



Many Starter Homes Have Shifted from Owner-Occupancy to Rentals

Persistently weak participation of first-time buyers in the home sales market has slowed the housing recovery.¹ Both demand- and supply-side factors have suppressed home purchase activity among would-be first-time buyers. Early in the economic recovery, young-adult homeownership demand was restrained by high unemployment and declining real incomes.² However, as the labor market has continued to heal and as young-adult incomes have begun to recover, attention has increasingly focused on supply-side constraints facing young potential homeowners. Tight mortgage credit is often cited as an obstacle, but in recent months attention has shifted to a low inventory of for-sale starter homes as an impediment to the return of the first-time buyer.³

Subdued construction of modestly priced houses is frequently cited as a reason for the limited supply of starter homes for sale.⁴ Another factor that has been noted often, but analyzed infrequently, is the increased use of single-family homes as rental properties during the housing bust and recovery. To explore the shift toward renting, this edition of *Housing Insights* analyzes net changes since the onset of the housing downturn in the number of starter homes – here defined as single-family detached units with less than 2,000 square feet of floor area – that are owner- and renter-occupied.⁵

The analysis reveals that the stock of owner-occupied starter homes declined by more than 1 million units between 2005 (roughly the peak of the housing boom) and 2013 (the most recent year for which data are available), whereas the inventory of renter-occupied starter homes rose by approximately 2 million units during this period. The greater than 1 million unit decline in owner-occupied starter homes during this period contrasts with an estimated net increase of more than 1 million owner-occupied single-family homes of 2,000 square feet or larger. In addition, the analysis finds that home builders have moved away from building new starter homes, with the proportion of new single-family (detached and attached) homes completed that have less than 2,000 square feet dropping from 40 percent in 2005 to 32 percent in 2015.

As single-family investors swooped into the market in the wake of the housing bust and converted homes from owner- to renter-occupancy, they helped to stabilize prices, remove excess vacant units from the market, and absorb a bloated inventory of foreclosed homes. While serving these important functions, they have also contributed to the starter-home shortage that now appears to be slowing the return of first-time buyers to the housing market.

Defining “Starter Home”

A starter home is often defined as one falling at the lower end of the home price distribution. Size is another defining characteristic, and accordingly this *Housing Insights* identifies starter homes by analyzing the square-footage distribution of single-family detached homes inhabited by first-time owner-occupants under the age of 35.⁶ Prior to the housing bubble, 71 percent of detached single-family units occupied by young first-time homeowners had less than 2,000 square feet of floor area, compared with 55 percent of houses occupied by other homeowners (see Exhibit 1).⁷ Data on the

¹ According to the National Association of REALTORS®, the first-time buyer share of principal residence home purchases fell for the third consecutive year in 2015 and remained near the lowest level in three decades. See National Association of REALTORS®, “First-time Buyers Fall Again in NAR Annual Buyer and Seller Survey,” Press Release, November 5, 2015, <http://www.realtor.org/news-releases/2015/11/first-time-buyers-fall-again-in-nar-annual-buyer-and-seller-survey>

² Suppressed household formation, mounting student loan debt, challenges in saving for a down payment, rising minority population shares, and delayed marriage and childbearing are also cited as factors contributing to subdued homeownership demand among young adults in recent years.

³ For a recent analysis of the declining inventory of for-sale starter homes, see Ralph McLaughlin, “House Arrest: How Low Inventory Is Slowing Home Buying,” *Trulia’s Blog*, March 21, 2016, <http://www.trulia.com/blog/trends/inventory-price-watch-q116/>

⁴ See Chris Kirkham, “Affordable Starter Homes Prove Increasingly Elusive”, *Wall Street Journal*, May 6, 2016, <http://www.wsj.com/articles/affordable-starter-homes-prove-increasingly-elusive-1462527001>.

⁵ The analysis is limited to single-family detached homes because the Census Bureau’s American Housing Survey only published the square footage of occupied single-family detached homes and manufactured homes prior to 2013. A large majority of first-time home buyers purchase single-family detached homes. According to the National Association of REALTORS®’ *2015 Profile of Home Buyers and Sellers*, 80 percent of first-time buyers who bought houses between July of 2014 and June of 2015 purchased detached single-family homes.

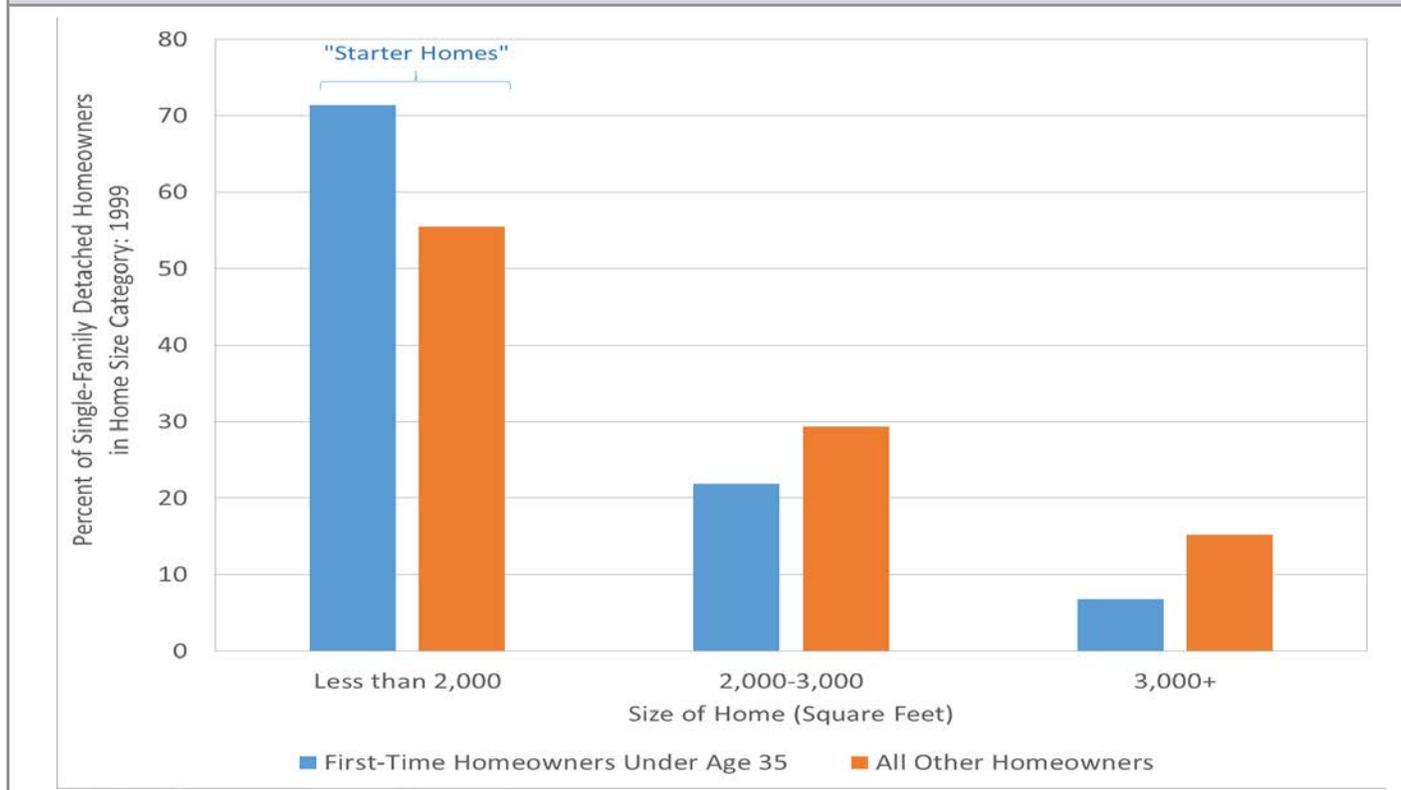
⁶ Home size, rather than price, is used to identify starter homes because the Census Bureau’s American Housing Survey, which is a key source of data for this analysis, provides information on unit size, but not price, for renter-occupied units.

⁷ To avoid possible distortions caused by the housing credit bubble and single-family homeownership boom of the early 2000s and the subsequent credit tightening after the housing downturn, Exhibit 1 uses data on the distribution of homes occupied by first-time homeowners in 1999. Data from 2001 and



characteristics of homes recently purchased by first-time buyers reinforces the reasonableness of using a 2,000 square-foot cutoff to define starter homes. According to the National Association of REALTORS®, 59 percent of primary residences purchased by first-time homebuyers between July 2014 and June 2015 were under 2,000 square feet, compared with only 32 percent of homes bought by repeat buyers.⁸ Given the high likelihood that young first-time homeowners occupy houses with less than 2,000 square feet of floor area, this size cutoff will be used to identify single-family starter homes in the remainder of this analysis.

Exhibit 1. Young First-Time Homeowners Tend to Occupy Single-Family Houses with Under 2,000 Square Feet of Floor Area



Source: U.S. Census Bureau, 1999 American Housing Survey.

More Than 1 Million Owner-Occupied Starter Homes Have Been Lost Since the Onset of the Housing Bust

Explosive growth of the single-family rental market has been a defining characteristic of the housing bust and recovery. Between 2005 and 2013, the number of renter-occupied detached single-family homes increased by approximately 3 million, accounting for more than half of the total growth in the renter-occupied stock.

Much of the growth in the single-family rental stock came from the starter home market. The number of renter-occupied starter homes expanded by nearly 2 million between 2005 and 2013, accounting for two-thirds of the growth in all single-

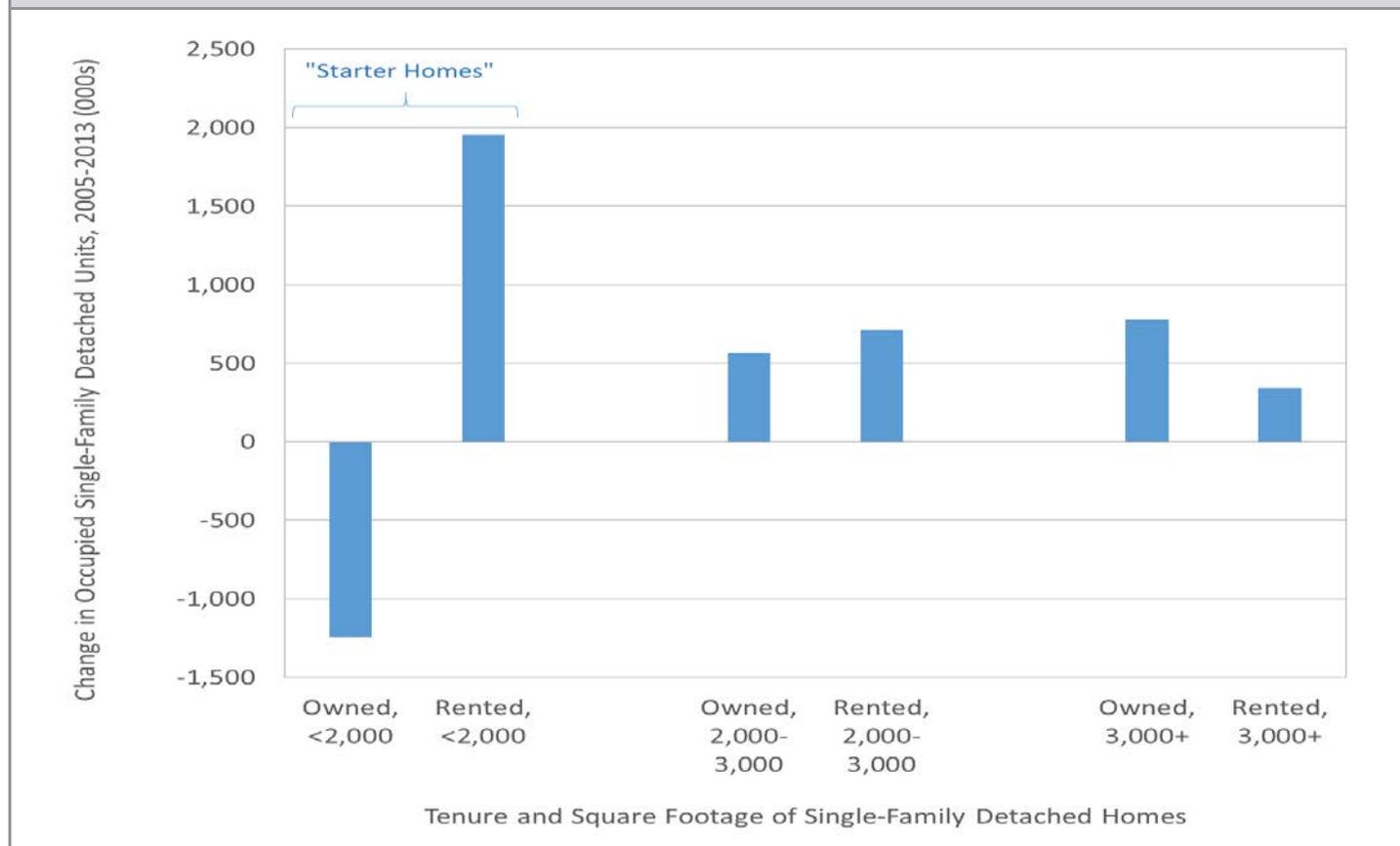
2003 showed similar, but even larger, differences in the proportions of young first-time owners and other owners residing in homes of less than 2,000 square feet.

⁸ National Association of REALTORS®, *2015 Profile of Home Buyers and Sellers*. The data on primary residence purchases covers all unit types, not just single-family detached homes.



family detached rentals (see Exhibit 2).⁹ During the same period, the number of owner-occupied starter homes fell by more than 1 million. The starter home segment was the only owner-occupied category that suffered losses during the period: The number of owner-occupied single-family detached homes between 2,000 and 3,000 square feet and above 3,000 square feet increased by more than half a million each.

Exhibit 2. Many Single-Family Starter Homes Have Shifted to the Rental Market



Source: Fannie Mae Economic & Strategic Research estimates based on data from the U.S. Census Bureau's American Housing Survey, American Community Survey, and Population Estimates Program.

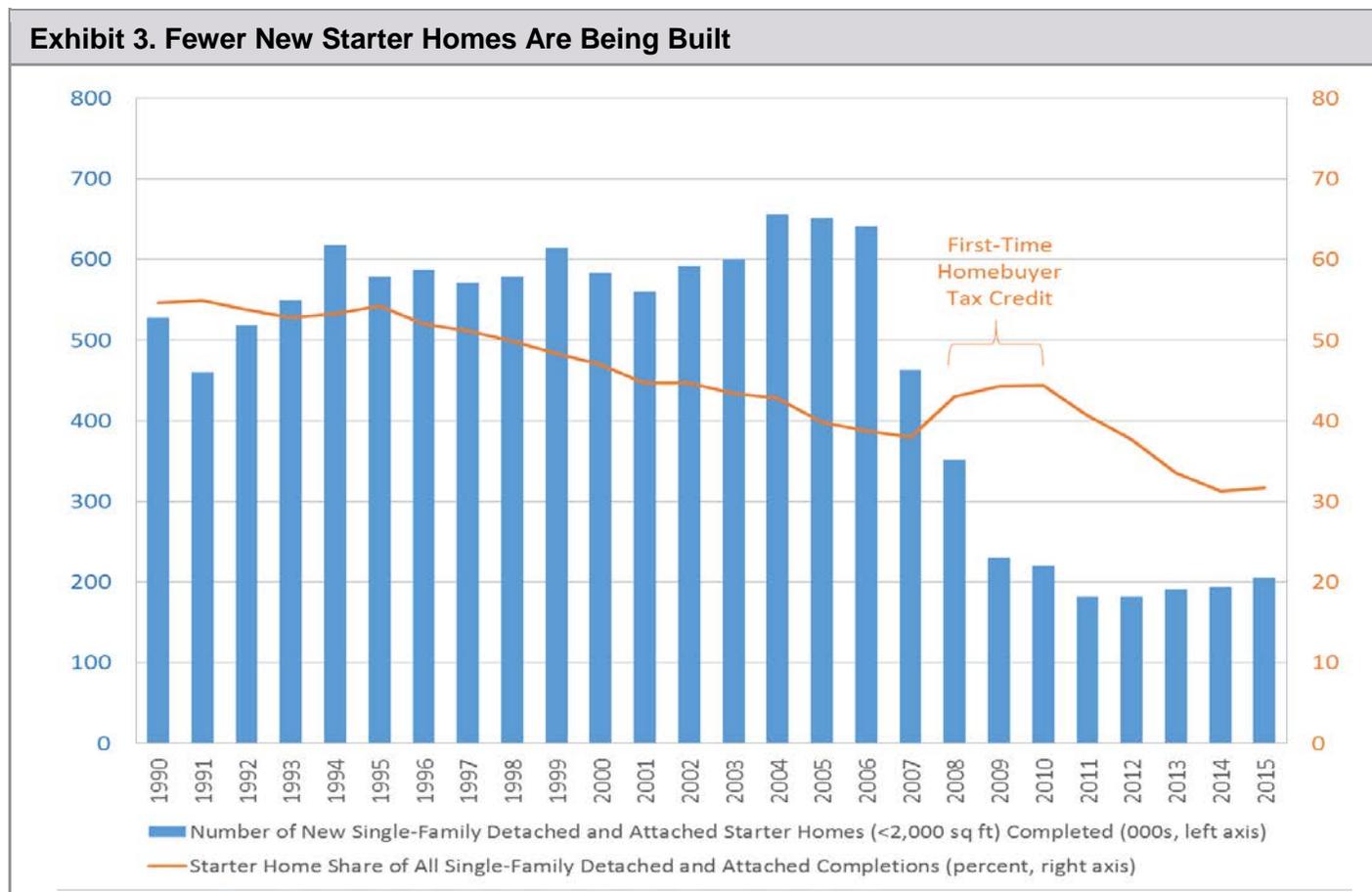
Fewer New Starter Homes Are Being Built to Backfill for Units Lost to the Rental Market

The preceding section points to a substantial shift of starter homes from the owner-occupied stock to the rental inventory. Unfortunately, new construction has been doing little in recent years to alleviate the pressures on the owner-occupied starter-home stock. In 2005, home builders completed about 650,000 single-family detached and attached homes of less than 2,000 square feet (see Exhibit 3). By 2011, starter-home completions had plummeted to less than 200,000 units per year, and have since shown little sign of rebounding. The dramatic decline in starter home construction is not simply a

⁹ The change estimates of Exhibit 2 are based on single-family detached occupied housing stock estimates by tenure and unit size that are developed in two steps. First, the square footage percent distribution of occupied single-family detached units by tenure from the Census Bureau's American Housing Survey are applied to estimates of occupied single-family detached units by tenure from the Census Bureau's American Community Survey. To develop estimates that are more consistent with the most current time series data on the total U.S. housing inventory, the results from the first step are then adjusted using the ratio of total housing units from the Census Bureau's Population Estimates Program to total housing units from the American Community Survey.



byproduct of the collapse in overall housing production during the housing bust. The proportion of newly built single-family homes that are in the starter home category also has dropped, from 40 percent in 2005 to 32 percent in 2015.



Source: Fannie Mae Economic & Strategic Research estimates based on data from the U.S. Census Bureau's Survey of Construction.

Concluding Remarks

The shift of the starter home inventory from owner-occupancy to rentals reflects, at least in part, a much-needed market adjustment in response to imbalances created by the credit bubble and homeownership boom of the early 2000s. The shift helped to remove bloated inventories of vacant and foreclosed single-family homes from the market, while also helping to meet exploding demand for rentals created by the economic downturn, foreclosure crisis, and coming of age of the large Millennial generation.

While this inventory adjustment played an important role in the housing recovery, it might also have contributed to the set of challenges facing potential first-time homebuyers by reducing the supply of starter homes available for owner-occupancy. In turn, the tight starter home supply and associated rapid price gains in the lower tiers of the home sales market are reducing first-time home buyer affordability.¹⁰

¹⁰ CoreLogic's national single-family house price index increased by 5.7 percent for the year ending in June of 2016, but the increase for homes priced at 0-75 percent of median was 8.1 percent during the same period. For additional discussion of supply and price dynamics affecting first-time home purchase affordability, see Fannie Mae Economic & Strategic Research Group, *January 2016 Economic and Housing Outlook: 2016: Affordability Constrains as the Expansion Matures*, January 11, 2016 <http://www.fanniemae.com/portal/research-and-analysis/emma-archive.html>.



Future market adjustments might shift some of the single-family rental inventory back to owner-occupancy. Indeed, some institutional investors in the single-family rental space have launched initiatives that make rental units available for purchase by their tenants.¹¹ However, given the substantial obstacles to homeownership faced by many first-time buyers, consideration might be given to additional private and public initiatives for expanding the starter home supply, such as expanding rent-to-own financing options and reviewing development regulations, impact fees, and construction approval delays that might be hindering the building of entry-level homes.¹²

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¹¹ See Heather Perlberg, "Blackstone Tenants Get a Shot at Buying Their Rental Houses," *Bloomberg*, July 5, 2016, <http://www.bloomberg.com/news/articles/2016-07-05/blackstone-s-tenants-get-a-chance-at-buying-their-rental-houses>

¹² Based on a survey of home builders, the National Association of Home Builders estimates that, on average, regulations at all levels of government account for about one-quarter of the cost of a new single-family home. See Paul Emrath, "Government Regulation in the Price of a New Home," *Housing Economics*, May 2016, http://www.nahbclassic.org/generic.aspx?sectionID=734&genericContentID=250611&channelID=311&_ga=1.185446955.369810761.1454704912. For a recent analysis of the associations between development regulations and the price elasticity of housing supply, see Ralph McLaughlin, "Is Your Town Building Enough Housing?" *Trulia's Blog*, July 19, 2016, <http://www.trulia.com/blog/trends/elasticity-2016/>