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Income Declines Drive Increase in Renter Cost Burdens

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"The proportion of renters paying more than 30 percent of income for housing rose from 49.8 percent to 53.0 percent between 2006 and 2010, whereas the share of owner-occupants with housing cost burdens remained flat at just under 31 percent."

Introduction

The U.S. homeownership rate fell last decade by the largest amount since the 1930s, leading some to proclaim the emergence of a "rentership society."[1] Homeownership rate declines have been demographically and geographically widespread and have been accompanied by rapid expansion of the single-family rental market.[2]

The shift from owning to renting will effect change in other aspects of the housing market, such as the composition of new housing production, the characteristics of renters and owners, and the relative costs of renting and owning. This *Data Note* utilizes American Community Survey (ACS) data to examine changes in renter and homeowner costs, and more specifically focuses on the proportion of households with "housing cost burdens," which are here defined as housing costs, including utilities, that account for 30 percent or more of pre-tax household income. The *Data Note* also tracks changes in housing cost burdens by age of householder, housing structure type, and state, and explores rent and income trends underlying recent changes in rental cost burdens.

The analysis reveals that the incidence of housing cost burdens has increased among renters during the last four years, but has remained stable among owner-occupants. Renters spending at least half of their income for housing have accounted for the bulk of growth in rental cost burdens in recent years. A decline in renter incomes that exceeded a deceleration in rents has been the principal factor behind the rise in renter cost burdens.

Cost burdens among renters have increased for young- and middle-age households and have risen for all housing structure types, including the fast-growing single-family segment. The southeastern United States, which has experienced particularly large declines in homeownership rates among young households, also has experienced rapidly rising housing cost burdens for young renters.

The rise in rental cost burdens has two potential implications. First, the sharp slowdown in renter income growth suggests that a strong economy that supports household income gains might help to slow or reverse the increase in rent burdens. Second, if the increase in rent burdens across housing structure types that was observed between 2006 and 2010 continues, then preserving and expanding the stock of both single-family and multifamily affordable rentals might offer one approach for addressing rental affordability problems.

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[1] Gittelssohn, John, "U.S. Moves Toward Home 'Rentership Society,' Morgan Stanley Says." *Bloomberg*, July 20, 2011. See also Rich, Motoko, "In a Depressed Housing Market, Renters Abound." *The Boston Globe*, February 24, 2012.

[2] See Cevarr, Michael, "Recent Homeownership Gains Erased During Housing Collapse. A Return to Sustainable Levels?" *Fannie Mae Data Note* (1, 7), September 2011; Simmons, Patrick, "A Bad Decade for the American Dream," *Fannie Mae Data Note* (1, 8), October 2011; and Kurth, Ryan, "Single-Family Rental Housing – The Fastest Growing Component of the Rental Market," *Fannie Mae Data Note* (2, 1), March 2012.

Measuring Housing Affordability

Home Purchase Affordability Indices

Well-known home purchase affordability indices, such as the National Association of REALTORS®' Housing Affordability Index and the National Association of Home Builders/Wells Fargo Housing Opportunity Index, assess the ability of a "typical" (e.g., median-income) family to purchase a home given prevailing house prices and interest rates and assumed mortgage terms. Because of recent home price declines and record-low interest rates, these metrics have indicated historically favorable conditions for home purchase in recent quarters.[3]

Housing Cost-to-Income Ratios

In contrast to the home purchase affordability indices, housing cost-to-income ratios, such as those used here, assess the affordability of the housing unit currently occupied by a given household. This approach compares a household's monthly housing costs, including utilities, to its pre-tax income to determine if the ratio surpasses a maximum affordable level. For most federal programs, this maximum level currently stands at 30 percent.

For renters, the housing cost component of the cost-to-income ratio is measured by gross rent, which includes contract rent plus the estimated monthly cost of any utilities (electricity, gas, water, and sewer) and fuels (oil, coal, kerosene, wood, etc.) not covered by the contract rent. Units for which no rent is paid are excluded from the calculations.

For owner-occupants, housing costs are measured by "selected monthly owner costs," which include payments for mortgages, deeds of trust, contracts to purchase, or similar debts on the property (including payments for first and subordinate loans); real estate taxes; fire, hazard, and flood insurance; utilities; fuels; and, if applicable, condominium fees. Costs for owner-occupied mobile homes also include, where applicable, installment loan payments, personal property taxes, site rent, registration fees, and license fees.

For both renters and owners, the denominator of the cost-to-income ratio is measured by household income prior to taxes, with those households reporting no income or a net loss excluded from the calculations.[4]

Households paying 30 percent or more of income for housing are typically considered to have a housing affordability problem, or to be "cost-burdened."[5] Although the 30 percent of income standard has long been used to identify households with housing affordability problems, it has limitations. For example, the standard does not differentiate households by income, and thus does not account for the fact that many upper income households can comfortably handle housing expenses that exceed 30 percent of income without straining the family budget, whereas poor families might be severely affected by housing costs that consume a far smaller share of income. In addition, some elderly households can comfortably sustain housing cost-to-income ratios that exceed the standard because they can draw down on assets accumulated over a lifetime to help meet current housing expenses.

As Rental Markets Have Expanded, So Too Have Rental Cost Burdens

Although home purchase affordability has improved because of falling home values and record-low interest rates, affordability as measured by housing cost-to-income ratios has deteriorated. The proportion of households with housing cost burdens increased from 36.5 percent to 38.1 percent between

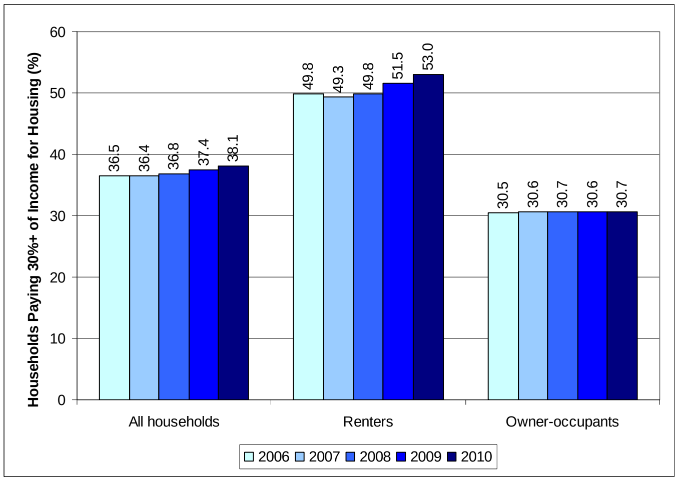
[3] During the fourth quarter of 2011, the composite and first-time buyer versions of the Housing Affordability Index and the Housing Opportunity Index reached record levels.

[4] The ACS asks about income received during the past 12 months. Because the ACS collects data throughout the entire calendar year, reference periods for adjacent ACS years of income data will overlap. For example, the reference period for the income estimate from the 2010 ACS (January 2009 through November 2010) overlaps with that from the 2009 ACS (reference period of January 2008 through November 2009). In addition, because some of the components of housing costs reflect expenditures at the time of survey rather than average costs over the past 12 months, the reference periods for income and housing cost data will not align precisely. Because of these factors, all time labels used in the text and exhibits refer to the year of ACS data collection and not necessarily to the actual reference period described by the data. For additional information on the cost and income components used in the calculations, see U.S. Census Bureau, *American Community Survey: 2010 Subject Definitions* (http://www.census.gov/acs/www/Downloads/data_documentation/SubjectDefinitions/2010_ACSSubjectDefinitions.pdf)

[5] Households with cost burdens are further differentiated into those who are "severely cost-burdened" (paying 50 percent or more of income for housing) and "moderately cost-burdened" (paying 30 to 49.9 percent of income for housing).

2006 and 2010 (Exhibit 1).[6] Growth of housing cost burdens has been confined to the rental market. The proportion of renters paying 30 percent or more of income for housing rose from 49.8 percent to 53.0 percent between 2006 and 2010, whereas the share of owner-occupants with housing cost burdens remained flat at just under 31 percent.

Exhibit 1. Rental cost burdens grow, but owner burdens are stable.



Source: U.S. Census Bureau, American Community Survey

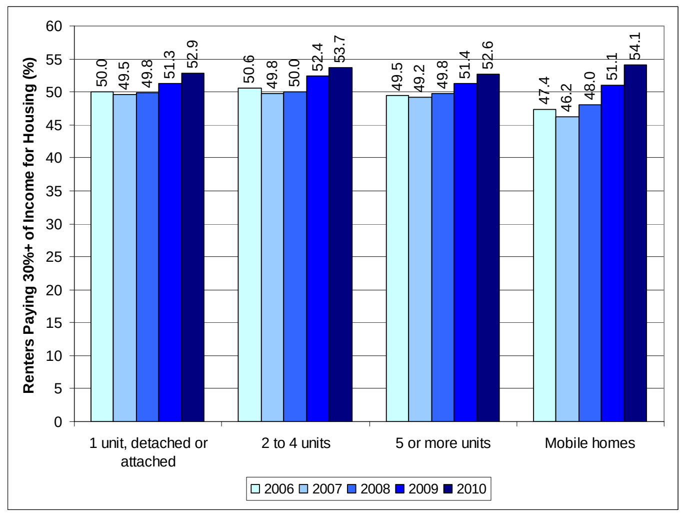
Most of the increase in rental cost burdens occurred among households paying at least 50 percent of income for housing. The share of renters with such “severe” housing cost burdens rose from 25.1 percent to 27.4 percent between 2006 and 2010, whereas those with “moderate” cost burdens increased from 24.6 percent to 25.5 percent. Among owner-occupants, severely cost-burdened households edged up from 11.7 percent to 12.3 percent of the total, and the share of owners with moderate burdens actually declined modestly.

Rental Cost Burdens Increase for All Housing Structure Types

One consequence of the recent decline in homeownership has been rapid expansion of the single-family rental market.[7] Between 2006 and 2010, the proportion of renters residing in detached or attached one-unit structures grew from 31.0 percent to 33.5 percent.

Like occupants of other housing types, the residents of single-family rentals have seen rents increase relative to household income (Exhibit 2). Between 2006 and 2010, the share of single-family renters paying at least 30 percent of income for housing grew by 2.9 percentage points, from 50.0 percent to 52.9 percent. This increase was statistically indistinguishable from that in the multifamily segment (5+ units per structure), which experienced an increase of 3.1 percentage points in the incidence of cost burdens.

Exhibit 2. All housing types experience increases in rental cost burdens.



Source: U.S. Census Bureau, American Community Survey

Nonelderly Renters Feel the Brunt of Rising Cost Burdens

The 2010 Census showed that young- and middle-age households experienced the largest declines in homeownership rates last decade.[8] These households also have experienced increasing housing cost burdens.

Between 2006 and 2010, the proportion of renters under age 35 with housing cost burdens rose by 3.1 percentage points, from 50.1 percent to 53.2 percent (Exhibit 3). Renters age 35-64 experienced an even larger increase of 3.9 percentage points, while elderly renters saw an increase of less than one

[6] Unless otherwise noted, all differences or changes noted in the text are statistically significant at the 90 percent confidence level.

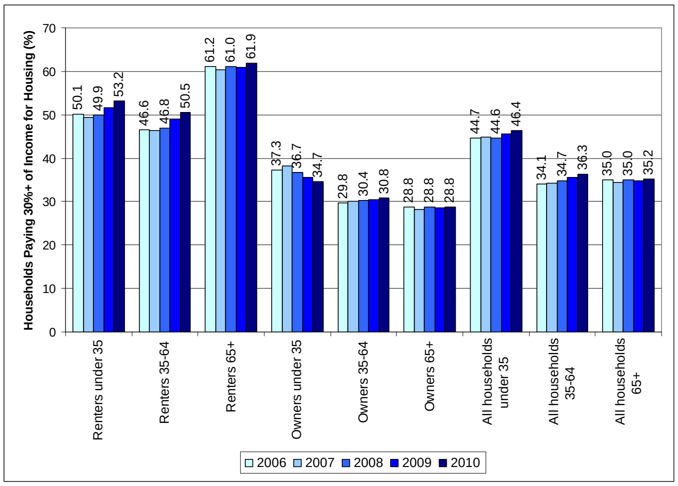
[7] Kurth, Ryan, “Single-Family Rental Housing – The Fastest Growing Component of the Rental Market,” *Fannie Mae Data Note* (2, 1), March 2012.

[8] Simmons, Patrick, “A Bad Decade for the American Dream,” *Fannie Mae Data Note* (1, 8), October 2011.

percentage point. Despite this slower growth, elderly renters still have the highest incidence of housing cost burdens of any age/tenure group.

For all age groups, growth in cost burdens for renters was greater than for owner-occupants. In the case of owners under 35, the incidence of housing cost burdens actually fell by nearly 3 percentage points between 2006 and 2010.

Exhibit 3. Growth in housing cost burdens largely confined to nonelderly renters.



Source: U.S. Census Bureau, American Community Survey

Rental Cost Burdens Rise Across the Nation

Growth in rental cost burdens has been geographically widespread. Between 2006 and 2010, 35 states experienced statistically significant increases in the incidence of rental cost burdens, whereas none experienced a significant decline. Increases in rental burdens also were widespread among young households. Between 2006 and 2010, 27 states experienced a statistically significant increase in the proportion of renters under age 35 with cost burdens, and no state showed a significant decline for this age group.

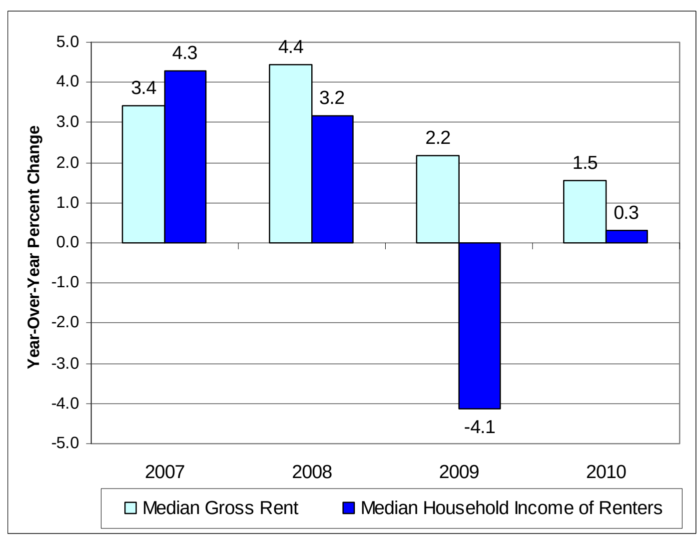
The southeastern United States experienced large declines in homeownership rates among young households during the 2000s. This region also has some of the highest incidences of, and fastest growth in, housing cost burdens among young renters (see Exhibits 4a and 4b, last page). Four states in the southeastern corner of the country (Alabama, Georgia, South Carolina, and Florida) had rates of housing cost burdens among young renters in 2010 that were greater than for the nation as a whole, and Florida had the country's second-highest incidence at nearly 61 percent. All four states experienced 2006-2010 increases in cost burdens among young renters that were larger than for the United States, with Alabama and Georgia experiencing percentage point gains that were at least twice as large as for the nation.

Behind the Bigger Burden: Renter Income Slowdown Outpaces Moderation in Rents

What lies behind the rise in rental cost burdens? Some initial insights can be gained by focusing separately on trends in the numerator and denominator of the housing cost-to-income metric.

Rent growth for the entire renter-occupied stock has outpaced renter income gains by a substantial margin in every year since the onset of the economic downturn (Exhibit 5).[9] In 2009, during the depth of the recession, rent increases remained positive while renter incomes contracted sharply by more than 4 percent. Although renter incomes have returned to slow growth during the economic recovery, they still lag rent increases by a substantial margin.

Exhibit 5. Renter income growth has lagged rent increases for three years.



Source: U.S. Census Bureau, American Community Survey

[9] It is important to note that the rent increases depicted in Exhibit 5 apply to all renter-occupied housing units with cash rent, regardless of building size or quality, and are not limited to institutional investment-quality multifamily properties.

Addressing the Growing Rental Affordability Challenge

For several years, housing market conditions have been bleak, with only the rental market showing some recent signs of rejuvenation. Rents have increased, vacancy rates have fallen, and multifamily construction has begun to climb out of its deep recessionary hole.[10] The single-family rental segment has grown particularly fast and has helped to absorb some of the REO inventory left behind by the foreclosure crisis.

Enthusiasm over renewed rental market strength should be tempered somewhat, however, by the rise in renter cost burdens. Particularly troublesome is a significant increase in the proportion of renters paying at least half of household income for housing.

A recessionary drop in renter incomes that outpaced the deceleration in rents is a key factor behind the rise in renter cost burdens. Thus, a robust economy that supports strong employment and income growth may offer the best hope for slowing or reversing the expansion of rental affordability problems.

Should the growth in renter cost burdens observed between 2006 and 2010 continue, then expanding the supply of affordable rental housing through new production and preservation might be worthy of consideration. This implication is supported by other recent analysis showing a declining supply of affordable rental housing, and particularly a drop in the share of renter-occupied units affordable to households with incomes below 50 percent of area median.[11] Because the rise in renter cost burdens has been pervasive across housing structure types, expanding the supply of affordable rentals might include not only constructing and preserving affordable multifamily units, but also expanding the supply of single-family rentals.

Of course, many other factors will affect the trajectory of the income and housing-cost components of cost-to-income affordability metrics. On the income side of the ledger, in addition to labor market conditions, returns on savings and investments and individual income tax policy will affect gross and disposable incomes. On the housing cost side, income and capital gains taxes, returns to alternative investments, regulation, and mortgage underwriting policies will influence rental investment decisions and thus future rent trends. In addition, costs of non-housing goods and services (e.g., commuting costs) will affect how much of the household budget can be devoted to housing, and therefore the sustainability of a given housing cost-to-income ratio. In response to changes in these various income and cost factors, households (and particularly renters) can change their shelter consumption, and thus further alter the future course of housing cost burdens.

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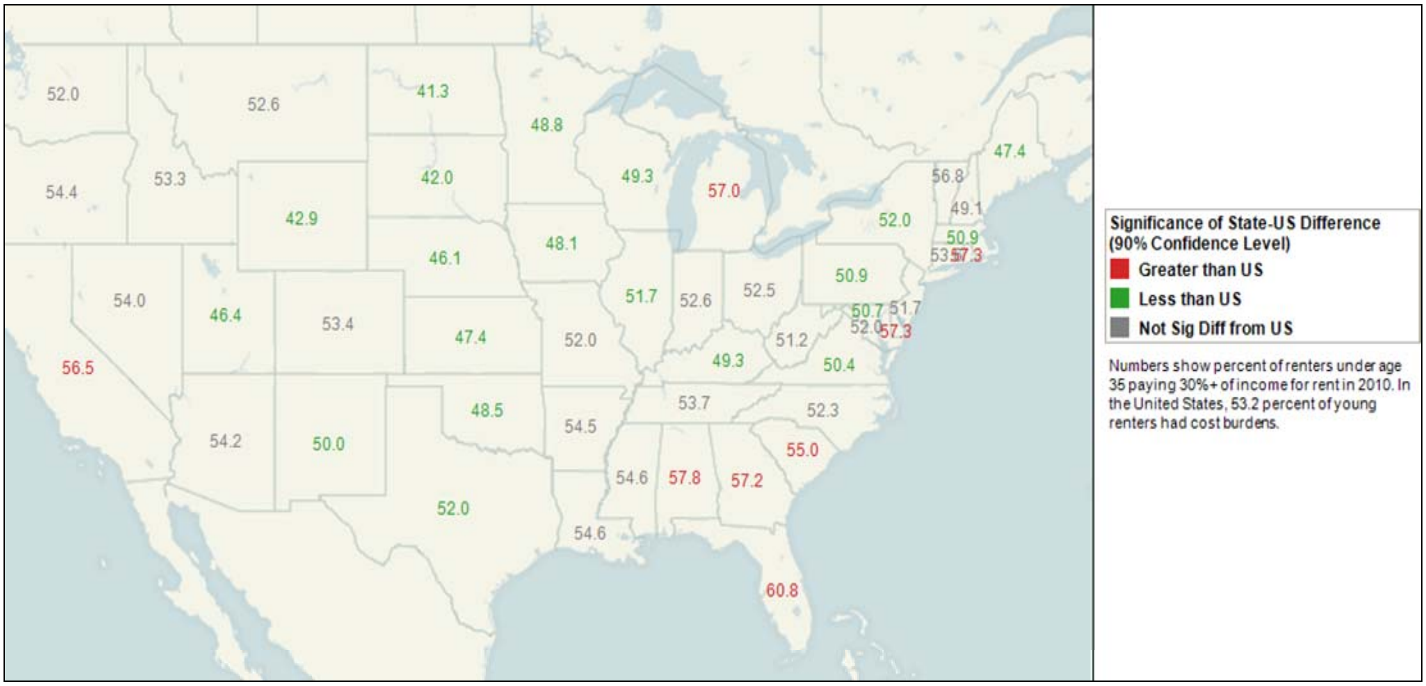
[10] Betancourt, Kim. *Multifamily Market Commentary – January 2012*. Fannie Mae. January 2012. Duncan, Doug, and Orawin T. Velz. "2012 – Year of the Political Economy." *Fannie Mae Economic Outlook*. January 9, 2012.

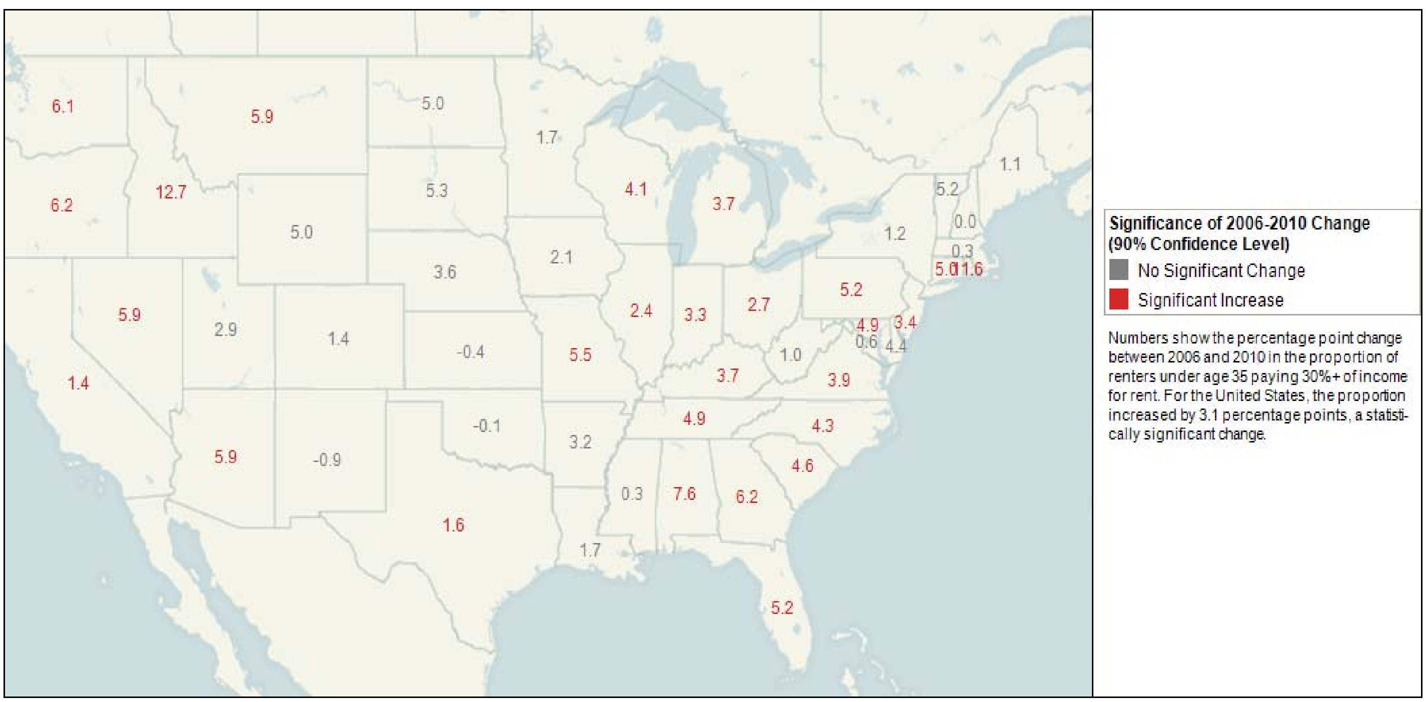
[11] Betancourt, Kim, and Tanya Zahalak. *Fannie Mae and Workforce Rental Housing*. First Quarter 2011.

Exhibit 4a. Southeast is hotspot for housing cost burdens among young renters.



Source: U.S. Census Bureau, American Community Survey. Not depicted are data for Alaska (50.6%) and Hawaii (61.4%). The difference between the Alaska rate and that of the nation is not statistically significant, whereas the Hawaii-United States difference is.

Exhibit 4b. Increases in cost burdens for young renters are widespread.



Source: U.S. Census Bureau, American Community Survey. Not depicted are changes for Alaska (+5.6pp) and Hawaii (+3.7pp), neither of which was statistically significant.

