Center for American Progress

The Housing Market Is Not Only For Homeowners

Policymakers Need to Focus on Renters to Facilitate a True 'Housing Recovery'

David Abromowitz December 10, 2012

Home prices have risen for six consecutive months,[1] leading many to conclude that the U.S. housing market is finally on the road to recovery.[2] But any mention of a broad "housing recovery" ignores the country's more than 100 million renters—roughly a third of the U.S. population—whose economic future is far less rosy.

Indeed, America's renters face a mounting, long-term affordability crisis. Demand for rental housing has skyrocketed in recent years, thanks to demographic changes and a hangover from the ongoing foreclosure crisis. Meanwhile, production of new rental units has failed to keep up, causing rents to climb more than 4 percent in 2012,[3] while middle-class wages have stagnated.[4]

As a result, one in four renters now spend more than half of their monthly income on housing—a sharp increase in the decade since 2001.[5] And that percentage isn't expected to go down anytime soon: The National Association of Realtors estimates that average rents will increase nationally by 4.6 percent in 2013 and continue to increase by at least 4 percent per year in 2014 and 2015.[6]

How have policymakers responded to this growing crisis? The picture is mixed at best, with rental housing often an afterthought in the debate over the future of mortgage giants Fannie Mae and Freddie Mac.

We can no longer afford to ignore the problems facing our country's renters. This issue brief provides background on today's rental affordability crisis, explains the federal government's critical role in the rental market, and lays out the need for stronger government support for the rental market going forward—in particular a limited and carefully crafted insurance backstop role supporting the flow of private capital into apartment financing.

What fueled today's rental affordability crisis?

In the past few years, the percentage of Americans who are renters has risen to almost 35 percent—the highest rate since 1995.[7] In fact, the United States added 1 million new renter households in 2011—the largest annual increase since the early 1980s.[8]

There are a number of reasons for the increase in rental demand. First, our country's two largest generations—the aging Baby Boomers and Millennial youth—are now entering the two age groups most likely to rent: retirees and those in their younger 20s coming into the housing market.

Second, household formation—the measure of individuals and families looking for a separate place to live—is growing at its fastest pace since the Great Recession began, with more than 1.1 million new households formed between September 2011 and September 2012.[9]

Third, the ongoing foreclosure crisis has forced millions of families to shift from homeownership to renting, especially in communities of color and among working-class homeowners who both suffered disproportionate losses of homes and wealth during the Great Recession.[10] According to the San Francisco Federal Reserve, it could take more than a decade for many of these families to hope to return to homeownership, during which time they have no option but to rent.[11]

Fourth, mortgage credit is less accessible than at any time in the recent past. This is paradoxical, as depressed home prices and record-low interest rates make owning a home more affordable than ever.[12] According to Federal Reserve Chairman Ben Bernanke, however, "overly tight lending standards may now be preventing creditworthy borrowers from buying homes."[13] In August 2012, for example, a typical rejected applicant for a loan backed by Fannie Mae or Freddie Mac had a credit score of 734 and a down payment of 19 percent—a quality credit profile by historical standards.[14]

Production of new rental units, however, has not kept pace with this increase in demand. According to Harvard's Joint Center for Housing Studies, as the number of low-income renters grew by 2.2 million over the past decade, the number of adequate and affordable rental units actually decreased.[15] Analysts project that the current pace for rental construction will fall well short of the production needed to meet increased demand between now and 2015. As a recent Freddie Mac analysis notes, there will be a net 1.7 million new renters between 2011 and 2015, but the United States is currently only producing about 200,000 new multifamily units per year.[16] Making the problem worse, analysts predict that there could be as many as 2.3 million more new renters between 2015 and 2020.[17] The result will be an increasingly tight rental market and higher rents for many Americans.

A glut of vacant single-family homes—one of the many byproducts of the prolonged foreclosure crisis—could help narrow this gap.[18] But converting these homes to rentals will only help certain groups of renters—typically middle-class and/or middle-aged families that may have been homeowners prior to a foreclosure. Many foreclosed homes are in outlying suburbs or overbuilt markets—where demand is much lighter—and economically distressed areas—where there is little housing demand due to the mass departure of jobs.[19]

But the populations driving demand for rentals—namely the cohort younger than age 25 heading out on their own, the aging Baby Boomers downsizing their housing, and immigrant families forming new households—are more likely to seek out rental housing in urban areas and rapidly recovering areas where jobs are most plentiful. As noted by the Joint Center for Housing Studies, "Singles and householders over age 65 are most likely to rent in larger multifamily buildings in center cities or suburbs. Renters who are married with children are most likely to live in single-family detached homes."[20]

As a result of this mismatch of supply and demand, rents in a wide number of markets have risen rapidly in recent years. In 2011 average rents nationwide rose 4.7 percent over the prior year for professionally managed properties with five or more units. This increase was well above inflation and double the 2.3 percent average rent increase of 2010.[21] It is increasingly hard to find an apartment, as well: Vacancy rates have fallen from 8 percent at the end of 2009 to 4.7 percent as of the second quarter of 2012.[22]

Meanwhile wages for the vast majority of workforce renters remain fairly stagnant, setting the stage for a broad affordability crisis.[23] Fifty-three percent of renters now pay more than 30 percent of their household income for their housing, while 27 percent of renters pay more than half.[24] These are both sharp increases in the numbers of cost-burdened households since 2001, when 40 percent of renters paid more than 30 percent of their household income for their housing, and 20 percent paid more than half.[25]

These increasingly unaffordable rents depress demand for goods and services beyond the housing market. One analysis found that lower-income families in unaffordable housing units spend 50 percent less on clothes and health care, 40 percent less on food, and 30 percent less on insurance and pensions compared to families in affordable units.[26]

The government's critical role in financing rental housing

We are reaching a crossroads in multifamily housing policy. Roughly 4 million apartment units were built from the 1970s through early 1980s using a variety of federal programs begun in the Nixon administration, including the Section 8 rental assistance program and the Section 236 mortgage program.[27] Many units are approaching or have reached the end of their subsidy periods—the time period during which the rents must remain affordable—leaving many lower-income tenants at risk of sharp rent hikes.[28] Another 1 million rental apartments produced under the low income housing tax credit program will soon be more than 15 years old, meaning that their affordability restrictions will soon expire.[29] Together these nearly 5 million apartments represent roughly 15 percent of the nation's apartment stock, as well as a major public investment.[30]

In addition to direct subsidy programs, the federal government for decades has supported a liquid and stable multifamily housing market through Fannie Mae, Freddie Mac, and the Federal Housing Administration. Specifically, Fannie and Freddie—both under government conservatorship since 2008—purchase conforming multifamily mortgage loans, package those loans into pools sold as mortgage-backed securities, and guarantee timely payments on those securities to outside investors. Fannie and Freddie also hold some multifamily loans in their own investment portfolios. Through these actions, Fannie and Freddie play a crucial role in making mortgage credit available under terms and at prices that put sustainable homeownership within reach for most American families.

In good economic times, Fannie and Freddie tend to back a smaller portion of the multifamily market. In 2007, for example, the companies combined for just 30 percent of multifamily loan originations, as private lenders and investors were eager to finance a robust rental market.[31]

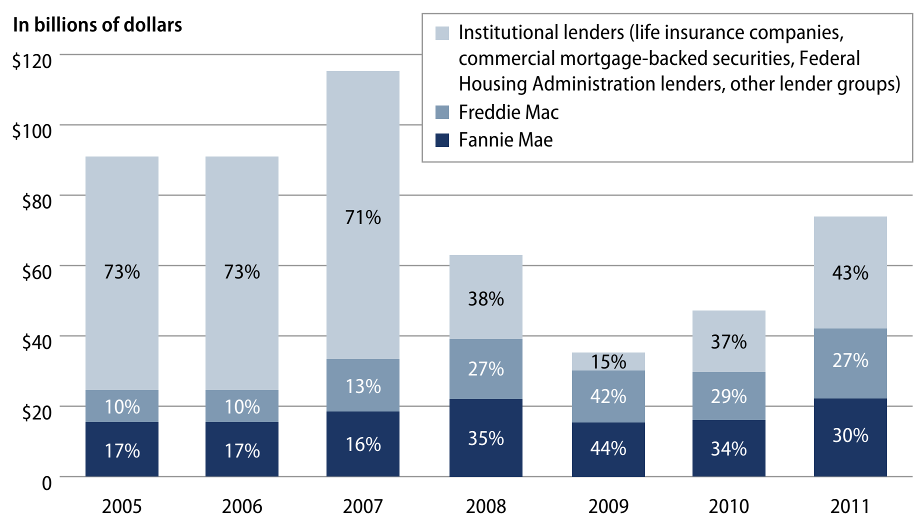
In times of financial gridlock and market downturns, however, Fannie and Freddie step in to keep the rental market afloat. Most recently, as private investors fled the housing market in 2007 and 2008, Fannie and Freddie's share of the multifamily market shot up to counter the rapid disappearance of private financing before easing back.[32] (see Figure 1)

Without the availability of government-backed credit for multifamily mortgages, the rental market would have completely collapsed in the wake of the financial crisis. In 2009 Fannie and Freddie facilitated 85 percent of all multifamily loans, tripling their share of the multifamily loan market from two years earlier. The institutions continue to play a key role in financing multifamily loans today, and supported 57 percent of total multifamily loans in 2011.[33]

FIGURE 1

As private investors fled, Fannie and Freddie saved the rental market

Financing of multifamily loans originated 2005¬–2011 (in billions of dollars)



Source: U.S. Government Accountability Office analysis of Mortgage Bankers Association data.

Even with Fannie and Freddie increasing their lending to support the market, multifamily unit construction dropped precipitously, from 284,000 starts in 2008 to 109,000 in 2009—the lowest number in at least 30 years.[34] If the rental market relied entirely on private financing without any government-backed insurance, it is highly likely that many of the hundreds of thousands of rental units built since 2008 would not have been built or improved through refinancing capital improvements. Without Fannie and Freddie attracting private capital to fund ongoing apartment lending, the loss of several hundred thousand additional apartment-construction starts since 2008 would have further pressured rents to shoot up, and thousands of much-needed construction jobs would also have been lost during the downturn. As a result, the current affordability crisis would be an economic catastrophe.

Not only did Fannie and Freddie provide multifamily financing when the private market without any government backstop was unable or unwilling to do so, but their loans performed far better than most of those originated in the private market. Specifically, Fannie and Freddie experienced delinquency rates of 0.45 percent at the end of 2009—14 times lower than default rates for private-label Commercial Mortgage Backed Security multifamily loans (6.5 percent), and 11 times lower than the default rates for commercial banks' multifamily loans (5 percent) at the same time.[35]

Additionally, Fannie and Freddie continued to offer loans to the full range of markets in cities across the United States during the downturn of the past five years, including loans for small apartment buildings and in smaller markets not as popular with many institutional private lenders.[36] Financing this market is critical to providing decent workforce rental housing, as buildings with 5 to 50 apartments provide homes for more than one-third of the renters in the United States,[37] and in many cities and towns they serve as the primary rental housing stock for moderate-income families.

Policymakers need to focus on the U.S. rental market

A healthy market for decent rental housing requires wide access to multifamily mortgages under a range of market conditions. This financing spurs the construction, maintenance, and resale of apartment buildings, expands supply where there is pent-up demand, and helps keep rents more stable for families at all income levels.

In recent years multifamily financing has relied heavily on government support. Without the availability of government-backed capital from Fannie Mae and Freddie Mac, as well as loans insured through the Federal Housing Administration, the entire rental finance market would have ground to a halt in the early years of the financial crisis. Such financial instability in the rental market would have had dire consequences for low- and moderate-income families and communities across the country.

Yet some policymakers today are considering significantly scaling back government support of housing finance in general, including for multifamily housing. Some are even calling for the federal government to withdraw from Fannie and Freddie's multifamily business entirely. One critical example is the Federal Housing Finance Agency—the regulator that oversees Fannie and Freddie—which appears poised to pursue plans to privatize the multifamily mortgage market. Earlier this year the agency announced that it was reviewing the economic impact of removing the government guarantee on multifamily mortgage-backed securities issued by Fannie and Freddie.[38] This proposal could reduce the amount of construction of new rental units, which would lead to increased rents for millions of low- and moderate-income families. This and similar congressional proposals for withdrawals of all government support for apartment finance would be a big mistake.

Lawmakers should instead focus on smart reforms to the way we finance multifamily housing in the United States. The Center for American Progress has put forth a plan for preserving a stable and liquid secondary market for multifamily mortgages funded by private investment capital, envisioned as part of a broader effort to reform Fannie Mae and Freddie Mac. Among other things, the plan includes an explicit, privately paid for, and limited guarantee on certain multifamily mortgage-backed securities issued by private firms, provided that the underlying loans meet strict underwriting, loan-type, and size requirements. (Unlike the past implicit federal guarantee of the debt and equity of the government-sponsored enterprises as corporate entities, neither the debt nor equity of the private firms themselves would be guaranteed by the federal government. Instead, any government guarantee would be limited just to payments to the purchasers of the mortgage-backed securities issued by such private firms.)[39]

In addition, to assure that renters benefit from any government backstop to the apartment finance market, the plan proposes that at least 51 percent of the rental housing units financed in the overall portfolio of such private firms for a given year have rents that are affordable. In this context, the plan would define affordable as rents below 30 percent of the income of occupants whose incomes are at or below 80 percent of local median income.

While most analysts agree that a healthy multifamily market requires a strong government role, there is significant disagreement on the issue of an explicit government guarantee. When the Center for American Progress recently reviewed 21 plans for mortgage market reform, only eight maintained an explicit guarantee on multifamily securities—and most of those plans simply mentioned the rental market in passing.[40]

One-third of Americans, including many of the most vulnerable in our society, rely on the rental market for their housing. This sector cannot remain an afterthought in discussions over the future of the housing market. As we chart the path to housing finance reform in the coming months, we must pursue approaches that create a lasting 21st-century finance system and meet the needs of both renters and homeowners.

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