The Missing Millennial Homebuyers

Property prices fell during the Great Recession, but millions of millennials in the US still couldn't afford their first homes. Here's why – and how we could tackle the next housing crisis better.

One of the things that separates the Covid-19 recession from the Great Recession of 2008 must surely be the housing market. Across the world, especially in developed economies, house prices have surged through the pandemic, stoked by unprecedented government stimulus measures. In the **United States** and **Europe**, prices are rising at rates last seen in the mid-2000s, at 13 percent and 5.8 percent respectively. Similar exuberance is sweeping Singapore, South Korea, Australia and New Zealand.

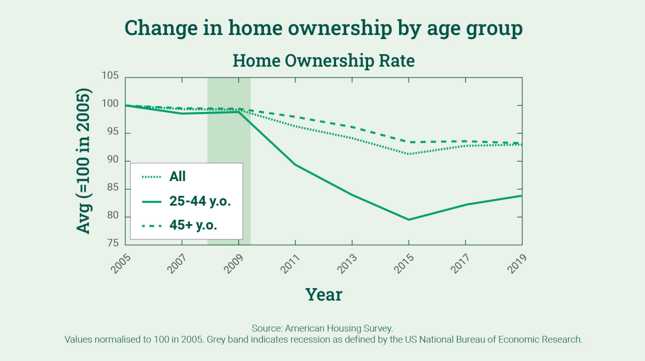
Turn back the clock to 2008 and the difference is stark. Following years of expansion, the housing market in the US collapsed in a wave of mortgage defaults and foreclosures. Homebuyers were leaving the market by the millions. But just as importantly, millions more would be kept out of the market altogether. By 2015, the country had almost 8 million fewer home purchases than could be expected had the recession not happened. Of these missing purchases, most would have been by millennials.

In a new **paper**, I show why millennials missed out on the American Dream of home ownership for years following the property bust of 2008. I also show how critical it is for government assistance measures to account for regional price differences in order to be maximally effective. In terms of stabilising housing markets, temporary stimulus measures such as house purchase subsidies to young buyers are more effective than permanent ones like reducing student debt.

My findings may offer valuable insights on the effects of changes in mortgage credit availability, and on how best to tame the runaway housing market of 2021.

Double whammy

Because households tend to be richer in metropolitan areas (so-called MSAs) with higher house prices, it may come as a surprise that the post-2008 plunge in home buying among people aged 25-44 was precisely concentrated in those locations, like San Francisco and Miami. For this demographic, home ownership fell by 25 percent in the top 10 percent most expensive MSAs (average price: US$240,000) and only 10 percent in the bottom 10 percent MSAs (US$100,000). The question is why, since mortgage credit availability was tightened across the country uniformly.



To find out, I developed a new spatial macro-finance model of regional housing markets with local and aggregate shocks to income and mortgage credit, differences in amenities, construction costs and the price elasticity of housing supply. Then, I calibrated the model to the US market and used a series of counterfactual experiments to identify the causes and consequences of this pattern.

I found that price differences between regional housing markets amplified the impact of the nationwide tightening of credit requirements, an effect I call *regionally-binding borrowing constraints*.

Here's how it took its toll. Higher prices in expensive areas meant buyers needed to borrow more relative to their income compared to peers living elsewhere. They were therefore more sensitive to changes in credit. In 2008 and the years that followed, not only were millennials living in these regions unable to borrow as much as before, their income was also persistently lower – by as much as 15 percent – than expected due to entering the job market during a recession.

These factors, highlighted in my model, ostensibly forced more millennials living in expensive regions to postpone buying homes when credit supply shrank, compared to older (and richer) people living in the same areas as well as peers in less expensive areas. At the same time, the option of enjoying nicer amenities in high-price regions through renting and the high costs of moving across regions prevented them from moving en masse to buy homes in more affordable areas.

My finding is borne out by the documented uneven decline in young home ownership across the US mentioned earlier. Indeed, data show that the number of first-time new mortgages in expensive MSAs fell by up to 55 percent, compared to 25 percent in low-price MSAs, and remained low throughout the 2010s. Households in the former group delayed home ownership by six years on average.

Helping buyers in "rich" regions

Somewhat surprisingly, the slump happened in spite of a federal programme to help Americans buy their first homes. The First-Time Homebuyer Credit (FTHC) was a tax incentive of around US$8,000 given to all new buyers between 2008 and 2010. It has been **found** to boost sales by 7–11 percent, and increase prices across the country. Buyers were three years younger than typical first-timers.

However, my study shows that this one-size-fits-all scheme managed to cushion only one-seventh of the home ownership bust in expensive MSAs but as much as half in lower-price ones. In other words, it mostly induced Americans to buy in cheaper regions. After all, US$8,000 would have paid for a far larger chunk of a US$100,000 home than a US$240,000 one. However, this outcome would have limited the increase in total welfare in the economy since, all else being equal, households seem to be better off living in expensive areas because of their typically nicer amenities.

A better solution might have been a subsidy *proportional* to local house prices instead of a lump-sum one. My model shows that such a version of the FTHC would have spurred home purchases in pricier regions and hence increased the total welfare gain by a third, without increasing the overall cost of the policy to taxpayers.

What about much-debated measures like cancelling student loan debt, which averaged US$40,000 per borrower in 2018? My research indicates that it would have bumped up wealth levels, thus increasing demand for homes and in turn driven up prices. Which brings us back to the position buyers in expensive areas found themselves in in 2008 when credit shrivelled up, making housing markets no less volatile.

In an economy, one agent's loss is sometimes another's gain. In the wake of the Great Recession, student debt has contributed to local housing and rental booms. Millennials who **relocated** from high-price to low-price MSAs to be able to afford their own homes bolstered the market in places such as Austin and Denver. I found that student debt and income-scarring decreased young home ownership by 8 percent and 15 percent respectively in high-price MSAs, but boosted it by 17 percent and 8 percent in low-price MSAs. Meanwhile, millennials who stayed in expensive cities likely contributed to an 8.3 percent hike in rents, benefitting individual and corporate landlords.

Recession's long shadow on youths

My model is the first to show that regional differences between housing markets are crucial to understanding the impact of credit contractions and economic disasters like the Great Recession on home ownership. Combined, these effects persistently compromised millennials' access to housing and, in turn, their welfare. In fact, 30 years later home ownership among millennials will still be 6 percent lower than in other cohorts according to my estimates.

The study also demonstrates that housing stabilisation policies should target high-price regions, and temporary measures that make homes more affordable in the short-run would work better than a systemic cure with the unintended effect of exacerbating the problem it was meant to treat. For Covid-era policymakers as well as young homebuyers, these findings could help tame a market at risk of spiralling out of control.

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