January 30, 2015

U.S. HOMEOWNERSHIP RATE STILL DECLINING BUT IT MAY NOT BE BAD NEWS

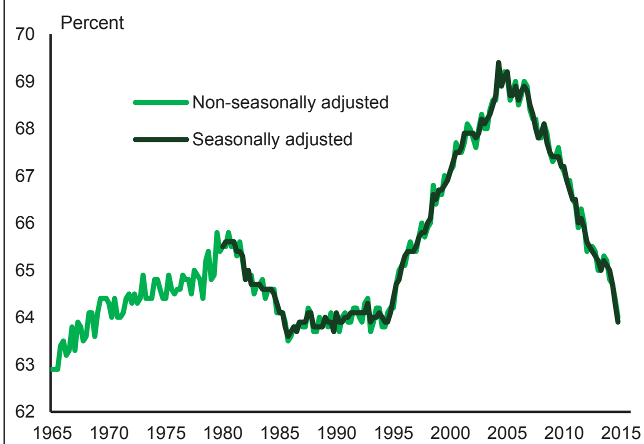
Highlights

- The homeownership rate fell 0.4 percentage points in the fourth quarter of 2014, to the lowest level in over 20 years.
- The fall was not due to a decline in the number of homeowners, which actually rose modestly in the quarter, but to a surge in the number of renter households.
- On a year-ago basis, the number of renter households was up a whopping 2.0 million in the fourth quarter, while homeowners are down 354k, leading to total growth in occupied housing units of 1.6 million – the best growth since 2005.
- The increase in renter households caused the rental vacancy rate to plunge to a 24 year low. The fall in vacancy is being met with rising rents and greater construction.
- With the job market gaining strength, mortgage rates falling, and lending conditions improving, the number of homeowners is likely to turn up.

In what has become a familiar pattern, the U.S. homeownership rate fell again in the fourth quarter of 2014 to 63.9%. Since peaking in 2004, the homeownership rate has fallen by a cumulative 5.5 percentage points, completely wiping out the gains of the previous decade (Chart 1).

The fall in homeownership rate, however, masks a more positive story. The homeownership rate is calculated as the ratio of owner-occupied housing units to the total number of occupied units. But, the Great Recession not only impacted homeownership; it also reduced the tendency of people to form independent households. Since 2008, the headship rate – the number of households per capita – has also fallen dramatically.

CHART 1. U.S. HOMEOWNERSHIP RATE



Source: U.S. Census Bureau

The prospects for the housing market will be determined not by the ratio of homeowners to renters but by the growth in the number of independent households. In terms of its impact on the housing market, the decline in the headship rate is more important than the drop in homeownership. Had the headship rate remained at its pre-recession peak, there would be over 2 million more U.S. households (renters and homeowners) than there are today.

The good news is that this trend appears to have reversed course over the past year. In the fourth quarter of 2014, the number of occupied housing units (equivalent

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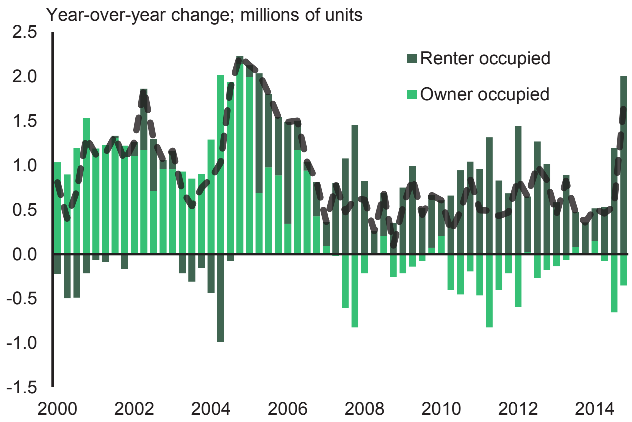
CHART 2. CHANGE IN OCCUPIED HOUSING UNITS



Source: Census Bureau

to the number of households) was up 1.6 million relative to a year ago, the fastest growth since 2005 (Chart 2).

An improvement in the level of household formation removes one of the main impediments to a stronger housing recovery. The increase in the number of renter households has pushed down the rental vacancy rate to a 24 year low (Chart 3). The decline in vacancy rates will continue to put upward pressure on market rents. Combined with falling mortgage rates, a strengthening job market, and recent changes in regulations to improve mortgage accessibility, the scales are tipping in favor of homeownership.

Slightly more homeowners, many more renters

The fall in the homeownership rate over the past several years reflects the fallout from the foreclosure crisis, the accompanying tightening in mortgage lending standards, and the carnage in the job market. The rise in foreclosures not only turned former homeowners into renters, it also restricted the ability of potential homeowners from becoming actual ones. As a result, by the fourth quarter of last year there were over 1.9 million fewer owner-occupied housing units than there were in 2006.

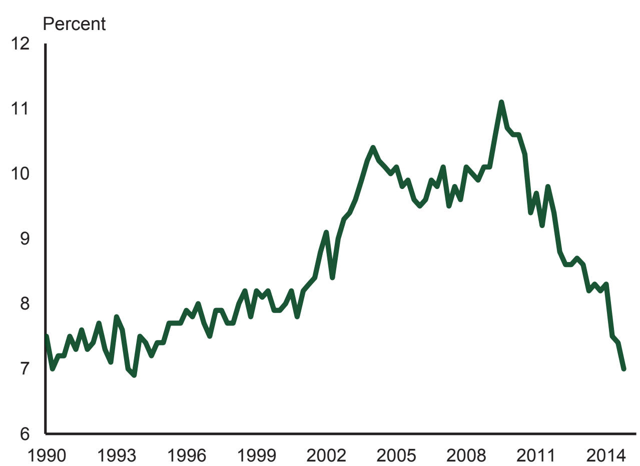
However, not all declines in the homeownership rate are due to fewer homeowners. All that is required for the homeownership *rate* to fall is for the change in renter households to be greater than the change in owner households. Somewhat counterintuitively, this means that if a person moves out of their parents' basement into a rented apartment, it could simultaneously show up as a decline in the homeownership rate and a rise in household formation.

This appears to be what happened in the fourth quarter of last year. According to the Census Bureau's Housing Vacancy Survey (HVS), the number of homeowner households rose by 366k, but the number of renter households rose by an even greater 971k (for total household growth of 1.34 million). While there is a margin of error in these quarterly estimates, the growth in the number of renter households is undeniable. It has shown up in an impressive decline in rental vacancy. From a peak of 11.1% in the third quarter of 2009, the rental vacancy rate fell to just 7.0% in the fourth quarter of last year (Chart 3).

Rental demand is likely to remain solid, supporting by urbanization, elevated student debt levels, and a trend toward getting married later in life. Still, studies have shown little change in young people's preference for homeownership.[1] In many cases, the decision to marry and purchase a home has been postponed due to the poor job market. As the job market improves and incomes rise, many renter households will turn into homeowners.

Indeed, the economic case for homeownership becomes stronger as vacancy rates fall and rents rise. Rents over the past year have risen 3.4% according to the consumer price index (Chart 4). The rise in

CHART 3. RENTAL VACANCY RATE



Source: U.S. Census Bureau

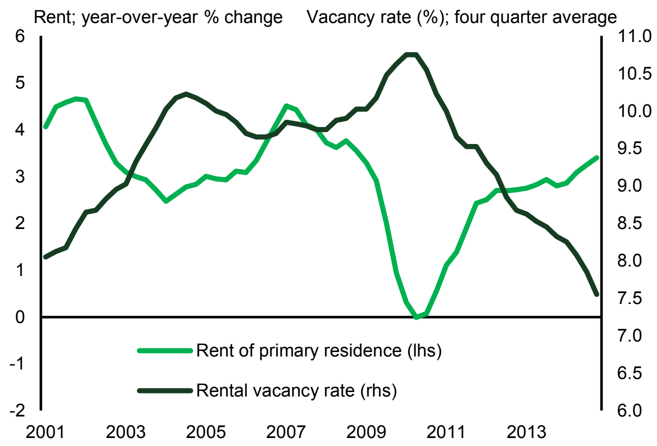
rents has occurred as home price growth has slowed from over 10% early in 2014 to 4.7% in November according to the Case-Shiller home price index. The deceleration in home price growth alongside the acceleration in rents implies a relative increase in the affordability of homeownership relative to renting.

Bottom line

The homeownership rate has fallen dramatically over the past several years, but so has the headship rate. As more people moved in with family members or bunked up with roommates, the growth in the number of households has fallen well below historic norms. Since 2007, household growth has averaged just 600k per year according to the HVS.[2]

The tide appears to be turning. Household growth rose to 1.6 million over the course of 2014. The increase in the number of households suggests that housing construction still has room to move up. Housing starts in December averaged 1.09 million (SAAR). Stabilization in the headship rate would imply trend household growth of around 1.4 million a year. Adding on depreciation of between 200k to 300k annually, this suggests that starts could rise another 50% just to get back to this demographically supported level.

CHART 4. RENT & VACANCY



Source: Bureau of Labor Statistics, Census Bureau

While all of the household growth over the past seven years has been in rental households, this too appears likely change going forward. With an improving labor market putting upward pressure on wages, mortgage rates falling and lending conditions improving, the case for homeownership has rarely been stronger.

End Notes

1 See Belsky, Eric S., "The Dream Lives On: The Future of Homeownership in America," (W13-1, Joint Center for Housing Studies, Harvard University, 2013), http://jchs.harvard.edu/sites/jchs.harvard.edu/files/w13-1_belsky_0.pdf

2 There are differences in household estimates between Census Bureau surveys. According to the Current Population Survey, which takes a snapshot of the number of households in March of each year, household growth averaged 990k between 2007 and 2014.

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