Unlocking Millennial Homeownership

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For millions of Americans, the promise of owning a home remains a cornerstone of the American Dream. Homeownership provides an avenue for accumulating wealth, promotes financial security, and plays a critical role in the development of family and community life. Yet, nearly a decade since the Great Recession ended, owning a home remains out of reach for many millennials (defined as those roughly between the ages of 22 and 37).[1]

Young adults today are less likely to own a home than in previous generations, despite showing a strong interest in owning one.[2] The scarcity of affordable housing options poses serious challenges for the economic futures of the nation's soon-to-be largest living adult generation, as well as for current homeowners.[3]

While Americans across the country struggle to access affordable and high-quality housing, millennials have faced unique challenges that contribute to their lower rates of homeownership. Three factors in particular—housing supply constraints, beginning their careers in a poor labor market, and high student loan burdens—have compounded the affordability crisis for millennials. To make it easier for millennials to own a home, policymakers at the federal, state, and local level must take a multi-pronged approach that addresses the economic challenges this generation faces.

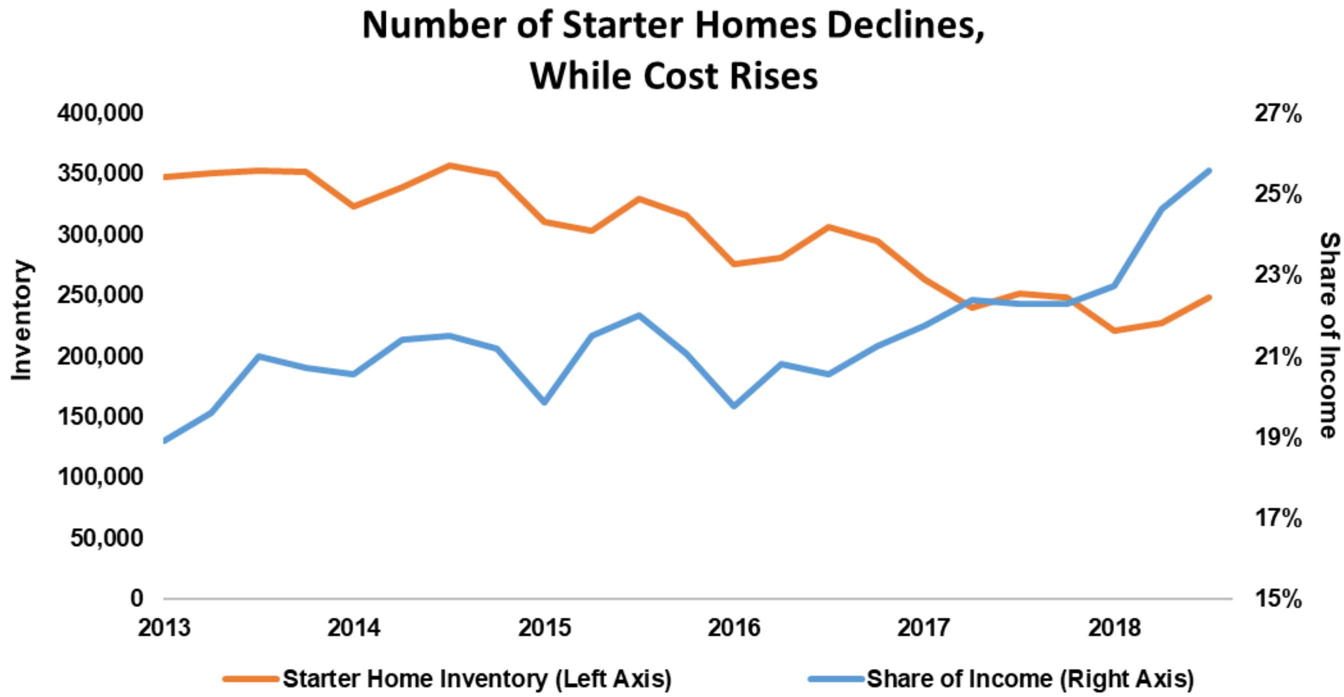
Millennials Are Struggling to Afford Homes

Rising housing prices and the limited availability of starter homes have made the American Dream much more expensive to obtain. From September 2010 to 2018, the median price of a new home rose from $228,000 to $320,000 – over a 40 percent increase.[4]

These price increases have hit millennials particularly hard occurring just as they started entering the labor market and began paying off student loans. Given that the Great Recession dampened economic opportunities and wages, millennials have less income to afford housing.[5] In short, the combination of rising prices and lower disposable income makes it much harder for millennials to enter the housing market.

Limited Starter Home Supply Has Raised Costs

When looking to buy a home, many single-family and first-time home buyers typically look for starter homes. These homes are usually smaller and more affordable, and serve as an attractive option. Unfortunately, the availability and supply of these types of homes has dwindled. The shortage has pushed up starter home prices, in essence eliminating a once typical path to homeownership for many people.[6]



Source: Trulia

Notes: Data on quarterly basis. Share of income is income needed to afford a median-priced starter home.

As the chart above indicates, the number of starter homes available started to decline in mid-2014. Within a year, those entering the housing market were forced to pay a larger share of their income for the limited stock of starter homes, a trend that has continued since then. So, while the supply went down, the cost went up. In the third quarter of 2018, for example, the starter home inventory decreased 0.9 percent from the year prior, while the share of income needed to afford a median-priced starter home rose 14.8 percent over the same period. Compared to six years ago, these homes have become scarcer, smaller, and costlier.[7]

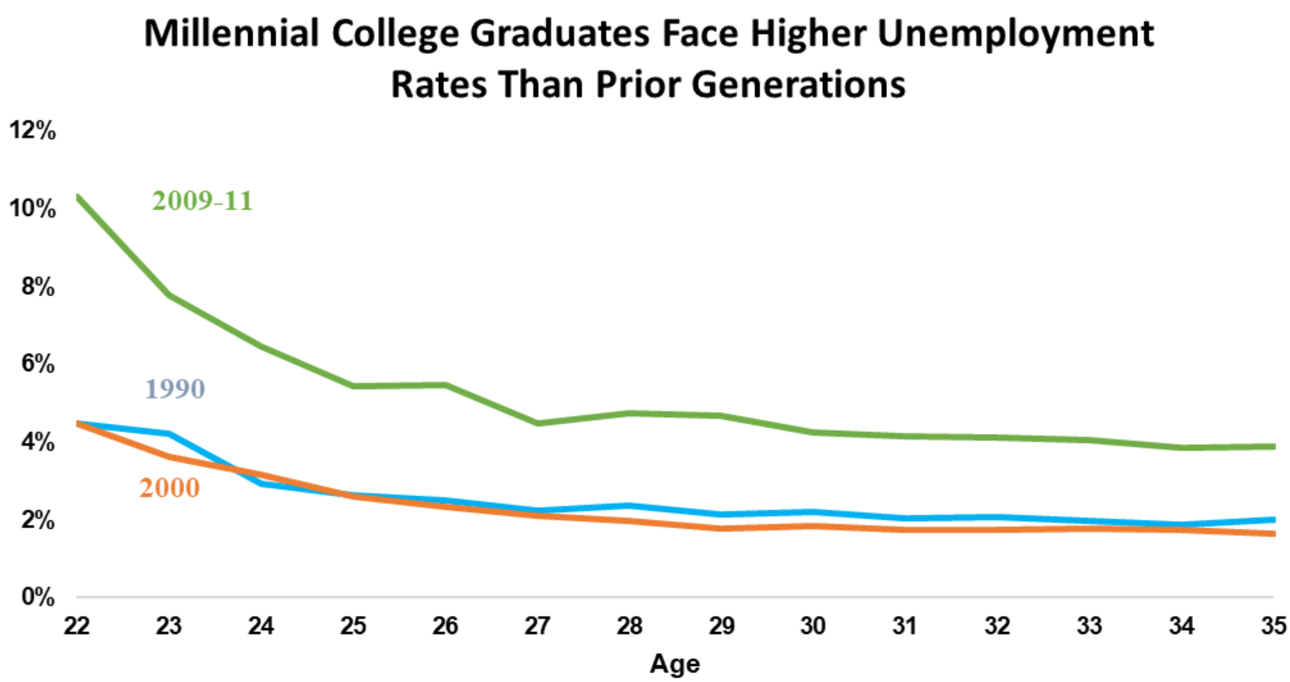
The limited supply partially stems from the aftermath of the Great Recession, when investors converted many starter homes into rentals. From 2007 to 2017, the number of renter-occupied units increased by about 8 million, while owner-occupied units increased by only 1 million.[8] That is to say, more people started renting and less people started owning.

Another factor contributing to the housing shortage is that baby boomers (typically those born between 1945 and 1965) are not selling their homes. One survey conducted in 2017 of homeowners 55 years and older showed that 85 percent do not plan to sell their home in 2018.[9] This ties up as many as 33 million properties owned up Boomers—many of which are urban condos and suburban single-family homes—reducing housing availability for millennials.

A vicious cycle thus ensues. Baby boomers' decisions to stay put lower the supply of available housing and push up the prices of existing and new homes. Climbing housing prices incentivize baby boomers to stay put, as the costs of moving become more expensive. Many also wait to sell their home expecting a higher price, thereby lowering supply even further. Even boomers who wish to downsize from larger homes have a hard time doing so due to inadequate levels of smaller home construction, typically smaller starter homes.[10]

Millennials Are Still Recovering From a Poor Job Market

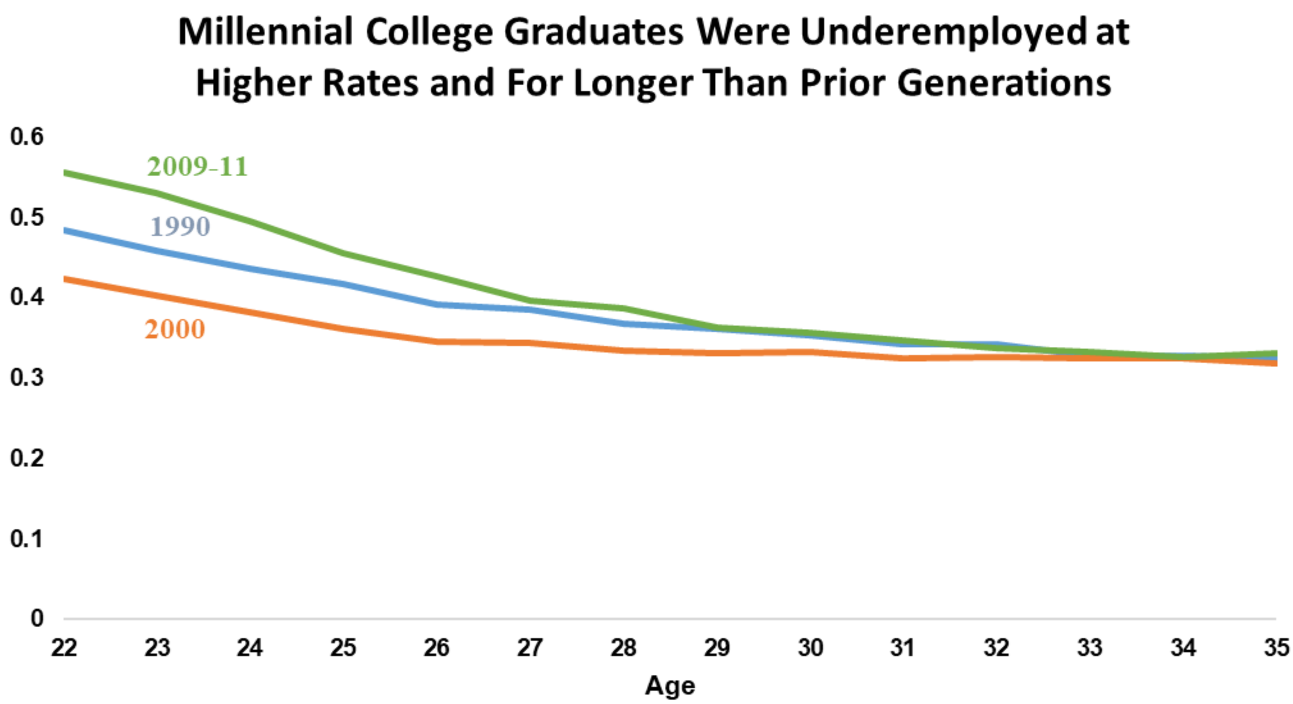
Many millennials entered the job market during one of the worst financial crises in history. As they graduated, they faced grim outlooks: limited job opportunities and, consequently, unemployment and underemployment rates significantly higher than similar age groups in years past. In fact, the unemployment rate for a 22-year old graduating between 2009 and 2011 was 10.3 percent. In 1990, the rate stood around 4 percent.[11]



Source: Federal Reserve Bank of New York, Census Bureau, and Department of Labor.
Note: Graph is a recreation of Federal Reserve Bank of New York study. College graduates are those with a bachelor's degree, all figures exclude those currently enrolled in school. Age denotes point of time reading.

Meanwhile, the underemployment rate (those working at jobs below their skill level) for a 22-year old graduating between 2009 and 2011 was 56 percent, or 10 percentage points higher than in 1990.[12] Since the recession, the share of underemployed recent college graduates in low-paying jobs has risen considerably, limiting their ability to purchase or afford a home.[13]

Generally speaking, graduating during a recession causes significant initial earnings losses, largely due to graduates having to accept lower-paying jobs.[14] Many young adults who graduated during the Great Recession currently earn 20 percent less than their older counterparts. In addition, older millennials born in the 1980s have a level of wealth 34 percent lower than expected had the recession not occurred.[15] In order to catch up, they will likely have to switch jobs more frequently than those who graduated in better times.[16]



Source: Federal Reserve Bank of New York, Census Bureau, and Department of Labor.
Note: Graph is a recreation of Federal Reserve Bank of New York study. College graduates are those with a bachelor's

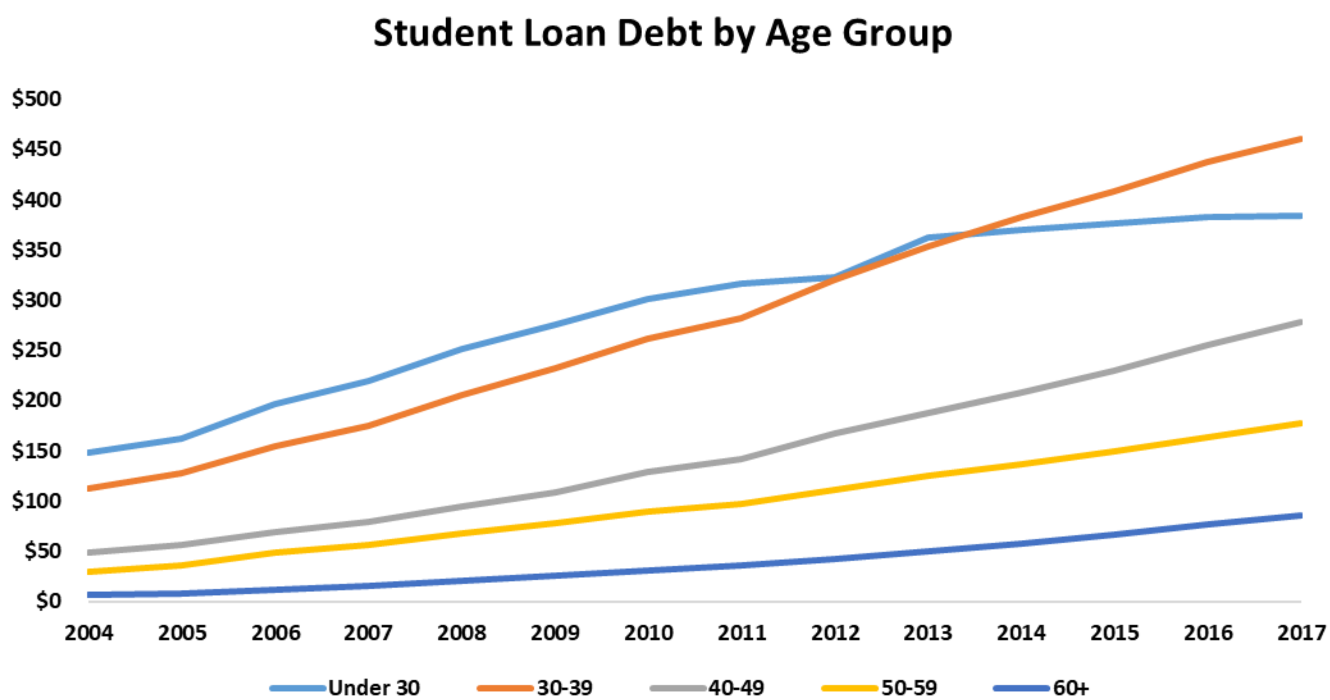
Student Loan Burdens Inhibit Home Ownership

Lower wages and the lack of economic opportunity relative to earlier generations also make it more difficult for millennials to pay off larger student loan debt. From 2006 to 2018, total student loan debt held by Americans more than tripled from $510.5 billion to over $1.56 trillion.[17] Today, the average millennial holds $33,000 in student loan debt, and the National Association of Realtors (NAR) reports that nearly 17 percent owe more than $100,000.[18]

Growing student loan burdens make it harder to purchase and own a home. A 10 percent increase in student loan debt, for example, causes a 1-2 percent decrease in homeownership rates after leaving school.[19] It also results in a higher debt-to-income ratio, which increases the likelihood of mortgage lenders denying loans. In 2017, NAR found that lenders rejected nearly one-fifth of student loan borrowers applying for mortgages due to their debt-to-income ratio.[20]

Student loan debt can also adversely affect credit scores. It is estimated that nearly 40 percent of borrowers who entered college in 2004 may default on their student loans by 2023.[21] Those who default will have to spend a considerable amount of time rebuilding their credit before purchasing a home, seeking financial products, or even finding good-paying jobs. For those who do not default, debt still hinders the ability to make a down payment. In a survey of millennials, NAR found that 85 percent cited student debt as one reason they cannot afford a down payment, while 74 percent cited financial insecurity due to existing student debt as another reason.[22]

Student loan debt affects current homeowners of all generations. As the chart below indicates, each age group saw an increase in student debt since 2004.[23] This has major consequences for the housing market, as 28 percent say that student loan debt adversely impacts their ability to sell their homes and move to a new residence.[24] As a result, student loan debt may exacerbate housing shortages.



Source: Federal Reserve Bank of New York
Note: Value in billions of dollars.

Renting is a Costly Alternative

With housing becoming more expensive, especially in cities that see high job growth, many millennials have opted to rent for longer periods of time. The housing shortage has made this a costly alternative, though. Only one-fifth of the nation's largest metro areas produced enough new housing between 2005 and 2015 to keep pace with job growth, leading in some cases to severe rent hikes.[25] In fact, since 2012 rent prices nationwide have continuously increased, finally flattening this year.[26]

With such high costs, prolonged renting can present long-term obstacles to homeownership and economic mobility. In fact, due to the inelastic supply of housing in locations millennials prefer to live, high rental costs make it harder for them to save for a down payment.[27]

Some of the large rent increases could be attributed to the rise in luxury apartment construction. Between 2012 and 2015, during the peak years of millennials in the job market, the ratio of high-end to total apartments increased by 63 percent, with a few cities building nothing but high-end apartments.[28] This means that millennials who move to cities in search of attractive job prospects will likely have to pay substantially more in rental costs.

Overall, growing rental costs severely impact homeownership rates for millennials. As rents and student loan debts accumulate, millennials and subsequent generations will have less money left over for an adequate down payment.

Future Outlook

Despite major financial hurdles, millennials will continue to grow the housing market in the foreseeable future. As this generation continues to age and start families, its demand for housing will continue to climb. For those who wish to own a home, current conditions may force them to move to less preferred locations, or take on heavier mortgage debt in order to put down roots where they want.

Policymakers need to address the student debt crisis in meaningful ways. To address the roots of the affordability crisis, they should focus on addressing key economic challenges that are standing in the way of millennial homeownership, including the low supply of starter homes, limited wage growth and economic opportunity, and large student loan burdens.

Federal programs, like those offered by the Department of Housing and Urban Development for first-time buyers, can alleviate some of the financial burdens associated with buying a home.[29] Creating good-paying jobs and taking steps to increase economic mobility would also help millennials afford a down payment and build credit. . Finally, expanding the public service loan forgiveness program, increasing federal aid (or Pell Grants), and cracking down on for-profit institutions, where students take on high levels of debt and experience high default rates, can all go a long way in addressing the issue.[30]

The affordability crisis imperils millennials' financial futures and may do the same for the next generation of young people. Failing to act will make the American Dream just that: a dream.

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[1] http://www.pewresearch.org/fact-tank/2018/03/01/defining-generations-where-millennials-end-and-post-millennials-begin/
[2] http://www.jchs.harvard.edu/sites/default/files/Harvard_JCHS_State_of_the_Nations_Housing_2018.pdf; https://www.apartmentlist.com/rentonomics/american-dream-homeownership-delayed-millennial-generation/
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[6] https://www.cnbc.com/2017/09/26/stop-sugarcoating-the-housing-market-economist-warns-that-buyers-face-increasing-troubles.html
[7] https://www.trulia.com/research/inventory-q118/#_ftn1

[8] https://fred.stlouisfed.org/graph/?g=kdUE
[9] https://www.realtor.com/research/housing-shortage-boomers/
[10] Ibid.
[11] https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci20-1.pdf
[12] Ibid.
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[14] http://www.nber.org/digest/nov06/w12159.html
[15] https://www.usatoday.com/story/money/2017/01/13/millennials-falling-behind-boomer-parents/96530338/; and https://www.marketwatch.com/story/the-great-recession-may-affect-this-lost-generation-for-years-to-come-2018-05-24
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[21] https://www.brookings.edu/research/the-looming-student-loan-default-crisis-is-worse-than-we-thought/
[22] https://sc.cnbcfm.com/applications/cnbc.com/resources/editorialfiles/2018/03/29/student-loan-page23.pdf.pdf
[23] This is because parents and grandparents are taking out more loans, such as Parent PLUS loans, to assist their child or grandchild.
https://www.valuepenguin.com/average-student-loan-debt#age
[24] https://www.nar.realtor/sites/default/files/documents/2017-student-loan-debt-and-housing-09-26-2017.pdf
[25] https://www.apartmentlist.com/rentonomics/housing-shortage-undersupply-of-new-construction/;
"Keeping pace with job growth" entails providing one unit for every one or two jobs.
[26] https://www.zillow.com/research/rents-flat-august-2018-21394/
[27] https://www.urban.org/sites/default/files/publication/98729/millennial_homeownership.pdf
[28] https://www.rentcafe.com/blog/cities/atlanta-ga/luxury-is-the-trend-in-new-rental-construction/
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