

REPORT SUMMARY

Introduction

As we begin 2008, the U.S. housing and mortgage markets are in the midst of what now accurately can be characterized as a housing bust. Mounting anecdotal reports from metro areas across the country – both recognized housing hot spots and slow-growth markets – indicate that middle-income households are the hardest hit by this ongoing crisis. But it is wrong to assume that the dramatic downturn is easing the housing-cost burden on middle-income families either in the short-term or over the long-term. This report shows that these families remain unable to access affordable homes in their communities under current market conditions, and that policy solutions focused on this crisis will only be successful if they are implemented in tandem with a long-term strategy for keeping our communities affordable.

In 2000, a historic run-up in home prices began in the United States. Since then, affordability has become a major concern, not just for the lowest income segments of the population, but also for middle-income families. As a result, critical workers – firefighters, office personnel, retail associates, nurses and teachers – and their families increasingly have been priced out of homeownership in most major metropolitan areas. Affordable home purchase and rental options available to these groups have diminished and, even where available, often are accessible only in locations far from jobs, schools and needed services.

As the housing market began to soften in late 2006, declining home prices in some metropolitan areas suggested potential opportunities for price relief. While there is considerable disagreement as to the severity of the housing bust and when the situation will turn around, there is consensus that the downturn has not hit bottom. Yet, home prices are only one of a complex set of factors that influence home affordability. As a result, even in cases where home prices have fallen significantly, there has not been a corresponding improvement in affordability for middle-income families.

Homes for Working Families was founded in late 2005 to focus exclusively on working families – families who earn between 60 percent and 120 percent of area median income – who cannot afford to buy or rent in communities near their places of work. We are dedicated to advancing policy changes that enable more of America’s working families to find safe, good-quality homes they can afford. As part of this strategy, we serve as an information clearinghouse by offering best practices, model policies, and academic and public opinion research to advance policy changes.

In an effort to better understand the effects of the current housing turmoil on the families we serve, Homes for Working Families commissioned Moody’s Economy.com to analyze the evolving nature of affordability for the lower and middle-income segments of the population and how the affordability situation plays out in varying market contexts.

Analyzing Affordability in Metropolitan Housing Markets provides the first quantitative analysis that has been conducted to determine the effects of the housing crisis by geographical area, income group and duration. This is significant because most factors that affect affordability are specific to, and vary greatly by, metropolitan area. Examining affordability for middle-income households in specific metropolitan areas not only provides a more accurate picture of the challenges these families face, but also informs the development of local solutions to address these challenges.

As you will see in the following pages, the overarching findings of this research confirm what we have been hearing directly from families all over the country – that the housing landscape facing middle-income households remains bleak. Affordability has diminished and has not improved, despite declining house prices. And, while house prices are expected to continue to decline, they are unlikely to fall sufficiently to restore the affordability levels last seen in the 1990s. The study corroborates anecdotal evidence, providing the first hard data on the susceptibility of middle-income households to affordability challenges and house price fluctuations, as well as the ways in which these negatively affect new homebuyers and existing homeowners.

It is clear from the findings of this report that the prohibitive affordability gap middle-income Americans currently face will continue to threaten their ability to access safe, good-quality homes in the coming years. National and local policy-makers must understand that the current drop in home prices will not solve the home affordability problem for millions of middle-income Americans.

Homes for Working Families believes elected officials, private sector leaders and the nonprofit community must come together now to enact immediate measures and develop comprehensive policy solutions that will address this problem over the long term.

National policy leaders should move quickly to agree on solutions such as expanding the low-income housing tax credit program, raising the Freddie Mac and Fannie Mae conforming loan ceilings and passing FHA reform.

Simultaneously, local leaders in high-cost, unaffordable metro areas must take action. This may come in the form of near-term solutions such as credit counseling and protecting access to mortgage markets so that hard-working families can purchase the current excess housing inventory. Longer-term solutions, such as making unused, publicly owned land available for affordable homes and expediting permitting and review processes to reduce production costs, also should be pursued.

Analyzing Affordability in Metropolitan Housing Markets is the first in a series of analyses from Homes for Working Families of how working families fare, both nationally and by market, in terms of home purchase and rental affordability. Homes for Working Families will use the results of this research to educate policy-makers at the federal, state and local levels, housing and mortgage professionals, and employers, and help them develop and agree on workable solutions.

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Executive Summary

- This report focuses on housing affordability for middle-income households in light of recent developments in house prices, interest rates and mortgage markets. Middle-income households for this study are defined as those earning between 60 percent and 120 percent of area median income. Understanding the barriers to housing affordability for this middle-income group is important as these households generally do not qualify for affordable housing programs and are experiencing rising cost burdens. The regional variations in housing affordability also are important, as house prices and supply conditions vary considerably by location.
- Assessments of changes in housing affordability and expenditures by income group over time, especially when looking at states and metropolitan areas, are hindered by the lack of up-to-date, comparable information, as well as readily available data on the distribution of house prices. This report adopts two innovative approaches to address these limitations. Both approaches utilize recently available data to generate econometric models that can estimate relevant measures of housing affordability that middle-income households face.
- The first approach uses the Case-Shiller Home Price Indexes, from Fiserv Lending Solutions, and data from the American Community Survey (ACS) to gauge affordability of homes most likely purchased by middle-income households for 40 metro areas.
- The second approach examines housing affordability from the expenditures point of view, i.e., a model is created that estimates both mortgage payments and rental payments for different states and metro areas for various income groupings. The model also evaluates how these payments have changed in the past several years. These estimates are based on detailed survey data from the ACS.
- There are three principal findings of this study.
 - First, not only has the fall in affordability been particularly dramatic for lower- and middle-income earners, but recent adjustments in house prices since they peaked in 2005 have improved affordability only modestly. The declines thus far have not been nearly enough to bring affordability back to normal levels. The

metro areas focused upon in this report have seen almost no improvement in affordability. The most significant negative influence on housing affordability – when looking at house prices, mortgage interest rates and changes in income – has come from the rapid rise in house prices that has occurred since 2000, according to analysis of the Case-Shiller indexes. Middle- and lower-income households have less access to homes affordable to their income levels than higher-income households according to analysis of ACS data.

- Second, there is significant regional variability in housing affordability trends and the differences between geographic areas are widening. Compared with the end of the 1990s, there is now twice as much dispersion in the affordability indexes by geographic area, driven primarily by diverse movements in house-price appreciation. The geographic areas that are currently least affordable are those that have experienced the fastest rates of house-price appreciation, especially metro areas in California, Florida and parts of the Northeast.
- Third, fallout from the subprime mortgage turmoil will have the greatest negative impact on middle-income earners in the least affordable markets. In these markets, borrowers stretched to attain homeownership during the housing boom. The monthly payments on many of their mortgages are rising as they reset to higher interest rates. Tighter credit also threatens current homeowners as it places additional pressure on those with existing mortgages who are having difficulty making payments and/or refinancing in a tough housing market.
- Additional findings include:
 - Affordability has worsened proportionately more for those at the lower end of the income distribution, which includes middle-income households, making the last few years a particularly difficult period for this group.
 - On average, if there had been no changes in incomes or interest rates since 2000, then housing affordability would have worsened by 89 percent as a result of the recorded rise in house prices alone. Rises in incomes since 2000, offset about 23 percent of the erosion in affordability and drops in interest rates had a mildly positive influence.

- Mortgage and rental payments, as a share of income, have risen significantly across most states in recent years.
- Over the next year, housing affordability will remain diverse and variable across states and metro areas and the income groups within those areas. The accelerating declines in house prices will make homeownership more achievable for some households. However, these effects will be at least partially neutralized by a rise in mortgage rates and reduced availability of mortgage credit, especially for middle-income households. Moreover, the fall in house prices will reduce the equity that those with existing mortgages have in their homes, which in turn will raise the risk of default and make it more difficult to lower mortgage burdens by refinancing.
- In the medium term, the combination of declining house prices and improvements in incomes will see housing affordability improve for some middle-income households, in spite of slightly higher interest rates. However, housing affordability for middle-income earners will remain well below the levels averaged in the late 1990s and early 2000s.