USAA Real Estate Company

HOW WILL LOWER DOWN PAYMENTS AFFECT HOUSEHOLD FORMATIONS?

RESEARCH ARTICLE

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According to the National Association of Realtors, America's first-time homeownership rate fell to 33% in 2014 – the lowest level since 1987. In an effort to boost home purchases, government officials have implemented a new down payment directive, but we are not convinced it is enough to reverse downtrends associated with housing sales.

Fannie Mae and Freddie Mac recently announced they would offer mortgages with a down payment as low as 3%, a 40% decline from prior loan minimums. Theoretically, lower down payments should increase home sales. In a recent Fed survey, renters cited unaffordable down payments and high closing costs as the main reasons preventing them from becoming owners. Consequently, government officials hope this new plan will attract more homebuyers; however, we believe that other factors will continue to hamper the housing market.

Not having a down payment is indeed an impediment to homeownership, yet two other issues have also plagued home sales. In particular, credit availability has been lacking. Mortgage data sources vary regarding credit scores, but most analysts agree that Americans have an average score below 700. Yet, applicants approved for mortgages had an average score of 726 in October, according to Ellie Mae. Therefore, a gap remains between lenders and most potential homebuyers. Secondly, wage growth has not kept pace with home prices. Despite our economy's booming labor market in 2014 (10 consecutive months with more than 200K jobs) wage increases have only improved 2.1% over the last 12 months. Meanwhile, home values increased 4.8% during that same period, according to the S&P/Case-Shiller Index. Thus, even though down payment requirements are lower, credit availability remains tight while home values continue to rise twice as fast as wage growth.

In the end, this recent down payment mandate is not likely to have a substantial impact on home sales without addressing other structural housing issues. For now, multi-family properties, which have benefitted from a decline in homeownership in recent years, are poised to capture a larger share of U.S. household formations in the near term, albeit at a slightly slower pace.

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