



Homeownership

After years of decline, both homeownership rates and the number of owner households turned down again in 2012. Minority homeownership rates fell even further than white rates, widening the white-minority gap. But some good news emerged during the year as foreclosure rates fell. In addition, low interest rates and depressed house prices made monthly mortgage payments for homebuyers more affordable than in 40 years, although access to credit remains a concern for all but the best-positioned borrowers.

HOMEOWNERSHIP TRENDS

According to the Housing Vacancy Survey (HVS), the US homeownership rate fell 0.7 percentage point from 2011 to 2012, to 65.4 percent, and then continued to trend down in the first quarter of 2013 to 65.0 percent (**Figure 17**). These declines extend an eight-year drop in homeownership rates. This also marked six years of declines in the number of homeowners, which has fallen by a total of 1.2 million since 2006.

The rollback in homeownership rates has hit some groups harder than others. On the one hand, homeownership rates for households aged 65 and over continued to increase in 2012, rising to the highest level on record. With older households making up a larger share of the adult population (thanks to the aging of the baby boom), the high homeownership rates among older households helped to slow the decline in the national rate. But on the other hand, homeownership rates for households in the 25–54 year-old age group were at their lowest point since recordkeeping began in 1976.

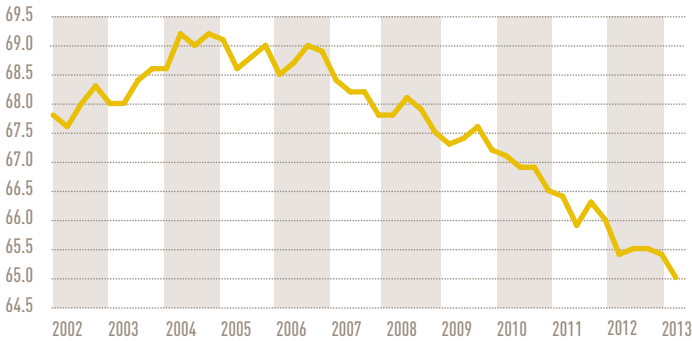
The drop in homeownership rates has also been particularly severe among minorities. At 43.9 percent, the homeownership rate for African-American households is at its lowest level since 1995. Both the Hispanic homeownership rate (46.0 percent) and the white homeownership rate (73.5 percent) are at their lowest values in a decade. Since their peaks, homeownership rates have fallen just 2.7 percentage points among whites, but 5.8 percentage points among blacks and 3.3 percentage points among Hispanics. As a result, the Hispanic-white gap has widened and the black-white gap has reached historic proportions.

Across household types, the largest drop in homeownership rates was among families with children. From 2005 to 2012, the rate for married couples with children dropped 7.0 percentage points, to 72.6 percent, while that for single-parent families fell 5.8 percentage points, to 35.6 percent. With these losses, their rates are 2.9 percentage points and 1.7 percentage points, respectively, below their long-run averages. Declines were less severe for married couples without children, single persons, and non-families. Rates for these groups remain above their historical averages, reflecting in large part the high shares of seniors within these household types.

FIGURE 17

The US Homeownership Rate Edged Down Again in 2012...

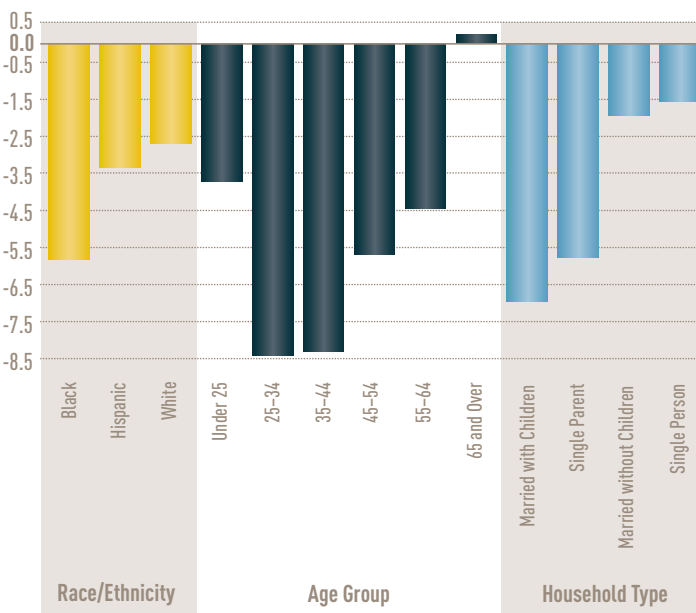
Homeownership Rate (Percent)



Source: US Census Bureau, Housing Vacancy Surveys.

...With Seniors the Only Group to Avoid Declines

Change in Homeownership Rate, 2005–12 (Percentage points)



Note: White and black households are non-Hispanic; Hispanic households can be of any race.
Source: JCHS tabulations of US Census Bureau, Current Population Surveys.

HISTORICALLY LOW INTEREST RATES

Several conditions may help to firm the national homeownership rate over the coming year, including steady employment growth and a turnaround in home prices. But the continuation of mortgage interest rates near record lows could also help. Interest rates on 30-year fixed-rate mortgages dropped from an already low 4.45 percent in 2011 to an average of 3.66 percent in

2012—the lowest annual average since 1972. As of March 2013, mortgage interest rates had dipped further, to 3.57 percent.

At least for those able to qualify, low interest rates have made mortgage payments on the typically priced home more affordable than at any time in the last four decades. The NAR affordability index reflects the ratio of median family income to the income required to qualify for the median-priced home, assuming a 20-percent downpayment and that a maximum of 25 percent of income is spent on monthly mortgage payments. The index approached 200 in 2012, implying that the median household could afford nearly twice the monthly payment on a median-priced home (Figure 18). The measure for first-time homebuyers assumes a house price of 85 percent of the median, an income of 65 percent of the median, and a 10-percent downpayment. This index—which never exceeded a value of 100 in its nearly 30-year history until 2009—stood at 129 in 2012.

The degree of affordability is perhaps even more striking when out-of-pocket mortgage costs are considered. Again assuming a 20-percent downpayment, the monthly mortgage payment on the median-priced home was just \$644 in 2012, the lowest level since 1972 when records began. This compares with a peak of \$1,266 in 2006, when interest rates were at 6.4 percent and home prices were substantially higher.

Even as home prices increased last year in most metros, the gains were not enough to offset the improvement in affordability created by lower interest rates. Indeed, home prices had to rise by at least 10 percent to drive monthly payments higher year-over-year. Thus, monthly payments for a newly purchased median-priced home declined in 80 percent of the metros where home prices had increased in 2012. But in places like Phoenix, rapid appreciation pushed monthly payments on the median-priced home up by 13.3 percent. In San Francisco and Miami, a more moderate 11.9 percent rise in prices meant a 1.7 percent increase in mortgage payments.

Even after rapid price appreciation, however, the median payment to median income ratio in Phoenix was still just 12.4 percent in 2012, well below the 14.6 percent national ratio. Indeed, only four metros—San Diego, San Francisco, San Jose, and Honolulu—had median payment to median income ratios above 25 percent. Other areas such as Boston, New York, and Los Angeles, where the cost of owning the median-priced home has long been out of reach for median-income households, the ratios were below 25 percent though still well above the national average.

REFINANCING SURGE

The drop in interest rates spurred refinancing activity last year. According to estimates from FHFA, refinancing volumes soared 42 percent in nominal terms to \$1.4 trillion in 2012, the highest level since 2006. With little change in the volume of purchase

FIGURE 18

Low Mortgage Interest Rates Helped to Lift Affordability to a Record High in 2012

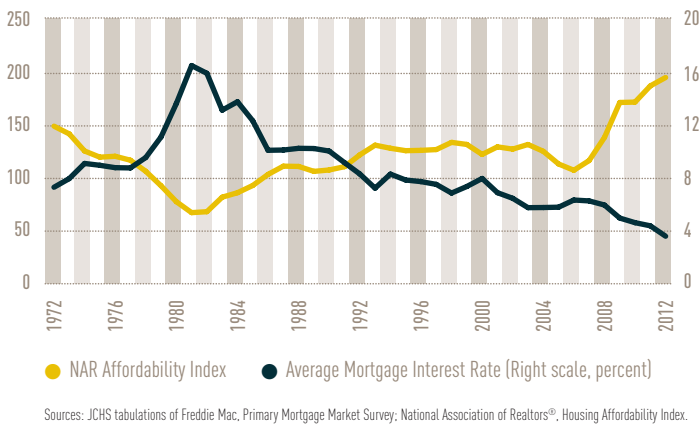
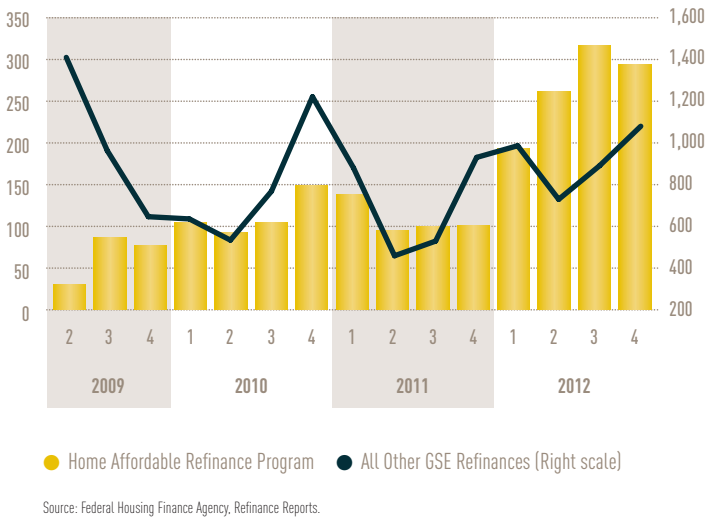


FIGURE 19

Changes to HARP Refinancing Requirements Led to a Surge in Activity in 2012

Number of Loans Refinanced (Thousands)



mortgages, refinances accounted for 72 percent of annual mortgage originations.

For borrowers able to refinance, the savings were often significant. Freddie Mac estimates that the average interest-rate reduction for those who refinanced in the fourth quarter of 2012 was 1.8 percentage points, implying a record 33-percent drop in interest costs for those borrowers. In the first year alone, this translates into a savings of about \$1,800 in interest payments for every \$100,000 borrowed. In addition, only 17 percent of

homeowners who refinanced in 2012 took cash out—the lowest share in records dating back to 1985. These homeowners took a total of \$29.1 billion in equity out of their homes, well below levels in the mid-2000s when owners took out \$84 billion in the second quarter of 2006 alone. Indeed, cash-in refinances were more prevalent than cash-out refinances in 2012, with fully 28 percent of refinancings resulting in lower loan amounts.

Changes in the Home Affordable Refinance Program (HARP) helped to fuel refinancing activity. Launched in 2009, HARP enabled borrowers with loans guaranteed by Fannie Mae and Freddie Mac to refinance to lower interest rates even if their homes were worth less than their outstanding mortgages. After a tepid initial response to the program, FHFA expanded the eligibility criteria (including removing limits on loan-to-value ratios or LTVs), reduced fees, and provided safeguards to shield loan originators from potential defaults. With these changes and the low prevailing interest rates, HARP loan volumes more than doubled in 2012, to 1.1 million, and made up more than one in five (22.6 percent) of all loans refinanced by the GSEs during the year (Figure 19). Although HARP has made refinancing available to underwater borrowers with GSE-backed loans, millions of similar borrowers with non-GSE-backed loans have not had the same opportunity.

CONTINUING CREDIT CONSTRAINTS

Access to credit remained limited in 2012. The sharp rise in average credit scores for loans guaranteed by the GSEs and FHA is a telling sign. For most of the 2000s, credit scores on GSE-backed loans averaged around 720 while those on FHA loans averaged around 650. With the onset of the housing crisis in 2008, credit scores in these market channels turned up sharply, to roughly 760 and 710, respectively. In large measure, this trend reflects the evaporation of loans to borrowers with weaker credit histories. In 2007, borrowers with credit scores below 620 accounted for 45 percent of FHA loans. By the end of 2012, that share was under 5 percent.

But even borrowers with relatively high scores faced challenges. Ellie Mae reports that the average credit scores of conventional mortgage applicants denied credit in the first quarter of 2013 were 722 for refinances and 729 for purchases. Given that average LTV ratios for both groups of applicants were just above 80 percent, borrowers had substantial equity to put down—just not enough to avoid having to buy mortgage insurance. On average, borrowers denied loans also had somewhat elevated debt-to-income ratios (41 percent vs. 33 percent among closed loans for home purchase).

Low-income and minority borrowers are particularly likely to be denied conventional loans (Figure 20). Home Mortgage Disclosure Act data reveal that denial rates in 2011 were 33.8 percent for those with incomes below 50 percent of AMI and 21.0 percent for those with incomes of 50–79 percent of AMI. By comparison, denial rates for households with incomes of

at least 120 percent of AMI were only 10.7 percent. Rates for African-American borrowers were at 36.9 percent—more than twice the 14.0 percent rate for white borrowers. Hispanics fared little better, with a denial rate 10.4 percentage points higher than the white rate. Lower-income applicants and minority borrowers also faced somewhat higher denial rates

for FHA loans than whites, but generally lower denial rates for FHA than conventional loans.

And those fortunate enough to qualify for mortgages often had to pay costs that exceeded headline interest rates. In the aftermath of the financial market crisis, both FHA and FHFA, the conservator of Fannie Mae and Freddie Mac, raised various fees to adequately price risk, cover losses, and shrink market share. As a result, all but the most creditworthy borrowers face higher interest rates today than what is considered the prevailing rate.

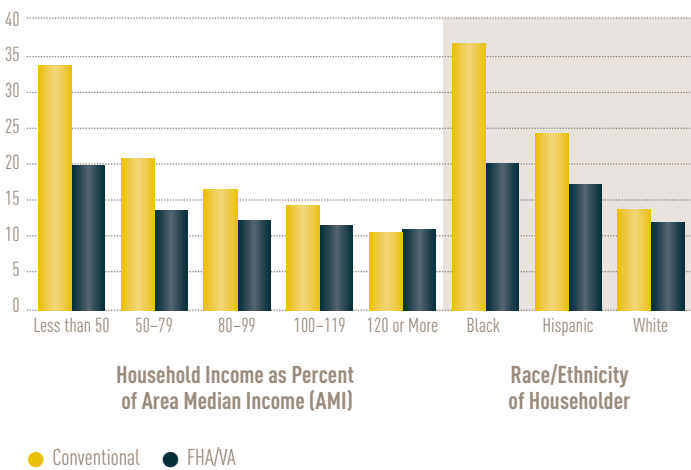
Part of the intent of higher premiums for FHA loans is to encourage the return of private capital to the housing market, but borrowers who cannot meet conventional underwriting standards have little choice but to pay these higher costs. Other options available to credit-constrained borrowers are programs offered by state housing finance agencies and a variety of nonprofit lenders that allow higher LTVs and flexible underwriting, but these programs remain fairly small in scale.

Despite efforts to entice private capital into the mortgage market, the GSEs and FHA continue to back the vast majority of loans (Figure 21). In 2001, loans securitized into private-label securities or held in bank portfolios accounted for nearly half of loan originations. Their market share rose to about two-thirds at the height of the housing boom before retreating to the low single-digits. Beginning in 2009, government-backed loans have accounted for roughly 90 percent of all originations. While the private securities market was still moribund in 2012, portfolio lending by banks showed its first substantial increase

FIGURE 20

Low-Income and Minority Households Are Much More Likely to Be Denied Mortgages

Denial Rate on Applications for Home Purchase Mortgages in 2011 (Percent)



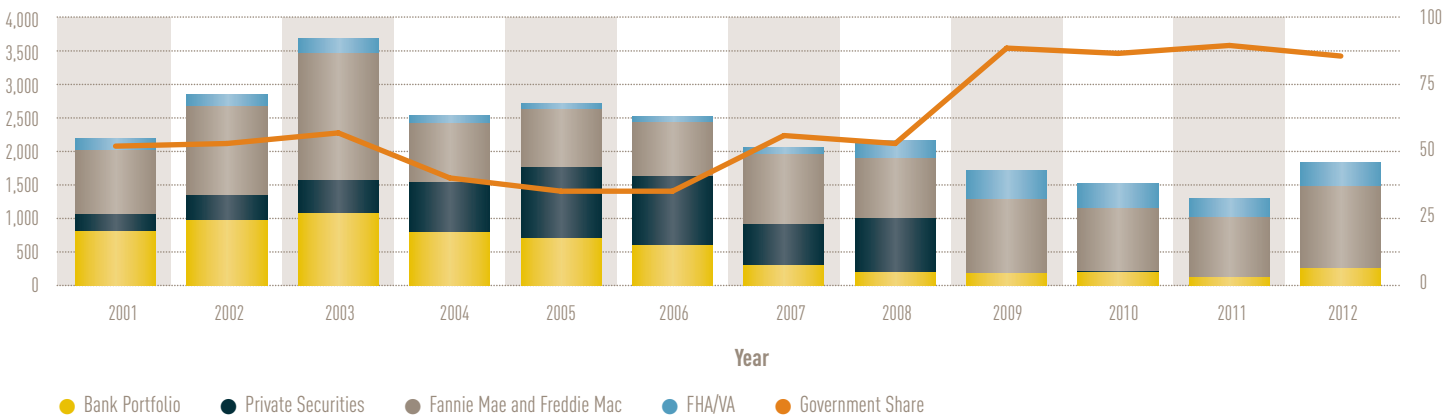
Notes: Black and white households are non-Hispanic. Hispanics can be of any race.
Source: JCHS tabulations of 2011 Home Mortgage Disclosure Act data.

FIGURE 21

The Government Continues to Have an Outsized Footprint in the Mortgage Market

Mortgage Originations (Billions of dollars)

Government Share of Originations (Percent)



Source: Amherst Securities Group LP.

in years (albeit to a modest level), bringing the government share down slightly.

PERSISTENT MORTGAGE DISTRESS

The foreclosure crisis is finally receding. In the first quarter of 2013, the share of loans at some stage of delinquency but not yet in foreclosure declined to 7.3 percent, well below the 10.1 percent peak in the first quarter of 2010. The majority of the decline is due to the drop in the share of seriously delinquent loans (with payments 90 or more days overdue). Meanwhile, the share of loans 30-days delinquent was not far above the pre-crisis average. Although still elevated, 60-day delinquency rates were down 36 percent from the peak.

Delinquencies fell across all loan types (Figure 22). The serious delinquency rate for prime loans, which make up the largest share of past-due mortgages, declined from 1.8 percent in the first quarter of 2012 to 1.6 percent in the first quarter of 2013. At the same time, the serious delinquency rate for FHA loans declined from 5.3 percent to 4.2 percent—a 16 percent drop. Although down in 2012, the rate of serious delinquencies in the subprime market increased in the first quarter of 2013.

It is clearly too early to declare an end to the crisis given the substantial backlog of homes in the foreclosure pipeline. More than 1.4 million homes were in foreclosure—3.6 percent of all mortgages in service—in the first quarter of 2013. This share is nearly five times the 1974–99 average of 0.8 percent. However, the number of loans in foreclosure fell 23 percent over the previous four quarters, a significant improvement from the 5 percent decline in the same period a year earlier. As of early

2013, the foreclosure inventory was back to 2008 levels and nearly 30 percent below the 2010 peak.

Most of the country shared in this progress, although inventories in states that process foreclosures through the courts remained relatively high. The inventory in judicial foreclosure states fell just 11.9 percent between the fourth quarters of 2011 and 2012, compared with 26.2 percent in non-judicial states. In addition, the share of homes in foreclosure was a full 4.0 percentage points higher in judicial than in non-judicial states.

Despite concerns that there would be a surge in proceedings following announcement of the National Mortgage Settlement in March, foreclosure starts in fact trended down throughout the year. By the end of 2012, the number of foreclosures stood at 1.49 million—the lowest annual total since 2007. The pace of foreclosure starts continued to slow in early 2013, dipping to a 1.15 million annual rate in the first quarter.

THE OUTLOOK

As the housing market stabilizes and consumer confidence continues to rise, attitudes toward homeownership as a short-run goal are improving. Indeed, 72 percent of respondents to the latest Fannie Mae survey believed that it was a good time to buy, including 61 percent of renters. The urgency to act may be increasing, with the share of households believing that home prices would rise over the coming year climbing from 26 percent in December 2011 to 43 percent in December 2012.

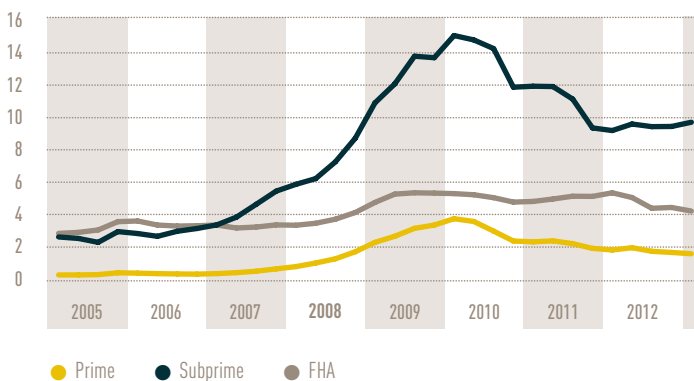
Although affordability is at a 40-year high, tight credit markets remain a challenge for would-be buyers. The emerging rebound in housing prices, coupled with steady job growth, may restore lender confidence that borrowers will be able to repay their loans and that the value of the collateral will exceed the debt if problems arise. But private lending activity is unlikely to accelerate for some time. The release in early 2013 of the qualified mortgage rule, defining standards for a borrower’s ability to pay, helped to remove one source of uncertainty. Still unknown, however, are risk retention standards for private loan securitizers and new capital standards for institutions holding mortgage-related investments under the Basel III Accord. The future of the GSEs is also on the table, along with what form—if any—a broad federal guarantee in the mortgage market might take. All of these decisions affect the risks and returns of private investors, and the lingering uncertainty continues to slow their return to the market.

At issue is whether, and at what cost, mortgage financing will be available to borrowers across a broad spectrum of incomes, wealth, and credit histories. Minorities, with generally lower income and wealth levels than their white counterparts, will make up an increasing share of young households over the next decade. The extent of access to mortgage credit for this growing market segment will have important implications both for the housing market and for the ability of many households to move into homeownership.

FIGURE 22

Delinquency Rates Have Fallen Across the Board, But Remain Well Above Pre-Crisis Levels

Share of Loans at Least 90 Days Delinquent (Percent)



Notes: Data are seasonally adjusted. Delinquencies do not include loans in foreclosure.
Source: JCHS tabulations of Mortgage Bankers Association, National Delinquency Survey.