

Accommodating the Housing Needs of Generation Y

IN THE COMING HOUSING RECOVERY, shifting demographics will fundamentally change housing market dynamics. The needs of middle-aged “trade-up” homebuyers, who dominated the market during the recent housing boom, will fade as the main driver of market demand. Instead, the needs of the maturing Generation Y—the children of the Baby Boom—will become a key factor in the marketplace. In recent years, this large demographic group, born between 1977 and 1997, has had a substantial impact on college enrollments and student housing needs. Soon, their entry as young adults into the broader housing market will generate substantial need for new affordable rental housing and starter homes that will reshape residential development patterns in both urban and suburban markets.

Demographic change shapes housing demand

AS A RESULT OF THE RECENT housing boom and bust, much attention has been focused on the impact mortgage lending has had on new home construction and overall conditions in the housing market. Certainly, access to mortgage capital under favorable terms and conditions has a profound effect on housing costs and housing demand for owners and renters alike. However, too little attention has been paid to the critical role demographics

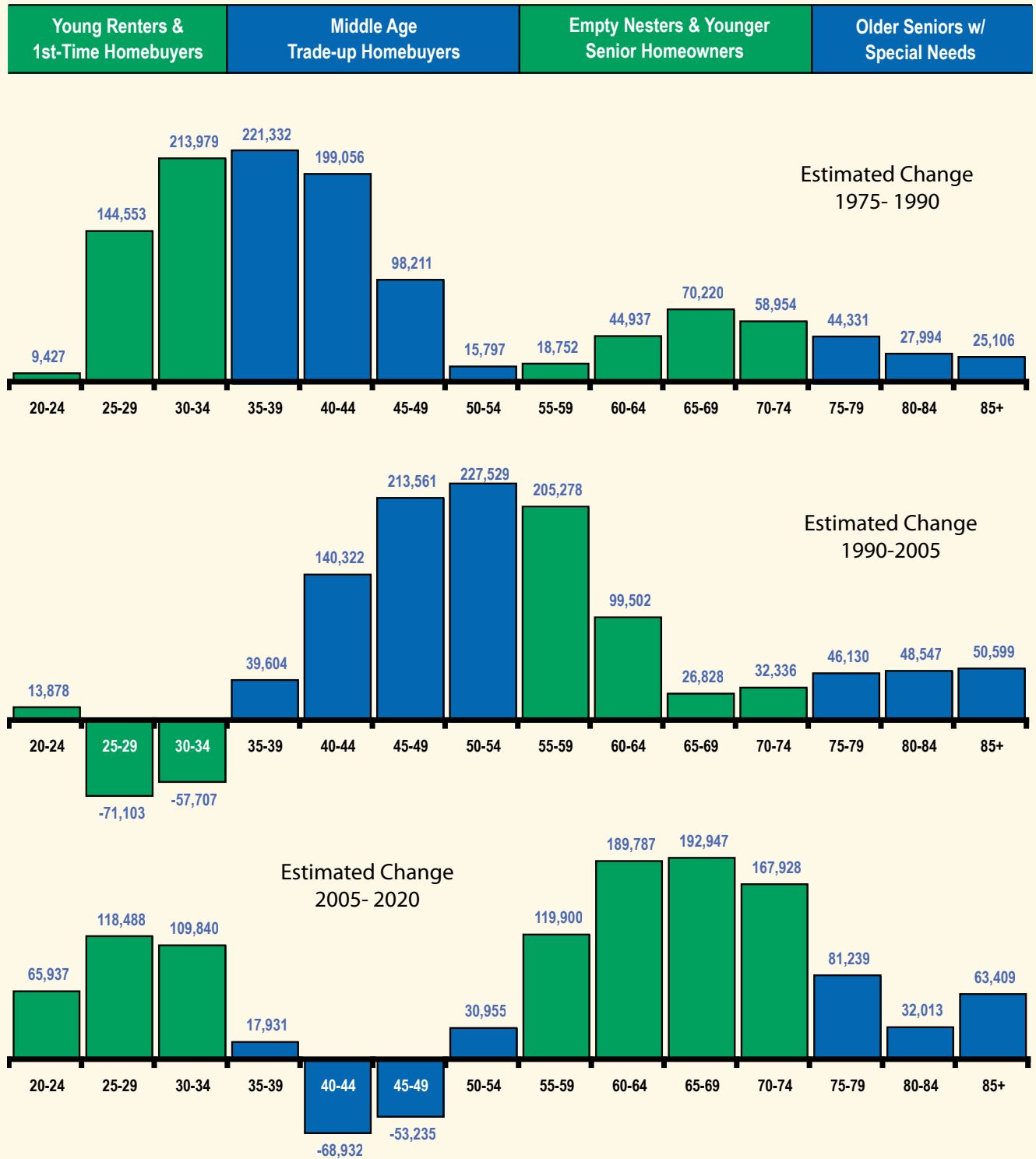
play in shaping the magnitude and nature of housing demand.

Housing demand results from both new household formation, as well as shifts in residence that occur as households age through stages of life in which housing needs and available resources change. In a somewhat simplified way, these life stages can be categorized into four broad age groups each with different housing needs.

Housing Needs by Age Group

- **Young households** (under age 35). Most of this age group has moderate income, and are predominately renters or first-time homebuyers in need of affordable starter homes.
- **Middle age households** (ages 35 to 54). This age group is mainly made up of larger households that need more space. Many have gained sufficient income to “trade up” to larger homes.
- **“Empty nesters” and early retirees** (ages 55 to 74). This age group is predominately homeowners who mostly choose to age in place in their current homes.
- **Older seniors** (age 75 and older). For this age group, maintaining their existing homes may become burdensome and, if so, they may seek alternative senior housing options.

Virginia's Adult Population by Age



Source: U.S. Census and estimates based on Census Bureau and VEC Virginia population projections

Chart 1

The coming housing cycle will look very different from the one now ending

HISTORICALLY, THE HOUSING MARKET has expanded and contracted in long-term cycles. In the post-WWII era, these market cycles have been accentuated by

the substantial difference in size of successive generations. This has caused housing demand to be disproportionately concentrated among particular age cohorts, for example Baby Boomers born between 1945 and 1964, and now their children — the “echo boomers” (Generation Y). As these large cohorts move through the life cycle, they stimulate substantial demand for certain types of housing. In contrast, smaller age cohorts—e.g., the “baby bust” (Generation X) born from 1965 through 1976 — cause demand for certain types of housing to wane. Awareness of the ebb and flow of households in different age groups is essential to understanding and responding to changing housing demand. (See Chart #1.)

The recent boom in the construction of “Mc Mansions” was driven as much by the concentration of housing demand among middle age Baby Boomers with older children, who had both the income and the need to “trade up” to larger homes, as it was by the easy credit available in the mortgage market. The peak of that demand coincided with the peak in new home sales. That demand will now steadily diminish for the next decade, as a much smaller group of Generation X middle agers replaces the Baby Boom generation — which is now aging into retirement.

Just as the 1990 housing recession left behind, in some markets, a glut of starter homes, the current downturn is now leaving behind a surplus of larger houses. The 15-year housing market trade-up cycle that lasted from 1990 through 2005 looked very different from the previous starter-home cycle that ran from the mid 1970’s through the 1980’s. In all likelihood, the new housing market cycle that will emerge with a housing market recovery will look very different from the trade-up market we have recently experienced.

BY AND LARGE, Baby Boomers have now completed the purchase of their “trade up” homes, and have entered a phase of life marked by very low rates of household mobility. Mobility is high among young households, but

Baby Boomers are now entering a stage of life marked by low mobility

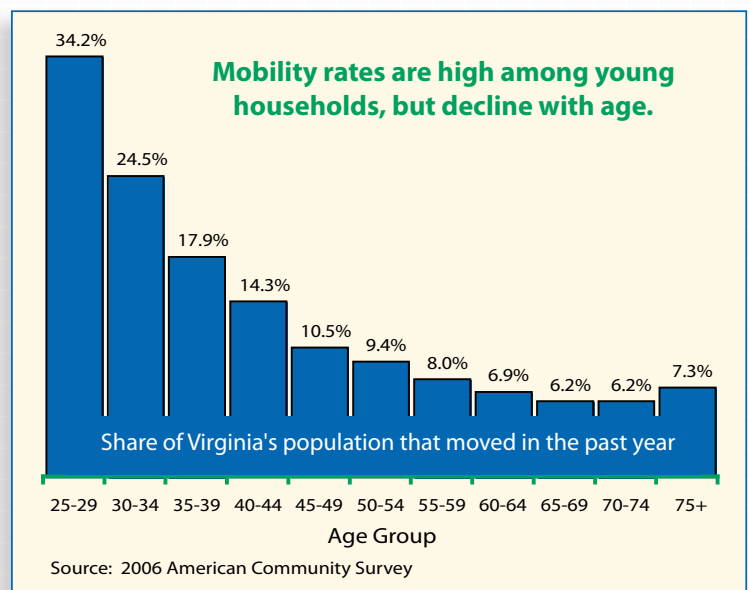


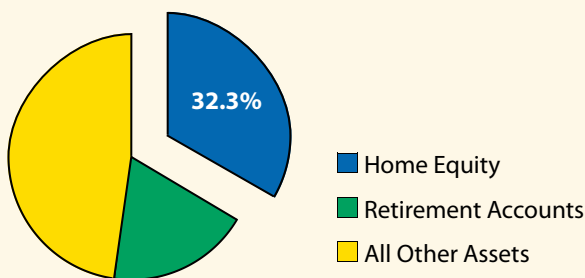
Chart 2

declines steadily with age, reaching a low point among households age 55 to 75, before rising moderately among older seniors as increasing frailty leads to consideration of alternative housing choices. (See Chart #2.)

There has been great anticipation of the increased housing demand to be generated by the large cohort of retiring Baby Boomers. It was assumed that they would be financially able to actualize their desire to “trade down” to new homes with less upkeep and/or to purchase second homes for future retirement living, due to their relatively high incomes and substantial built-up home equity.

The severity of the current housing downturn and its negative impact on home equity, now calls these assumptions into question. In the near term, with a substantial oversupply of larger homes in the market, will large numbers of Baby Boomers make these housing choices? Or, will they instead do as their parents did and age in place in order to rebuild the equity they counted on to help fund their retirement years? (See Chart #3.)

Home Equity Makes up the Largest Single Share of Household Net Worth.



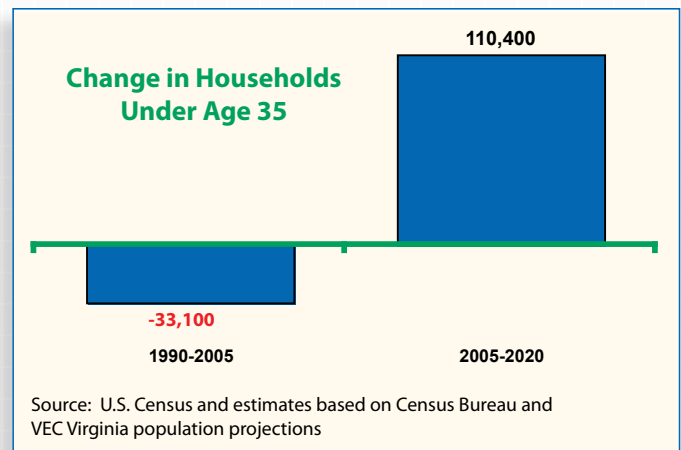
Source: U.S. Census Bureau, Survey of Income and Program Participation, 2000

Chart 3

BETWEEN 2005 AND 2020, the 402,200 projected increase in

households age 55 to 74 is more than three and a half times the 110,400 projected increase in households under age 35. Nonetheless, when differential mobility rates are factored in, and consideration given to the fact that the Baby Boomers are already adequately housed to meet their current needs, then the likely largest net increase in housing demand will come from young households. While less numerous than

In the coming housing cycle, demand for new housing will be driven by younger households



Source: U.S. Census and estimates based on Census Bureau and VEC Virginia population projections

Chart 4

their parents’ generation, Generation Y is far larger than Generation X which preceded it. This will result in a substantial increase in new household formation as Generation Y completes college, enters the workforce and forms new independent households. Whereas households under age 35 declined by 33,100 in the 1990 to 2005 housing cycle, they are expected to increase by 110,400 between 2005 and 2020. (See Chart #4.)

The number of households headed by people age 75 and older will also continue to increase rapidly. The growth in older senior households is projected to increase from 82,700 in the 1990 to 2005 housing cycle to 106,700 between 2005 and 2020. However, as with empty nesters and early retirees, the mobility rate for this group is far lower than for younger households, and so their net demand for new housing will be much smaller than for younger households.

The current housing stock is inadequate to meet the needs of younger households

RELATIVELY LITTLE STARTER HOME AND NEW APARTMENT CONSTRUCTION OCCURRED in the

recent housing cycle. Generation X, because it was smaller than the preceding Baby Boom generation, created a fairly limited impact on new housing construction except in rapidly growing regions. Existing starter homes and apartments vacated by Baby Boomers as they moved up the housing ladder were generally adequate to meet Generation Xers' needs. Instead, new housing construction primarily focused on the substantial increased demand among Baby Boomers for new, large trade-up homes. Consequently, there is now an undersupply of apartments and starter homes, and an oversupply of expensive trade-up homes relative to the increased demand among young households that will be experienced in the coming housing cycle.

As Generation Y enters the housing market, the existing stock of apartments and starter homes will not be adequate to meet their needs. The number of homes and apartments freed

up by Generation Xers will not be sufficient to meet the demand generated by the larger generation following them. Except in very slow growing regions with net out-migration of young households, new affordable starter home and apartment construction will be required. In rapidly growing regions such as Northern Virginia, with high rates of natural increase and in-migration, considerable new affordable housing construction will be required to prevent substantial housing shortages.

WHEREAS MIDDLE AGE HOUSEHOLDS are overwhelmingly homeowners, young households remain

predominately

renters. Increased production of quality, affordable rental housing will be needed over the next decade to satisfy the needs of new Generation Y households entering the housing market. (See Chart #5.)

Quality, affordable rental housing will be especially needed

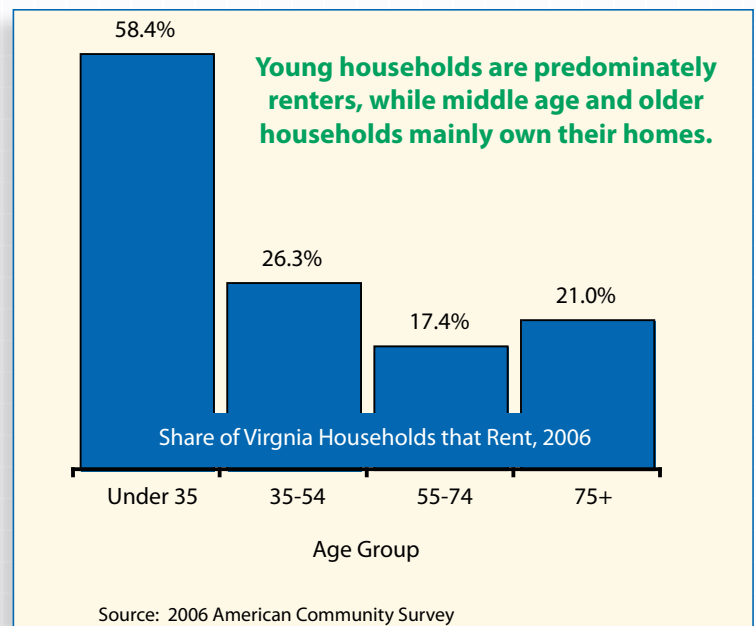


Chart 5

This need will be accentuated by the greater difficulty Generation Y may face in becoming homeowners in contrast to Generation X or their Baby Boom parents. Today, young households are economically stressed compared to older households. Their earnings are lower, and they carry high levels of debt. (See *Chart #6*.) The significant tightening of credit standards and down payment requirements that has resulted from the subprime lending bust, may delay home purchase by Generation Y households. That, in turn, will increase the magnitude and duration of Generation Y's impact on rental housing demand.

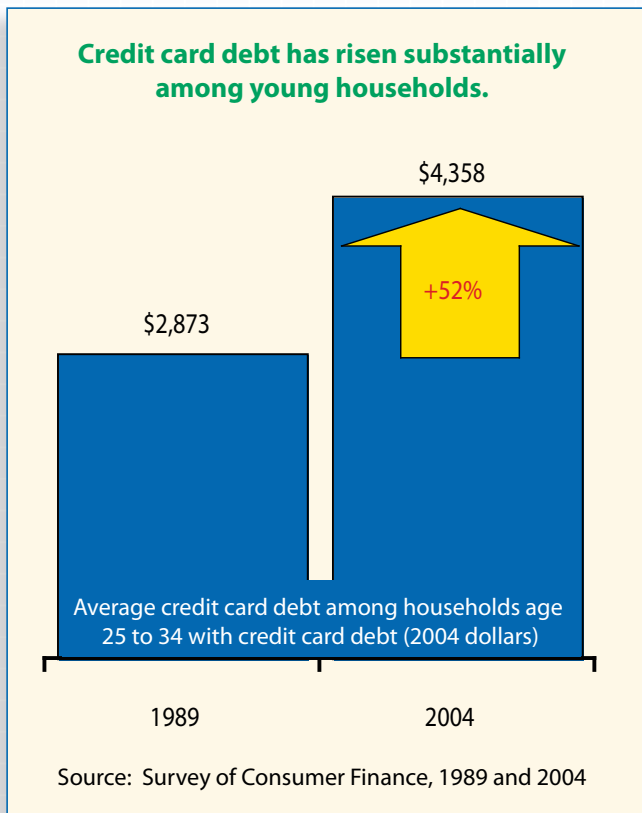


Chart 6

HOUSING AFFORDABILITY WILL BECOME A KEY issue for local communities in attracting

Housing affordability for young workers will challenge local economic development

and retaining an adequate workforce. In the most recent housing cycle, increased housing demand was heavily concentrated among age groups with the highest household income. However, in the coming cycle, the opposite will be true. A far higher share of net household growth, and a large share of the net increase in housing demand, will be among younger and older households whose incomes are less than the overall median. Localities that fail to address the affordable housing needs of young households will see their workforce stagnate as Baby Boomers retire and young workers seek more attractive living environments elsewhere.

For a generation, suburban land use planning has accommodated new household growth through low density large lot zoning. It also has helped pay for the infrastructure costs created by sprawl through significant proffers and other residential development fees. This land development management system was able to function due to the substantial construction of large, high-value, trade-up homes for which demand is now waning.

For the next generation, net household growth will be focused on age groups of more limited means — especially new young households seeking more

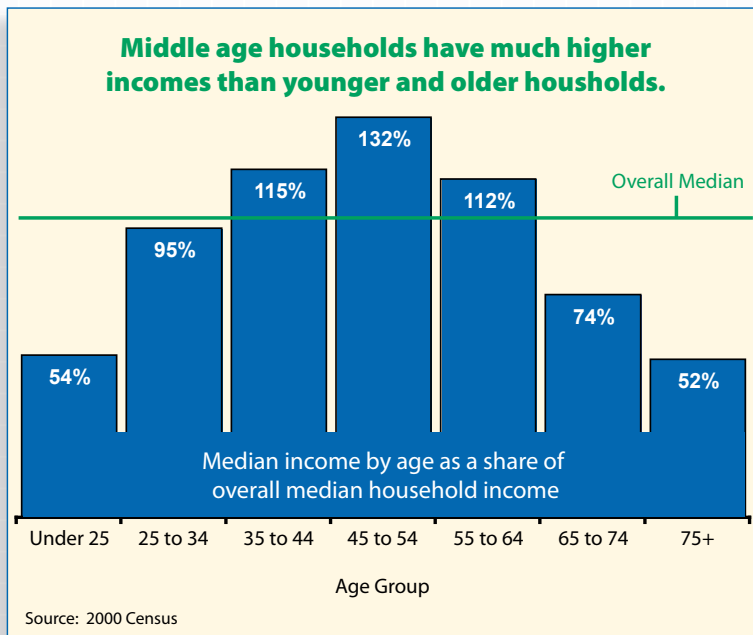


Chart 7

affordable rental and home purchase opportunities. (See Chart #7.)

This transition in housing needs will be made more difficult by the recent run-up in energy costs and shortage of funding for new road-building projects. Traffic congestion and the high cost of commuting are now making distant exurban home construction a poor alternative for young urban and suburban workers seeking housing they can afford.

New local strategies are needed to meet the needs of Generation Y

MEETING THE NEEDS OF GENERATION Y WILL REQUIRE local governments to again focus

on the development of affordable housing opportunities. In particular, metropolitan localities will need to rethink their land use

planning paradigms in order to create new opportunities for higher density housing construction. Likewise, as the net increase in housing demand shifts from middle age to younger households with more limited incomes, local governments must partner with the home building industry to reduce development costs while maintaining the long-term quality of the housing stock and the vitality of local communities. In the near term, the large inventory of foreclosed homes will help make home purchases more affordable in high-cost areas. However, as the housing market begins to recover and prices stabilize, then production of additional new affordable units will be required.

There are positive signs that Generation Y is embracing more urban lifestyles and housing preferences that will support the changes in land development and housing construction required to meet their needs. There is growing public support for more vibrant mixed-income and mixed-use communities that can accommodate a wider array of housing options.

Working together, local governments, community groups and developers can come to consensus on new models of housing development that will enable urban and suburban communities to continue to grow and thrive in the coming cycle of demographic and housing market change.

For more information:

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