This Time It's Different! Or Is It?

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During the dot-com bubble, "it's different this time" was a common response to the sometimes wild valuations some tech firms received. Ultimately, we learned that things really were not that different from other business cycles—it just took longer for the cycle to turn. To distinguish between a permanent change and an unusually long cycle is difficult, if not impossible. The slow recovery in residential investment raises the questions: Are we experiencing a longer cycle, or has there been a more permanent shift in the structure of the housing sector? Can we tell if things are really different this time?

One element that differentiates the current recovery from previous ones is the slow pace of the housing sector's growth. After bottoming out in early 2011 and following an upward trend for two years, national new house sales on a seasonally adjusted basis have been essentially flat since January 2013 and are at a pace about half that of 2000–01. In May 2014 speeches, Fed Chair Janet Yellen and Reserve Bank presidents William Dudley, Charles Plosser, and John Williams all cited a slowing housing sector, in the face of strong fundamentals, as a source of economic uncertainty.

Current and expected house prices, apartment rents, mortgage interest rates, demographics, banks' willingness to lend, consumer balance sheets, and tastes and preferences for housing services all affect residential investment and hence the economy. As a way to make sense of these many factors, I split the factors into the "4 As" of housing: affordability, availability of credit, access to credit, and appeal of homeownership. Though we can't pin the recent softness in housing on any one factor, examining the "4 As" does reveal what we know, what we don't know, and what we need to research further.

More questions than answers

In a recent post on the Atlanta Fed's *Real Estate Research* blog realestateresearch.frbatlanta.org/, I touched on the affordability and availability dimensions. In sum, affordability as measured by

How will housing preferences such as size and density change when couples start having families?

indexes such as the National Association of Realtors' should not overly concern us, given that mortgage rates are still pretty low and house prices in many areas have not rebounded to prerecession levels. Regarding the availability of credit, recent bank lending data is consistent with (1) banks' continued interest in mortgage origination and (2) their return to construction and development lending as a line of business.

Alas, when we look at the accessibility of credit and the appeal of homeownership, we end up with more questions than answers—and we see that these factors may even be a source of things being "different this time."

It is not clear that the accessibility of mortgage finance, which refers to the attributes of a potential borrower that will qualify the borrower for credit, has improved broadly to the extent needed to boost housing. In its first-quarter 2014 flow of funds data release, the Fed reported that aggregate household net worth had reached a new record high. Despite this new high, improvements in household balance sheets have been uneven and have favored older households that own their homes.

Analysis from the St. Louis Fed indicates that the wealth of households headed by someone under the age of 40 has been much slower to recover from the Great Recession than has that of households headed by someone aged 40 years or more. The homeownership rate of younger families has plunged due to foreclosures and delayed entry into homeownership. Consequently, younger families were less likely to benefit from the recent house-price gains that helped rebuild homeowners' equity and household net worth.

The economic plight of millennials

To make matters worse, younger households are also more likely to have student loans as part of their balance sheet. According to Equifax, outstanding balances on student loans ballooned from roughly $700 billion in 2009 to roughly $1.1 trillion in the fourth quarter of 2013. One thought is that recent graduates have less access to mortgage credit, given that either the burden of student debt impedes accumulation of a sufficient down payment or it thrusts buyers above the 43 percent debt-to-income (DTI) ratio that the qualified mortgage (QM) rule dictates. Hence, recent graduates are unable to make a positive contribution to the housing recovery due to limited access to mortgage credit.

While shouldering student debt certainly does not help access to mortgage credit, two factors make student loans less likely to be the primary cause of housing's slow recovery. First, mortgages guaranteed or insured by the government or those made by small lenders and kept in their portfolios do not need to meet the DTI limit of QM standards, which were intended to make certain that borrowers had a reasonable ability to repay their mortgages. According to the Consumer Financial Protection Bureau CFPB, approximately 92 percent of mortgages issued prior to the QM rule would qualify under the new rules. Though financial institutions can make mortgages that do not meet QM standards, many institutions appear reluctant to do so considering the liability they could face if a borrower is unable to service the mortgage. Second, people have many ways to obtain a mortgage with less than 20 percent down (including Federal Housing Administration loans). Thus, the evidence regarding the direct impact of student loan debt on access to credit is suggestive but not conclusive. Could it be that rather than being *unable* to buy a house, consumers—especially younger adults—are more *unwilling* to own and would rather rent?

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Millennials move on

If the accessibility and availability of mortgage finance were not an issue, would there be a strong desire to purchase a home? Perhaps we have confused someone's *ability* to become a homeowner with that person's *desire* to become a homeowner. Two things we know are going to happen are that the baby boomers will retire and the millennials (or "echo boomers") will continue to form households.

As discussed in an article in the January–April 2014 edition of *EconSouth* (frbatlanta.org/pubs/econsouth/14q1_summary_millennials.cfm), the millennials watched the Great Recession dramatically reshape the landscape of employment and consequently also their general expectations—including those regarding housing. Furthermore, the housing that millennials desire may differ from the housing that the baby boomers are selling. If careers in the future are going to be more varied, it may be that freedom to move around is more desirable. Assuming that renters are more mobile, our society may have shifted from one that values homeownership to one that values mobility. In the short run, things may seem quite different given that millennials have deferred big decisions such as forming households, getting married, and starting families. How will housing preferences such as size and density change when couples start having families?

It would be nice to identify one factor as *the* cause of housing's slow recovery. In fact, many factors have been at play and most are not independent of each other. It is this joint determination, or endogeneity, that makes it difficult to say whether things really are different this time. ∎