GENWORTH MORTGAGE INSURANCE

FIRST-TIME HOMEBUYER MARKET REPORT

FEBRUARY 2018

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The housing market expanded moderately in the fourth quarter, as single-family home sales increased two percent from a year ago. Sales to first-time homebuyers continued to lead the housing market, while sales to repeat buyers remained flat. Growth in the first-time homebuyer market continued, but at a slower rate. This slower pace of growth reflects two trends in the housing market today. One is that the first-time homebuyer market has made a significant recovery since 2014, growing by 40 percent. It is no longer cyclically depressed compared to the historical average. In fact, the first-time homebuyer market had a very strong year in 2017, with more than two million first-time homebuyers completing home purchases. The second reason for slower growth is that housing supply of new homes priced below $300,000, which is the main price point for first-time homebuyers, has not kept pace with the growing demand. The larger presence of first-time homebuyers has made that problem far more acute.

In our inaugural report, we noted that the current housing cycle differs from the previous cycle in that it is driven by first-time homebuyers. As the first-time homebuyer market matures, what does it mean for the wider housing market? We believe that while growth in the first-time homebuyer market will be more moderate, it will continue to play an important role in the housing market. While the first-time homebuyer market has grown, we are reminded that there are still 2.7 million missing first-time homebuyers since the Housing Crisis started in 2007, and it will take time to bring back those first-time homebuyers. We expect that the footprint of first-time homebuyers will continue to dominate the mortgage market, where over 55 percent of purchase mortgages go to first-time homebuyers. In the housing market, we will continue to see around 40 percent of single-family home sales go to first-time homebuyers. For homebuilders, even if direct exposure remains low, the tighter market created by first-time homebuyers will boost price and provide ready liquidity for repeat buyers. A historically large first-time homebuyer market will also likely raise the homeownership rate among younger households, which remains low.
historically. In the mortgage market, we expect the expansion of the first-time homebuyer market to boost the mortgage debt balance of American households, creating opportunities for mortgage lenders and investors. We also expect the low down payment mortgage market—in particular, the private mortgage insurance market—to continue to grow with the first-time homebuyer market.

The overall macroeconomic environment remains favorable for the housing market and first-time homebuyers. We believe that the new tax law will be positive for the housing market, by raising the after-tax income of potential first-time homebuyers and increasing the after-tax profitability to homebuilders (see our analysis [here](#)). However, we believe the higher inflationary pressure from the tax cut at a time of full employment to be behind the recent run-up of interest rates. And we think it will create uncertainty in the housing market in the near term. Between September 2017 and early February 2018, mortgage interest rates have jumped by 50 basis points. It is worth watching because, in the last major run-up in interest rates between April and September 2013 (with about twice the increase), the growth of the first-time homebuyer market slowed from 12 percent to two percent, and the growth of the repeat buyer market slowed from 19 percent to three percent.
KEY FINDINGS:

1. In the fourth quarter, first-time homebuyers purchased 505,000 single-family homes (fig. 1), up four percent from a year ago. This accounted for 39 percent of all single-family homes sold (fig. 3), and 55 percent of all purchase mortgages originated (fig. 4).

2. 2017 marked another year of growth for the first-time homebuyer market with 2.07 million first-time homebuyers (fig. 2) purchasing either new or existing homes, an increase of 129,000 (or seven percent) from a year ago. It not only crossed the two million mark, but also represented the best year for the first-time homebuyer market segment since 2006. Over the past three years, the first-time homebuyer market has grown by 588,000, or 40 percent. Growth in this segment has also been the main engine of growth in the housing market in the past three years, representing 82 percent of the increase in the number of transactions in the housing market. In 2016 and 2017, the expansion in the first-time homebuyer market has pushed the market above its historical average, decreasing the three million deficit created by the Housing Crisis. As of year-end 2017, we estimate that 2.7 million first-time homebuyers are still missing from the housing market since 2007.

3. In 2017, 3.4 million single-family homes were sold to repeat buyers, unchanged from a year ago. While the first-time homebuyer market expanded significantly over the last three years, the repeat homebuyer market has been largely flat (fig. 7). Existing homeowners are staying in their homes longer, reducing the liquidity in the housing market.

4. The first-time homebuyer market again grew faster than both purchase originations and overall home sales in the fourth quarter. It also continued to out-perform the repeat buyer market in both the home sales market and the mortgage market (fig. 5, fig. 6). A flat repeat buyer market resulted in slower growth in total home sales.

5. Growth in purchase originations again exceeded growth in single-family home sales in the fourth quarter, reflecting a continued decline in cash-sales. Faster purchase origination growth over home sales has been a constant trend since 2012 (fig. 8). The purchase mortgage loan count was up three percent from a year ago during the fourth quarter, while single-family home sales increased by two percent. For the full year 2017, the number of purchase loans is up five percent from last year, while home sales are up two percent.

6. Despite strong growth in the overall first-time homebuyer market, we continue to see very disappointing trends in the supply of new homes affordable to first-time homebuyers. New homes priced under $250,000, which is the key price segment for first-time homebuyers, were flat in the fourth quarter and down two percent in 2017. Homebuilders reported faster sales growth in new single-family homes priced between $200,000 and $250,000, which is up 16 percent from a year ago (table 2, fig. 16). But that growth came at the expense of homes priced below $200,000. Growth in new home sales was concentrated in the $300,000 and above price segment, which will add overall supply to the housing market (more specifically to the repeat buyer market) and benefit first-time homebuyers indirectly. However, compared to prior housing cycles,
this will result in a slower increase in housing supply and more home price growth, which means that the overall housing market should remain a seller’s market.

7. The single-family housing market continues to experience an insufficient supply of homes for sale. During the fourth quarter, the supply of existing homes for sale averaged 3.5 months, down from 4.0 months a year ago (fig. 15).

8. The lack of housing supply has led to accelerating home prices. In 2017, home price appreciation, as measured by the Federal Housing Finance Agency (FHFA) home price index for purchase loans, accelerated to 6.7 percent growth, up from 6.1 percent growth a year ago (fig. 17).

9. Since first-time homebuyers represent the transition of housing demand from rental to owner-occupied housing, strong first-time homebuyer demand is beginning to lift homeownership rates, especially for households headed by younger adults. In the fourth quarter, homeownership rates among households headed by people under 40 saw the largest gains (fig. 9). But even after these recent gains, they remain well below historically normal levels. This suggests that the first-time homebuyer market will likely remain strong in the coming years.

10. Within the mortgage market, first-time homebuyers have historically relied on lower down payment mortgages, defined as those with a combined loan-to-value ratio (LTV) of 80 percent or higher. When buying a home, 79 percent of first-time homebuyers used a low down payment mortgage, while 21 percent used a high down payment mortgage in the fourth quarter (fig. 11).

11. Growth in the number of first-time homebuyers was not limited to the low down payment mortgage segment. Low down payment mortgages financed 398,000 home sales to first-time homebuyers, up three percent from a year ago (table 1, fig. 10) and the highest fourth quarter since 2000. High down payment mortgage products financed 107,000 home sales to first-time homebuyers, an increase of eight percent from a year ago. High down payment lending to first-time homebuyers had its best fourth quarter since 2007.

12. Among low down payment mortgage products, private mortgage insurance again reported the fastest growth in first-time homebuyers, as more lenders and borrowers embraced 97 LTV products. This was the 26th consecutive quarter of growth for the industry. The private mortgage insurance industry insured loans for 157,000 first-time homebuyers during the fourth quarter (fig. 12). This represented an increase of 22 percent from a year ago (table 1) and the best fourth quarter since the Genworth data series started in 1994. The private mortgage insurance industry is also the segment of the mortgage market that has seen the biggest increase in the mix of first-time homebuyers in the current housing cycle (fig. 13). In contrast, eight percent fewer first-time homebuyers used mortgages backed by the Federal Housing Administration (FHA). While the FHA remains the single largest source of financing for first-time homebuyers at 167,000 loans for the quarter (fig. 12), private mortgage insurance should take over that role in the near future, assuming that the current trend continues. Elsewhere in the low down payment mortgage market, VA reported a five percent increase in its first-time homebuyer market, while USDA reported a ten percent decrease for the fourth quarter.

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3 First-Time Homebuyer
13. Government lending programs remained very large in the first-time homebuyer market. During the fourth quarter, 232,000 first-time homebuyers purchased homes using government lending programs, representing 46 percent of the entire market (fig. 14). The footprint of government lending programs in the purchase market and in the first-time homebuyer market segment have expanded sharply over the last ten years.

DEFINING AND ESTIMATING THE FIRST-TIME HOMEBUYER MARKET

In these reports, 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 years\(^4\). Adopting this definition allows us to use data available from the mortgage industry and from government agencies, which is the basis of our methodology\(^5\). 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 21.8 million first-time homebuyer records between 1994 and 2017, accounting for 50 percent of the estimated total number of first-time homebuyers. Of the estimated 2.1 million first-time homebuyers in 2017, over 1.7 million or 81 percent 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.

\(^4\)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.

\(^5\)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.
Q4 2017 TRENDS

FIRST-TIME HOMEBUYERS STILL THE FASTEST GROWING SEGMENT AMID HOUSING SLOWDOWN

After a weak third quarter, home selling activities returned to moderate growth in the fourth quarter. Sales of single-family homes during the quarter were up two percent from a year ago. Growth in single-family home sales began to slow down in the second quarter of 2017, resulting in a full year growth rate of just two percent. While the slowdown affected both first-time homebuyers and repeat buyers, the number of first-time homebuyers continued to grow. During the quarter, first-time homebuyers purchased 505,000 single-family homes, an increase of four percent from a year ago. It was the best fourth quarter for the first-time homebuyer market since 2006. For the full year, the total number of single-family homes sold to first-time homebuyers was 2.07 million units, 129,000 units (or seven percent) more than 2016. However, growth has decelerated compared to 2015 and 2016, when the first-time homebuyer market grew by 18 percent and 12 percent, respectively. The slowdown is to be expected since the first-time homebuyer market has expanded by almost half a million over two years, and has stayed above its historical average of 1.8 million a year for the past two years. Over the past three years, the housing market has seen 588,000 more first-time homebuyers, an increase of 40 percent. To put this number in perspective, the number of single-family home sales over the same period has increased by 717,000. So 82 percent of the increase in housing market transactions has come from first-time homebuyers. The first-time homebuyer market has released some of the pent-up demand that has accumulated over the past ten years and is beginning to restore homeownership rates among younger households.

Fig. 1

First-Time Homebuyer Market—Quarterly

Source: Genworth Mortgage Insurance

Q4 was the best fourth quarter for the first-time homebuyer market since 2006.
MORE FIRST-TIME HOMEBUYERS IN THE HOUSING MARKET

First-time homebuyers have been the primary driver in the current housing cycle. The first-time homebuyer market has reported faster growth compared to overall single-family home sales since the third quarter of 2012. That trend continued in the fourth quarter; home sales to first-time homebuyers increased by 20,000 units, while overall single-family home sales were up 22,000 units. But, the slowdown in the first-time homebuyer market means that the growth rate in the segment was similar to what was experienced in the overall housing market. For the full year, sales of single-family homes to first-time homebuyers were up 129,000 units from a year ago, while the total number of single-family homes sold grew by only 101,000 units. This is because the number of homes sold to repeat buyers fell by 24,000 units. In the mortgage market, the number of mortgages to repeat homebuyers increased by 3,000 units from a year ago during the fourth quarter, but was up 38,000 for the entire year.

The first-time homebuyer’s share of the single-family housing market increased by one point in the fourth quarter to 39 percent, and its share in the purchase origination market increased from 54 percent to 55 percent. First-time homebuyers always represent a larger share of the purchase origination market than the housing market because, compared to other buyers, they are more reliant on mortgage financing. For the entire year, first-time homebuyers accounted for 38 percent of the housing market, up from 36 percent in 2016; and its share in the mortgage market increased from 54 percent to 55 percent. The share of first-time homebuyers in the housing market has seen a notable uptick in this housing cycle. In 2014, first-time homebuyers accounted for 31 percent of home sales and 52 percent of purchase mortgage originations. Historically, first-time homebuyers have accounted for 35 percent of home sales and 46 percent of purchase mortgage originations. The first-time homebuyer market has now surpassed its historical market share.

The FTHB market has expanded by almost 600 thousand over 3 years, and is expected to stay above its historical average of 1.8 million.
The FTHB mix has increased steadily over the past 3 years. It accounted for 39% of home sales and 55% of home purchase borrowers in Q4.
RETREAT OF REPEAT BUYERS A DRAG FOR HOME SALES

Repeat homebuyers purchased 800,000 single-family homes during the fourth quarter, unchanged from a year ago. Repeat buyers with mortgage financing increased by one percent in the fourth quarter, while cash buyers were unchanged from a year ago. Repeat buyers have not been the engine of growth in the current recovery. Over the past three years, home sales to repeat buyers have been largely flat. Repeat buyer growth has been stronger in the mortgage market, because fewer repeat buyers have relied on cash. The number of cash sales has been falling.

The FTHB market has grown faster than the rest of the housing market since 2013.

The FTHB market has grown faster than the purchase origination market since 2015.
The growing presence of first-time homebuyers has been re-shaping 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. In 2017, all-cash home sales decreased seven 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, exceeding growth in the single-family housing market, which grew by two percent.

The lower mix of cash sales and rising FTHBs have helped purchase origination growth to exceed home sales.
Repeat buyers come to the housing market when consumers’ housing demand changes and their current homes no longer meet their needs or aspirations. Job changes, changes in income and interest rates, build-up of housing equity due to normal repayment, and higher home prices can all change housing demand. The current environment of rising income, more job openings, and substantial accumulation of home equity from rising home prices should result in greater housing demand from repeat homebuyers, not less. The decline in sales suggests that lower inventory in the housing market may have discouraged potential repeat buyers in the past few quarters. Repeat homebuyers with an existing home can afford to delay home buying more than first-time homebuyers. Many homeowners see remodeling as an alternative to buying, and this is borne out by stronger growth in remodeling spending. Therefore, the supply pressure on home prices is felt more by first-time homebuyers, while the supply pressure on the availability of homes is felt more by repeat homebuyers. Finally, higher mortgage rates this year have increased the cost of financing, and may have contributed to lower sales to repeat homebuyers. Lower sales to repeat buyers in an otherwise positive macro environment is an indication that the housing market is not working well for all potential homebuyers, and also serves to remind the housing industry that low inventory can damage the industry as well as homebuyers.

**RISING HOMEOWNERSHIP RATE AMONG YOUNGER HOUSEHOLDS**

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 the homeownership rate data. In the fourth quarter, the homeownership rate for all households was 64.2 percent, 0.5 percentage point higher than a year ago. The increase was largest for households headed by people under the age of 35 (up 1.3 percentage points to 36 percent), and between 35 and 39 (up 1.6 percentage points to 56.6 percent). Homeownership rates for the under-35 group remain well below their historical average of 39 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, even if it does not fully recover to peak levels.
FIRST-TIME HOMEBUYER DOWN PAYMENT CHOICE

First-time homebuyers have always relied on mortgage products with lower down payments, defined as those with a combined LTV of 80 percent or higher. This reliance demonstrates 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. When policymakers, lenders, and housing advocates discuss ways of lifting homeownership, down payment affordability should be an important consideration. In the fourth quarter, 79 percent of first-time homebuyers used low down payment mortgages, while only 21 percent used high down payment mortgages. The market share of low down payment mortgages among first-time homebuyers is largely unchanged in the past year, but has increased by four percentage points over the past three years to 79 percent.

Source: Census Bureau Housing Vacancy Survey

A strong FTHB market is beginning to lift homeownership rates among younger households.
Low down payment mortgages attract a higher percentage of first-time homebuyers than high down payment mortgages. During the fourth quarter, 66 percent of low down payment mortgages went to first-time buyers, versus only 35 percent of high down payment purchase loans. The availability of low down payment mortgages is therefore an important factor in expanding the first-time homebuyer market.

During the past three years, the mix of first-time homebuyers in the mortgage market has increased from 52 percent to 55 percent, an increase of 3 percentage points. During the same period, the share of first-time homebuyers is around three percentage points higher among homebuyers with low down payment mortgages, and unchanged among homebuyers with high down payment mortgages. So the increase in the overall first-time homebuyer mix is only due in part to higher first-time homebuyer mix among low down payment mortgage borrowers. The low down payment mortgage market, which has a higher-than-average first-time homebuyer mix, has expanded more rapidly than the overall purchase market. Over the last three years, the mix of low down payment mortgages has increased from 62 percent to 66 percent of the total purchase mortgage market. Therefore, the increase in first-time homebuyer mix has come from more first-time homebuyers using low down payment mortgages, as well as a bigger market share for low down payment mortgages. In fact, the market share of low down payment purchase mortgages is at the higher end of the 24-year period covered by our dataset.
MI MARKET SHARE CONTINUES ITS UPWARD TRAJECTORY

Within the low down payment mortgage market, private mortgage insurance saw significantly higher growth during the fourth quarter, as lenders and borrowers increasingly turned toward 97 LTV products. The private mortgage insurance industry helped 157,000 first-time homebuyers during the fourth quarter, which is an increase of 22 percent from a year ago. For the full year, the private mortgage insurance industry provided credit enhancement on 600,000 first-time homebuyer mortgages, up 18 percent from 2016.

The growth experienced by the mortgage insurance industry is due in part to the higher first-time homebuyer mix in its purchase loans. Compared to other segments of the mortgage industry, the mortgage insurance industry has seen the largest gain in its mix of first-time homebuyers. We expect this trend to continue as loans with 97 LTVs continue on a growth trajectory. The expansion in the private mortgage insurance industry means that it is catching up to the FHA, which remains the largest provider of loan guarantees for first-time homebuyers in the mortgage market. The FHA financed 167,000 first-time homebuyers, down 8 percent from a year ago during the fourth quarter. For the full year, the FHA provided credit guarantees on 711,000 first-time homebuyer mortgages, down three percent from a year ago. If this trend continues, the private mortgage insurance industry should replace the FHA as the largest source of credit enhancement for the first-time homebuyer market in 2018. Historically, the FHA’s market share has contracted during housing expansions, allowing private capital to play a bigger role in the mortgage market. The number of VA loans to first-time homebuyers was up five percent during the fourth quarter, while USDA loans to first-time homebuyers were down ten percent.

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<tr>
<th>First-Time Homebuyer Market Growth, Third Quarter</th>
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<tr>
<td></td>
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<tr>
<td>Q4</td>
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<tr>
<td>Growth (#)</td>
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<tr>
<td>2017</td>
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<tr>
<td>Growth (#)</td>
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<td>Growth Rate (%)</td>
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Source: Genworth Mortgage Insurance

<sup>6</sup> Low down payment mortgage

FHA remains the top mortgage product for FTHBs in Q4, but private MI is the fastest-growing and will likely become the top product soon.
The number of FTHBs has increased across all mortgage products in the current housing cycle.

Private MI has seen its FTHB mix rising strongly since 2011.
GOVERNMENT LENDING RETAINS A LARGE FOOTPRINT IN THE FIRST-TIME HOMEBUYER MARKET

The pullback in FHA loans this quarter resulted in fewer government loans to first-time homebuyers. During the fourth quarter, government lending programs helped 232,000 first-time homebuyers, down six percent from a year ago. 2017 was the first year in the current housing cycle that government lending to first-time homebuyers decreased. For the full year, government loans to first-time homebuyers were down by less than one percent. Despite this decline, government lending programs’ footprint in the purchase market and in the first-time homebuyer market segment today are around three times the size they were ten years ago. The share of government loans in the first-time homebuyer market has increased from 20 percent in 2007 to 46 percent in the last quarter. These programs played an important counter-cyclical role in supporting the first-time homebuyer market during the Housing Crisis. However, with the first-time homebuyer market no longer in need of this high level of support, the policy rationale for maintaining such a large presence has diminished.

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.15) 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 5.5 million units in 2017. Based on our estimate, 4.2 million units were purchased with mortgage financing, which implies that 1.3 million units were purchased with cash or bought by international homebuyers, and another half a million loans were originated for homes purchased by owners who did not intend to live at the property. Among the 3.7 million units purchased by homebuyers who intend to use the property as a primary residence, 2.1 million were first-time homebuyers and 1.7 million were repeat homebuyers. The 3.7 million combined homebuyer market can also be divided into different mortgage products: private mortgage insurance (1.0 million), FHA loans (0.9 million), below-80 percent LTV GSE loans (0.8 million), other conventional markets (0.4 million), VA loans (0.4 million), and USDA loans (0.1 million).

Compared to 2016, the conventional mortgage market reported an eight percent increase in the number of purchase loans, while government loans were down 0.5 percent and cash sales were down 7 percent. Within the housing market, the private mortgage insurance industry reported the fastest growth in the mortgage market with an 11 percent increase in purchase loan growth. It also displaced FHA as the largest credit enhancement on purchase mortgages, covering over one million purchase loans.

Source: Genworth Mortgage Insurance
SLOW GROWTH IN HOUSING SUPPLY AND LACK OF SUPPLY IN AFFORDABLE HOMES

The slow recovery in new single-family housing and the sharp cutback in affordable housing have been two problems facing the current housing recovery. While there is increased awareness of growing first-time homebuyer demand in the homebuilding industry, sales growth in that segment has been moderate. In the under-$250,000 price segment, sales declined by two percent in 2017. Sales of new homes priced under $200,000 have fallen by 17 percent and will likely experience further declines. The bright spot has been single-family homes priced between $200,000 and $250,000, where homebuilders have increased production. In 2017, this segment grew by 16 percent. Another price segment to pay attention to is the $250,000 to $300,000 segment, which is the price segment just above the median home price. While this price segment was up only one percent in 2017, it grew 17 percent year-over-year, so that is a possible area where homebuilders are expanding production. Growth in new construction is still concentrated in the $300,000 and above price segment, which increased 15 percent in 2017. This is well above the national median home price for existing homes and also likely beyond what many first-time homebuyers can afford. This can still benefit first-time homebuyers indirectly by expanding housing supply to cater to potential repeat homebuyers, and making more affordable existing homes available to potential first-time homebuyers. But compared to past housing cycles, this has resulted in a slower recovery in housing supply and a faster growth in home prices.

### Table 2: Growth in New Home Sales by Sales Price

<table>
<thead>
<tr>
<th>Sales Price</th>
<th>2017 Growth Rate ('000 units)</th>
<th>2017Q4 Growth Rate ('000 units)</th>
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<td>-19% (-3)</td>
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<tr>
<td>Over 750K</td>
<td>35% (8)</td>
<td>50% (3)</td>
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</table>

Source: Census Bureau

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 ten percent year over year during the fourth quarter. The supply of homes for sale has come down to 3.5 months of sales during the fourth quarter, compared to 4.0 months a year ago. A seller’s market is defined as one with less than six months’ worth of inventory at the current sales pace, which puts upward pressure on home price appreciation. Home price growth has accelerated since 2014. In the first eleven months of 2017, home prices were 6.7 percent above the level from a year ago, up from the 6.2 percent growth rate in 2016. Even though
homebuilders are beginning to increase production at the “lower” end of the market, the response so far seems insufficient to ease the pressure on inventory, or for home prices to moderate. In our view, strong first-time homebuyer demand and insufficient increase in supply will keep home prices growing at the current pace in 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 in 2018. 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 for at least another year. 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 insufficient increase in supply will keep home prices growing at the current pace 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 should maintain home price growth for at least another year.
Fig. 17

**New Homes Sold—by Sale Price**

- Source: Census Bureau

Fig. 18

**Home Price Appreciation**

- Source: FHFA Purchase-Only Index

The large influx of FTHBs should maintain home price growth for at least another year.

The current recovery has seen no growth in new homes priced under $250,000.
IMPLICATIONS OF RISING HOME PRICES

Rising home prices will likely have many secondary effects. Within the housing market, this will create the incentive for more new housing developments further away from existing amenities, where land prices are more affordable. Rising home prices will result in a higher average loan balance and result in higher origination volume without an increase in home sales or in loan count. The 6.7-percent increase in home prices has already pushed the conforming loan limit on conventional mortgages to $453,100 in 2018. For homebuyers, rising home prices will likely result in both higher debt loads and larger monthly mortgage payments.

For existing homeowners, rising home prices have already sharply increased the amount of homeowner’s equity. Historically, homeowner’s equity has been used to increase household’s housing-related consumption, driving more move-up home-buying and more remodeling and repair projects. The lack of supply in the housing market will likely push more spending towards remodeling and repair projects. Homeowner’s equity can also be used to finance non-housing related consumer spending. Whether housing-related or not, higher home prices will likely result in increased consumer spending, which will likely drive increased refinance activities through cash-out refinancing loans and home equity loans. Equity extraction will become the key motivation for refinancing as home equity accumulates and interest rates rise.

POTENTIAL IMPACT OF THE NEW TAX LAW

On the individual tax side, the new tax law contains three important measures that will likely affect the disposable income of potential first-time homebuyers. These are lower individual tax rates, higher limits on standard deductions, and increased child-tax credit. Based on estimates by the Joint Committee on Taxation, these three measures are expected to reduce tax revenue by $286 billion in fiscal year 2019 (the first full year under the new tax law). This is offset by the repeal of deduction for personal exemptions, which is expected to increase tax revenue by $137 billion in fiscal year 2019, which results in a net tax reduction of $149 billion, or around 1 percent of the after-tax personal income.

Looking at a home-owning family with median income based on 2016 Home Mortgage Disclosure Act data (HMDA), median-priced home (and a 30 year mortgage), and two kids, we estimate that lower individual tax rates will likely reduce income tax by $1,300, higher standard deduction will likely reduce income tax by $2,000, and higher child-tax credit will likely reduce income tax by $2,000, but the elimination of personal exemptions will likely increase income tax by $4,000, resulting in a net reduction of $1,300 or close to 2% higher income.

On the deduction side, two measures stand out. The limitation of mortgage interest deduction to mortgages under $750,000 for primary and secondary homes (down from $1 million previously), and the introduction of a $10,000 cap for sales and state and local income and property taxes. These two measures reduce the tax benefits of owning a home. The impact of the new tax law will depend on how much people choose homeownership
versus renting based on tax benefits, and how much higher after-tax income go toward housing. In addition, the impact will differ regionally, with less benefit in high-tax, and high-income states.

On the corporate tax side, the new tax law lowers the corporate tax rate from 35% to 21%. Many companies have announced one-time bonuses and wage increases for workers, so the tax cut will likely lead to higher income for current and potential homeowners. More importantly, lower corporate tax rate could also be passed onto consumers in the form of lower prices, as businesses see an increase in after-tax profit margin. In the housing industry, higher after-tax profit should encourage increased production and passing on of some of the savings to homebuyers, which can ease pressure on home price growth. However, both the timing and magnitude of price reduction are uncertain. Overall, the new tax law is expected to raise the after-tax income of potential first-time homebuyers, while taking away some of the benefits previously dedicated to homeownership. We believe that the income effect is likely to be larger than the removal of tax benefits, so it is on net good for first-time homebuyers.

One concern for the first-time homebuyer market is that the new tax law comes at a time when the economy is already at full-employment. This could add to the inflationary pressure in the economy and drive up long-term interest rates. Already, we have seen a 50 basis point increase in mortgage interest rates between September and early February. While the housing market should be able to digest the higher rate in the long run, it will likely slow down housing market activity over the next few quarters. In the last major run-up in interest rates between April and September 2013 (with about twice the increase), the growth of the first-time homebuyer market slowed from 12 percent to 2 percent and the growth of the repeat buyer market slowed from 19 percent to three percent.
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.