Millennials AND Homeownership

— by BRAD SHUSTER —

Homeownership is not as out of reach as millennials may think. Many misperceptions abound that the industry could help dispel.

In a study based on the 2010 median home price of $158,100, the Center for Responsible Lending, Durham, North Carolina, concluded it would take a little more than 20 years for a person with an average income of roughly $50,000 to save enough for a 10 percent down payment. ¶ A police officer making roughly $56,000 a year would have to save for two decades before purchasing a home. A registered nurse making $69,110 would need 15 years of savings, while a veterinarian earning $91,250 per year would need to save for 11 years. ¶ Those are eye-opening statistics—particularly for those in the upcoming millennial generation. There's been no shortage of articles that debate whether millennials will be the fuel that reignites the U.S. real estate and mortgage markets. ¶ It's clear this generation faces a number of challenges that previous generations did not.

Those include fewer job opportunities and unprecedented student debt. When confronted with the prospect of saving for more than two decades to buy a house, it's no wonder millennials might be discouraged about their outlook for homeownership.

The rate of homeownership has fallen to its lowest levels in nearly 20 years (see sidebar, "Ken Rosen: Homeownership Should Be a National Priority"). And in November, the National Association of Realtors®, Chicago, reported that the share of first-time buyers fell to its lowest point in nearly three decades, despite an improving job market and low interest rates.

The drop in the number of first-time buyers is preventing a healthier housing market from reaching its full potential, NAR said when reporting the results of its annual survey, the *2014 National Association of Realtors® Profile of Home Buyers and Sellers*.

The long-term average in NAR's survey, dating back to 1981, shows that four out of 10 purchases have been from first-time homebuyers. In the most recent 2014 survey, the share of first-time buyers dropped 5 percentage points from a year ago, to 33 percent, representing the lowest share since 1987, when first-time buyers represented 30 percent of the market. Yet I believe this age group could be a key factor in the recovery of the housing market.

The millennial generation—loosely defined as those born between 1980 and 2000—certainly holds a good deal of promise.

KEN ROSEN: HOMEOWNERSHIP SHOULD BE A NATIONAL PRIORITY

Millennials will be an important factor in stimulating the housing market, but regulatory agencies and lenders need to make it easier for the millennial generation and other first-time homebuyers to obtain a mortgage and buy a home, according to Kenneth Rosen, chairman of the Fisher Center for Real Estate and Urban Economics at the University of California, Berkeley, and chairman of Rosen Consulting Group, a real estate market research firm based in Berkeley. National MI spoke to Rosen recently to get his take on today's housing market and the outlook for millennials and homeownership.

Rosen believes the demand for single-family housing has been repressed for a few reasons. "The huge run-up in home prices a few years ago is part of it," Rosen says. "Financial institutions and regulators overreacted to the housing crisis, and as a result, it's become more difficult for first-time homebuyers to get a mortgage loan as criteria have become more stringent."

First-time homebuyers face unprecedented student debt, so they don't have the same buying capacity that previous generations may have had, Rosen says. "There's also been a scarring effect left over from the housing crisis and all of the foreclosures. People are more fearful of making the commitment to buy a home," he says.

The rate of homeownership in the United States continues to decline, Rosen adds. In late October, the U.S. Census Bureau reported that the U.S. homeownership rate fell to the lowest level in more than 19 years as the market shifted toward renting and stricter credit criteria deterred some potential buyers. The share of Americans who own their homes was 64.4 percent in the third quarter, down from 64.7 percent in the previous three months, according to the Census Bureau. That marked the lowest level since the first quarter of 1995.

At its peak in June 2004, the rate of homeownership was 69.2 percent, Rosen noted. "The drop seen in homeownership levels represents millions of people who aren't able to get a mortgage or haven't saved enough for a down payment," he says. Rosen expects the rate of homeownership to go back up, but not for a few years. "Millennials are delaying their home purchases by about a decade," he says. "While previous generations may have bought a home in their mid-20s, millennials typically wait until they're in their mid-30s."

Still, Rosen believes millennials will play a critical role in revitalizing the housing market, although he adds that lenders will need to ease their criteria to allow more first-time homebuyers to enter the market. "Easing FICO® score requirements and making lower-down-payment loans more available are a good start," he says.

"The industry needs to get together—both the real estate and mortgage industries—and talk more about the benefits of homeownership not just for consumers, but as a national policy. For more than 60 years, government efforts to increase homeownership were the focus of U.S. housing policy," Rosen notes. The housing crisis and subsequent spike in foreclosures has caused many to question that policy, and also prompted regulatory agencies to clamp down on mortgage lenders and other financial institutions, he says.

"We need to rebuild the trust in housing and housing finance by making homeownership a campaign," Rosen says. "The government needs to go back to making homeownership a national priority. The industry should also talk about the purchase of a home as a good investment today."

Rosen personally has faith the housing market is on its way to recovery. "As an investment, I'd rather own a house over the next 10 years than own stock," he says.

Despite high levels of unemployment and more than $1 trillion in outstanding student debt, millennials are viewed as one of the most educated generations in recent history. They are also financially knowledgeable.

In terms of housing, one of the central debates about millennials centers on whether they are destined to be a generation of renters rather than homebuyers. While it's true many young people in their 20s are renting today—or perhaps living with their parents—I believe as they move into their 30s, millennials will pursue homeownership in the same way previous generations have.

In other words, millennials still aspire to become homeowners, but that purchase will likely be delayed until they are in their 30s.

> Today there are 13.3 million households headed by millennials, but this number will swell to 21.6 million by 2018.

According to Ken Rosen, chairman of the Fisher Center for Real Estate and Urban Economics at the University of California, Berkeley, and chairman of Rosen Consulting Group, a real estate market research firm based in Berkeley, when compared with previous generations, millennials are delaying the purchase of a home by about a decade as the average age at which people get married and start to have children increases.

Government statistics bear this out: The age at which young people buy their first home is rising. The average age of first-time homebuyers in the United States is 34 years old, according to data from the National Association of Home Builders (NAHB), Washington, D.C., and the U.S. Census Bureau.

There are other reasons to believe that this generation will eventually turn to homeownership. Buying a home is, on average, 38 percent cheaper than renting nationwide, according to an October website article by Jed Kolko, chief economist for San Francisco–based Trulia Inc. Buying is at least 20 percent cheaper than renting in all of the 100 largest metros except Honolulu, according to Kolko. To come up with those figures, Trulia's model assumes a traditional 30-year fixed-rate mortgage with a 20 percent down payment.

"But there may be good reasons for financing a home purchase other ways," Kolko, writes. "Consumers tell us that the main obstacle to homeownership is the down payment. For those would-be homeowners—especially first-timers without savings or equity from another home—a low-down-payment mortgage might be the only option."

Trulia analyzed several different financing scenarios, including a 15-year mortgage, a Federal Housing Administration (FHA) mortgage, a 10 percent down mortgage using private mortgage insurance, and paying all cash.

It turns out it's 35 percent cheaper to buy versus rent if the consumer puts down 10 percent and uses private mortgage insurance (see Figure 1).

Raising awareness: A home purchase is within reach

While these statistics suggest that millennials will eventually become homeowners, raising awareness on all the financing options available will be critical to the housing recovery.

I believe the real estate and mortgage industries could do more to educate this demographic group to make them aware that purchasing a home isn't totally out of reach. As they age, it is clear members of this generation will be a significant factor in the housing market.

How big of a factor? A $2 trillion one, according to one study. In *Millennials and Their Homes: Still Seeking the American Dream,* the Demand Institute, New York, an organization jointly sponsored by The Conference Board and Nielsen, surveyed more than 1,000 millennial households (defined by the survey as 18- to 29-year-olds) about their current living situation, moving intentions and home preferences, as part of a broader effort to understand where future home and community demand is headed. The study was released in mid-September.

The Demand Institute estimates millennials alone will spend $1.6 trillion on home purchases and $600 billion on rent over the next five years.

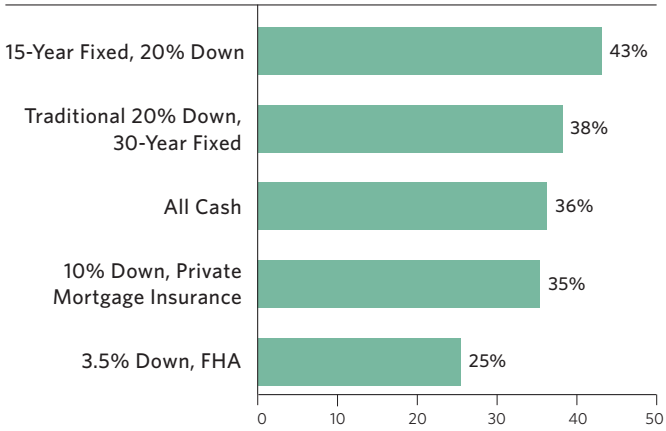
Overall, those born in the early 1980s through 2000 are expected to represent $1 in every $4 spent on housing through 2018. That means in five years' time, millennials will be responsible for the creation of 8.3 million new households, including rentals and home purchases.

Today there are 13.3 million households headed by millennials, but this number will swell to 21.6 million by 2018 and they will spend more than $2 trillion on rent and home purchases combined—more on a per-household basis than any other generation, according to the Demand Institute.

Economists often look to California as a trendsetter when it comes to consumer behavior, and one recent study indicates there's every reason to believe the upcoming generation of

FIGURE 1

HOW MUCH CHEAPER TO BUY THAN TO RENT, BY MORTGAGE TYPE (NATIONAL AVERAGE)



SOURCE: Trulia Inc.

NOTE: National average; assumes itemizing at 25 percent tax bracket and staying in home for seven years

consumers will be a force in the home purchase market.

In its *2014 Millennial Survey* released in late October, the California Association of Realtors® (CAR), Los Angeles, reported that more than half of California millennials expect to buy a home within five years. The CAR survey of 1,000 young adults in California aged 18 to 34 years old showed that 54 percent gave homeownership an importance rating of 8 or higher on a scale of one to 10, (with one being "not at all important" and 10 being "extremely important").

However, the vast majority of millennials in California were uncertain or doubtful about whether they could obtain a mortgage (see Figure 2).

Also in late October, Foothill Ranch, California–based loanDepot LLC released its *National Survey of Millennials*. The survey of more than 1,000 millennials who don't own a home found that more than one-third, or 35 percent, plan to buy within five years and they are acting now by getting their credit in order, paying down debt and saving for a down payment.

For mortgage lenders, the question is not when millennials will purchase homes, but how?

Not when, but how?

In effect, lenders have a ready-made market in millennials, but that hinges on making sure they are aware of all their options to buy a home and secure a mortgage.

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At least a portion of this younger age group believes they shouldn't even attempt to buy a home or obtain a mortgage, in large part due to bruised credit scores, student loans and leftover financial anxieties from the recession.

There's also a fairly common misconception that down payments of 10 percent to 20 percent are needed to purchase a home. Even young adults with annual incomes around the $50,000 mark could face significant challenges in meeting those down-payment requirements.

Still, like every generation before them, millennials want to—and plan to—purchase a home. Making them aware that there are options available that don't require a 20 percent down payment may very well be the key to stimulating the housing recovery.

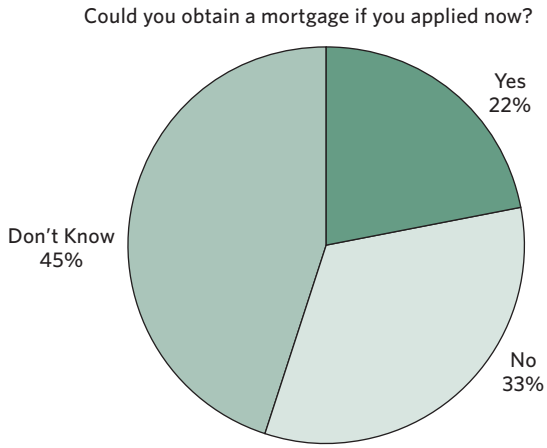
It's well understood that private mortgage insurance protects lenders from a borrower's default by requiring the homeowner to cover the default risk through the purchase of mortgage insurance. What's less recognized is that borrowers also benefit because they have the option of purchasing a home sooner without having to save for years to come up with a 20 percent down payment. From mid-range incomes to higher salaries, the prospects for doing so can be daunting.

A Sept. 8, 2014, Federal Reserve Bank of New York blog post, "Why Aren't More Renters Becoming Homeowners?," discussed some of these challenges. The New York Fed found that two-thirds of the renters surveyed described their ability to gain access to mortgage credit as "somewhat or very difficult." Only 5 percent of the surveyed group said it would be easy to obtain a mortgage. Lacking a 20 percent down payment was one of the chief reasons cited as an obstacle to homeownership.

But it's certainly not the only obstacle. The recent NAR survey on homebuyers and sellers showed that nearly half of first-time buyers in this year's survey said the mortgage application and approval process was much more or somewhat more difficult than expected.

FIGURE 2

PERCENTAGE OF CALIFORNIA MILLENNIALS DOUBTFUL/ UNCERTAIN THEY COULD OBTAIN A MORTGAGE



SOURCE: California Association of Realtors® (CAR)

NOTE: Survey of non-owner millennials in California; not a national sample

More options for lower-down-payment loans

Our industry needs to work at making the younger generation of potential homeowners aware there are mortgage loans available that don't require a 20 percent down payment—and that includes private-sector mortgages, not just FHA loans.

During the housing decline, FHA stepped in and filled a gap. More recently, private mortgage insurers have started to take back that market share as the market stabilizes.

Today I still see FHA mortgages being originated that could get better execution with private mortgage insurance. A general rule of thumb is that borrowers with a FICO® score of 680 or higher and with a loan-to-value ratio (LTV) at or below 95 percent typically will find a more competitive deal in the private sector than with FHA.

Millennials also need to hear more about the very real possibility of purchasing their own homes, along with guidance on obtaining the mortgage credit to do so.

It appears our industry is starting to move in that direction. There was discussion of lower-down-payment mortgages at

the Mortgage Bankers Association's (MBA's) 101st Annual Convention in Las Vegas in October, with Federal Housing Finance Agency (FHFA) Director Mel Watt announcing a number of policy steps aimed at increasing mortgage credit availability.

Among other things, Watt said that he supports the return of the 97 percent LTV product at the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. "To increase access for creditworthy but lower-wealth borrowers, FHFA is also working with the [the GSEs] to develop sensible and responsible guidelines for mortgages with loan-to-value ratios between 95 [percent] and 97 percent," Watt said in a speech at the convention.

In a more recent op-ed in the Oct. 27 issue of *The Washington Post,* MBA President and Chief Executive Officer David Stevens wrote that mortgages guaranteed by Fannie Mae and Freddie Mac with 3 percent down payments would require mortgage insurance, protecting taxpayers and lessening taxpayer risk by shifting a segment of mortgages away from the FHA, where taxpayers are on the hook for any and all loss, to private companies, which would be responsible for a majority of the risk.

"Americans should not miss out on the lowest interest rates we may see," Stevens wrote. "Responsibly letting qualified buyers take advantage of this market through access to low-down-payment loans is the right thing to do and will help homebuyers and the economy."

I'm encouraged by the results of some of the surveys I've mentioned, as well as by the statements made by FHFA Director Watt and MBA CEO Stevens. As the father of three members of the millennial generation, it's my hope that each of my children will eventually have the opportunity to be homeowners—if that is what they want.

Raising awareness that there are options available for creditworthy borrowers, even if they don't have a large down payment saved, will go a long way toward helping millennials and other generations who wish to purchase a home in the future. **MB**

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