2 HOUSING MARKETS

Although the news was mixed in 2014, housing markets made some advances that set the stage for moderate growth. Single-family construction continued to languish, but multifamily construction remained on a strong upward trajectory. New home sales were sluggish, but distress-related sales of existing homes fell sharply. In addition, rising home prices helped to reduce the share of underwater borrowers, and foreclosures were on the decline. Many homeowners with low-value houses, however, still faced the problem of negative equity.

HOUSING CONSTRUCTION TRENDS

Homebuilding activity continued to increase in 2014, with housing starts up 8.5 percent **(Figure 9).** But because growth was from such a low base, this gain amounted to fewer than 80,000 additional units. And despite surpassing the one-million unit mark, residential construction for the year still lagged below any level posted from 1959 through 2007.

The weakness centered once again on the single-family side. Starts increased by just 30,300 units in 2013–14, to 647,900—which, up until 2008, would have been the lowest annual level in the postwar era. By comparison, multifamily starts continued their run, rising by 48,100 units to 355,400. Indeed, growth in construction of multifamily units last year was a little under 16 percent.

Reflecting the low level of residential construction in general, and of single-family homes in particular, the housing sector contributed only modestly to the economy in 2014. Residential fixed investment (RFI)—which includes homebuilding as well as homeowner spending on improvements—accounted for just 3.2 percent of GDP, significantly less than the 4.5 percent averaged in records dating back to 1969.

Despite its relatively small share of the economy, residential fixed investment has at times generated 15–20 percent of annual GDP growth. Last year, however, housing's contribution decreased steadily as overall economic growth accelerated. For 2014 as a whole, RFI accounted for a negligible 0.05 percentage point of the 2.4 percent increase in GDP (about 2 percent), a significant drop from its 0.33 percentage point shares (about 14–15 percent) in 2012 and 2013.

With the weakness in construction, homeowner improvements continued to prop up residential spending. While government estimates vary, the Census Bureau and Bureau of Economic Analysis both report that homeowner outlays for improvements accounted for about a third of residential construction spending last year—down from nearly half at the 2011 peak, but still above the quarter averaged in 1993–2006.

FIGURE 9

After a Surge in 2013, Nearly All Major Housing Indicators Slowed in 2014

	2012	2013	2014	Percent Change	
				2012–13	2013–14
Residential Construction (Thousands of units)					
Total Starts	781	925	1,003	18.5	8.5
Single-Family	535	618	648	15.4	4.9
Multifamily	245	307	355	25.3	15.7
Total Completions	649	764	884	17.7	15.6
Single-Family	483	569	620	17.8	8.9
Multifamily	166	195	264	17.4	35.3
Construction Spending (Billions of dollars)					
Residential Fixed Investment	447	519	550	16.1	5.9
Home Sales					
New (Thousands)	368	429	437	16.6	1.9
Existing (Millions)	4.7	5.1	4.9	9.2	-2.9
Median Sales Price (Thousands of dollars)					
New	252.8	273.3	282.8	8.1	3.5
Existing	182.3	200.3	208.3	9.9	4.0

Notes: Components may not add to total due to rounding. Dollar values are adjusted for inflation by the CPI-U for All Items.

Sources: US Census Bureau, New Residential Construction and New Residential Sales data; National Association of REALTORS®, Existing Home Sales; Bureau of Economic Analysis, National Income and Product Accounts.

FALTERING HOME SALES

Behind the lackluster performance of single-family construction is the persistent weakness in new home sales. Sales of new single-family homes increased just 2 percent last year, a sharp slowdown from the 17 percent pace of 2013. At just 437,000 units, new home sales were still up more than 40 percent from the cyclical low in 2011, but roughly 30 percent below the annual averages in the 1970s, 1980s, and 1990s.

While not nearly as depressed as new home sales, existing home sales also lost momentum in 2014, falling to 4.9 million units. Indeed, the National Association of Realtors (NAR) reports a 2.9 percent drop for the year. Although significantly slower than in 2012 and 2013, the pace of existing home sales in 2014 was still almost 20 percent above the recessionary low in 2008.

The good news is that the softness in existing home sales largely reflects a decline in distress-related sales, suggesting that markets are stabilizing. Metrostudy data show dramatic declines in investor purchases as well as in all-cash sales and sales of bank-owned properties **(Figure 10).** At the same time, mortgaged home sales and regular (non-REO) re-sales to owner-occupants—the traditional foundation of the home sales market—were both up for the year.

Other sources confirm this trend. CoreLogic, for example, reports that the share of cash sales fell again in February 2015, marking 26 consecutive months of year-over-year declines. At 38 percent of home sales, cash sales were 9 percentage points below the 2011 peak, but still well above the 25 percent annual average before the housing boom and bust.

THE DRAG OF LOW INVENTORIES

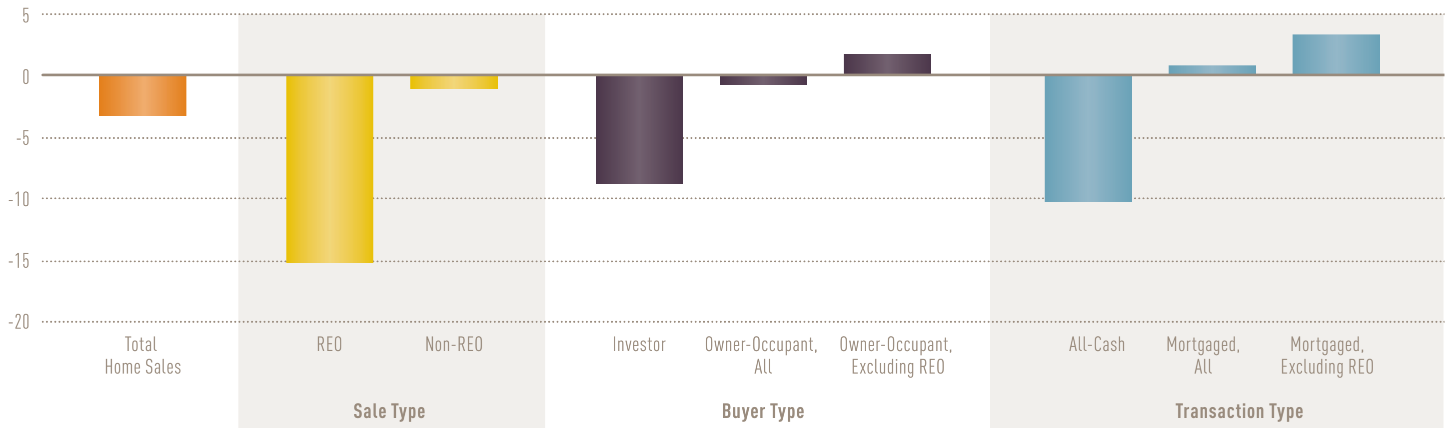
While the average number of homes for sale edged up 3.8 percent in 2014, the increase was apparently driven by the slowdown in sales rather than growth in the number of homes put on the market. Even so, the average supply increased to 5.2 months for the year, up from 4.9 months in 2013 but still under the 6.0 month level indicating market balance. Estimates through April, however, show that the for-sale inventory in early 2015 was back below year-earlier levels.

Several trends have combined to shrink the pool of homes available for sale. For one, many owners are unable to put their homes on the market because the price drop during the housing crash left them with little or no equity. According to CoreLogic, 10.8 percent of homeowners with mortgages were still underwater on their loans in the fourth quarter of 2014, and another 2.8 percent had less than 5 percent equity.

FIGURE 10

A Steep Drop in Distress-Related Sales Drove the Slowdown in Overall Home Sales Last Year

Percent Change 2013–14

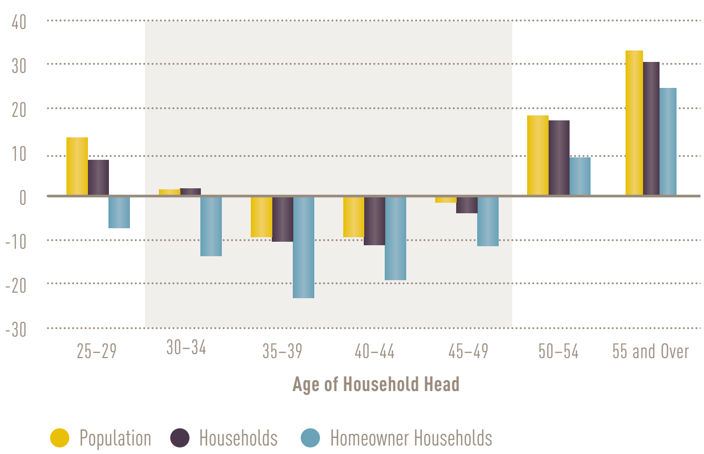


Note: REO sales are of real estate owned by lenders.
Source: JCHS tabulations of Metrostudy data.

FIGURE 11

The Aging of the Gen-X Population Has Reduced the Number of Homeowners Most Likely to Trade Up

Percent Change 2003–13



Source: JCHS tabulations of US Census Bureau, Current Population Surveys.

In addition, many homes remain stuck in the foreclosure process or held off market. The Mortgage Bankers Association (MBA) estimates that the number of homes in foreclosure nationwide exceeds 920,000 units. The Housing Vacancy Survey also shows no improvement in the share of vacant homes held off market in total or held off for "other reasons," including foreclosure.

The lack of homes for sale also reflects decade-long trends. In particular, the aging of the population and declines in age-specific homeownership rates have drastically reduced the number of homeowners in their 30s and 40s—the age groups that traditionally account for more than half of all participants in the homebuying market. The replacement of the larger baby-boom generation by the smaller gen-X population in these key age groups has thus reduced the pool of owners most likely to put their homes on the market and to buy other properties. Indeed, the number of homeowners aged 35–39 (prime ages for new-home and trade-up buying) is down 23 percent from a decade ago **(Figure 11).**

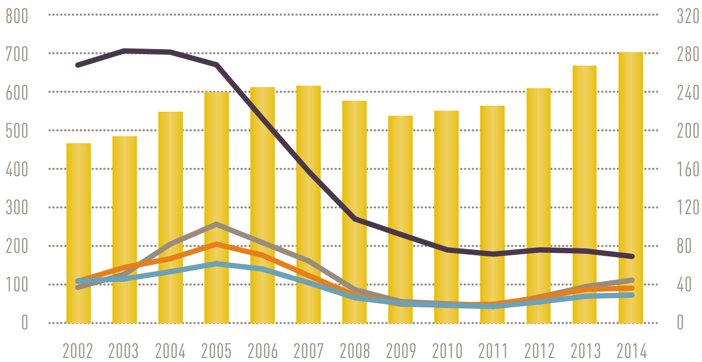
At the same time, the changing age structure of the population implies lower residential mobility. Older households move less often than younger households, which means that fewer buy and sell homes. And while residential mobility rates have been falling for decades, the Great Recession accelerated the pace of decline, especially among homeowners. This trend extends to young adults, the age group with the highest propensity to move from one home to another.

Looking ahead, inventories of homes for sale could build as owners become more confident about the market. As it is, survey data from Fannie Mae indicate that 41 percent of respondents felt it was a good time to sell in the fourth quarter of 2014—a big improvement from the 11 percent share in the fourth quarter of 2011. In addition, many borrowers who lost their homes to foreclosure have had that blemish wiped from their credit reports, making them again eligible for FHA and other mortgages. This could provide a tailwind for the market. According to NAR estimates, up to 1.0 million such households have already restored their credit standing, and 1.5 million more could do so shortly. Still, several

FIGURE 12

The Strength of New Home Prices Is Largely Due to the Weakness in Low-End Sales

New Homes Sold (Thousands) Thousands of Dollars



Median New Home Price [Right scale]

Price Tier [Left scale]

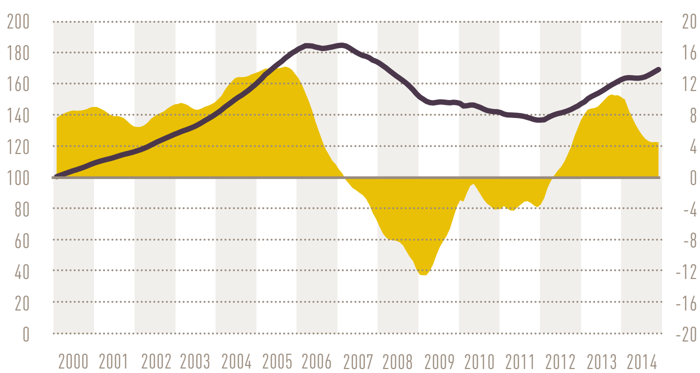
- Under $250,000
- $250,000–299,999
- $300,000–399,999
- $400,000 and Over

Source: JCHS tabulations of US Census Bureau, New Residential Sales data.

FIGURE 13

While Existing Home Prices Continued to Rise in 2014, the Pace of Appreciation Slowed

Indexed Home Price (Thousands) Year-over-Year Change (Percent)



Existing Home Prices [Left scale] Price Appreciation [Right scale]

Source: JCHS tabulations of CoreLogic Case-Shiller Home Price Indexes.

factors—such as rising interest rates, low equity, or ongoing credit impairment—could have a contrary effect, leaving owners stuck in their current homes and keeping for-sale inventories tight.

PRICES ON THE RISE

While the volume of new homes built is near record lows, the prices of those homes have hit a record high. Even with the slowdown in appreciation from 8.1 percent in 2013 to 3.5 percent in 2014, the median sales price of new homes stood at $283,000 last year—some 35 percent above the median sales price of existing single-family homes.

Rather than signaling a broadly healthy market, however, this record-setting price is largely due to changes in the size, quality, type, and location of new homes. Although the median price of new single-family homes sold last year was 31 percent above the 2009 cyclical low in nominal terms, the constant-quality price index for new homes was up only 14 percent. An increase in size appears to be the cause, with the typical new home 12.5 percent larger in 2013 than in 2009. This trend is especially evident in the Midwest, where the size of the typical new home increased nearly 25 percent in 2009–13, helping to give median prices a 43 percent lift over this period. Indeed, the rise in the median new home price reflects weak sales of moderately priced homes, which normally account for the majority of purchases **(Figure 12)**. As a result, the median price of new homes could dip when sales of lower-end homes pick up again.

According to the National Association of Realtors, median prices for existing homes sold were up for the third consecutive year in 2014, rising 4.0 percent from 2013, to $208,300. As in the new home market, existing home prices benefited not only from low inventories but also from strong demand for higher-quality units. MBA survey data indicate that the average loan size for home purchase applications increased even faster than house prices in 2012–14, and hit a record high in March 2015. Meanwhile, the jumbo mortgage segment largely drove the increases in the MBA Mortgage Credit Availability Index last year.

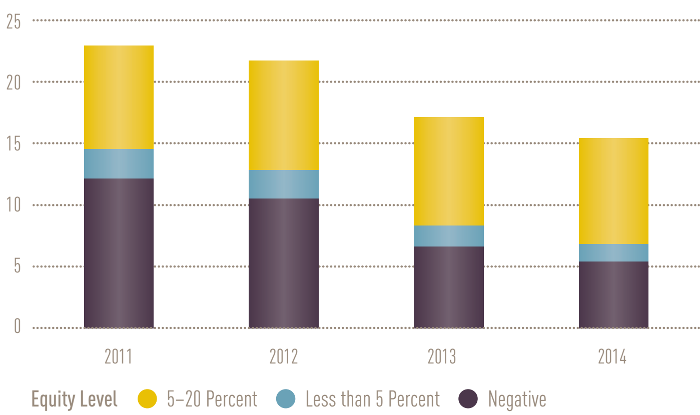
House price indexes that are less affected by changes in the mix of existing homes sold than the NAR measure also point to a slowdown in price appreciation in 2014. The CoreLogic Home Price Index, for example, shows a steady year-over-year cooling from 11.4 percent in January to 4.7 percent in December **(Figure 13)**. Zillow reports a slightly smaller decline from 7.8 percent to 4.5 percent.

The relative easing of home price appreciation was apparent across the 20 metros tracked by the CoreLogic Case-Shiller indexes. At the high end, San Francisco posted a healthy 9 percent rise in prices for the year, albeit significantly below the 23 percent jump in 2013. Price increases in Las Vegas also slowed from 26 percent to 7 percent in 2014. Meanwhile, Chicago and Washington, DC, were at the bottom of the list for home price appreciation, joined by formerly high-flying Phoenix.

FIGURE 14

Although the Number of Underwater Homeowners Is Shrinking, Many Borrowers Still Have Little Equity

Households (Millions)



Note: Annual household counts are as of the fourth quarter.
Source: JCHS tabulations of CoreLogic data.

Price appreciation within the bottom tier of homes generally outpaced the rest of the market, in some cases significantly. For example, prices for the lowest tier of existing homes in Chicago were up 12 percent in 2014, compared with just 1 percent in the metro area as a whole. Similarly, bottom-tier home prices in Atlanta climbed 15 percent last year, three times the rate of the metro-wide increase. The high appreciation rate in this tier of the market likely reflects the decline in distress-related sales, as well as the widespread shortage of low-priced homes for sale.

NEGATIVE EQUITY PRESSURES

But despite their recent upturn, prices of low-tier homes remain far below their mid-2000s peaks, leaving many owners with negative equity. According to CoreLogic data, 16 percent of homeowners with mortgaged units valued at less than $200,000 were underwater on their loans at the end of 2014, compared with just 6 percent of owners of higher-valued homes. Zillow noted a similar pattern at year-end, finding that 27 percent of households with mortgages owning bottom-tier homes had negative equity, compared with 15 percent of those owning middle-tier homes and 9 percent of those owning top-tier homes.

Negative equity remains widespread in states where house prices fell the most during the downturn. Shares of underwater loans are predictably highest in states such as Nevada (24 percent), Florida (23 percent), and Arizona (19 percent), although they are also high (16 percent) in Illinois and Rhode Island. These five states alone account for more than a third of underwater mortgages. At the metro level, Tampa and Phoenix have the largest shares of negative equity loans, followed by Chicago.

Within metro areas, negative equity problems are highly concentrated in minority and low-income neighborhoods. In the 10 percent of zip codes with the highest rates of negative equity, the average minority share of the population is 51 percent and the typical household income averages just 83 percent of the state median. And at the household level, the 2013 American Housing Survey indicates that 29 percent of black and 25 percent of Hispanic homeowners were upside down on their mortgages, compared with 16 percent of white and Asian/other owners. Shares of negative equity loans are highest among homeowners aged 25–44 (19 percent), but also significant among homeowners aged 65 and over (a little over 11 percent).

Nationally, however, consistent increases in existing home prices have reduced the share of underwater owners from a peak of more than 25 percent in 2011 to 10.8 percent in the fourth quarter of 2014. This represents a drop from over 12 million homeowners to 5.4 million **(Figure 14).**

The number of homeowners with near-negative equity (less than 5 percent) also improved from 2.4 million in 2011 to 1.4 million in 2014. Like underwater homeowners, these households are stuck in place because they are unable to cover the costs of selling their homes. Indeed, even homeowners with low equity (5–20 percent) may not be able to afford to sell or qualify for additional financing to make home improvements or cover other needs. Troublingly, the number of households in this category has held between 8 million and 9 million since 2011. At the end of 2014, the total number of households with low, near-negative, and negative equity still exceeded 15 million.

REDUCTION IN DISTRESSED BORROWERS

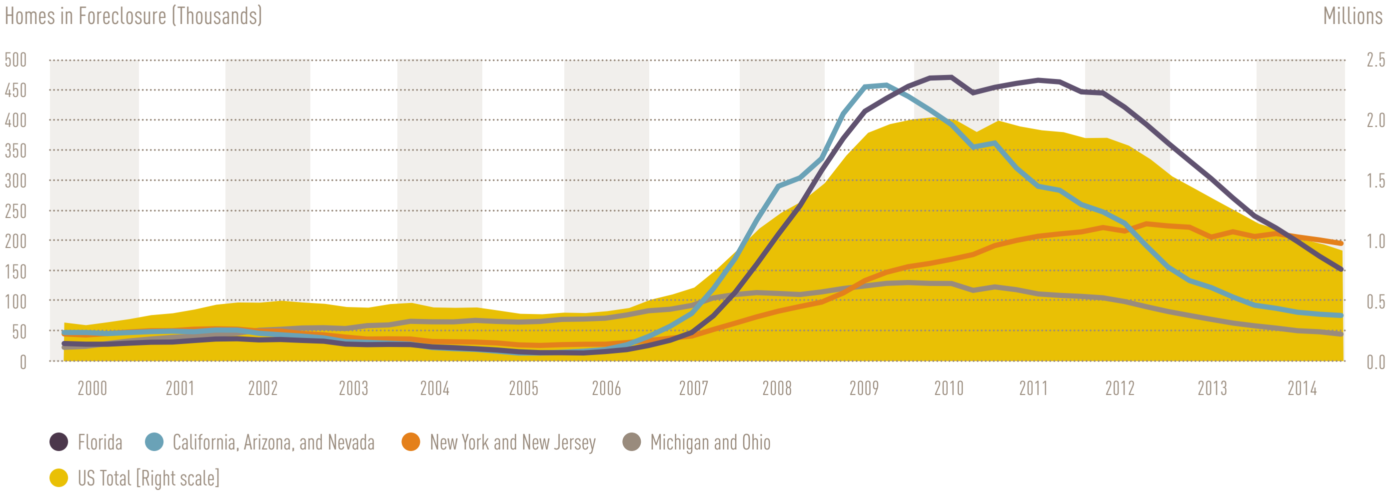
On the positive side, the share of loans entering the foreclosure process in 2014 was at its lowest level since 2006. In addition, the share of severely delinquent loans (90 or more days past due) or in foreclosure dropped 1 percentage point in the fourth quarter, to 4.5 percent. For the year overall, the number of severely delinquent loans was down 11 percent and the number of homes in foreclosure was down 20 percent, bringing the year-end total below two million for the first time since 2007.

Some of the states hardest hit by the foreclosure crisis led the drop **(Figure 15).** In Florida, the foreclosure inventory fell by 37 percent in 2014 and now stands 68 percent below the peak in 2010. The numbers of homes in foreclosure were also off 23 percent in Arizona and 17 percent in California, leaving inventories in both states more than 80 percent below peaks.

In contrast, progress in certain northern states has been slow, in part because of protracted foreclosure processes. In New York, the number of foreclosed homes shrank by 10 percent in 2014 but remained just 16 percent below peak levels. In New Jersey, the inventory of foreclosed homes was unchanged last year, stuck just 14 percent below the peak. As a result, New Jersey overtook Florida as the state with the largest share of mortgaged

FIGURE 15

Foreclosure Inventories Have Dropped Sharply, Especially in the Hardest-Hit States



Source: JCHS tabulations of Mortgage Bankers Association, National Delinquency Surveys.

homes in foreclosure. It should be noted, however, that New York and New Jersey have also posted below-average improvement in 60- and 90-day delinquencies and above-average rates of 30-day delinquencies, implying that high delinquency rates are a factor on their own.

THE OUTLOOK

Given how far housing markets have to go to regain even pre-boom levels, the slowdown in construction, sales, and price appreciation in 2014 set off some alarms. Indeed, the housing supply expanded less in the previous 10 years than in any decade since the 1940s, while existing home sales were running at late-1990s rates.

Even so, a deceleration from the robust house price appreciation of 2013 could be a sign that markets are returning to balance as a result of stable interest rates and fewer sales of distressed homes. With foreclosures and delinquency rates on the decline and steady job growth holding promise of wage gains, housing markets thus appear poised for a new phase of growth mirroring that of the overall economy. But like that of the economy, the recovery is likely to continue at only a moderate pace until income growth picks up and rising home prices help to reduce the number of underwater and distressed homeowners.