The Potential Impact of Student Loan Debt Forgiveness on the Housing Market

The plan to forgive loan debt could help convert American renters to buyers, but it also could add more competition in the low-inventory entry-level market.

By Vincent Salandro, Builder Magazine, September 1, 2022

President Joe Biden in late August announced a plan to forgive student loan debt for Americans. At the time the plan was announced, federal student loans totaled $1.6 trillion across more than 45 million borrowers. As part of the plan, the Department of Education will provide up to $20,000 in debt cancellation to Pell Grant recipients with loans and up to $10,000 in debt for non-Pell Grant recipients earning individual incomes of less than $125,000 per year.

According to the White House fact sheet, middle-class borrowers grappling with high monthly payments and student loan debt struggle to build wealth and face greater barriers buying homes, saving for retirement, and starting small businesses.

“[Student loan forgiveness] will have a good effect on prospective home buyers, particularly first-time buyers, saving for a down payment,” says Buzz Roberts, president and CEO of the National Association of Affordable Housing Lenders (NAAHL). “Since Pell Grant recipients are disproportionately people of color, that should also be particularly helpful for increasing minority homeownership. About half of the student loan debtors today have less than $10,000 of debt, so for [those debtors], it will be entirely wiped out.”

David Dworkin, president and CEO of the National Housing Conference, says student loan forgiveness is “one of the most consequential administrative actions for housing in a generation,” adding that the decision will aid access to homeownership for “millions of low-, moderate-, and middle-income millennials, Gen Zers, and people of color.”

Federal Reserve data indicates that 30% of adults—representing over 4 in 10 people who went to college—incurred at least some debt for their education, including 20% of college attendees who still owed money. Adults younger than 30—in the millennial cohort—who attended college were more likely to have taken out loans than older adults, according to the Federal Reserve. Data from the Education Data Initiative shows the average federal student loan debt balance is $37,667. Related to the housing market, an analysis from the Federal Reserve found the homeownership rate falls by nearly 2 percentage points for every additional $1,000 in student loan debt held by a borrower.

According to Zonda surveys of renting millennials each of the past six years, four of the five top reasons why millennials have not become homeowners are related to affordability, says Zonda chief economist Ali Wolf. In particular, millennials cite the inability to save for a down payment and the existence of student loans as two of their homeownership hurdles. Wolf says the pandemic has served as “an accidental test case” for the loan forgiveness due to the student loan forbearance policy in place since 2020. For example, two individuals with the average student loan amount could have come up with “a reasonable down payment in many markets” had they put money that would have been allocated to student loan payments in a savings account, she says. During the forbearance period in some markets, consumers were able to save for nearly an 8% down payment by putting their student loan deferral money into a savings account versus paying off their loans each month, according to Wolf.

“The math shows that the absence of student loan debt has a greater impact on lower-cost housing markets than higher-cost areas,” Wolf says. “The student loan deferral program allowed consumers to combat some of the long-standing affordability challenges related to down payment funds. We expect the student loan forgiveness program to have a similar effect. The forgiveness of $10,000 won’t be a game changer for most, but it will help make homeownership look a bit more accessible.”

In addition to forgiving loans, the program also cuts monthly payments in half for undergraduate loans. The Department of Education’s suggested income-driven repayment plan is designed to protect low-income borrowers and caps monthly payments for undergraduate loans at 5% of a borrower’s discretionary income, which is half of the current rate for borrowers.

“This [discretionary income cap] will have two significant effects. First, it will also help people save for down payments, particularly these days when inflation is squeezing a lot of people,” says Roberts. “But also, going to 5% will create room for home buyers to take on a larger mortgage and actually be able to buy a house. Home prices are high, interest rates have gone up, [and] that’s taken a lot of people out of the market. This would be a step for getting people [back] in the market.”

Both Wolf and Roberts say the policy change may also have the effect of adding entry-level demand in a period already impacted by supply shortages, rising prices, and inflation. Roberts says action can be taken to help expand supply for the potential increase in demand, particularly for starter homes for first-time buyers. The NAAHL is advocating for Congress to enact a new Neighborhood Homes Investment Act, which would provide tax credits for building or sustainably rehabilitating homes in distressed communities and would help produce an additional 50,000 units per year.

“First-time buyers were already taking the brunt of the impact of the hot housing market following two years of consistent home price appreciation and higher mortgage rates,” Wolf says. “The lowest price points are where the market has been consistently the most competitive and the lowest in inventory. We are watching closely how impactful this is to entry-level housing demand and overall home price appreciation. Helping convert more Americans from renters to owners is vital for wealth building, but too much demand in a short period of time can contribute to continued first-time home buyer struggles.”