Housing Markets

Signs of a housing market rebound have begun to accumulate. Rental demand was up and vacancies down in 2011, leading to a jump in multifamily construction. With the economy steadily adding more jobs, home sales picking up, and new home inventories at record lows, the single-family market may also be reviving. Still, the persistent weakness in existing home prices, the large backlog of foreclosures, and the tight lending environment are restraining the recovery.

MARKETS AT A TURNING POINT

While multifamily starts surged 54 percent and home improvement spending eked out a 0.6 percentage-point gain, single-family starts dropped some 8.6 percent last year **(Figure 8).** Because of the lag between starts and finished construction, completions of both single- and multifamily homes were also off more than 10 percent, falling to record lows. Even manufactured home placements plumbed new depths in 2011, at just 47,000 units. The sharp and sustained retreat made 2011 the worst year for completions in records dating back to 1968.

But the beleaguered single-family market now appears to be turning around, with starts picking up significantly in the second half of 2011 and standing 16.6 percent above weak year-earlier levels in the first quarter of 2012. Permitting, a leading indicator of starts, was also up 16.9 percent early this year. With homebuilders reporting strong growth in orders and new home sales, residential construction activity appears to be emerging from the deepest, most prolonged downturn in recent history.

Indeed, despite the spectacular boom early in the decade, 2002–11 was the worst 10-year period for overall housing production since recordkeeping began in 1974. Moreover, this cycle marks the only time in the post-WWII era that starts dipped below 1.0 million units a year and then rebounded so weakly **(Figure 9).** Making matters worse, the fall-off in demand was even more dramatic than the plunge in housing production, leaving national vacancy rates at elevated levels.

The downturn in remodeling has also been sharp and prolonged, although not nearly as severe as in homebuilding. After a peak-to-trough drop of 28.4 percent (compared with more than 75 percent in new construction spending), home improvement spending increased to 49 percent of residential construction expenditures in 2011. This is the largest share in records dating back to 1993 and well above the 25 percent averaged in 1993–2008. Although real expenditures on improvements were down 1.6 percent in the first quarter of 2012 from year-earlier levels, the Joint Center's Leading Indicator of Remodeling Activity points to a resumption of spending growth in the second half of 2012. Investment in lender-owned properties should also help to prop up remod-

FIGURE 8

Another Down Year for Housing, But Signs of a Turnaround Are Appearing

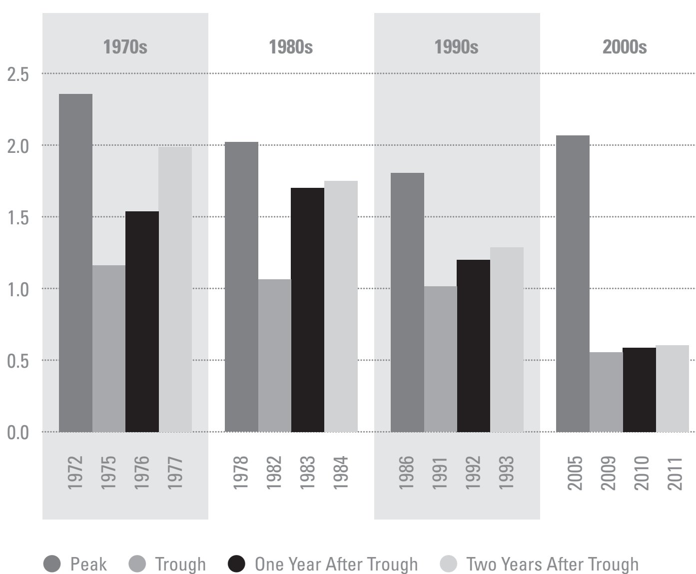
	2010	2011	2011:1	2012:1	Percent Change	
					2010–2011	2011:1–2012:1
Single-Family Home Sales						
New (Thousands)	323	306	294	343	-5.3	16.7
Existing (Millions)	3.7	3.8	3.8	4.0	2.1	6.3
Residential Construction						
Total Starts (Thousands)	587	609	583	712	3.7	22.1
Single-Family (Thousands)	471	431	418	487	-8.6	16.6
Multifamily (Thousands)	116	178	165	225	54.0	36.1
Completions (Thousands)	652	585	578	569	-10.3	-1.6
Median Single-Family Sales Price						
New (Dollars)	228,800	227,200	230,200	228,100	-0.7	-0.9
Existing (Dollars)	178,600	166,200	161,000	156,500	-6.9	-2.8
Construction Spending						
Residential Fixed Investment (Billions of dollars)	348.8	337.5	335.5	356.0	-3.2	6.1
Homeowner Improvements (Billions of dollars)	115.1	115.8	113.9	112.1	0.6	-1.6

Note: All dollar values are in 2011 dollars, adjusted for inflation by the CPI-U for All Items.
Sources: US Census Bureau, New Residential Construction; National Association of Realtors®, Existing Home Sales; Federal Reserve Board, Flow of Funds.

FIGURE 9

The Housing Downturn Has Been Deeper, and the Recovery Weaker, than in Any Cycle Since the 1970s

Housing Starts (Millions)



Source: JCHS tabulations of US Census Bureau, New Residential Construction Surveys.

eling expenditures in the coming year as banks and other institutions prepare foreclosed units for the market. For example, last year Fannie Mae alone spent $557 million on repairs to about 89,800 of its foreclosed properties.

IMPROVING HOME SALES

After hitting a record low of just 306,000 in 2011, sales of new homes in the first quarter of 2012 stood 16.7 percent above year-earlier levels. While the increase occurred from record lows, new home sales appear to be staging a recovery that, for the first time in this cycle, does not depend on the temporary stimulus of federal homebuyer tax credits. In addition, homes are selling more quickly. The typical new home for sale in March 2012 was on the market for just 8.0 months, compared with 8.7 months in March 2011 and 14.4 months in March 2010.

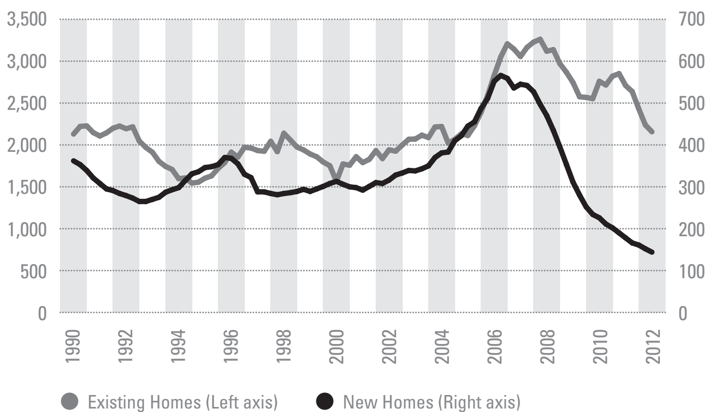
Existing home sales show a similar trend. The National Association of Realtors® (NAR) reports that sales of single-family homes and condominiums increased just 1.7 percent, to 4.3 million, in 2011 as a whole but accelerated in the second half of the year. By the first quarter of 2012, existing home sales were 5.2 percent above year-earlier levels.

Underscoring the impact of tight credit conditions on homebuyers as well as increased investor interest in distressed properties, cash purchases made up 30 percent of existing home sales last year. The share of sales to first-time homebuyers fell to 33 percent in

FIGURE 10

While Inventories of Homes on the Market Have Dropped Sharply...

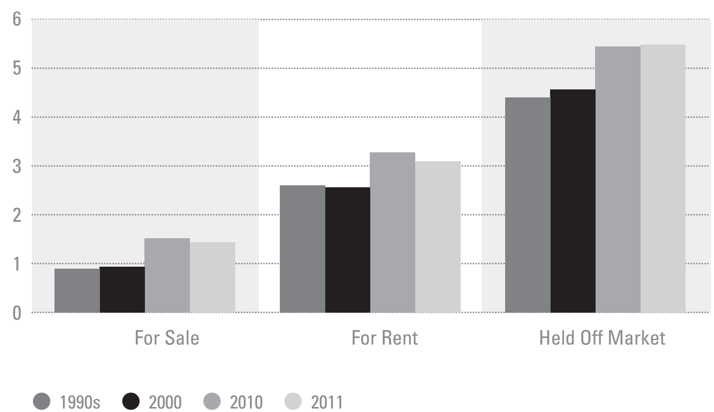
Single-Family Homes for Sale (Thousands)



Sources: US Census Bureau, New Residential Sales; National Association of Realtors®, Existing Home Sales via Moody's Economy.com.

...The Large Share of Units Held Off Market Is Keeping Vacancy Rates High

Vacant Units as a Share of Housing Stock (Percent)



Source: JCHS tabulations of US Census Bureau, Housing Vacancy Surveys.

2011, down from 39 percent in 2010 when federal tax credits were still available. Even so, the number of first-time buyer sales managed to slowly but steadily rise from mid-2010 lows.

HIGH "OFF-MARKET" INVENTORIES

Inventories of new single-family homes for sale fell 20 percent in 2011, sinking to just 143,000 units in March 2012—the lowest level in nearly five decades of recordkeeping. Even with the feeble pace of new home sales, this level of inventory equates to less than a 6.0 months' supply for the first time in more than five years. The inventory of existing homes for sale also shrank by some 23 percent in 2011, reducing the supply in the first quarter of 2012 to 6.2 months—also the lowest level since 2006. The 6.0-month supply mark is important because it is considered a rough indicator of market balance, where neither buyers nor sellers have the upper hand in price negotiations.

Despite this depletion of the for-sale stock, the inventory of vacant units held off market continued to grow last year **(Figure 10).** This excess supply is of concern because of its potential drag on the housing recovery**.** According to the latest Housing Vacancy Survey, the number of vacant units held off the market rose in 2010–11, partially offsetting declines in the numbers of "on-market" vacant homes for rent and for sale. Units held off market now account for 5.5 percent of the housing stock—nearly a full percentage point more than in 2000–2. This increase implies that, relative to that period, there are more than 1.2 million excess off-market vacant units. When these units come on the market, they could exert even more downward pressure on home prices. For now, though, the decline in vacant units for sale is helping to put a bottom under prices, while the decline in vacant units for rent has begun to spark rent increases in many markets.

LAGGING HOME PRICES

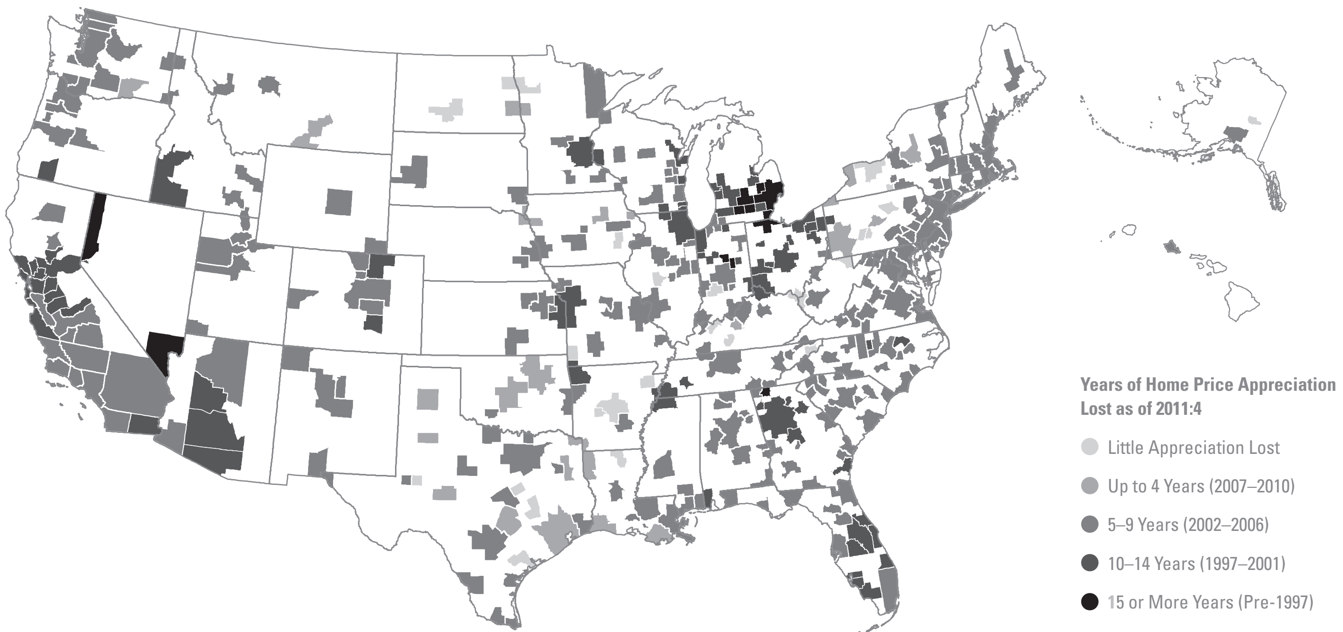
After another bad year for home prices, the first glimmers of a turnaround began to appear by the first quarter of 2012. The median new single-family home sold for $227,200 in 2011, down 0.7 percent in real terms from 2010 to a new cyclical low. Based on the Census Bureau's constant-quality adjusted new home price index, however, real prices fell 3.8 percent—suggesting that similar homes sold for significantly less in 2011 than in 2010. By this measure, real price declines accelerated as the year progressed, ending the fourth quarter 5.5 percent lower than a year earlier.

Existing home prices also showed renewed weakness for much of 2011 after stabilizing in 2010. Nationwide, both the S&P/Case-Shiller Home Price Index and NAR's median price dropped at least 4.0 percent in nominal terms to new cyclical lows in 2011. The Freddie Mac House Price Index indicates that the declines were widespread, reaching 328 (90 percent) of the 364 metropolitan areas covered. Indeed, home prices in fully 307 (84 percent) of these metros were also at new lows last year. As a result, home values in most metropolitan areas have retreated to pre-boom levels, erasing more than 15 years of appreciation in some cases **(Figure 11).**

Price declines at the low end of the market were especially severe. Among the 16 metros covered by the S&P/Case-Shiller index, prices for bottom-tier homes plummeted an average of

FIGURE 11

Home Prices in Most Metro Areas Have Fallen to Pre-Boom Levels



Sources: JCHS tabulations of Freddie Mac Home Price Index.

49 percent from the peak, compared with 39 percent for middle-tier homes and 31 percent for top-tier homes. Net price appreciation for low-end homes totaled just 18 percent in 2000–11, significantly less than the 34 percent at the high end. In 2011 alone, prices of bottom-tier homes fell 7.4 percent on average, while those for middle-tier homes were off 5.8 percent and for top-tier homes just 3.1 percent.

While too soon to tell with confidence, the worst may be over. According to the CoreLogic March 2012 Home Price Index, national prices were just 0.6 percent below year-earlier levels. In fact, some areas saw the pace of declines slow in 2011, while others posted nominal increases in the first quarter of 2012. For example, median home prices in Phoenix and Cape Coral registered gains early this year both from the previous quarter and from the year-earlier level. Overall, prices in the first quarter were up in 74 of the 146 metros covered by NAR and 43 of the top 100 metros covered by CoreLogic.

Furthermore, an alternative index from CoreLogic that excludes distressed sales (which made up about a third of sales last year and contributed heavily to the weakness of prices) indicates that prices climbed for three consecutive months after the turn of the year, lifting the March 2012 national number 0.9 percent above March 2011. The FHFA Home Price Index, which is also less likely to include distressed sales, also showed a year-over-year increase in the first quarter 2012, providing further evidence that home prices are finally stabilizing.

EMPLOYMENT GROWTH AND THE HOUSING RECOVERY

The vigor of housing demand hinges on the strength of employment growth. In the current cycle, 19 consecutive months of job gains have brought total employment growth since February 2010 to 3.7 million. Relative to the size of the decline, though, the rebound in jobs has been weak. Indeed, total employment in the US is still lower than when housing starts reached a trough fully three years ago **(Figure 12).**

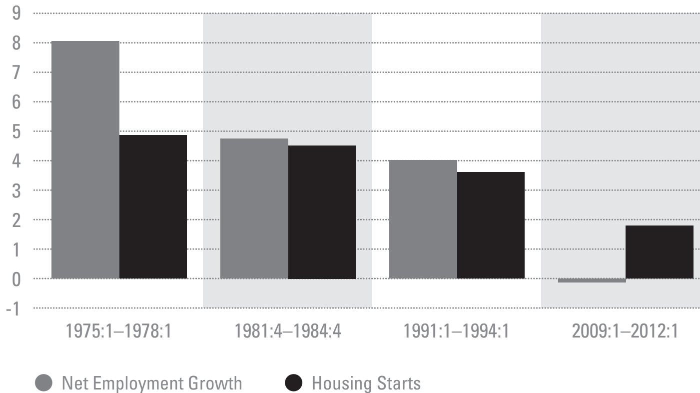
The homebuilding sector has both contributed to and suffered from tepid employment growth. From January 2001 to their April 2006 peak, residential construction and specialty trade contracting together accounted for fully 25 percent of overall employment growth. Since then, however, these sectors lost more than 1.4 million jobs and accounted for fully 35.8 percent of the net decline in total employment from April 2006 to December 2011. At the end of last year, the number of homebuilding jobs alone was down 41 percent from its peak and stood at its lowest level since January 1993.

Anemic construction activity, in turn, has been a drag on economic growth until recently. Although representing only a modest share of GDP, residential fixed investment (driven largely by new construction spending) usually helps to lead the economy out of recessions. In the 11 quarters immediately following every recession since 1970, RFI contributed 0.4–0.8 percentage point to GDP growth on average, accounting for 11–17 percent of gains. Since the recovery began in 2009,

FIGURE 12

Housing Starts Have Gotten Little Help From Employment Growth This Cycle

Millions



Note: Employment growth and housing starts are summed across the 12 quarters following the trough in starts for the last four major housing downturns.

Sources: JCHS tabulations of Bureau of Labor Statistics, Establishment Surveys; US Census Bureau, New Residential Construction.

however, RFI's contribution has averaged just 0.04 percentage point, adding just 1.6 percent to meager GDP growth during this period. But with the uptick in residential construction in late 2011 and early 2012, RFI posted two consecutive quarters of solid growth and provided its first significant boost to GDP since the end of the Great Recession.

IMPEDIMENTS TO A STRONGER RECOVERY

While many housing market indicators are headed in a favorable direction, several forces still stand in the way of a robust recovery. In particular, the persistent weakness of house prices has prevented any significant reduction in the number of owners owing more on their mortgages than their homes are worth. In fact, CoreLogic reports that the number of underwater loans rose in the fourth quarter of 2011 to 11.1 million—representing more than one in five mortgages and some $717 billion in negative equity.

States that had the most dramatic housing booms and busts are generally faring the worst on this count. Nevada (at 61 percent) and Arizona (at 48 percent) still have the largest shares of underwater mortgages, while Florida and California (each with approximately two million) together account for more than a third of all such loans in the country. These loans are at risk of default and could add to the already large number of distressed properties selling for bargain-basement prices. In addition, owners are not in a position to sell their homes without incurring a loss and are therefore holding back a stronger recovery in existing home sales that would give a much needed boost to economic activity.

Foreclosures remain another trouble spot. In the first quarter of 2012, 7.4 percent of the nation's mortgages were 90 or more days past due or in the foreclosure process—a slight improvement from the 9.7 percent peak two years ago but still well above the 1.7 percent averaged in the 1990s. CoreLogic estimates that 3.0 million foreclosures were completed in 2009–11 alone, and the persistently high level of loans still in the foreclosure pipeline will no doubt add to that number.

Moreover, the protracted process—especially in states with judicial foreclosures—guarantees that the backlog will extend for years to come. According to Fannie Mae, the average time to complete foreclosure cases in 2011 was well over a year, ranging from 391 days in Missouri to 890 days in Florida. As of early 2012, foreclosure inventory rates in the typical state with judicial foreclosures were high and rising, while those in states with non-judicial processes were lower and falling.

An additional drag on the recovery comes from the increased difficulty of qualifying for mortgage credit. Not only have high unemployment levels eroded credit scores, but lenders have also set higher thresholds for qualifying for loans. In addition, low-downpayment loans are harder to secure. Apart from Federal Housing Administration (FHA) loans, mortgages with downpayments of less than 10 percent are scarce, and even FHA limits such loans to borrowers with higher credit scores. Further evidence of the difficult credit environment is that some 33 percent of NAR's member brokers reported contract failures in December 2011, compared with just 9 percent a year earlier. These failures occurred largely because mortgage applications were declined or the appraised value of the homes came in below negotiated prices.

THE OUTLOOK

Despite the many factors restraining the recovery, other trends—including steady employment growth, depleted inventories of for-sale homes, and a surge in sales and construction activity—make the housing market outlook significantly brighter than a year ago. Rental markets have already turned a corner, although the rebound in multifamily construction is modest in absolute terms. Sharply lower home prices and interest rates, along with improving labor markets, are raising hopes that new and existing home sales will continue to gain momentum. With inventories of for-sale homes so low, a sharp increase in demand could help prices firm.

At the same time, however, the overhang of excess units held off market, elevated vacancies within the for-sale stock, and the long pipeline of foreclosures will limit the need for new single-family construction. And three years after the official end of the Great Recession, there are still more than 20 million US workers either unemployed or underemployed, millions of households with negative equity in their homes, and millions more seriously delinquent on their loans or already in the foreclosure process. On balance, then, the sheer depth of the downturn and scale of the mortgage debt overhang mean that it will be some time before a robust housing market recovery is at hand.