EXECUTIVE SUMMARY

Based on data from the first half, we believe that 2017 is shaping up as one of the biggest years for first-time homebuyers in the housing market, and significantly higher than the historical average of 1.8 million units between 1994 and 2016. Some of the three million missing first-time homebuyers who delayed home purchases are returning to the housing market, while members of the millennial generation are reaching their primary home-buying age. The combination of pent-up demand and demographic tailwinds have led to the surge in the first-time homebuyer market over the past two and half years, and are having a profound impact on the housing market.

As we noted in the last report, the current housing cycle differs from the previous cycle in that it is driven by first-time homebuyers whereas the previous cycle, especially towards the end, had been driven by repeat buyers. We see both opportunities and challenges in today’s market, where the rising first-time homebuyer market is reviving homeownership and expanding markets, but also creating low inventory conditions and deteriorating affordability.

Genworth Mortgage Insurance has been helping first-time homebuyers become homeowners since 1981. In 2016, 55 percent of our purchase loans went to first-time homebuyers. The private mortgage insurance industry is the largest provider of private capital for first-time homebuyers, insuring 507,000 of these mortgages in 2016. We understand the first-time homebuyer segment, both the ones we serve and those served by others.

We started working on the First-Time Homebuyer Market Report in 2015. The question was both simple and important: how many homes are sold to first-time homebuyers in a given month? We then raised the bar higher still: by extending the monthly series back to 1994, and reporting the latest data with a minimal lag. Our approach is different from others in that we rely on government reports and industry sources. We believe this is a breakthrough, one that will help the housing industry and policymakers gain insights into the first-time homebuyer market. This report is a testament to our commitment to the first-time homebuyer market.

-Tian Liu
Chief Economist at Genworth Mortgage Insurance
KEY FINDINGS:

1. In the second quarter, first-time homebuyers purchased 570,000 single-family homes, accounting for 36 percent of all single-family homes sold, and 57 percent of the purchase mortgages originated. Only 1999 had more first-time homebuyers during the second quarter.

2. Growth in the first-time homebuyer market outstripped the rest of the housing market in the second quarter, continuing a trend that started in the third quarter of 2013. The first-time homebuyer market was up eight percent year over year during the second quarter, exceeding the two percent growth rate reported for overall single-family home sales. Measured in units, the growth in the number of homes sold to first-time homebuyers (42,000 units) exceeded the growth in the entire single-family housing market (32,000 units), suggesting first-time homebuyers are expanding while repeat buyers are contracting.

3. Homebuilders reported faster sales growth in the “low” end of the market, reflecting their increased focus on the first-time homebuyer market. But the volume of new construction remained insufficient relative to first-time homebuyer demand. New single-family homes priced between $200,000 and $250,000, the segment most popular with first-time homebuyers, was the fastest-growing segment for homebuilders, reporting year-over-year growth of 33 percent during the first half. But the volume increase remained modest at 13,000 units for the first half. The insufficient supply of new starter homes has led to a sharp decline in the number of vacant homes for sale, driving the homeowner vacancy rate to its lowest level since 1994.

4. The lack of housing supplies has led to accelerating home prices. Year to date, home price appreciation as measured by the Federal Housing Finance Agency (FHFA) home price index for purchase loans accelerated to 6.6 percent growth, up from 6.1 percent growth a year ago.

5. Since first-time homebuyers represent the transition of housing demand from rental to owner-occupied housing, strong first-time homebuyer demand in the past two and a half years is beginning to lift the homeownership rate, especially for households headed by younger adults. In the second quarter, the homeownership rate among households headed by people under 35 years of age was 35.3 percent, which is 1.2 points higher than a year ago, but still well below its 2004 peak of 43.6 percent. This suggests further improvement in the first-time homebuyer market is likely even though the market is already very large by historical standards.

6. In the mortgage market, growing demand from first-time homebuyers is driving faster purchase origination market growth. The purchase mortgage loan count was up five percent from a year ago during the second quarter, beating the two percent growth in the number of single-family homes sold.

7. Since first-time homebuyers typically rely on mortgages to finance their purchases, rising first-time homebuyer demand has reduced the percentage of home sales paid for by cash. During the second quarter, all-cash sales were down three percent year over year. As home sales growth slowed during the second quarter, this has become a bigger source of growth for the mortgage market.
8. Within the mortgage market, first-time homebuyers have always relied on mortgage products with lower down payments, defined as those with a combined loan-to-value ratio (LTV) of 80 percent or higher (higher LTV means lower down payment). The first-time homebuyer mix moves inversely with down payment requirements. During the second quarter, 68 percent of all homebuyers using low down payment mortgages were first-time buyers, but only 36 percent of those using high down payment purchase loans were. Low down payment mortgages represented 78 percent of all first-time homebuyer purchases in the second quarter versus 22 percent for high down payment mortgages.

9. The number of first-time homebuyers increased across the down payment spectrum during the second quarter. Low down payment mortgage products financed 448,000 home sales to first-time homebuyers, up eight percent from a year ago. High down payment mortgage products financed 123,000 home sales to first-time homebuyers, up eight percent from a year ago. This means that growth in the first-time homebuyer market is driving mortgage credit expansion, not the other way around.

10. Among low down payment mortgage products, private mortgage insurance saw significantly higher growth during the second quarter, as lenders and borrowers embraced the 97 LTV products. The private mortgage insurance industry helped 163,000 first-time homebuyers during the second quarter, which is an increase of 17 percent from a year ago. Around 58 percent of the growth in the first-time homebuyer market during the second quarter came from the private mortgage insurance market, while nine percent of the growth came from the Federal Housing Administration (FHA).

11. Government lending programs remained very large in the first-time homebuyer market. During the second quarter, government lending programs helped 272,000 first-time homebuyers, up three percent from a year ago. Their footprint in the purchase market and in the first-time homebuyer market segment were over three times the size 10 years ago. Because of their low down payment focus, the footprint of government lending programs will likely grow relative to the overall mortgage market with the first-time homebuyer market.

12. As first-time homebuyers enter the housing market and take on mortgage debt, household mortgage debt growth has accelerated. We estimate that the amount of mortgage debt outstanding at the end of the second quarter was four-five percent higher compared to a year ago versus growth rates of one-two percent during 2015 and 2016. Growth was faster among low down payment mortgage segments during the second quarter. Ginnie Mae and the mortgage insurance industry reported year-over-year growth rates of nine percent and 13 percent for their respective mortgage portfolio.
DEFINING AND ESTIMATING THE FIRST-TIME HOMEBUYER MARKET

In this report, we adopt the definition of first-time homebuyers provided by the Department of Housing and Urban Development (HUD), which is widely used within the housing and mortgage industry. Under this definition, a first-time homebuyer is an individual who has not been a homeowner in the previous three years¹. Adopting this definition allows us to use data available from the mortgage industry and from government agencies, which is the basis of our methodology². Our data includes publicly available reports from the FHA, the mortgage insurance industry, VA, and USDA, as well as proprietary data from Genworth Mortgage Insurance, which makes our coverage of the first-time homebuyer market more comprehensive than is possible with agency securitization data alone. Where data is not available, we use assumptions to extend coverage. Together, government and industry sources provided 20.9 million first-time homebuyer records between 1994 and 2017, accounting for 50 percent of the estimated total number of first-time homebuyers. Of the one million estimated first-time homebuyers during the first half of 2017, 811,000 came from actual data or reports.

In addition to reporting the mix of first-time homebuyers in the mortgage market, we also report the number of homes sold to first-time homebuyers. This allows us to tie the first-time homebuyer market with home sales and purchase loan originations, which is very important to understanding the impact of first-time homebuyers on the entire housing market. Our series goes back to 1994, which allows users to place today’s market size in the context of the last two housing cycles. In addition, we separately identify first-time homebuyers enabled by private mortgage insurance from the overall conventional market. By doing so, we provide an estimate of the low down payment mortgage market, which is an important source of credit to first-time homebuyers.

2017 TRENDS

First-time homebuyers continued to lead the housing recovery in 2017. In the second quarter, they purchased 570,000 single-family homes, an increase of eight percent from a year ago, exceeding the two percent growth rate reported for overall single-family home sales. It was the biggest second quarter for first-time homebuyers since 2000. This brings the total number of single-family homes sold to first-time homebuyers to 996,000 in the first half, an increase of 83,000 from the same period last year. Based on first half performance, 2017 is shaping up as one of the biggest years for the first-time homebuyer market. First-time homebuyers accounted for 36 percent of all single-family homes sold during the quarter, and 57 percent of the purchase mortgages originated. The first-time homebuyer market has reported faster growth compared to the overall market every quarter since the third quarter of 2013. During the second quarter, the year-over-year growth in home sales to first-time homebuyers (42,000 units) exceeded the growth in single-family home sales (32,000 units), which means that first-time homebuyers are driving growth in the housing market.

¹ The full definition is archived here: https://archives.hud.gov/offices/hsg/sfh/ref/sfhp3-02.cfm. See our inaugural June report under the section “Who is a First-Time Homebuyer?” for a discussion of the difference between the HUD definition and the literal definition.

² See “Estimating the First-Time Homebuyer Market” and “Appendix” sections in our June report for a detailed discussion on our methodology, data sources, and assumptions.
As has been the case for the past two years, home sales growth during the first half of 2017 was in large part driven by growth in the first-time homebuyer market. Sales of single-family homes to first-time homebuyers was 83,000 units higher compared to a year ago, accounting for around 83 percent of the growth in single-family home sales.

**Fig. 1**

**First-Time Homebuyer Market**

The first-time homebuyer market follows a clear seasonal pattern, with more sales during the peak home selling season in Q2 and Q3.

**Source:** Genworth Mortgage Insurance

**Fig. 2**

**First-Time Homebuyer Mix**

The seasonal pattern for the first-time homebuyer market is different from the overall housing market, resulting in a higher mix in Q3 and Q4 compared to the first two quarters.

**Source:** Genworth Mortgage Insurance
While new construction aimed at first-time homebuyers has not seen any meaningful industry impact in the past few years, growth in the first-time homebuyer market is beginning to catch the attention of the homebuilding industry. During the first half, homebuilders reported faster sales growth in the “low” end of the market. New single-family homes priced between $200,000 and $250,000, the segment popular with first-time homebuyers, was the fastest-growing segment, reporting year-over-year growth of 33 percent during the first half. But the volume increase has remained modest at 13,000 units for this time period. For the full year, we believe that homebuilders will likely add 20,000 to 30,000 units in that price range. Given that sales to first-time homebuyers grew by over 80,000 units in the first half already, the market will likely remain under-supplied in the near term. However, we do think that the increase in production at the “low” end of the market will continue over the next few years and will be an important source of growth for the homebuilding industry.

The insufficient supply of new homes has led to further tightening in the housing market. In the market for previously-owned homes, inventory available for sale was down eight percent year over year during the second quarter, and the supply of homes for sale has come down to 4.2 months of sales during the second quarter, compared to 4.6 months a year ago.

Another way the housing market adjusts to insufficient supply is through the drawing down of vacant housing units so that the available housing stock is used more efficiently. Compared to a year ago, the number of vacant housing units for sale was down by 100,000 units during the second quarter, reducing vacancy rates to 1.5 percent, which is their lowest level since 1994.

Finally, the tighter housing market has put further pressure on home price appreciation. Home price growth has accelerated since 2014. In the first two months of the second quarter, home prices were 6.9 percent above the level from a year ago, up from the six percent growth rate in 2016. Even though homebuilders are beginning to increase production at the “low” end of the market, the response so far seems insufficient to ease the pressure on inventory, or for home prices to moderate beginning later this year. In our view, strong first-time homebuyer demand and a lack of insufficient supply response from homebuilders means that growth in home prices will not likely slowdown in 2017 and 2018. The lack of supply is the biggest limiting factor facing first-time homebuyers in the housing market, and it is unlikely to be resolved in the near term. This puts us at odds with the consensus view among economists calling for slower home price growth starting this year. The argument goes that home price growth is outstripping income growth and the eroding affordability is not sustainable. While deteriorating affordability will price some first-time homebuyers out of the market, our view is that the large influx of first-time homebuyers will continue to push prices higher.
Supply of Existing Homes For Sale

The supply of existing homes for sale has tightened since 2014.

Vacant Homes For Sale

The Homeowner Vacancy rate is at its lowest level since 1994.
First-time homebuyers represent the transition of housing demand from rental to owner-occupied housing. Stronger first-time homebuyer demand is consistent with rising homeownership rates, especially among households headed by younger adults. This pattern is beginning to appear in homeownership rate data. In the second quarter, the homeownership rate for all households was 63.7 percent, 0.8 percentage point higher than a year ago. The increase was largest for households headed by people under 35 years of age. At 35.3 percent, it was 1.2 points higher than a year ago. But it remains well below the 2004 peak of 43.6 percent. Even as the first-time homebuyer market has reached historical levels, we must remember that among younger households, the homeownership rate remains quite low, so further growth in that market is likely to continue.
The growing presence of first-time homebuyers has been reshaping the mortgage market. Since first-time homebuyers typically rely on mortgages to finance their purchases, rising first-time homebuyer demand has reduced the percentage of home sales paid for by cash. During the second quarter, all-cash sales were down three percent year over year. The flipside of fewer all-cash sales is that the number of purchase mortgage loans has been growing faster than home sales. The purchase mortgage loan count was up five percent from a year ago during the second quarter, beating the two percent growth in the number of single-family homes sold. As home sales growth slowed during the second quarter, first-time homebuyers and the replacement of cash-buyers became a bigger source of growth in the mortgage market.

Within the mortgage market, first-time homebuyers have always relied on mortgage products with lower down payments, defined as those with a combined loan-to-value ratio (LTV) of 80 percent or higher (higher LTV means lower down payment). This reliance means that the first-time homebuyer mix moves inversely with down payment requirements so that low down payment mortgage products attract a higher percentage of first-time homebuyers. During the second quarter, 68 percent of all homebuyers using low down payment mortgages were first-time buyers, but only 36 percent of those using high down payment purchase loans were. This shows that down payment affordability is a greater hurdle for first-time homebuyers than it is for repeat homebuyers, and that low down payment mortgage products are necessary for accelerating the path to homeownership for many. Overall, around 78 percent of all first-time homebuyers used some form of low down payment mortgages, compared to 22 percent using high down payment mortgages.

In the second quarter, the homeownership rate for households headed by people under the age of 35 increased by 1.2 percentage points.

Homeownership Rates by Age of Householder

Source: Genworth Mortgage Insurance, Census Bureau Housing Vacancy Survey
The number of first-time homebuyers increased across low and high down payment mortgage products during the second quarter. Low down payment mortgage products financed 448,000 home sales to first-time homebuyers, which is an increase of eight percent from a year ago. By comparison, high down payment mortgage products financed 123,000 home sales to first-time homebuyers, and was also up eight percent from a year ago. What this shows is that the increase in the first-time homebuyer market is largely organic, rather than driven by easy credit. It is first-time homebuyers driving the mortgage credit expansion, rather than easy credit driving the first-time homebuyer market.

68 percent of all homebuyers using low down payment mortgages were first-time buyers, but only 36 percent of those using high down payment purchase loans were.

Around 78 percent of all first-time homebuyers used some form of low down payment mortgages, compared to 22 percent using high down payment mortgages.
Within the low down payment mortgage market, private mortgage insurance saw significantly higher growth during the second quarter, as lenders and borrowers gradually embraced the 97 LTV products. The private mortgage insurance industry helped 163,000 first-time homebuyers during the second quarter, which is an increase of 17 percent from a year ago. Other low down payment products reported growth rates of six to eight percent. The private mortgage insurance industry and the FHA, the two largest providers of financing for first-time homebuyers, together accounted for close to three quarters of the growth in the first-time homebuyer market during the second quarter.

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<th>First-Time Homebuyer Market Growth, 1H 2017</th>
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Government lending programs remained very large in the first-time homebuyer market. During the second quarter, government lending programs helped 272,000 first-time homebuyers, up three percent from a year ago. Government lending programs’ footprint in the purchase market and in the first-time homebuyer market segment today are over three times the size they were 10 years ago. Because of their low down payment focus, the footprint of government lending programs will likely grow with the first-time homebuyer market.

**MORTGAGE PRODUCT CHOICE**

Housing finance as a key input is critically important to the housing market. The approach we have adopted to estimate the first-time homebuyer market helps us build a bridge between the housing market and the mortgage market. The chart on the next page (fig. 11) shows the composition of the single-family housing market from a financing and homebuyer status perspective, illustrating the relationship between the housing and mortgage markets. Each block in the chart shows a group of first-time or repeat homebuyers using a particular method of financing. The size of each block is proportional to the number of homebuyers in that category.

The single-family housing market reported home sales of 2.7 million units in the first half of 2017. Based on our estimate, 1.7 million units were purchased with mortgage financing, which implies that close to 1.0 million units were purchased with cash or bought by international homebuyers. Among the 1.7 million units purchased by homebuyers who intend to use the property as a primary residence, one million were first-time homebuyers and 0.7 million were repeat homebuyers. The 1.7 million combined homebuyer market can also be divided into different mortgage products: private mortgage insurance (0.46 million), FHA loans (0.43 million), below-80 percent LTV GSE loans (0.35 million), other conventional markets (0.24 million), VA loans (0.17 million), and USDA loans (0.06 million).

<sup>3</sup>Low down payment mortgage
As first-time homebuyers enter the housing market and take on mortgage debt, household mortgage debt growth has accelerated. We estimate that mortgage debt outstanding at the end of the second quarter was four to five percent higher compared to a year ago, vs. growth rates of one to two percent during 2015 and 2016. Growth was even faster among low down payment mortgage segments during the second quarter. Ginnie Mae and the mortgage insurance industry reported year-over-year growth rates of nine percent and 13 percent for their respective mortgage portfolios. This is a departure from the post Housing Crisis period. The total amount of mortgage debt outstanding at the end of 2016 is lower than its 2007 peak level of $11.3 trillion. Although it has begun to increase in 2015 and 2016, the rate of increase has been very modest at one to two percent. First-time homebuyers will likely support a faster growth rate in mortgage debt outstanding, which means more mortgage debt will need to be held by investors. The other source of increased supply of mortgage debt will come from the Federal Reserve, which is expected to unwind its holdings of Treasury and mortgage backed securities (MBS). The Federal Reserve’s holding of MBS alone amounts to $1.7 trillion. These two changes will likely test investor appetite for mortgage debt and put upward pressure on mortgage rates.
Residential mortgage debt outstanding in 2016 was below its 2007 peak, but is expected to rise due to expansion in the first-time homebuyer market.

Source: Federal Reserve Board
CONCLUSIONS

Based on data from the first half, we believe that 2017 is shaping up as one of the biggest years for first-time homebuyers in the housing market on record—significantly higher than the historical average of 1.8 million units between 1994 and 2016. Some of the three million missing first-time homebuyers who delayed home purchases are returning to the housing market, while members of the millennial generation are reaching primary home-buying ages. The combination of pent-up demand and demographic tailwinds have led to the surge in the first-time homebuyer market over the past two and half years, and are having a profound impact on the housing market. As we noted in our inaugural June report, unlike the previous housing cycle, which had been led by repeat homebuyers, the current housing cycle has been led by first-time homebuyers. During the first half, 83 percent of the growth in home sales is driven by first-time homebuyer demand. Further, the rapid growth in the first-time homebuyer market has been largely organic. While the 97 LTV program has been helpful, we find evidence that strength in the first-time homebuyer market is evident across all mortgage product categories and that first-time homebuyer demand is largely driving credit expansion, not the other way around.

The rapid increase in the number of first-time homebuyers over the past two and half years has revived the momentum in homeownership among younger households. It is generating strong demand for new and existing affordable single-family homes, for mortgage credit, and normalizing the housing market away from cash sales. It is absorbing vacant housing inventory and creating home equity for homeowners. A comparison of where the homeownership rate is today—even after recent gains—with where it has been historically shows that further gains are viable.

The main challenge arising from the strong first-time homebuyer market is the lack of new construction at the “low” end of the market, which has created upward pressure on home prices. The increased supply in the $200,000-$250,000 price range during the first half of this year is welcome, but clearly insufficient relative to the size of demand. Our expectation is different from the consensus view on this. The consensus view among housing economists today is that the home price growth over the past few years is unsustainable, and will cool down soon as supply increases. That seems unlikely given the demand and supply imbalance we are seeing today, which we expect will continue in the near-term. The inability of the homebuilding industry to expand production of affordable homes has many potential causes, and will require a collaborative approach from policymakers and the housing industry to generate appropriate solutions.

The next challenge is that the expansion in mortgage credit will be large compared to what the secondary market has experienced in the last few years. Coupled with the Federal Reserve’s desire to unwind its holding of mortgage debt, it will create upward pressure on interest rates and potentially more volatility as well.
ABOUT TIAN LIU

Tian Liu has served as Chief Economist for Genworth Mortgage Insurance Corporation since 2014. He is responsible for tracking and analysis of U.S. and regional economic conditions. He authors the company’s Weekly Economic Report and provides regular updates on housing and mortgage markets. Mr. Liu began covering the U.S. housing market in 2007. His commentary on the housing market has appeared in the Wall Street Journal, New York Times, CNBC, Washington Post, and other notable publications.

Mr. Liu has a Masters in Economics from the University of Chicago and an undergraduate degree in Economics from the Australian National University. He resides in Raleigh, North Carolina, with his wife and two children.