

After the Fall: What Will Be the New Market?

Where new homes should be built in the United States is an open question. Will the rapid housing development on the outer edges of metropolitan regions witnessed over the past six decades continue? Planners and pundits have been arguing about this for years, but there are emerging trends worthy of close watch.



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NOW THAT GREEN shoots are beginning to appear in the economy—even the housing market appears as if it may be at or nearing the bottom of its fall—it is a good time to look at what the housing market may become as it rebounds over the next few years. What will sell—and where will the strong markets be?

The first factor to consider is demographics:

- ▷ The U.S. population is growing at a rate of 2.5 million to 3 million people a year. The average U.S. household comprises 2.6 persons—and is shrinking, which suggests the nation needs some 1.2 million new homes per year, plus additional homes to replace those lost to decay, fire, and the like.
- ▷ The actual number of new homes needed is probably higher since the top half of the echo boomers—those born between 1980 and 1994, and the largest demographic tranche in U.S. history—have now reached their mid- to late 20s, the prime age for forming new households. An analysis conducted earlier this year by Fannie Mae based on data from the Harvard Joint Center for Housing Studies predicts there will be 14.6 million net new households formed in the United States between 2005 and 2015, an average of 1.46 million a year.

Compare this with the current rate of housing production:

- ▷ In 2008, only 485,000 new homes were sold, and at year-end there was an unsold inventory of 353,000, for a total of 838,000 new homes. Add to that the 275,752 new rental units started and the total production of new units was around 1.1 million, a shortfall of 350,000 units needed just to meet new household formation.

▷ At present, new housing production is trending around 500,000 per year—again, well below the rate needed to meet new household formation.

Thus, the potential demand for rental and for-sale housing is high and growing, but is constrained by rising unemployment, tight credit, and uncertainty about housing prices. Indeed, first-time homebuyers will continue to find buying their first place challenging for years to come—especially if the first-time homebuyer credit is not extended beyond November 30—and the expectation is that they will rent for longer than past generations had, either by choice or necessity.

To help this large group buy a home, homebuilders will need to offer starter homes at low prices, meaning smaller, simpler homes on smaller lots. This is easier said than done, of course, except in the outer suburbs, where home prices have fallen mostly due to high foreclosure rates. That said, it is too soon to know whether these outer neighborhoods will again attract large numbers of people who want to buy and live in them.

Therefore, it is an open question whether the rapid housing development on the outer edges of metropolitan regions witnessed over the past six decades will continue. Planners and pundits have been arguing about this for years, but there are emerging trends to watch closely.

A recent U.S. Environmental Protection Agency study titled “Residential Construction Trends in America’s Metropolitan Regions” shows that there has been a striking move back to the urban core in many markets. In other markets, this

reurbanization is small but growing; elsewhere it has been negligible.

The study looked at the 50 largest metropolitan regions in the United States from 1990 to 2007 and concluded that “. . . in roughly half of the metropolitan areas examined, urban core communities dramatically increased their share of new residential building permits.” For example:

- ▷ In 15 regions, the central city more than doubled its share of permits.
- ▷ In the early 1990s, New York City issued 15 percent of the residential building permits in the region. Over the past six years, it has averaged 44 percent.
- ▷ Chicago saw its share of regional permits rise from 7 to 23 percent over the same period. Portland, Oregon, went from 9 to 22 percent. Atlanta went from 4 to 13 percent.
- ▷ The increase has been particularly dramatic over the past five years.
- ▷ Data from 2007 show the shift inward continuing in the wake of the real estate market downturn.

The report concludes that this acceleration of residential construction in urban neighborhoods reflects a fundamental shift in the real estate market. In fact, if core urban suburbs are included—i.e., those closest to the central city—more than one-half of all residential permits in New York, Chicago, and Los Angeles were in the urban core in 2007. There were, of course, those urban areas where little or no shift occurred, among them cities like Cleveland, Cincinnati, and Dallas.

Will this urban shift continue once the housing market rebounds? This depends in part on whether people believe that the price of gasoline will stay at or below \$2 a gallon or

whether it will rise back to \$4 a gallon or more. The more sensitive people are to the price of gasoline, the more they will pay to live in closer, more urbanized locations. Keep in mind, too, that studies of past crises suggest that trends emerging prior to the event were not changed afterward, but rather accelerated.

Today, the weakest housing markets are in the outer suburban edges, where declines in housing prices have been most dramatic. Urban markets by and large have been stronger; home prices have held up better, and foreclosure rates have been lower except in certain lower-income but previously gentrifying neighborhoods.

Over the past years, baby boomers have shown increasing interest in urban living as they age. They are finished with moving to the suburbs, and are moving to the city or the sun when they look for their next home. While the jury is still out on the echo boomers, anecdotal evidence suggests they are a more urban, environmentally sensitive generation. However, it won't be known if they will shy away from the outer suburbs until they have school-age children.

In short, there is growing demand for new homes and apartments, demand that is constrained by unemployment, cost, income, and tight credit. Demand for more urbanized living is growing, too. The paradox is that urban housing is more expensive and takes longer to build than homes on undeveloped greenfields due to the lack of available sites, tougher building codes, and intense resistance to development in existing neighborhoods. Will local governments ease the process of development and expand opportunities for infill development? Will the industry produce sufficient housing in urban and suburban infill markets to meet the pent-up demand and keep prices within reach of today's price-constrained echo boomers? Or will this generation chose to—or have to—either rent in the central city and suburban town centers or buy their first home on the outer edges as generations before have done? **UL**