Housing in America: The Next Decade

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Housing Strategies in a New Economy
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Three Topics

- Short term outlook – Watch Out for Wishful Thinking
- Transitioning to the Future – Reopening the Private Capital Markets
- The Longer Term – Expect the Unexpected
The Short Term Outlook
The Good News:
Month-over-month Change in At-Place Employment

*Thousands of Jobs*
But Watch Out for Wishful Thinking
The Single Family Story

- Home prices down 29% and falling
  - Down another 10% this year
  - Despite historically low interest rates

- Foreclosures growing

- Aggressive federal action ended:
  - Treasury purchased $1.26 trillion MBS’s
  - Homebuyer tax credits ended

- HAMP modification program
  - Only 5% of modifications now permanent
Foreclosures will climb

- 2008  1.7 million foreclosures
- 2009  2 million
- 2010  2.4 million or more

Driven by:
- High unemployment – 10%+
- Homes “underwater”
Homes “underwater” – the sleeping giant!

- A leading indicator of foreclosure
- Now 12–16 million households
- Projected to be 21 million by end of 2010
  - 40% of all homes with mortgages!
- If 1 in 5 foreclosed that will double 2009 foreclosures
Five States have the biggest problems:
  ◦ California, Arizona, Nevada, Michigan and Florida

Worst areas –
  ◦ Outer ring suburbs
  ◦ Poor inner city neighborhoods

But homes with jumbo and prime mortgages also “underwater”
“I agree, the place was a tear-down, but I just remembered we were only renting it.”
Rental Housing: Hold on until 2012

- Vacancy rate 8% in 2009, rents down 3%
- 2010 and 2011 will see weak demand and more new product coming on line
- 2012 and 2013 should see rising demand, more jobs, and little new product – rents up

Assuming jobs back and unemployment down!
The Bad News: Defaults climbing
Commercial/Multifamily Delinquency Rates

CMBS (30+ days and REO)
Life Companies (60+ days)
Fannie Mae* (60+ days)
Freddie Mac^ (60+/90+ days)
Banks & Thrifts (90+ days)

MBA Commercial Real Estate/Multifamily Finance
Quarterly Data Book Fourth Quarter 2009, 3/31/2010
The Multifamily Story – Good News: Starts Down

Multifamily Permits, Starts and Completions Thousands, Seasonally adjusted annual rate
The rest of the decade will be good for rental housing:

- Generation Y will rent longer than prior generations
- Immigrants will rent
- Falling homeownership rate = more renters
- More urban living = more renters
Transitioning to the Future – Reopening the Private Capital Markets
Federal Government Now Supports 96% of Housing Finance

- Fannie Mae and Freddie Mac –
- FHA and Ginnie Mae –
  - 30% of the market (up from 3%)
- Only a few “green shoots” in the private mortgage market
How to Restore the Private Market?

- Reform the mortgage origination and securitization process
- Reform or replace Fannie Mae and Freddie Mac
Financial Reform Legislation: Mortgage Origination & Securitizing

- Both the House and Senate Financial Regulatory Bills, now in conference, would
  - Require regulators to define “safe” mortgages and/or sound underwriting
  - Require originators and securitizers to retain 5% of risk, +/-, on an unhedged basis for loans or MBS pools that did not meet these standards
No such regulatory standards or risk retention requirements exist today.

Issues:

- Would these “skin-in-the-game” provisions reduce the risk of another housing or MBS crisis?
- Would they limit capital to housing markets?
- What would their impact be on amount and cost of credit, and cost of housing?
Why do we need them?
- To provide liquidity to the residential markets when the capital markets collapse and the private sector cannot provide liquidity
- To support moderate and affordable housing
- To support the multifamily markets

But why change now?
- Implied full federal backing but off budget

No Administration proposal until
- 2011 or 2012
Proposals to

- Abolish them
  - Barney Frank – “Abolish them”
- Privatize them
- Make them fully government owned
- Create new public/private enterprises
The Longer Term – Expect the Unexpected
“Sooner or later, something fundamental in your business world will change…”

Andy Grove, Intel Co–founder
Demographics as Destiny

- Four major demographic cohorts will set the housing markets in the decade ahead:
  - The Older Baby Boomers
  - The Younger Baby Boomers
  - Generation Y
  - Immigrants

- The Boomers and Gen Y are ½ of U.S. population
The Older Boomers

- Ages 55 to 64 – They become “seniors” next year
  - 26 million strong
- Seniors from 65–75 are the fastest growing group this decade
  - Children of the 60s, have redefined every age they entered
  - When will they retire? For most, not for years
    - Healthier and more energetic – “60 is the new 50!”
The Older Boomers

- No longer moving TO the suburbs, but away FROM them
- RCLCO: retiring Boomers want urban areas
- Moving closer jobs, kids and GRANDKIDS!

World’s cutest granddaughter!

Nolen McIlwain
The Younger Boomers

- Ages 46 to 54 – 52 million
  - Almost 2X the Older Boomers
- Trapped in the suburbs
  - Many of their homes “underwater”
- Their buyers Generation X
  - Smaller cohort with lower incomes
Generation Y

- Late teens to early 30s – 83 million
- Greenest generation ever
- Women moving up –
  - 60% of masters degrees to women
- Into “herding”
  - Third places—coffee houses & bars
Generation Y

- Incomes down last decade
  - Men’s down 23%
  - Women’s down 3%
- At the prime household formation age
  - But NOT BUYING due to job market
- New attitudes to homeownership
  - No jobs, big school loans
  - See others trapped by “underwater” homes
  - Tight credit and no ‘Mommy Money”
  - RCLCO – they want to live in urban areas

→ Will rent for years to come
Immigrants

- 40 million – 13% of households
- Immigrants who arrive between 2005–2050 and their descendants will drive 82% of population growth
Immigrants

• Larger families and multigenerational
• Ready to move to large suburban homes
  • If they can afford them
  ▸ By 2050 “whites” 47% of the population
  ▸ Generation Y values diversity & intermarries
  ▸ Tony Trella:
    ◦ ‘By 2050, will we be able to tell who is ‘white?’”
Demand for Housing and the Future of Homeownership
Pent up Demand

- Population growing 2.5+ million per year
Housing Demand Suppressed Today

- Need 1.5+ million homes a year
- Today household formation suppressed
  - 2006/7: 1.6 million
  - 2008/9: <0.4 million
  - A 75% drop in two years
- Today’s low housing starts sufficient to meet new household formation
Where will the homeownership ratio go?

- From 1960 to 1990 – 62%–64%
- Federal policies of last 20 years drove it to 69%
- Today – 67%
- Expect it to settle between 62% and 64%
- Lower than that represents a major shift
What about home prices this decade?

- Expect 1–2% per year appreciation in real prices
  - Robert J. Shiller of Yale: over the long term homes appreciate at inflation + ¾ to 1%
  - Nic Retsinas of Harvard: Homes will appreciate at inflation + 1.7 to 2% on average this decade
  - Actual rate will vary greatly by location
Homes will remain more affordable for Gen Y and immigrants

The not so good news:
- The recession will keep incomes down long term for first time and move up buyers
The Bad News in Slow Appreciation

- Existing home owners will have little equity growth
  - “Underwater” home owners unable to sell their homes for years w/out high inflation
- Homes remain more expensive near job centers
Unless there are active government programs
Green Housing – From Here to Net Zero in Ten Years
Still, over 1 million have some form of “green” certificate

Today’s standard homes more energy efficient than a decade ago

And homes will be smaller
The Next Frontier: Net Zero Homes

The Net Zero Home:

• Linked to the electric grid
• Solar and wind produce electricity
  ◦ Highly efficient – insulation, HVAC, lighting, etc.
  ◦ Buys from and sells to the grid as needed
  ◦ Sells as much or more than it buys
Conclusion

This is The Urban Century:

Urbanizing the American Suburbs
The Suburban Century is Over
From Levittown in 1950
To Suburban Town Centers
And Growing Central Cities
Fastest growing household types:
- Married couples w/o kids
- Singles

Boomers finished migrating to suburbs

Gen Y more urban and will rent

Federal, state and local policies beginning to encourage compact development
2009 Study by EPA:

- In 26 studied, urban core communities dramatically increased residential development over 20 years

Home values strongest thru the recession:

- Central cities
- Suburban town centers

Home values weakest:

- Outer ring suburbs
- Poor inner city neighborhoods
Final Thoughts

- What will be the impact of 6 to 8 million households forced out of their homes by foreclosure?
  - 12 to 15 million people, many young families and kids

- What will be the emotional, economic and political fall out, and the impact on the housing markets?
A Final Thought

- Hard to build 1.5 million homes in Cities and Suburban Town Centers
  - Slower and more expensive

- Need to radically reform planning, zoning, and codes

- Opportunity for ULI:
  - Work at the federal, state, and local level to promote in-fill development and keep it affordable to all
  - Promote suburban town centers –
    - New ones and those already developing