YOUNG ADULT ECONOMICS SERIES

The High Cost of Putting a Roof Over Your Head:
Young Adults Face Unaffordable Rental and Housing Markets in Major Cities Across the U.S.

1. HIGHER AND HIGHER EDUCATION
2. PAYCHECK PARALYSIS
3. GENERATION DEBT
4. **THE HIGH COST OF PUTTING A ROOF OVER YOUR HEAD**
5. AND BABY MAKES BROKE

Fall 2006

Over the past decade, rents and home prices in major cities across the country have escalated rapidly. As young adults transition from college into the workforce, already owing an average of $20,000 in student loan debt, securing affordable housing in the current market can pose an overwhelming challenge.

Because our nation's largest cities contain the best prospects for high-paying jobs and professional career paths, young professionals still migrate to major metropolitan areas like New York, Chicago, San Francisco and Boston. The high cost of rent, however, often leaves them trapped in a prolonged rental cycle, unable to save enough money for a down payment on a home, or prompts them to become financially overextended by taking on large, risky home mortgages.

A Dēmos Policy Brief (#4)
A Network for Ideas & Action

Budget-Busting Cities

Many of the most vibrant and attractive industries are centered in the nation's top 20 metropolitan areas. For young college graduates, the pull of these cities is strong: Between 1995 and 2000, more young, single, college-educated people moved into major cities than out. New York is still the financial, publishing and advertising center of the nation; Chicago leads in sales and management consultant work; and San Francisco is a hub for technology jobs. These cities offer higher pay for entry-level jobs and provide young professionals access to culture, nightlife, and networking opportunities.

- The price of living in these major cities, however, is high. Between 1995 and 2002, for example, median rents in San Francisco rose 76 percent; Boston, 62 percent; and San Diego, 54 percent.[1]

- Home values in major metropolitan areas soared between 2000 and 2005 according to the Census Bureau. In San Diego, home values jumped 127 percent; Los Angeles, 110 percent; and New York, 79 percent.

- According to the Department of Housing and Urban Development's Fair Market Rent data, in 2004, the average studio apartment in Boston was just over $1,000. In the San Francisco-Oakland area, the average rent for a studio apartment in 2004 was $943.

While young professionals gravitate toward the largest cities, young adults without college degrees are migrating away from them. Unable to afford the cost of housing in the cities where they grew up, many of these young adults are moving to lower-cost alternatives—cities like Atlanta, Dallas, Phoenix and Las Vegas.[2] Our nation's largest and most diverse cities are become virtually unaffordable for many young people with, and most without, college degrees.

Rental Trends

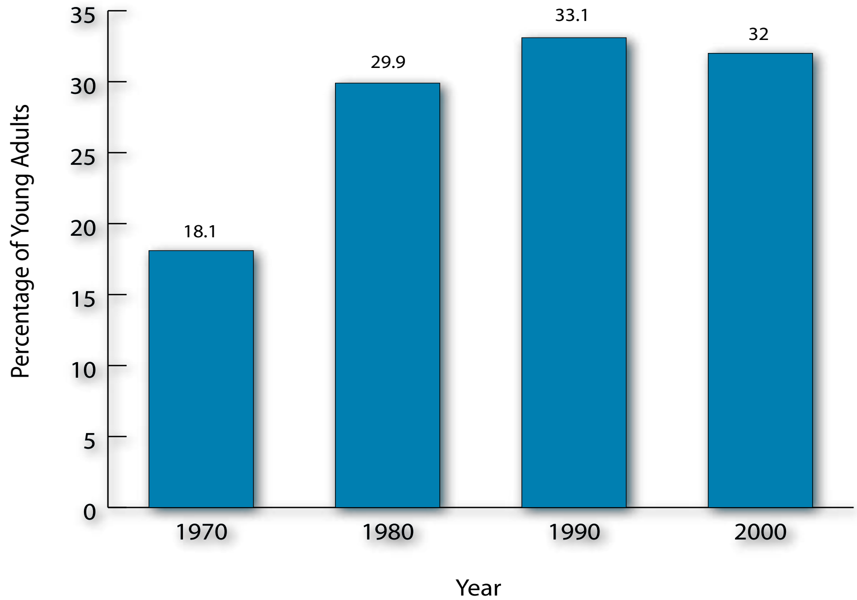
Rising rents, particularly in central cities, have resulted in a higher percentage of young adults who spend more than 30 percent of their income on housing—the standard threshold of "affordability." Despite higher education levels and higher percentages of cohabitation, young adults are spending more of their income on rent than did previous generations. Excessive rents, combined with lower starting salaries, have complicated young adults' efforts to transition out of the rental cycle.

- In 1970, the median rent paid by 25-to-34-year-olds was $497 (in inflation-adjusted Dollars). By 2000, those in the 25-to-34-year-old age group were spending 25 percent more on rent—about $627 per month.[3]

- In 2002, young adults paid a median of just over 22 percent of pretax income on rent; in 1970 the median figure was 17 percent.

- In 2000, one third of young adults between 25 and 34 spent more than 30 percent of their income on rent—up from less than 20 percent in 1970.[4] According to the Census Bureau, in 2005, 46 percent of all renters spent 30 percent or more of their gross income on housing costs.

Percentage of Young Adults (aged 25-34) Spending More than 30% of Income on Rent



Source: U.S. Census Data, 1970-2000, Integrated Public Use of Microdata Series. Available at www.ipums.org

Delayed Homeownership

Because young adults are spending more of their income on rent and student loan payments, it is becoming increasingly difficult for them to save for a down payment on a home. Particularly in large metropolitan areas, keeping up with rent and other bills is ensnaring young adults in a prolonged rental cycle. For those unfortunate enough to face job loss, divorce, or a major unanticipated expense, maintaining monthly rental payments and living expenses can be daunting. To cope, growing numbers of young adults are even moving back in with their parents: four out of 10 young adults will move home at least once after being on their own.[5]

Since the 1970s, the amount of time it takes for young first-time homebuyers to accumulate enough money for a down payment has steadily increased,[6] and rising home prices have resulted in down payments that are smaller as a percentage of the purchase price. Once affordable neighborhoods featuring starter homes in places such as Levittown, NY, however, are now priced out of the financial reach of many young adults, sparking an exodus of young non-college educated people from areas such as Boston and Long Island. After falling during the 1980s, home ownership rates began rebounding slowly during the 1990s. Thanks to rising home values, declining interest rates, and new innovative mortgages, the home ownership for young adults grew from 47 to 49 percent between 2000 and 2005.[7]

» According to data collected by the Chicago Title and Trust, the average first-time home buyer today is 32 years old, about four years older than in 1976.[8]

» Home ownership rates for young households aged 25 to 34 began declining in the 1980s, falling from 48 percent in 1982 to 43 percent in 1992. As the market rebounded, the late 1990s witnessed the largest national gain in the home ownership rate since the 1950s, boosting the young adult home ownership rate to 47 percent. By 2005, 49 percent of those aged 25 to 34 were home owners.[9]

There is some evidence that the gains in home ownership enjoyed by the young adult population were uneven. While the home ownership rate for young singles was climbing during the 1990s, the home ownership rate for young households with children declined. In 1977, 63 percent of young households without children owned their homes; in 1997, 66 percent did.[10] In the same period the rates for young households with one child fell 3 percentage points; the rates for households with two children fell 4 percentage points, and those with three children fell 7 percentage points. Home ownership among households with four or more children dropped 10 percentage points.

The other important trend in young adults' home ownership is the big gap that still exists between whites, African Americans and Latinos. The legacy of discrimination in lending practices is still evident today in the differences in home ownership by race. While half of white households aged 25 to 34 were home owners in 2000, only a quarter of African-American households of the same age group were homeowners. Latino and Asian home ownership rates also trailed that of white households, with about one-third in this age group owning homes. Since 2000, home ownership rates among both lower-income people and people of color rose quite substantially, yet wide gaps remain. For example, between 1960 and 2000, home ownership among African-American young adults rose from 22 percent to 27 percent, but is still 23 percentage points lower than the home ownership rate among young white households.

The Über-Mortgage

According to the National Association of Realtors, between 1998 and 2003 median home prices in the New York metropolitan area rose by 76 percent, adjusted for inflation. In Sacramento, median home prices doubled between 1997 and 2002, and prices in Seattle increased by 42 percent over the same five-year period. Meanwhile, the increase in median home prices across the country was 26 percent (in the five-year period between 1998 and 2003).[11] While the fluctuations in home prices are very local in nature, prices have skyrocketed in many of the major cities across the nation. The typical household lacks the income to buy a median-priced house in 34 metropolitan areas, up from 14 metro areas in 1999.

Among the young adults who do become homeowners, even many of those who are well-educated and better-paid are able to do so only by taking on major mortgage payments that leave them with very little financial cushion and by paying small down payments, thus taking them longer to build equity. Today, it is not uncommon to find a couple in their early thirties spending almost half their income to support a house payment. In fact, Gen Xers' housing debt is 62 percent higher than it was for Baby Boomers at the same life stage.[12]

In *The Two-Income Trap*, a book by Elizabeth Warren and Amelia Warren Tyagi, the authors found that today's two-parent, two-earner households have less disposable income than did a two-parent, one-earner family in the 1970s. The authors point to a suburban bidding war rooted in the scarcity of homes in good school districts as a reason for the rapidly rising cost of homes, as well as to a newly deregulated mortgage industry. This industry created a range of new mortgage products marketed to lower-income and younger households, who typically struggle to amass enough cash for a down payment. These new mortgages come at a price: extra fees, points and mortgage insurance, none of which help pay down the principal on the loan.

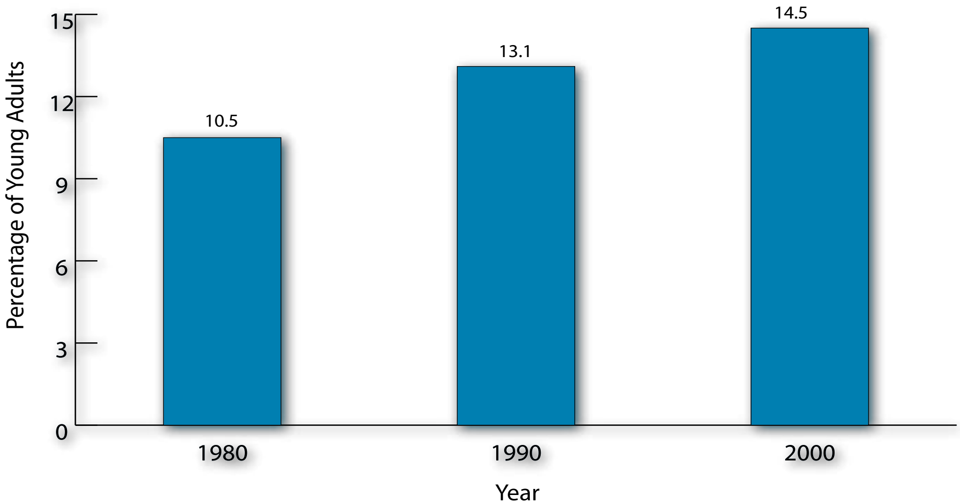
» The median monthly mortgage payment for those in the 25- to 34-year-old age group grew by almost one-third between 1980 and 2000.[13]

» In 1980, 25-to-34-year-old households spent 15.7 percent of their household income on the mortgage; by 2000, this percentage had grown to 17.3 percent.

» The percentage of 25-to-34-year-olds spending more than 30 percent of their income on their mortgage each month rose sharply between 1980 and 2000, from 10.5 to 14.5 percent.

Policy Recommendations

Percentage of Young Adults (aged 25-34) Spending More than 30% of Income on Mortgages



Source: U.S. Census Data, 1970-2000, Integrated Public Use of Microdata Series. Available at www.ipums.org

Overall, today's young adults are hitting the marker of home ownership later in life and paying more in real terms than their parents did. New steps are urgently needed to help young people afford home ownership.

A significant impediment toward purchasing a first home is the difficulty of saving enough money for a down payment. The low percentage value of down payments is why many young families find themselves overextended in a mortgage. Combined with existing low levels of asset accumulation, these challenges show the need for several types of new policies to help ensure young Americans become can become stakeholders in our society. We suggest the following policy efforts:

» The **mortgage deduction should be limited** so that it provides incentives for home ownership without making the deduction yet another tax boon for the wealthy. Currently, families whose earnings are low enough to be exempt from federal income taxes, those with incomes below $50,000, can't claim the deduction—even though they pay property taxes and payroll taxes just like other homeowners. The mortgage interest deduction should be made refundable for families in households earning less than $50,000 and the benefit level for all families should be capped at

$10,000. Capping the deduction at $10,000 would lead to $8.5 billion in extra revenue, which could be used to support broader based wealth-building incentives, such as matched savings accounts.

» The federal government should develop a **matched savings program** that would help young Americans and other low-income families save toward a down payment on a home. First-time homebuyers earning less than $50,000 should receive a $1 for $1 tax credit for money they save toward a down payment. There could be limits on the total amount of the match, say $7,500, which would help a first-time buyer accumulate $15,000 toward a home purchase—much more than the average young adults puts toward a down payment today.

Endnotes

1. John M. Quigley and Steven Raphael, "Is Housing Unaffordable? Why Isn't It More Affordable?" *Journal of Economic Perspectives* 18, no. 1 (Winter 2004):191-214.

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3. Author's calculations, using U.S. Census Data, 1970-2000, provided by Integrated Public Use Microdata Series (http://www.ipums.org). Steven Ruggles, Matthew Sobek, Trent Alexander, Catherine A. Fitch, Ronald Goeken, Patricia Kelly Hall, Miriam King, and Chad Ronnander, *Integrated Public Use Microdata Series: Version 3.0* [Machine-readable database]. Minneapolis: Minnesota Population Center [producer and distributor], 2004.

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5. Dara Duguay, "For New Graduates: How to Avoid Returning to the Nest," Consumers Research Magazine, March 1, 2003, p. 19.

6. Christopher J. Mayer and Gary V. Englehardt, "Gifts, Down Payments, and Housing Affordability," *Journal of Housing Research* 7, no. 1 (1996):59-77.

7. U.S. Census Bureau, Housing Vacancies and Homeownership (CPS/HVS), Table 12. "Household Estimates for the United States, by Age of Householder: 1982 to Present." Available at http://www.census.gov/hhes/www/housing/hvs/historic/histt12.html.

8. Chicago Title Insurance Company, "Who's Buying Homes in America?" (Chicago: Chicago Title Insurance Co., 1999), available at https://www.ctic.com/homesurvey/home.pdf.

9. U.S. Census Bureau, Housing Vacancies and Homeownership (CPS/HVS), Table 12.

10. Lewis M. Segal and Daniel G. Sullivan, "Trends in Homeownership: Race, Demographics, and Income," *Economic Perspectives* 22, no. 2 (1998):53.

11. Josh Barbanel, "Behind the Region's Run-up in Prices," *New York Times*, July 13, 2003.

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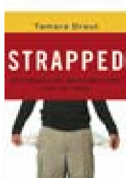
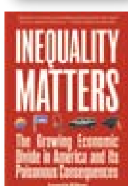


Inequality Matters: The Growing Econimic Divide in America and Its Poisonous Consequences (New Press 2006), Edited By James Lardner & David A. Smith



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About Dēmos

Dēmos: A Network for Ideas & Action is a non-partisan public policy research and advocacy organization committed to building an America that achieves its highest democratic ideals. We believe this requires a democracy that is robust and inclusive, with high levels of electoral participation and civic engagement; an economy where prosperity and opportunity are broadly shared and disparity is reduced; and a strong and effective public sector with the capacity to plan for the future and provide for the common good. Founded in 2000, Dēmos' work combines research with advocacy—melding the commitment to ideas of a think tank with the organizing strategies of an advocacy group.

About the Economic Opportunity Program at Dēmos

The Economic Opportunity Program addresses the widespread economic insecurity and declining opportunity that characterizes American society today. Our efforts focus on envisioning and ensuring the future middle class by promoting new ideas in the areas of higher education, income and asset-based policy. Our work examining the growth of personal debt among low- to middle-income households is indicative of the new challenges Americans face as they try to get by—let alone get ahead.

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