Housing: The Key to Economic Recovery

Nothing matches the might of housing when it comes to adding value to the U.S. economy. New housing construction and remodeling activity are powerful drivers of...
ALWAYS CRUCIAL TO THE ECONOMY, housing is especially important in today’s unsettled world. It is uniquely positioned to cushion the effects of recession and lead the nation to recovery.

Housing plays a central role in translating interest rates into demand and employment. Even before the events of September 11 accelerated the nation’s economic decline, the Federal Reserve sought to bolster the economy by reducing interest rates. While other sectors were struggling and even collapsing into recession, housing remained one of the few bright lights in the economy. Housing production (residential fixed investment) grew at a rate of 8.5 percent in the first quarter of 2001, at a rate of 5.9 percent in the second quarter and at a rate of 2.4 percent in the third quarter while other components of investment were in decline.

... the nation’s economic engine. Housing accounts for about 14 percent of the nation’s Gross Domestic Product and drives other closely related sectors of the economy. Housing creates millions of jobs each year and generates billions of dollars in tax revenue. As housing goes, so goes the U.S. economy. Housing is a key to economic recovery in 2002.

Housing’s stellar performance in the face of such unprecedented conditions can be attributed to a number of factors. In addition to historically low mortgage interest rates, new construction and home sales have reflected strong underlying demand for new housing, low inventories of unsold units on the market, and the resounding faith of the American people in the value of real estate as a long-term investment.

While some slippage of housing market activity was anticipated during the fourth quarter of 2001 and the first quarter of 2002, along with weakness in general economic activity, housing is nevertheless well-positioned to lead the economy forward in 2002. Here’s why:

Mortgage Interest Rates are at the Lowest Levels in 30 Years

Long-term mortgage interest rates in the fourth quarter of 2001 were the lowest in more than 30 years, increasing the purchasing power of American home buyers. At the end of the year, interest rates on 30-year mortgages were near 7 percent, and rates for adjustable rate mortgages were hovering in the 5 percent range.

Such low interest rates allow more families to become home owners and allow buyers to purchase more expensive homes than they might otherwise buy. This stimulates the economy directly through the sale transaction and indirectly through related purchases and expenditures that ripple through the economy after the sale.
Low interest rates also provide home owners the opportunity to reduce their mortgage payments by refinancing and to gain low-cost access to accumulated equity in their homes. In turn, this process pours money directly into the economy since it frees up consumers’ resources for discretionary spending.

New Household Formations are Fueling Housing Demand

Demographic forces have also contributed to strength in housing demand. Driven by population growth, new households are being formed at an annual rate of more than 1 million per year. This rate of growth is expected to continue for the next decade. To meet this demand, replace homes that are demolished or destroyed and meet demand for second homes, the nation’s builders will need to construct about 1.6 million new homes and apartment units each year of this decade.

Although the U.S. is by any standard the best housed nation in the world, it still faces a critical shortage of affordable housing. Almost 14 million households have “critical housing needs,” meaning that they spend more than half of their income on housing or live in seriously substandard conditions. One in every seven renter households (5.3 million Americans) is included in this group, and they receive no government assistance.

Housing —

The Wealth of the Nation

The market value of homes owned by U.S. households now stands at nearly $12 trillion. This marks an increase of 50 percent over the past 5 years, reflecting a large volume of housing production as well as solid rates of house price appreciation. Furthermore, housing equity (market value less mortgage debt) increased by the same proportion over this time frame and was approaching $7 trillion by the end of 2001 despite heavy borrowing by households against their accumulated equity.

Housing is, by far, the most important single asset on the household balance sheet. It accounted for nearly 30 percent of total household assets at the end of 2001 (even when claims on life insurance and pension fund reserves were included), and this proportion obviously was much higher for the 73 million households who owned their own homes. Furthermore, the housing share of assets has risen substantially over the past two years as the market values of corporate equities and mutual funds have fallen dramatically. Indeed, the market value of these assets has dropped by about one-third since the stock market peak of early 2000 when the equity/mutual fund share of total household assets temporarily rose above the dominant position historically held by housing.

Low Inventory

A lean inventory of unsold housing is another important factor in today’s economic

New Households Fuel Demand for Housing

Projected Number of Households: 2000-2010

<table>
<thead>
<tr>
<th>YEAR</th>
<th>TOTAL NUMBER OF HOUSEHOLDS</th>
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<tbody>
<tr>
<td>2000</td>
<td>105,480,101</td>
</tr>
<tr>
<td>2001</td>
<td>106,478,583</td>
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<tr>
<td>2002</td>
<td>107,690,262</td>
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<tr>
<td>2003</td>
<td>108,800,265</td>
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<td>2004</td>
<td>109,907,037</td>
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<td>2005</td>
<td>111,052,797</td>
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<td>2006</td>
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<td>2007</td>
<td>113,396,397</td>
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<tr>
<td>2008</td>
<td>114,596,986</td>
</tr>
<tr>
<td>2009</td>
<td>115,802,105</td>
</tr>
<tr>
<td>2010</td>
<td>117,059,577</td>
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</tbody>
</table>


Real Estate is a Major Component of Wealth

How Household Wealth is Divided

- Real Estate: 28%
- Equities/Mutual Funds: 17%
- Noncorporate Businesses: 10%
- Other Assets: 6%
- Life Insurance/Pension Fund Reserves: 19%
- Credit Market Instruments: 4%
- Deposits: 10%
- Consumer Durables: 6%

The number of unsold homes is low in absolute terms and relative to sales, so builders aren’t burdened with hefty carrying costs and haven’t been forced to liquidate inventories and further depress production.

**Housing’s Importance to the National Economy**

Housing is crucial to the performance of the U.S. economy. The production of housing and the value of housing services produced by the housing stock account for about 14% of the nation’s Gross Domestic Product, and housing market activity drives other closely-related components of the economy as well. Housing also is vital to local and state economies, creating jobs and generating taxes and wages that positively influence the quality of life.

The construction of 1,000 single-family homes generates: 2,448 jobs in construction and construction-related industries, approximately $79.4 million in wages, and more than $42.5 million in federal, state and local tax revenues and fees.

Construction of 1,000 multifamily homes generates: 1,030 jobs in construction and related industries, approximately $33.5 million in wages, and more than $17.8 million in federal, state and local tax revenues and fees.

**Additional Spending by Housing Consumers**

Housing’s economic impact doesn’t end when a home is sold and the new owners move in. In fact, housing continues to be an economic force long after the sale is closed. In the first 12 months after purchasing a newly built home, owners spend an average of $8,900 to furnish, decorate and improve their homes—more than twice the $4,000 spent by non-movers. Buyers of existing homes spend $3,766 more than non-moving home owners during the 12 months after purchasing the home. Renters also spend significant amounts on furnishing their new apartments.

For most people, a home is a solid investment, providing not only a place to live but a solid rate of return with low risk of loss. Since 1980, home prices have increased at an average rate of about 5 percent annually and have never shown an annual loss. Although stock values increased at a higher rate, they were much more volatile, and in some years (including 2000 and 2001) they declined significantly. Moreover, a home is an investment in the future, a durable product that will provide services for many years.