowners was significantly greater than for all homeowners and for owner-occupants in any other age group.

preferences – affect the magnitude and nature of housing demand among young adults. But among these many factors, strong job and income growth are probably the two most essential precursors to a recovery in young-adult housing demand.[10] Since 2013, labor market and income changes for young adults have been mixed. For the year ending in the second quarter of 2014, the young-adult unemployment rate fell, but remained about 2 percentage points above the rate at the beginning of the recession. During the same period, real wages for young adults declined slightly, another indication that more robust labor market improvements are required to improve substantially the financial situation of young adults.[11] Absent a more robust labor market rebound, housing demand among young Americans, who traditionally represent potential first-time homebuyers, is likely to remain subdued, thereby hindering the housing market recovery.

On a positive note, the substantial decline in housing cost burdens among young homeowners continued unabated last year. Compared with the peak of the housing bubble, young homeowners today have housing costs that are much better aligned with incomes.

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[10] For a discussion of the importance of job and income growth for household formation and homeownership attainment among young adults, see Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2014*.
[11] Annual wage change is based on Bureau of Labor Statistics data on the median weekly earnings of full-time wage and salary workers aged 25-34, adjusted for inflation using the Consumer Price Index for All Urban Consumers, Research Series.