Housing in America:

The Next Decade

John McIlwain
Senior Resident Fellow, ULI/J. Ronald Terwilliger Chair for Housing
The Urban Land Institute
Trustees Meeting
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Introduction and Executive Summary

The housing markets in the United States are at an inflection point. Today, they are in a state of turmoil. As the economy recovers, markets will stabilize but the old "normal" will not return. Once nascent trends will emerge as major drivers, creating new markets in new places. Those who fail to understand these new trends will miss opportunities or find themselves building what is no longer in demand.

Part One reviews the current state of the market. Home prices are stabilizing in many parts of the country but overwhelming challenges remain; national housing prices will fall another 10 percent this year until they stabilize in the second half of the year or in early 2011. This assumes that job losses come to an end in the next few months and unemployment begins to decline this year.

The biggest challenge to the housing markets today is the growing number of homes with mortgages that are "underwater," i.e. with principal balances higher than the current values of the homes which secure them. By the end of this year some 40 percent of all homes with mortgages are predicted to be "underwater."

Part Two looks at the need to re-establish the private market residential finance system which is now virtually all supported by the federal government through the Federal Reserve, Fannie Mae, Freddie Mac or the Federal Housing Administration (FHA). Fannie Mae and Freddie Mac need to be reformed or replaced and way mortgages are originated and securitized changed before investors will come back.

Part Three of the paper looks at long term trends which are emerging. After the recession, demand for housing will increase. There are four demographic groups that will drive housing markets for the next decade, each of which is large and facing a unique set of challenges:

- Older Baby Boomers who will become seniors in unprecedented numbers;

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- Younger Baby Boomers many of whom will be unable to sell their current suburban homes to move to new jobs;
- Generation Y who will be renting far longer than past generations; and
- Immigrants and their children who will want to move to the suburbs but may find them too expensive even after current drop in housing prices.

Workforce housing will remain a challenge. The age of suburbanization and growing homeownership is over. The outer suburbs will have the least expensive housing but the cost in time and money of long commutes will eliminate the any savings. Many who live there will do so not by choice but by necessity.

Shifts in markets present opportunities for those who understand the trends. Over time a new mode of metropolitan development will emerge presenting opportunities and stiff challenges. ULI will have an important role in identifying the new markets and working with all levels of government, facilitating development that responds to the new markets and is sustainable in a world challenged by a changing climate and energy supplies.

Part One: The Next 2-3 years – Watch Out for Wishful Thinking

Home prices had fallen 29% last October from their July 2006 peak according to the S&P/Case-Shiller Home Price Index (the Case-Shiller Index). By some estimates homeowners in the U.S. have lost about $6 trillion in value since the market's peak. Moody's Economy.com forecasts that home prices will fall another 10 percent in 2010 before they stabilize, bringing fall close to 40 percent from the peak in 2006.

There are signs that national home prices will stop falling this year. The Case-Schiller Index is holding steady and has had two quarters of modest rise last year. Much of the fall in housing prices along with many of the foreclosures have occurred in only four states: California, Nevada, Arizona and Florida, and markets in many other states have experienced only modest declines and some markets are rising.

The rate of new foreclosures has also slowed and there has been an increase in sales of new and existing homes which has led to a decline in the inventory of unsold homes now around a seven month supply. The recovery of the stock market, predictions that the official recession may be over and reduced job losses all suggest that the worst is over.

The stabilization in home prices, decline in foreclosures, and increased sales, however, have occurred during unprecedented government intervention in the housing markets such as the Home Buyer tax credit, already extended once, and now scheduled to end this spring.

Decline in Median Single-Family Home Prices in Select U.S. Metro Areas	
Metro Area	**% Change 2007- 2009**
Phoenix	-44.6%
Los Angeles	-41.8%
Miami	-40.6%
San Francisco	-33.1%
Atlanta	-24.8%
Washington	-24.6%
Chicago	-24.0%
U.S. Average	**-18.4%**
Minneapolis	-17.9%
New York	-17.2%
Seattle	-16.9%
Boston	-12.0%
Denver	-6.6%
Houston	5.3%
Source: National Association of Realtors, 2010	

Mortgage interest rates are at 50-year lows and likely to remain so for 2010. This is despite the scheduled end in March of the Fed's program to purchase $1.25 trillion in mortgage securities. The Administration did act in December to enable Fannie Mae and Freddie Mac to continue buying mortgages by increasing the limits of federal assistance that can be provided to them. Both the tax credit and the Fed purchases can be further extended though the mood in Congress has turned against such expenditures.

The biggest obstacle to stabilizing home prices is the threat of new wave of foreclosures. In 2008, more than 1.7 million homes were foreclosed or lost by short sale or deed in lieu. Another two million were lost last year and Moody's Economy.com projects 2.4 million to be lost in 2010, an estimate that may turn out to be conservative.

One in seven households with mortgages was either in foreclosure or in default at the end of September. The default rate has been stable for the last several months due largely to the government's Home Affordable Modification Program (HAMP) but still close to 100 basis points above a year ago and eight times as high as in early 2006.

The problem is that HAMP has produced few permanently modified mortgages. Of the 759,000 borrowers signed up for trial modifications through last December, only 31,000 loans have been permanently modification, fewer than 5% of those eligible. HAMP is deferring foreclosures but may not avoid them. Data from prior modification programs also suggests that half or more of permanently modified mortgages default within a year, though the HAMP experience may be better.

Unemployment is one of the two leading indicators of a mortgage default. The other is a home being "underwater," that is with a mortgage with a loan balance higher than the value of the underlying home.

The number of "underwater" homes is the sleeping giant of the housing crisis. There were 48.4 million homes that had a mortgage in 2005. Estimates of how many of these homes currently are "underwater" vary from 12 to 16 million, over one in four. Deutsche Bank Securities projects that 21 million U.S. households will be "underwater" by the end of 2010 meaning that over 40% of mortgaged homes would be at risk, including homes with prime mortgages as well as with Alt-A and sub-prime mortgages. This is a situation without precedent in the last seventy years. Note that these numbers do not count secondary debt and so may be conservative.

Decline in Jobs and Unemployment Rate in Select U.S. Metro Areas

Metro Area	% Job Loss 2007-2009p	% Unemployment 11/2009p
Washington DC	0.4%	6.1
Houston	-0.4%	8.2
New York	-1.1%	8.9
Boston	-1.3%	7.7
Seattle	-3.0%	8.8
Denver	-3.3%	6.8
Minneapolis	-3.7%	7.0
Miami	-4.2%	10.6
San Francisco	-4.5%	10.3
Los Angeles	-5.1%	11.5
Chicago	-5.4%	10.3
Atlanta	-6.9%	10.1
Phoenix	-9.6%	8.1

p = November 2009 preliminary

Source: U.S. Bureau of Labor Statistics, 2009

Not every "underwater" homeowner owner will walk away from their home; many will continue to pay their mortgages because they can afford to and expect the value of their homes to rise again, or, perhaps, just because they love their home and want to continue living there. Nevertheless, if only one "underwater" homeowner in five decides to walk from their home, this would double mortgage defaults over last year. "Underwater" homes affect the normal working of housing markets. It limits the ability of the unemployed to sell their homes in order to move for a new job, constraining labor market mobility and economic recovery. It is stalls the "move-up" market as well as families are unable to sell their home to buy the next one and can lock older retirees into the suburbs, limiting their ability to move, whether to the Sun Belt, the city, or to smaller homes in nearby suburban town centers.

Foreclosure Rates in Top U.S. Metro Areas*				
Metro Area	**Properties with Filings**	**% Housing Units**	**1 per X Housing Units**	**% Change from Q3 2008**
Phoenix	40,566	2.43	41	18.56
Miami	53,710	2.23	45	34.67
Los Angeles	69,403	1.58	63	32.38
San Francisco	22,876	1.35	74	22.06
Atlanta	24,787	1.17	85	13.9
Washington	19,318	0.91	110	9.25
Denver	9,235	0.89	113	-1.58
Chicago	33,065	0.88	113	28.46
Minneapolis	9,767	0.74	136	98.68
Seattle	6,495	0.46	217	37.75
Boston	7,962	0.44	229	19.46
Houston	8,482	0.39	256	-8.12
New York	24,715	0.33	299	14.69
U.S. Total	**937,840**	**0.73**	**136**	**22.5**
*** Q3 2009**				
Source: RealtyTrac, 2009				

It is hard for any mortgage modification program to respond to unemployment or a significantly "underwater" home. It would be necessary to have a moratorium on foreclosures and/or to require banks to provide principal write downs, neither of which is feasible economically or politically. This means that despite the promising signs that home prices are reaching their nadir nationally, foreclosures will rise in the year ahead and prices continue to fall. Some markets are regaining health, but caution should be the word of the day regarding home values.

Part Two: Transitioning to the Future – Reopening the Private Capital Markets

Virtually all funds supplied to the residential market today are the direct result of federal action. All new mortgages today are being bought or securitized by the federal government and private investors have completely exited the market absent a federal guarantee. What was once considered the world's most efficient housing finance system, attracting trillions of dollars of investment from around the world, is now shunned by all, both here and abroad.

Bringing private investment back is essential to restoring a healthy housing finance system, but how and when this will happen is not clear. The economy must improve and jobs come back for foreclosures to decline and housing prices to stabilize nationally. The infrastructure of housing finance also needs to be reformed; Fannie Mae and Freddie Mac need to be reformed or replaced, and the mortgage system reformed to ensure sound underwriting and due diligence.

Efforts in these areas are at an early stage and it is too early to predict what the final outcome will be. Their resolution, however, will have a fundamental impact on housing markets for years to come. The cost and availability of debt will affect the ability of millions to buy homes or to afford to rent in new buildings, most especially Generation Y who normally would be forming their first households in the years ahead.

The Future of Fannie Mae and Freddie Mac

Fannie Mae and Freddie Mac have been in federal conservatorship for a year and a half. They own or guarantee half of the nation's $11 trillion in home mortgages and together with the Federal Housing Administration are responsible for backing nine mortgages in 10 made today.

The government has invested $112 billion in the companies to keep them functioning and last year committed to double that to $200 billion. This allowed them to generate $1.3 trillion single-family mortgage-backed securities last year, up 39 percent from 2008. Their single family portfolios continue to decline in quality: during their last quarter ending November 30th loans in all stages of delinquency increased to 7.6 percent of their combined portfolios, most of which has been in their single family portfolios as their multifamily portfolios continue to perform well.

The Administration has said that a proposal for restructuring Fannie Mae and Freddie Mac will be included in the President's 2011 budget, due out in February. Little is known at this time about this proposal; it is unlikely, however, that legislation reforming the companies will be enacted this year. 2010 is an election year with a shortened and already crowded legislative agenda. Reforming Fannie and Freddie will be extremely controversial.

The Treasury Department announced on December 24th that it would continue to provide capital as needed to the companies for the next three years to assure investors of federal backing and enabling the companies to continue actively supporting housing markets.

When the companies were placed in conservatorship they were required to begin reducing the size of their portfolios this year. In December, the Treasury relaxed this requirement. This will allow the companies to continue buying mortgages which is especially important if the Fed's program of buying mortgage securities ends as scheduled this spring.

There is little reason for the Administration to push for reform of the companies at this time. The federal government is now their conservator, regulator and prime investor. As such, it is able to use the companies as a virtual federal agency, working with FHA, to keep the housing markets

liquid and support the Administration's mortgage modification efforts. Yet the companies remain "independent" entities due to the technicalities of the conservatorship law and so their liabilities remain off the federal balance sheet.

The time to reform or replace the companies is when the housing markets recover and no longer need such active federal support. Proposals have ranged from fully privatizing them to making them federal agencies; neither alternative is likely. If they become federal agencies, their liabilities are added to an already swelling federal debt, a sensitive issue these days. Fully privatizing them, on the other hand, raises the risk that there will be no way the federal government can effectively maintain credit flows to the housing markets during a credit crisis; these seem to occur with annoying regularity once a decade. Housing is too large a part of the U.S. economy and too politically sensitive for the government not to have effective tools to support it when needed.

Nor is it likely they will leave conservatorship unchanged. The old model is widely viewed as flawed, given the conflicting incentives of maximizing stockholder value and providing affordable mortgages to moderate and middle income Americans.

Many proposals have been made that walk the line between privatization and turning them into government agencies. The Center for American Progress, a think tank with close ties to the Administration, recently made a proposal that the Administration is expected to study closely. It calls for the creation of a number of government-chartered firms, called Chartered MBS Issuers or CMIs, which would finance certain types of home loans by selling securities guaranteed by the government; the types of loans eligible would be determined by federal regulators.

CMIs would be privately owned but regulators would limit their profitability and fees would be charged to cover the risk to the government. The government would set risk standards for both the mortgage securities issued by CMIs and those issued by private entities. CMIs would have to support affordable rental housing and could hold only limited amounts of mortgages and related securities.

Suggesting that the obligations of CMIs be federally guaranteed is problematic. This would mean that their liabilities would be part of the federal debt and subject to annual appropriation as is the case today with FHA. This would inevitably limit their activities and the amount of housing credit they could supply to the sectors of the housing market open to them; in effect they would become mini-FHAs.

The proposal that the government regulate the private mortgage securitization market as well as securities issued by CMIs will be very controversial. More federal oversight of the private mortgage market is needed and there is legislation currently in Congress to this effect. Many in the industry, however, are very opposed to this.

This proposal is but one of many offered and the final nature of the reform will not be known for several years. In the meantime, expect the government to use Fannie Mae and Freddie Mac aggressively to support the housing markets.

Reforming the Mortgage Origination and Securitization Process

Re-establishing a robust private mortgage market will require both strong fundamentals and a reformed mortgage origination and securitization structure which eliminates the major abuses of the past years. The inappropriate incentives among mortgage originators, securitizers and rating agencies need to be removed by requiring anyone originating mortgages and then selling or securitizing them to retain a portion of the risk (or "skin in the game"). This should apply as well to those creating CDOs or the like.

H.R. 4173, The Wall Street Reform and Consumer Protection Act of 2009, voted out of the House on December 11 on a largely party line vote, is one possible approach to this kind of reform. It would, if enacted, require regulators to define which loans were considered to have an appropriate credit risk. Originators of all loans but these would be required to retain five percent of the risk. Anyone securitizing mortgages would have to retain five percent of the risk as well unless there was what regulators considered adequate due diligence and they or a third party took a first loss position. It is now up to the Senate to craft its own financial regulatory bill, which is anticipated this winter and spring under the leadership of Senator Dodd. Chances of final passage of this legislation are uncertain.

If this or similar legislation does pass, it is likely that most mortgage credit will flow into the types of loans deemed sound by regulators as originators are unlikely to retain much if any of the risk and thereby add to their liabilities and required capital. A major problem with the requirement that securitizers retain risk is it will require them to add to their capital to offset this liability. The result could reduce the level of mortgage securities in the market and constrain the flow of capital into housing.

The reform of Fannie Mae, Freddie Mac and the mortgage origination and securitization process will influence the flow of capital to the housing markets. The total volume of debt available, its cost, and to whom it is available will be affected. If the cost of capital is raised too high by these reforms, the cost of housing will rise, potentially reducing the amount of housing produced and pricing many out of the housing markets in the decades ahead.

Part Three: The Longer Term – Expect the Unexpected

> *"The massive shock to housing markets has raised questions about the future strength of demand. Although demographic trends provide a solid underpinning for the long run, market conditions over the next 5–10 years will surely have an impact. A deep, prolonged recession would likely suppress immigration to levels that are never fully made up. Moreover, such conditions might even lead to enduring changes in household formation behavior." The State of the Nation's Housing, Joint Center for Housing Studies of Harvard University (Harvard Joint Center)*

Andrew Grove of Intel writes, "Sooner or later, something fundamental in your business world will change." He goes on to add that:

> "… strategic inflection points do not always lead to disaster. When the way business is being conducted changes, it creates opportunities for players who are adept at operating in the new way. This can apply to newcomers or to incumbents, for whom a strategic inflection point may mean an opportunity for a new period of growth."

Early signs of new trends have been present for years now. The trends will become stronger following the recession and affect where people live, whether they own or rent, and the size and style of the homes they chose. These choices, whether by desire or necessity, will be very different from the choices of people over the years since World War II. That was the period of the great suburbanization of America; the coming decades will be the time of the great re-urbanization as 24/7 central cities grow and suburbs around the country are redeveloped with new or revived walkable suburban town centers.

Demographics as Destiny

Metropolitan growth and decline is driven by demographics. Globally, not only is more than half the population of the world now living in urban areas but all future population growth is projected to occur in urbanized areas. In developing countries, the impact is enormous, with over 1 billion people currently living in urban slums of the developing world, a number which is growing rapidly.

The U.S. has the third largest population in the world and is growing more rapidly than all but six other countries; if current trends continue the population of the United States will rise to 438 million in 2050 from 308 million today. 82 percent of that increase will be due to immigrants arriving from 2005 to 2050 and their U.S.-born descendants, according to the Pew Research Center. During this period the non-Hispanic white population, now a majority, will become the largest minority (47 percent) as it increases more slowly than other racial and ethnic groups.

The four major demographic waves in the U.S. to watch are:

- The aging Baby Boomers, the oldest of whom are now in their mid-sixties;
- The younger Baby Boomers in their late forties and early fifties;
- The kids of the Baby Boomers, called variously Generation Y, the Millennials, the Next Generation, the Net Generation, or the Echo Boomers, a group that is still growing through immigration. Together with the Baby Boomers, they comprise over one half of the U.S. population.
- Immigrants, their children and grandchildren, who are growing more rapidly than "native born" households.

The Older Baby Boomers – There are 78 million Baby Boomers, the oldest of whom will become 65 in 2011. From then on, the population of "senior citizens" is projected to grow faster than the total population of the U.S.

The Boomers are really two cohorts; the older group from 55 to 64, and the younger group, from 46 to 54, now in or entering what should be their prime earning years. Between these two, the younger group is larger, comprising two thirds of the cohort; only the older one third are approaching retirement this decade.

The Boomers have redefined every age they have entered and the older ones will do so again. They do not yet see themselves as aging; instead, "60 is the new 50." Some have begun to retire but most will push full retirement back for years both because they are working at jobs they enjoy and because they need to rebuild their retirement funds.

In the coming decade fewer of the Older Boomers will be moving. Those who have not yet sold their suburban homes find themselves trapped as falling home prices have left their homes "underwater," worth less than the mortgage(s) on them. It will take years before home prices rise sufficiently to restore their lost equity. Those that can move are no longer flocking to the Sun Belt, choosing instead to move closer to their children, and, more importantly, their grandchildren.

This older Baby Boomer cohort is healthier and more energetic than their parents. The move into retirement and life care communities will be deferred for at least a decade or more unless these housing forms adapt to the desires of this new group of young seniors. As a result, the market for senior housing will grow more slowly than expected.

This older cohort is entering an urban phase; a 2009 RCLCO survey found that 75% of retiring Boomers said that they want to live in mixed age and mixed-use communities, i.e. in urban settings. Not all will want to move to the central city, and walkable, urbanized suburban town centers will see an influx of aging Boomers.

This trend can be seen in the early success of urbanizing town centers such as Bethesda, Reston Town Center, and White Plains. Many of these are now stalled due to the collapse of the condo and resale market, but once the Boomers can sell their homes and buy condos, these centers will thrive during the decade ahead.

The Younger Baby Boomers – The younger cohort of Boomers is facing very different challenges. They have decades before they consider retiring and their children are likely to be still at home, either because they have not left yet or because they have "bounced back." Many find their suburban homes now "underwater" and even those not "underwater" will be hard to sell. The older Boomers sold their suburban homes to the larger population of younger Boomers looking to move up; the Younger Boomers now have the much smaller Generation X, now in their late thirties to mid-forties, to sell to.

Generation X is also made up of smaller households, is a more urban generation, and is facing distinct economic challenges. The Harvard Joint Center reports that

> "Real median household incomes in all age groups under 55 have not increased since 2000**.** In fact, for the first time in at least 40 years, there is a chance that the real median household income for these age groups will be lower at the end of the decade than at the start. Moreover, the severity of today's economic contraction could hold down incomes and wealth for years to come." 2009 State of the Nation's Housing

This will suppress prices on suburban homes for years to come, making it harder for the Young Boomers to move. The reduced prices of these homes and their larger size, however, make them an attractive option for larger immigrant families though prices will have to drop considerably for this to happen. As the Harvard Joint Center notes:

> "The housing now occupied by many older white baby boomers will be well suited to the needs of younger and generally larger minority households. With their lower incomes, however, minority households may be unable to afford these homes when they come onto the market. Indeed, the ongoing adjustment in house prices across the country may help improve affordability in the short term, but it is unlikely to bridge the gap completely." 2009 State of the Nation's Housing

The Younger Boomers are facing flat incomes, lost equity in their homes and a smaller group of move-up buyers. The market for large suburban homes will be weak over the coming decade and there are already enough large suburban homes to meet the market demand for the coming decade despite the growing U.S. population.

The second home market also will be weak in the coming decade. The Younger Boomers are at the prime stage for buying a second home. Most Younger Boomers will be unable to afford a second home because of diminished earnings, tight credit, and the lack of equity in their first home on which to draw for a down payment on their second. Only those second home markets

that appeal to the wealthiest will remain strong, though there may be opportunities for lower cost but well designed, smaller second homes.

Generation Y – There is no precise definition of Generation Y but it is generally people in their late teens to early thirties, some 83 million. It is distinct in many ways from prior generations. It has not been a revolutionary generation but it will produce radical evolutionary changes. For instance, there are now more women in colleges and universities than men for the first time in U.S. history and women are earning 60% of the master's degrees; women are on the way to dominating the workforce.

Stephanie Siejka of RCLO speaks of WINKs, "Gen-Y Women with Income and No Kids (and typically no spouse or partner, for that matter)." Many more are living alone than their male counterparts.

This is the generation of the on-line social network, and "herding," the ability to meet up on a moment's notice at a social gather place (think Starbuck's and other "third places"). They value community highly and ideas, information (not always correct but often corrected by the widespread on-line network) and opinions flash among them with speeds that leave older generations unable to keep up. Reputations are made and lost in weeks, and good reports can lead to a sudden upsurge in business just as fast as a bad report can kill a once promising business. They move and think quickly and easily multi-task, and are also committed to a healthy work/life balance; they will work hard, but not at the expense of time with family and friends.

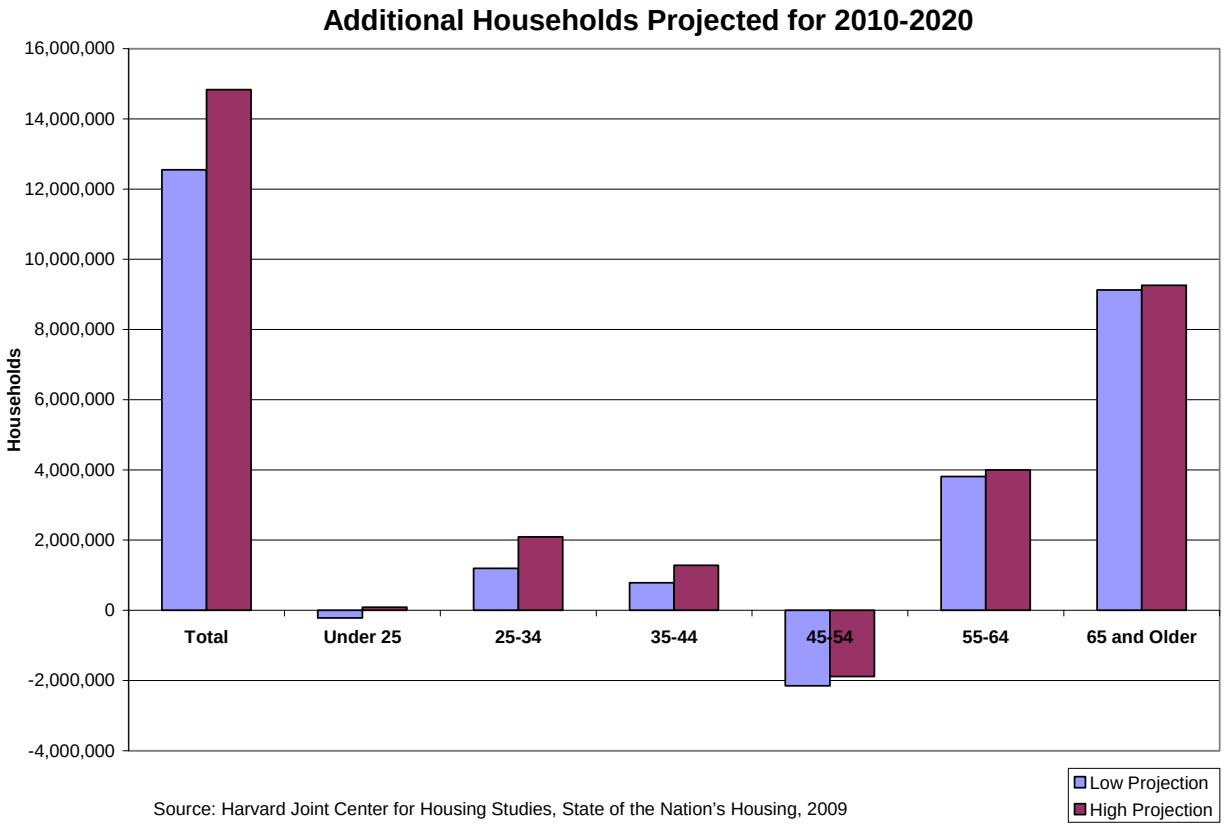
Many are active and socially responsible and volunteer in large numbers, looking for ways, especially on-line, to improve the world. They are acutely aware that they will live through unprecedented changes in the climate and will be impacted in unpredictable ways. They also know they are the last generation to grow up with endless supplies of cheap carbon-based fuels. They can expect to live well into their nineties and they will see a dramatically different world at the end of this century than the one they were born into. They are the "greenest" generation yet.

They value diversity and do not see differences in races or ethnicity as barriers to be overcome; what older generations think of as barriers are not even noticed. Instead, they cluster around educational levels and cultural affinities which are frequently created by a mix of traditions from other cultures; consider this the age of fusion.

They are an unpredictable generation. They have been more immediately impacted by the current recession than other generations. Brought up as the "Credit Card Kids," they now find that after college and grad school there are no jobs and large school loans to pay off. Yet they remain an "aspirational generation," as one member of Generation Y put it, saying "We want to live differently than our parents and believe we can have what we see on TV."

This generation will be income constrained. The U.S. Census reports that during the past decade incomes of those 25 to 34 have fallen 12% for men and 3% for women. This is unlikely to change in the coming decade and will result in most of Generation Y living more modest lives than their parents with little money for housing.

Household formation is suppressed today by high unemployment. Generation Y is at the age of highest new household formation but is instead living in their parents' basement, have doubled and tripled up, or gone back to school to weather the storm. Once there are jobs for them again, they will move into the housing market in large numbers, creating new demand.



Source: Harvard Joint Center for Housing Studies, State of the Nation's Housing, 2009

Generation Y will have a smaller impact on the housing markets than the Baby Boomers even though they are a bigger cohort. The Baby Boomers dwarfed all prior generations in size and thus became the dominant driver in the markets as they grew up. Generation Y is larger than its immediate predecessor, Generation X, but only incrementally so; as Generation Y forms households they will add to demand reversing the decline caused by Generation X, but not to the extent that the Baby Boomers did. They are also forming households later than prior generations further reducing their impact on housing demand.

Their attitudes to homeownership have been changed by the housing crisis and the recession. They see people trapped by "underwater" homes that can't be sold and millions of foreclosures.

This is tempering their interest in buying their own home and they will be renters by necessity and by choice rather than homeowners for years ahead.

They have to pay off existing school loans and the "Bank of Dad" and "Mommy Money" are gone as their parents struggle to rebuild their retirement portfolios. They have lost the confidence of prior generations that homeownership is a way to develop wealth. They believe instead that they will have to save for retirement, especially as they have a low level of confidence in Social Security.

They say they want to live in urban areas; a 2008 survey by RCLCO found that 77% of Echo Boomers report wanting to live in an urban core, not in the suburbs where they grew up. They want to be close to each other, to services, to places to meet, and to work, and they would rather walk than drive. They say they are willing to live in a smaller space in order to be able to afford this lifestyle.

The ability of most of this generation to afford urban living, however, will be limited and once they have school age children they will look to the suburbs for good public schools. They may, however, move to more the older, less expensive suburbs or to compact suburban town centers rather than low density cul-de-sacs.

To get Generation Y to buy their first home, builders will need to offer starter homes in large numbers at low prices, meaning small, simple homes on small lots (but ones that are well designed and built to green energy standards). This is hard to do except in the outer edge suburbs. For this reason many young families will be look to live in the older suburbs where prices have fallen, or move to the outer edge suburbs regardless of the cost to them in dollars and time of long commutes.

This will be a big change from the past when people moved to the outer suburbs by choice in order to find a newer, bigger home. Over the coming decade, many of those who move out will do so reluctantly and will miss the sense of community and amenities they value. In addition, their suburban homes will appreciate in value slowly if at all, since their major attractiveness will be their low price.

This provides a major opportunity for developers to create new outer edge communities with real town centers and urban amenities. Even on the outer edges a compact, walkable lifestyle that is affordable will be attractive to income constrained young families, especially if it has transportation alternatives.

Immigrants – It is estimated that there are 40 million foreign born people, both legal and illegal, living in the U.S. now, comprising around 13 percent of the population. Their impact, however, is far greater when their U.S. born children and grandchildren are included. Immigrant households are 50 percent more likely to live in poverty even though more immigrant households have at least one worker than native born households.

The Latino population, already the nation's largest minority group, will triple in size by 2050 and, along with other minorities, will account for over 70 percent of the nation's population growth. Hispanics will make up 29 percent of the U.S. population in 2050, up from 14 percent in 2005. They also have lower educational levels, with fewer having graduated from high school than the native born population.

This growth is increasingly a result of births in the U.S. rather than immigration; of the 117 million people added to the population during between 2005 and 2050 due to immigration, 67 million will be the immigrants themselves and 50 million will be their U.S.-born children or grandchildren. For this reason, the Latino and Asian populations are projected to have younger median ages than the rest of the population as whole.

Experience has shown that immigrant families revert to the national norms in education, incomes and lifestyles after the first few generations. What the impact of the current recession will be on this normalizing trend is unclear except that it is likely to slow the growth in incomes and wealth in this population. This in turn is likely to slow their normal progression to homeownership.

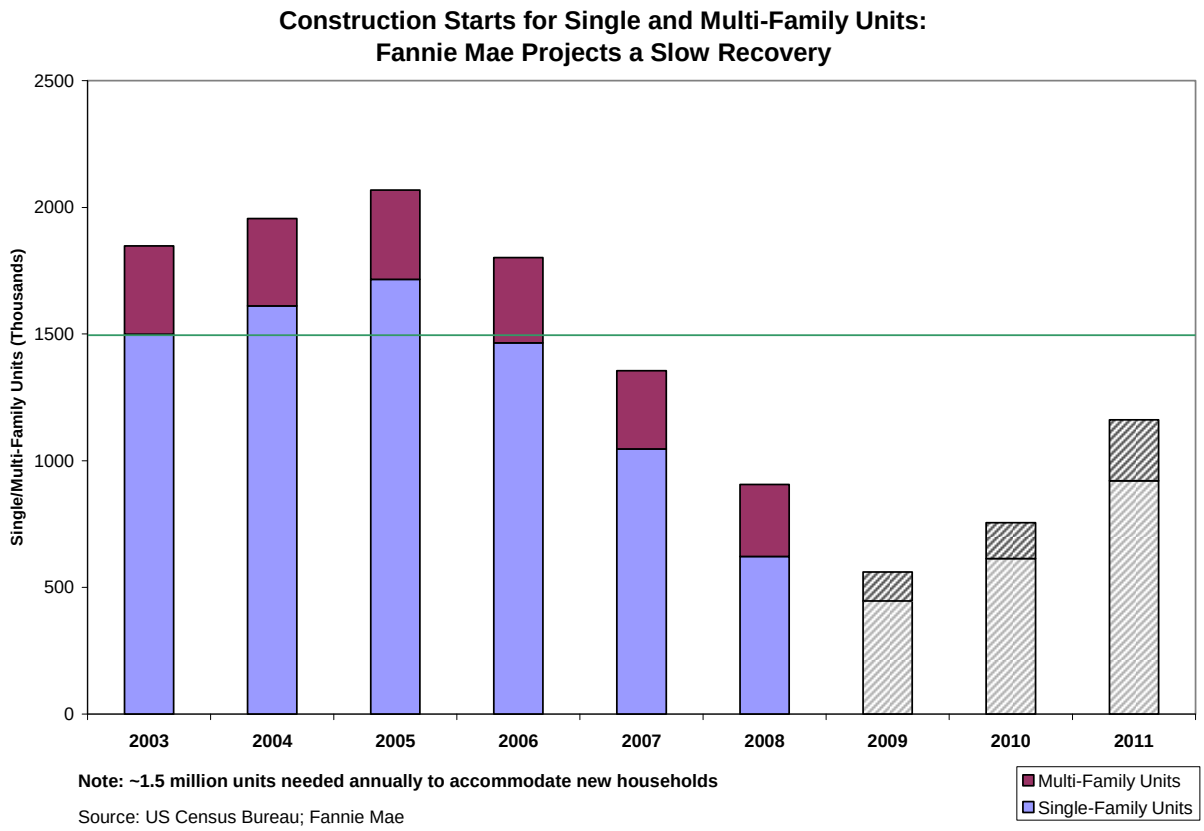
Immigrant populations naturally cluster together. These clusters have moved from the central cities where they tended to gather in the past to the inner suburbs over the last two decades. It is not clear yet whether they will make the jump to the next ring of suburbs. Latinos especially favor larger homes as they have larger, often multi-generational families. This would favor moving to those suburbs with larger home if they can afford them. On the other hand, they also like living closer together, not isolated from one another and with a greater sense of community than most people experience in the suburbs. This suggests that the established cul-de-sac suburbs may be not be attractive to them.

The Demand for Housing and the Future of Homeownership

The U.S. population is growing at a rate of 2.5 million to 2.8 million people a year. The size of households, however, has been on a long term decline; it was 4.6 in 1900, 3.38 in 1950 and 2.6 in 2000. Recently, however, it has begun to increase slowly. The fastest growing household size recently has been the single person household, most of who are women. Going forward, the Harvard Joint Center projects that:

> "[m]arried couples without children (including empty-nesters) will be the fastest-growing household type, followed closely by single person households. While the number of married couples with children will fall by nearly a million among whites, it will increase by more than a million among Asians and Hispanics." 2009 State of the Nation's Housing

There will be an ongoing and robust need for housing production in the decade ahead. The Harvard Joint Center projects that from 1.25 to 1.4 million new households will be formed annually in the coming decade.



The impact of the current recession has dramatically suppressed natural household growth. The number of new households grew by only 772,000 in the year ended March 31, 2008 compared with an increase of 1.63 million a year earlier based on Census data, a 53 percent drop in a year in which millions of young adults graduated from high school and college. When the jobs return there will be a surge in housing demand caused by those who would have but could not form a new household doing so along with those just coming into the housing market.

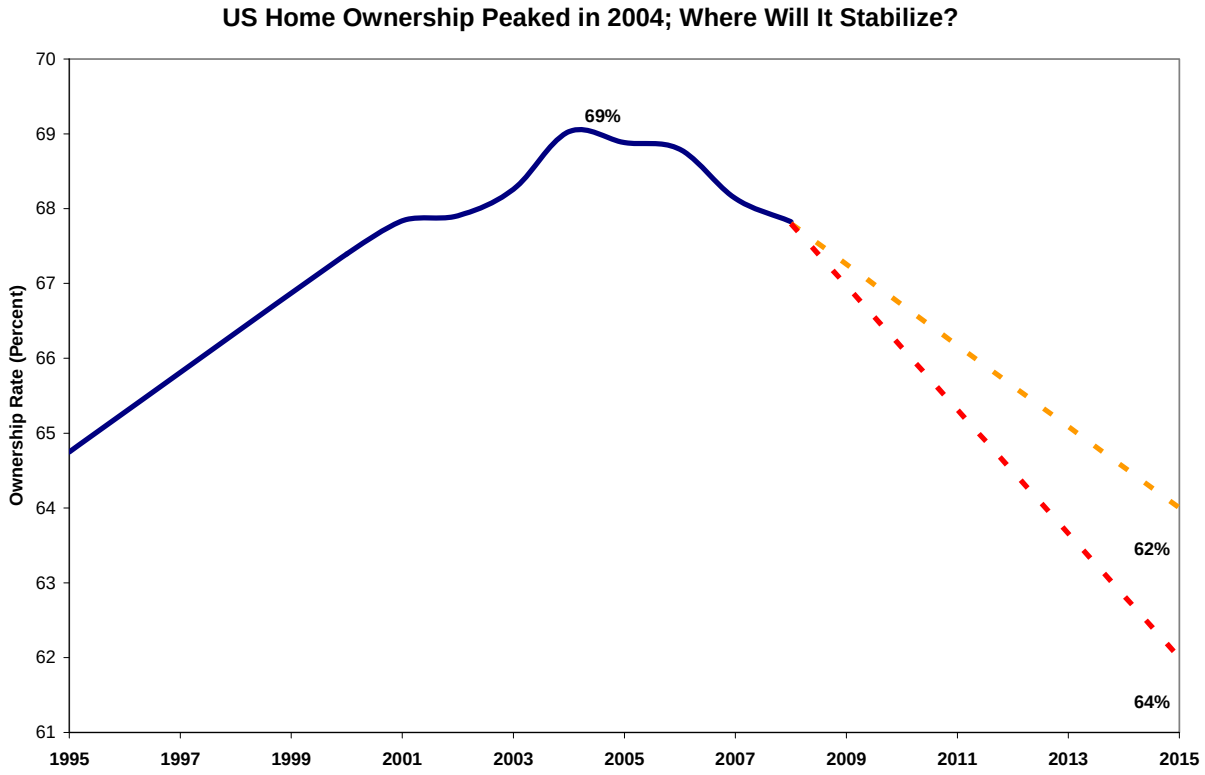
Over the past decade, housing production topped 2 million homes a year, far greater than demand. This has led to the collapse is production today; only 600,000 homes were started in 2009. This number is projected to rise to 800,000 in 2010 but is still below what is needed to meet new household demand when the economy recovers. The percentage of new housing production that is multifamily will increase as production returns since most new households will be members of Generation Y and immigrants, both of which will be renting in large numbers. This will be reflected in a decline in the homeownership rate.

Homeownership in the U.S. has risen steadily, with occasional corrections, from a low of 43 percent during World War II to a high of 69 percent in 2004. In the past five years it has been steadily falling and was 67.3 percent in the first quarter of 2009. It will continue to fall. The Harvard Joint Center notes that

> "demographic forces—especially the shift toward minorities, who have much lower ownership rates than whites—in fact worked against homeownership gains. Indeed, if homeownership rates by age, race/ethnicity, and household type had remained at 1995 levels, demographic trends alone would have reduced the homeownership rate by a full percentage point over this period." 2009 State of the Nation's Housing

This is a startling reversal of past trends, especially as there is a historically high number of young members of Generation Y are at the prime age to become first time homebuyers. This generation, however, will rent far longer than prior generations.

It is most likely that home ownership rate will settle somewhere between 62 and 64 percent, the range experienced between 1960 and 1990. This is the range that both Sam Zell, at a ULI meeting in New York this month, and Arthur C. Nelson, the director of the Metropolitan Research Center at the University of Utah, have separately predicted.



Source: Harvard Joint Center for Housing Studies, *State of the Nation's Housing* , 2009

From 1900 through 1930, homeownership levels fluctuated from 45 percent up to 48 percent until the Depression and the war brought it down to 43 percent in 1940. Following the war, the great suburbanization of the U.S. raised over the next two decades to 62 percent in 1960, driven by a booming economy, rising real incomes, favorable tax laws, a rejuvenated home building industry, and easier financing.

The rate only began to climb above 64 percent in the 1990s and the first decade of the current century when Administrations of both parties adopted national policies designed to encourage home ownership; the result was to drive both home prices and the home ownership rates to unsustainable levels.

Government policies are in the process of being rebalanced today. A homeownership rate of 62 to 64 percent will have only a modest impact on local communities. Their tax base has been far more impacted by the decline in values of the single family homes than in multifamily buildings. There have been many studies which extol the virtues of homeownership for community stability and educational and health benefits for children. These are being questioned by new studies, however, and new evidence suggests that housing stability is more important than whether a home is owned or rented in producing positive outcomes.

If, on the other hand, a confluence of circumstances conspires to produce a rate in the 50s, this will be a "game changer." The most likely cause for such a low homeownership rate would be a prolonged or double dip recession, with a slow recovery.

The homeownership rates of different racial and ethnic groups differ widely. In 2004, when the overall rate peaked, the homeownership rate for the white population was 76 percent, that of the black population 49 percent, Latinos 48 percent and Asians 60 percent. This disparity is likely to grow as the rate declines since a disproportionately large numbers of blacks and Latinos were victims of predatory lending practices; by some estimates almost half of all loans in default are held by blacks. Both blacks and Latinos already have lower rates of income and wealth, and higher unemployment rates than the white community, and so the impact of these high rates of default and foreclosures are likely to be significant.

Affordable and Workforce Housing

Home prices are reaching levels of affordability not been seen for years; the latest median sale price for homes nationally was $172,600, according the National Association of Realtors. Nor are they anticipated to rise rapidly in the future. The rate of appreciation will revert closer to long term norms.

Robert Shiller, a Yale economist and co-creator of the Case/Shiller index, has shown that over the long term, housing prices generally rise about ¾ to 1 percent a year over the rate of inflation, about 1 percent or less in real dollar terms. Nic Retsinas, Director of the Harvard Joint Center, is only modestly more optimistic, projecting that home-price growth in the next decade will average about 3.5 percent a year, based on his estimate of increases of about 1.5 percent above inflation and the Federal Reserve's long-term inflation forecast of about 1.7 percent to 2 percent.

For Americans that already own their home, this means their homes will only grow modestly in value. This will be especially troublesome to those whose homes are "underwater" as it will take many years for them to regain equity in their homes.

This would seem to be good news for people looking to buy their first home. The problem is the location of those homes which have lost the most in value; they are those on the outer suburban edges and in certain hard hit inner city neighborhoods which have become the most affordable.

First time homebuyers will find themselves once again forced to "drive until they qualify," leaving behind the communities in which they work. This is a false economy, as has been demonstrated by recent studies by the ULI Terwilliger Center for Workforce Housing; the savings in the cost of the home are often more than offset by the greater cost of transportation to jobs and to all the many services it takes to support a home and lifestyle.

The recent "Priced Out" studies by the ULI Terwilliger Center of home prices in the Washington, DC and San Francisco Bay area metro regions show that for the moderate income workforce, housing remains largely unaffordable in the urban areas and closer in suburbs where many of them work.

While home prices are not anticipated to rise significantly faster than inflation in the years ahead, neither are incomes. Thus the current unaffordable relationship between income and price in areas close to jobs is likely to remain for years to come, pricing the workforce out of homes near where they work. Hardest hit will be Generation Y, who will be challenged to find homes they can buy except on the outer edges where they say they do not want to live.

The Future of Rental Housing

The rental vacancy rate in the U.S. was 8 percent at the end of 2009, the highest level since 1980. At the same time, rents fell 3 percent. These conditions will continue through 2010 and into 2011, as units started in 2007 and 2008 come on line. The one bright spot is that multifamily starts are down almost two thirds from their peak of two of years ago.

The years from 2012 through 2014 will be good for multifamily. The economy will have recovered by then and unemployment fallen back to 6% or 7%, which will spur demand for rental housing and housing in general as household formations rebound. There will be, however, little new multifamily product on the market due to the low rate of starts today. Some experts are predicting increases in rents in 2012 of as much as 4 to 6 percent. A similar strong increase in rents is expected for 2013. This represents only a 1% year annual increase from 2007, so even these higher rents should be generally affordable to the young Echo Boomers and immigrants who will be the primary market.

Longer term trends also favor both rental housing and multifamily housing in general. The falling homeownership rate, the wave of Generation Y deferring home ownership, and growing urbanization will increase long term demand for rental and multifamily housing.

The Greening of Housing – From Here to Net Zero in Ten Years

The movement towards greener, more energy efficient building has been gaining momentum prior to the recession. Most green buildings, however, have been commercial, and among residential buildings, most of the certified green ones have been multifamily. The certification of single family homes has been growing more slowly; while the number which met one green standard or another is now over one million that is still less than one percent of existing homes. Most standard homes built today, however, are far more energy efficient than ones built only a decade ago, even without a "green" certification.

Anecdotal evidence from builders still in the market suggests that homes which meet a green standard are selling better than those that do not, so long as any premium in price is modest and offset by energy savings. This is despite the fact that most homebuilders remain skeptical about the benefits of building green in marketing their homes. Surveys showing that more than one half of homebuyers want a green home but most are unwilling to pay more for it. The challenge is to develop technologies that reduce energy use and promote other sustainable practices that cost the same or less as standard practices. Many of these technologies are available today though they are not yet widely known or understood.

What is considered "green" is evolving and standards for certification are changing, especially regarding the efficiency of energy use, a trend which will continue. Local building codes are requiring more efficient homes, and provisions for a national building code are contained in the current "cap and trade" legislation pending in the Congress. Energy prices are expected to remain volatile which will add support at the local, state and national level for tougher standards for energy use in homes and all construction. This volatility will also increase market demand for homes that use less energy especially among Generation Y, the largest wave of new households in U.S. history.

Standards, markets and technologies are evolving and a new goal is emerging, namely the net zero energy home. Most definitions of this describe a home linked to the national electrical grid which buys from and sells electricity into the grid. These homes are heavily insulated and built with smaller, highly efficient HVAC systems.

They produce electricity with solar and sometimes wind powered systems. Since renewable energy systems like these produce energy only when the sun and wind are available, these homes need to draw power from the grid. On the other hand, they also produce more power than is needed a certain times. Then they sell electricity into the grid often during times of highest demand such as the daytime (which also happen to be the most inefficient and costly times for power companies to supply energy). If well built, the net energy sold can exceed the amount purchased, thus adding to the overall supply of energy in the community.

A few net zero homes are being built in Europe and the U.S. Their cost is somewhat higher than that of standard homes but this premium will diminish. The pace at which their production

increases, and the pace at which the energy efficiency of homes in general increases, will depend on various factors. These include including the cost of energy; local standards; and national policies seeking to reduce dependency on foreign energy sources and the impact on the climate. Whatever the pace this trend will continue until the net zero energy home is the standard for newly built homes.

The Urban Century – Re-urbanizing the American Suburbs

Many factors are converging to shift the housing markets from the traditional American cul-de-sac suburbs to the newer form of suburban town center as well as to the central parts of those cities with vibrant 24/7 downtowns.

- Married couples without children (including empty-nesters) will be the fastest-growing household type, followed closely by single person households.
- The aging Baby Boomer cohort is either staying put in their suburban homes or, if and when they can, selling them and moving closer to jobs and urban amenities.
- The Younger Boomers already have their suburban homes. Even if they wish to buy a new one, and are able to sell their existing one, such a move does not add to the supply of suburban homes.
- The prime group of move up buyer for new suburban homes is Generation X, a significantly smaller group. Their ability to sell their existing homes is constrained by the market today and many find themselves with homes which are "underwater." When they do move they will there are already a sufficient supply of modestly priced suburban homes to move up to.
- Generation Y is not yet ready to move to the traditional suburban cul-de-sacs.

For these reasons, Professor Ellen Dunham-Jones of the Georgia Institute of Technology said at a recent ULI Conference on Sustainable Suburbs, that there will be an "enormous market for more urban lifestyles within the suburbs."

The trend to greater urbanization was already well underway in many cities across the U.S. before the recession. A recent study by the U.S. Environmental Protection Agency titled "Residential Construction Trends in America's Metropolitan Regions" shows that there has been a striking move back to the urban core in many markets. In other markets, this re-urbanization is small but growing; elsewhere it has been negligible.

The study looked at the 50 largest metropolitan regions in the United States from 1990 to 2007 and concluded that ". . . in roughly half of the metropolitan areas examined, urban core communities dramatically increased their share of new residential building permits." For example:

- In 15 regions, the central city more than doubled its share of permits.
- In the early 1990s, New York City issued 15 percent of the residential building permits in the region. During the early part of the past decade it averaged 44 percent.
- The city of Chicago saw its share of regional permits rise from 7 to 23 percent over the same period, while Portland, Oregon, went from 9 to 22 percent and Atlanta, Georgia, went from 4 to 13 percent.
- The increase has been particularly dramatic during the past decade; data from 2007 show the shift inward continuing in the wake of the real estate market downturn.

This acceleration of residential construction in urban neighborhoods reflects a fundamental shift in the real estate market. In fact, if core urban suburbs are included—i.e., those closest to the central city—more than one-half of all residential permits in New York, Chicago, and Los Angeles were in the urban core in 2007, the highest in decades.

Suburban town centers are demonstrating great market resilience. In the Washington, DC metro region, for instance, housing prices in places like Bethesda, MD, and the Ballston to Roslyn corridor in Arlington have remained stronger through the current recession than prices in the outer suburbs such as Loudoun and Prince William Counties. Public policy is changing as well. Policies at the federal, state and local level are beginning to encourage more compact development in an effort to use less oil and to reduce the emissions of greenhouse gasses caused by cars and trucks. After all, the greenest energy efficient building located in an outer ring greenfield uses more energy than an average building in an urbanized area.

The challenge presented by this re-urbanization is that once the economy recovers and household formation resumes, the demand for urban housing will greatly outstrip the supply. This imbalance is likely to continue for the rest of the current decade and beyond. Producing enough urban housing to meet the demand is that most urban housing, even in the suburbs, requires infill development, which is time consuming and costly.

The obstacles are well known: hard to assemble and expensive land; intense opposition to development from community leaders, over-democratized development review processes; complex and often out of date planning, zoning and building codes; and more complex and expensive construction types needed to obtain economic densities. Efforts are being made at the local level to address these problems but unless a radical and revolutionary shift occurs in thousands of localities across the country, all too many members of Generation Y and immigrants will be forced to move well away from the urban and suburban town centers they would chose were they available and affordable.

The challenge to ULI is to help bring about the radical reformation of local rules needed to permit faster and more affordable infill development. ULI can also help the industry better understand the importance and opportunity to be found in building communities on the outer edges which contain real urban town centers and housing affordable to the whole range of the market. Active and farsighted public policies may help these outer ring suburbs grow into new satellite towns, much like the "Garden Cities" envisioned so long ago by Ebenezer Howard.

Regional Winners and Losers

As metropolitan regions urbanize, not all will grow at the same rates; as is often the case, even during a time of continuing population growth, there will be regions which grow slowly or not at all. Which these will be are likely to shift from what they have been in past decades.

Job and population growth go hand in hand, and it is often hard to tell the driver and the result. The migration to the Sun Belt, for instance, produced millions of new jobs as new homes, stores and other amenities were created for the incoming migrants.

This trend has seen a sharp shift in the past year. In December, 2009, the U.S. Census Bureau reported that the Sun Belt migration has come to a sudden halt. Population growth in four of the fastest growing states has halted. In Arizona it has slowed precipitously, dropping to eighth in overall growth rate from first three years ago. In Florida, Nevada and California, there was a net migration out of the state for the first time in decades.

Florida's case is particularly dramatic. It has moved from being the state with the most net domestic migration from July, 2001 to July, 2005 down to 45th with a loss of 31,179 people to other states from July 2008 to July 2009. In terms of its total growth rate with foreign arrivals included, Florida now ranks 32nd, down from third in 2002.

Similarly, Nevada has fallen to 17th in total growth, after leading the country from 2000 to 2004. It now ranks 36th in domestic migration, losing 3,801 people after adding more than 170,000 from other states from July 2003 to July 2006.

Texas, on the other hand, was the big winner, adding 231,539 people, more than any other state and also more than Florida, Arizona, California, Nevada and Colorado, combined. Other states improved their positions as well. Massachusetts, New York and New Jersey, for instance, are holding on to more residents than in past years. Likewise, California's net out migration has dropped from 99,000 people as of July, down from 313,000 three years ago.

Robert Lang, co-director of Virginia Tech's Metropolitan Institute, has noted that if current trends play out, three-fifths of that growth would occur in 20 'megapolitan' regions. "Imagine a - contiguous span of populated land from Portland, Maine, to Richmond, Va., the joining of

Carolina's Research Triangle with Georgia's Atlanta, the meeting of the Puget Sound and the Willamette Valley," says Charlie Hewlett, of RCLCo.

These sudden shifts in migration patterns may be signs of things to come or temporary blips. What is clear is that cities with strong 24/7 downtowns have fared better during this downturn than those without. The same is true in the suburbs; the inner suburbs and suburban town centers have fared far better than the outer suburbs with stronger home prices and lower foreclosure rates.

The other factor is the economy of the region. This is in turn impacted by whether the region is deemed a desirable place to live by those in the top, limited talent pool of educated and creative workers. For this reason cities such as Seattle, San Jose, San Francisco and Washington, DC, New York, San Diego, and Los Angeles are likely to do well over the longer term. Even Miami, despite one of the steepest drop in home prices in the U.S., is likely to recover over time as long as it continues to be viewed as the capital of South America.

Conclusion

The most difficult issue to predict is the impact of the current housing crisis on those who have suffered the most from it. Six million or more households will have been forced out of their homes by the current wave of foreclosures by the end of 2010 with more in 2011, over 15% of all households with mortgages. This will impact 12 to 15 million people, including children and young families. Their credit will be impaired for the next ten years and their housing options limited. The emotional impact on the children and parents and disillusion about the “joys” of homeownership will be intense; new attitudes to homeownership and the American Dream will emerge. The need for housing assistance is already greater than the federal government can meet. State and local governments are cutting budgets and reducing services as tax revenues decline especially in areas of high foreclosures. The impacts of this crisis will extend well into the future.