2 HOUSING MARKETS

After a mixed year in 2014, the national housing recovery gained traction in 2015. Residential construction continued to climb as single-family starts revived. Sales of both new and existing homes also increased, and likely would have been even stronger if inventories were not so low. The widespread rise in home prices benefited millions of underwater homeowners and spurred renewed investment in homes and rental properties. With this rebound, the housing sector has increased its contribution to the economy, with more room to grow.

CONSTRUCTION GAINING MOMENTUM

Homebuilding remained on the upswing in 2015, with total housing starts climbing 10.8 percent to 1.1 million units **(Figure 7).** Single-family starts reached the 715,000 mark while completions hit 647,900 units, their highest level since 2008. Even so, the single-family sector is still struggling to recover after a decade of weakness, with only 750,000 units completed annually on average between 2006 and 2015—the lowest number in any 10-year period since 1968. But single-family construction is set to expand thanks to an 8.7 percent increase in permits, to 696,000 units. In fact, single-family permitting accelerated in 2016, averaging 730,000 units at a seasonally adjusted annual rate in the first four months of the year.

On the multifamily side, all key construction measures rose by double digits. Growth in multifamily starts topped 10 percent for the fifth consecutive year in 2015, reaching a 27-year high of 397,300 units. With single-family construction still recovering, 2015 was the fourth consecutive year that multifamily units accounted for more than 30 percent of housing starts, compared with 20 percent on average between 1990 and 2010. Signaling further expansion, multifamily permits rose 18.2 percent last year, to 486,600 units.

Overall construction activity expanded nationwide, with permitting up in 70 of the 100 largest metro areas. Just over a third of these metros issued more permits in 2015 than their annual averages in the 1990s, and 20 issued more than their annual averages in the early 2000s. New York was the standout, with permits (primarily for multifamily units) soaring 80 percent in 2015, due in part to the impending expiration of a tax abatement program. But permitting in Dallas, Los Angeles, Miami, San Diego, and San Francisco also increased more than 25 percent last year. In contrast, several of the markets that had rebounded quickly after the recession saw permitting slow, including Washington, DC (down 7 percent), Houston (down 11 percent), San Antonio (down 24 percent), and San Jose (down 42 percent).

FIGURE 7

Key Housing Market Indicators Point to Strengthening in 2015

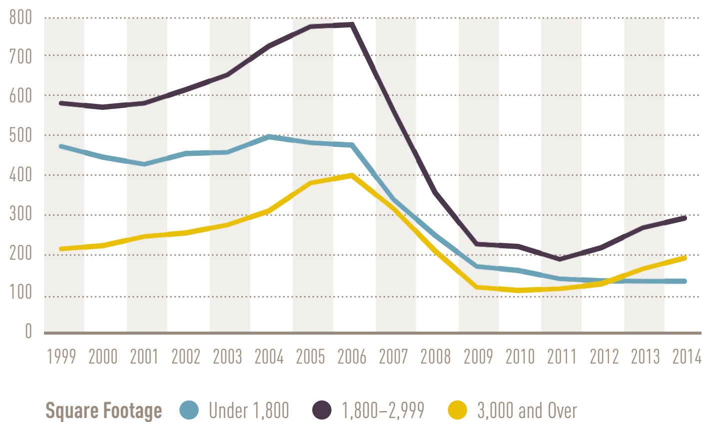
	2014	2015	Percent Change 2014–15
Residential Construction (Thousands of units)			
Total Starts	1,003	1,112	10.8
Single-Family	648	715	10.3
Multifamily	355	397	11.8
Total Completions	884	968	9.5
Single-Family	620	647	4.5
Multifamily	264	320	21.2
Home Sales			
New (Thousands)	437	501	14.6
Existing (Millions)	4.9	5.3	6.3
Median Sales Price (Thousands of dollars)			
New	283.1	296.4	4.7
Existing	208.5	222.4	6.6
Construction Spending (Billions of dollars)			
Residential Fixed Investment	550.6	600.1	9.0
Homeowner Improvements	134.8	147.8	9.6

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.

FIGURE 8

Construction of Smaller Single-Family Homes Has Yet to Rebound

New Single-Family Homes Completed (Thousands)



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

CHARACTERISTICS OF THE NEW STOCK

Single-family homes are getting bigger, with the median size in 2015 a record-setting 2,467 square feet. Indeed, only 135,000 single-family homes completed in 2014, or about a fifth, were under 1,800 square feet—the lowest number and the smallest share of units this size going back to 1999 **(Figure 8).** The majority (58 percent) of single-family construction between 2000 and 2014 occurred in low-density urban areas, with another 25 percent built in mid-density urban neighborhoods, 6 percent in high-density urban neighborhoods, and 12 percent built in rural areas.

Meanwhile, the median size of multifamily units fell from nearly 1,200 square feet at the 2007 peak to 1,074 square feet in 2015, reflecting the shift in the focus of development from the owner to the rental market. Many new multifamily units are in large structures, with nearly half of the units completed in 2014 in buildings with 50 or more apartments. In addition, a majority of newly constructed units were located in dense urban areas. Indeed, about 36 percent of all new multifamily units added between 2000 and 2014 were in high-density neighborhoods, and another 30 percent each in medium- and low-density sections of metro areas. Even so, growth in the multifamily housing stock during this period was even more rapid in rural areas (up 24 percent) than in urban areas (up 19 percent).

THE DEVELOPMENT LANDSCAPE

The gradual recovery in single-family construction largely reflects weak demand in the face of sluggish income growth and tight mortgage credit. But constraints on land, labor, and lending may also play a role. Metrostudy data show that the supply of construction-ready land (vacant developed lots) in 50 metro areas shrank by 30 percent from 2008 to 2013, before settling just above levels posted in the early 2000s.

Land supply is firming across metro areas, including those with significant excesses during the housing bubble. In major Florida metros, for example, the average months supply of vacant developed lots soared after 2006, dropped precipitously after 2009, and stabilized in 2015 at 34 months—within the 24–36 month range considered normal. While experiencing milder cycles, major metros in California and Texas had only about a 20-month supply of vacant developed land in 2015, raising the possibility of future constraints on building activity. Land availability in these large states, among others, thus bears watching.

Labor shortages could also be a damper on construction activity. More than 2 million workers left the industry between 2007 and 2013, reducing the construction workforce to 80 percent of its 2007 peak. According to a Census Bureau analysis, only 40 percent of those who lost their jobs between 2006 and 2009 had returned to their previous positions or to other jobs in the industry. Of the remaining displaced workers, more than half found work outside construction and the rest did not return to the formal labor force.

This contraction left the construction workforce significantly older. The share of trades workers age 55 and over rose from 10 percent in 2007 to 16 percent in 2013, while the share under the age of 35 fell from 43 percent to 35 percent. This pattern reflects not only the aging of workers that held onto their jobs through the recession, but also a falloff in hiring of younger workers. Indeed, only 13 percent of newly hired construction workers in 2013 were under age 25, down from 18 percent before 2006. Without younger workers to bolster the ranks as older workers move toward retirement, labor shortfalls may emerge. As it is, a 2015 National Association of Home Builders (NAHB) survey found that a majority of construction firms were already reporting labor shortages in many trades.

To help rebuild its diminished workforce, the construction industry may have to reevaluate the composition of its labor pool. Given that more than a quarter of workers in the trades in 2013 were foreign-born, unpredictable changes in immigration could have an outsized impact on the availability of skilled labor. At the same time, women make up less than 3 percent of trades workers and thus represent a largely untapped resource for the industry.

Meanwhile, development financing is recovering from a sharp drop-off during the recession. According to NAHB, residential construction loan volumes were up 4.5 percent in the fourth quarter of 2015, marking 11 consecutive quarters of increases. While growing nearly 19 percent for the year as a whole, the residential construction loan stock remained 70 percent below the 2008 peak. Other types of acquisition, development, and construction loans have recovered more fully and now stand 51 percent below peak. Credit may be tightening, however. NAHB financing surveys indicate that credit easing slowed at the end of 2015, while the Federal Reserve Board's Senior Loan Officer Opinion Survey on Bank Lending Practices reported some tightening of lending criteria for construction and development loans in late 2015 and early 2016.

STRENGTHENING HOME SALES

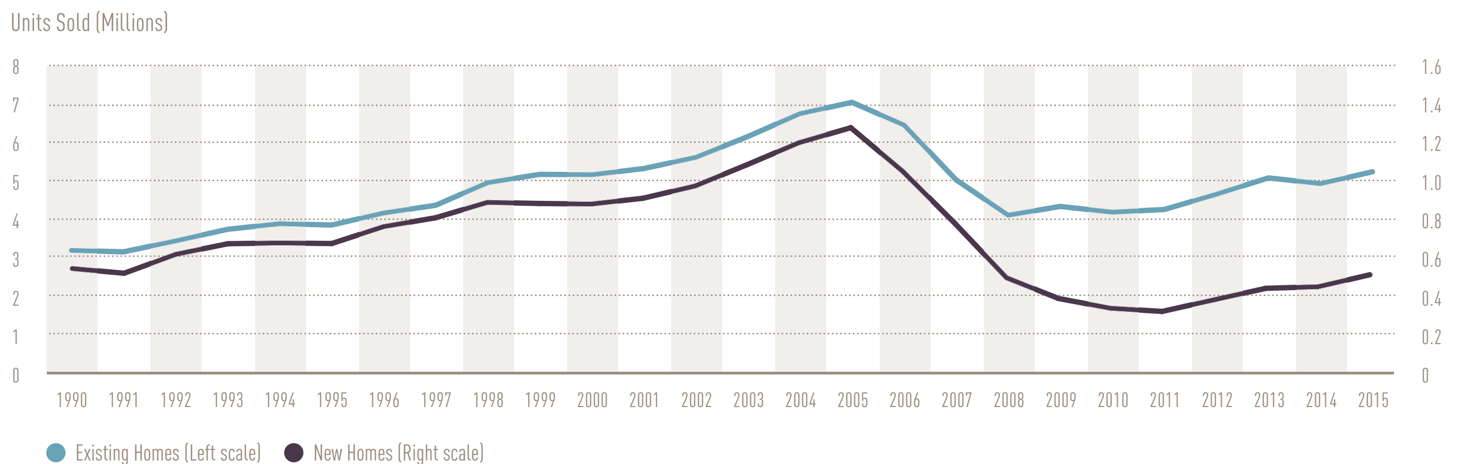
After a slow year in 2014, sales of new single-family homes rose by a robust 14.6 percent in 2015. At just 501,000 units, however, sales remained well below averages in previous decades **(Figure 9).** Sales of existing homes also rebounded from their 2014 decline, up 6.3 percent to just under 5.3 million units. Although the rollout of new mortgage disclosure regulations in October led to a temporary dip, existing home sales closed 2015 on a strong note.

Encouragingly, sales of non-distressed properties are driving growth. CoreLogic reports that real-estate owned (REO) and short sales fell by 10–11 percent in 2015, while non-distressed resales rose by 7.6 percent. With this shift, distressed sales accounted for just over 12 percent of existing home sales in 2015, down from 14 percent a year earlier and 28 percent at the peak in 2009–2011. In addition, cash sales (often to investors) accounted for about a third of home purchases last year, the lowest share since 2008 but still well above the pre-crisis average of 25 percent. Meanwhile, the National Association of Realtors (NAR) reports that the first-time buyer share of home sales slipped for the third straight year to 32 percent, its lowest level since 1987.

FIGURE 9

New Home Sales Are Still at Historic Lows

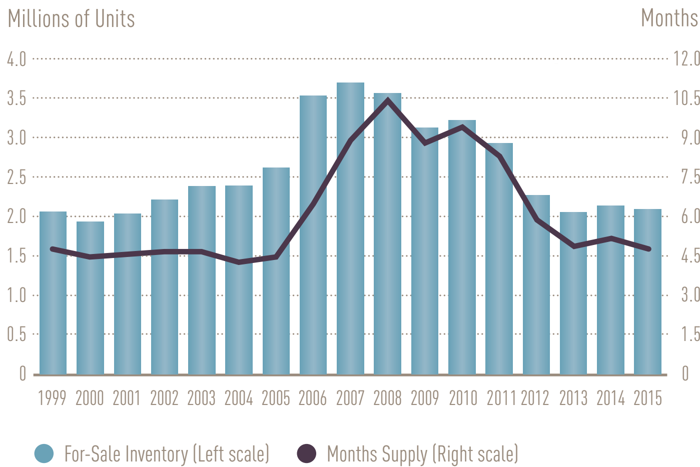
Units Sold (Millions)



Sources: JCHS tabulations of NAR, Existing Home Sales and US Census Bureau, New Residential Sales data.

FIGURE 10

The Number of Existing Homes For Sale Dipped Again in 2015



Source: JCHS tabulations of NAR, Existing Home Sales.

LOW INVENTORIES AND VACANCY RATES

The stock of existing homes for sale declined 1.9 percent last year, to 2.1 million units. Supply stood at 4.8 months, making 2015 the fourth consecutive year that inventories held below the 6.0-month level, the conventional measure of a balanced market **(Figure 10).** In contrast, the inventory of new homes for sale climbed 8.2 percent, ending the year at 217,000 units. But even with three years of significant growth, the supply of new homes slipped to just 5.2 months.

One factor keeping first-time homebuyers on the sidelines is that the stock of affordable homes for sale is extremely limited. According to Zillow, inventories of metro area homes in both the bottom- and middle-value tiers shrank by more than 38 percent in 2010–2015, while those in the top tier fell by 31 percent. In 2014–2015 alone, bottom- and middle-tier inventories were each down 9 percent, while top-tier inventories declined by 3 percent. As a result, less than 20 percent of existing homes for sale in some of the nation's largest metros—including Dallas, Denver, Nashville, Phoenix, and Raleigh—were in the most affordable value tier for their areas.

The number of vacant units for sale also declined 1.7 percent from 2014, to 1.4 million. Vacant units for rent were down 3.7 percent, to 3.3 million, adding to rental market tightness. The number of vacant units held off market, however, remained elevated at 7.2 million, or 55 percent of all year-round vacant homes. Over half of these vacant units are classified as "other." According to the Housing Vacancy Survey, about 7 percent of these "other" units were in foreclosure while another 5 percent were involved in other legal actions. Fully 25 percent were held off market for personal or family reasons, while 16 percent were in need of repair and about 6 percent were abandoned, condemned, or to be demolished. Just under one in ten were undergoing repairs. The large stock of vacant off-market housing may therefore reflect the overhang of distressed properties, as well as the reluctance of some owners to either invest in or sell their units as the market continues to recover.

Overall vacancy rates for both for-sale and for-rent homes are low. After hovering between 2.4 percent and 2.9 percent in 2006–2011, the vacancy rate for owner units fell back in line with longer-term averages in 2015, standing at 1.8 percent for the year. In contrast, the rental vacancy rate plunged from the double-digits in the mid-2000s to a 30-year low of just 7.1 percent last year.

PROPERTY PRICES ON THE RISE

Home prices continued to climb last year. NAR reports that the median price of existing homes rose for the fourth straight year, to $222,400—a 6.6 percent increase in real terms from 2014 and the highest level since 2007. Meanwhile, nominal home prices reached a new peak in 2015. The CoreLogic, S&P/Case-Shiller, and OFHEO indexes, which are less affected than the median price by the mix of homes sold, show that prices of repeat sales were up 5.3–5.7 percent through the end of last year.

The median new home price increased 4.7 percent in real terms to $296,400 in 2015, topping the 2005 peak. In nominal terms, new home prices were up for the sixth consecutive year, while the Census Bureau's constant quality index hit a new high. With the number of distressed sales continuing to fall, the gap between new and existing home prices narrowed somewhat from 37 percent on average in 2011–2014 to 33 percent in 2015, but remains relatively wide. By comparison, the average price disparity in the 1990s was just 18 percent.

Home prices in all 20 metro areas tracked by S&P/Case-Shiller were up last year, with increases ranging from under 3 percent in Chicago, Cleveland, and Washington, DC, to about 10 percent in Portland, San Francisco, and Seattle. Prices are now rising across markets that experienced widely different cycles **(Figure 11).** In Los Angeles and Las Vegas, where significant house price inflation in the mid-2000s was followed by sharp declines, prices are again rising rapidly. In the case of Denver, home prices rose only moderately in the first decade of the 2000s but have now climbed to a new high. And in Detroit, where price appreciation was modest but the ensuing drop was large, home prices reached an eight-year high last year.

In some metro areas, home values are rising in every tier. In Los Angeles, for example, average nominal increases for all three tiers of zip codes (ranked by median home value in January 2000) topped 150 percent in 2000–2015. Appreciation in Denver

also averaged at least 70 percent in every tier, with values in 93 percent of zip codes at new peaks in 2015. The recovery in Las Vegas is more mixed, with values up an average of 53 percent in the top tier, 47 percent in the middle tier, and 31 percent in the bottom tier. And in Detroit, top-tier values rose 15 percent on average over this period, while middle-tier values edged up just 2 percent and bottom-tier values fell 22 percent. Thus, while the housing recovery has reached much of the country, neighborhoods hit especially hard by the crash and the recession are still struggling to rebound.

According to CoreLogic data, the broad uptick in home prices reduced the number of homeowners underwater on their mortgages from 5.3 million in the fourth quarter of 2014 to 4.3 million in the fourth quarter of 2015. While this is a far cry from the 12.1 million peak at the end of 2011, the share of homeowners with high loan-to-value (LTV) ratios remains elevated. Of the homeowners that were still underwater last year, 20 percent had LTV ratios of 100–105, 44 percent had LTVs of 105–125, and 38 percent had LTVs of 125 or higher. However, another 1 million homeowners had less than 5 percent equity at the end of 2015, leaving them at risk if home prices decline.

While the national picture has brightened considerably, pockets of mortgage distress remain. Among the 50 largest metro areas, the share of mortgaged owners with negative equity was under 2 percent in Austin, Houston, Portland, San Jose, and San Antonio, but over 19 percent in Las Vegas, Miami, Orlando, and Tampa.

HOUSING AND THE ECONOMY

Residential fixed investment (RFI), which includes both new construction and homeowner improvement spending, is a critical component of the economy. In 2015, RFI generated $600 billion or 3.3 percent of gross domestic product (GDP), a significant increase from the all-time low of 2.4 percent hit in 2011 **(Figure 12).** RFI also contributed 10 percent or 0.35 percentage point to real GDP growth last year, providing a lift far exceeding its relative size in the economy.

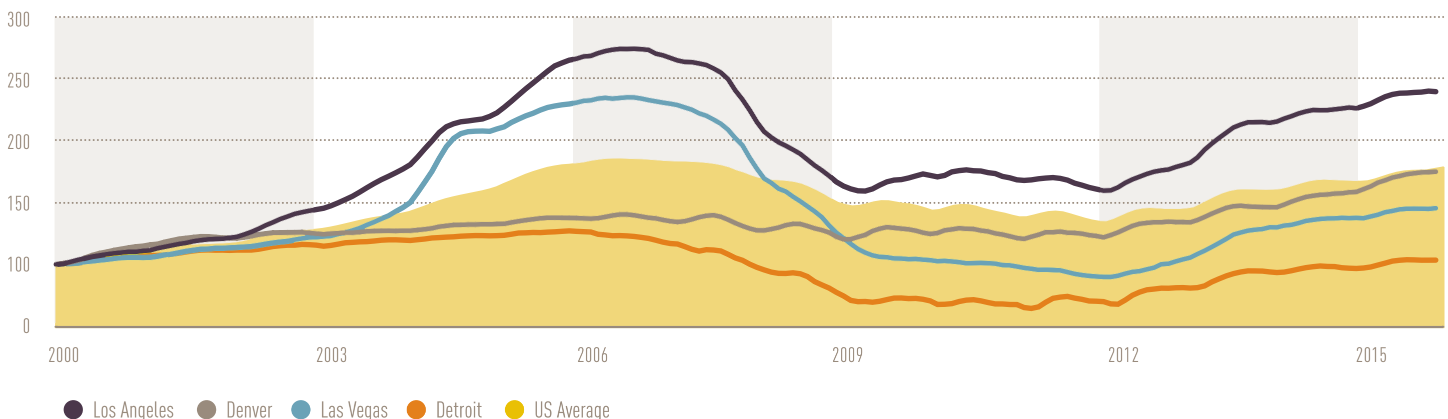
On the improvements side, rising prices for rental properties have stimulated a surge of spending. Total spending on improvements, maintenance, and repairs to rental units rose nearly 10 percent in 2014, to just under $60 billion. Most improvement expenditures on multifamily properties are for replacement projects, such as building system upgrades or new roofing or flooring. While spending in this category has increased since the downturn, maintenance and repair expenditures have been essentially flat, leaving room for additional investment in the rental stock.

Meanwhile, homeowner improvement spending accounted for just over a third of residential construction spending last year, down from about half during the worst of the housing crisis in 2011. Before the crash, homeowners devoted about 40 percent of their remodeling budgets to replacement projects, about 40 percent to discretionary projects such as kitchen and bath remodels, and the remaining 20 percent to property improvements and disaster repairs. After cutting back sharply when the crisis hit, homeowners are now undertaking more discretionary projects. At last measure in 2013, discretionary spending was

FIGURE 11

Although up Substantially in Most Metros, Home Price Appreciation in Some Markets Still Lags

Indexed House Prices

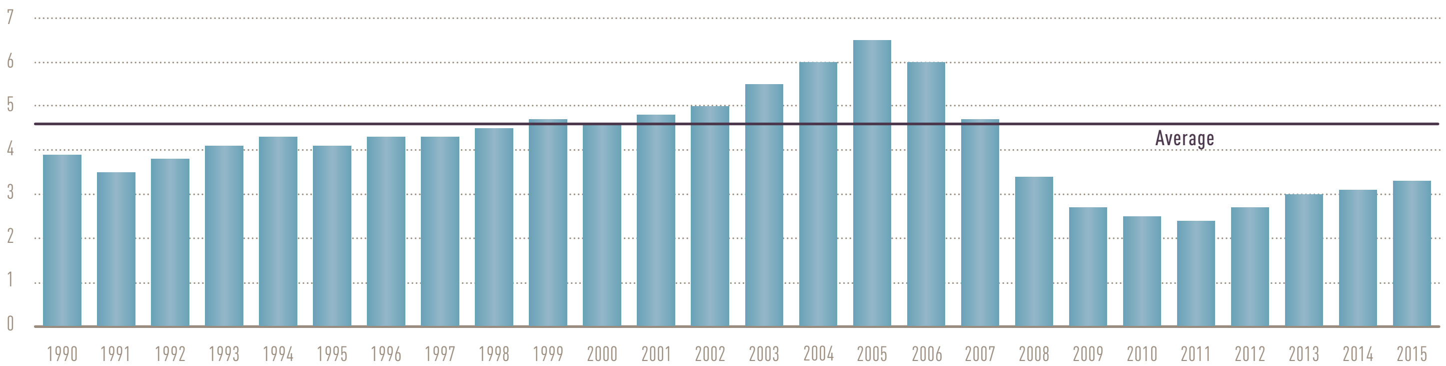


Source: JCHS tabulations of S&P/Case-Shiller House Price Indexes.

FIGURE 12

The Housing Sector Is Gradually Returning to Its Traditional Share of the Economy

Residential Fixed Investment as a Share of GDP (Percent)



Source: JCHS tabulations of BEA, National Income and Product Accounts.

up 6.9 percent from 2011 and back above 30 percent of total homeowner improvement expenditures. As home prices rise and owners continue to build equity, they are likely to take on more of these big-ticket projects.

Rising property values should also generate housing wealth effects. Historically, as home equity grows, households increase their consumer spending by several cents on the dollar. Estimates from Moody's Analytics, however, suggest that the impact of housing wealth (as measured by the value of the national housing stock) on retail sales declined by half after the housing bubble burst. But this same study also found that the housing wealth effects in metro areas where home prices were back to pre-crisis peaks in 2014 were about 2.5 times those in metros where home prices had not fully recovered. With home prices now strengthening in most markets, housing wealth effects should thus provide a lift to both consumer spending and the economy.

THE OUTLOOK

A number of positive trends—continued strong gains in multifamily construction, growing momentum in single-family construction, increases in new and existing home prices and sales, and further reductions in mortgage distress—made 2015 a year for cautious optimism. In fact, NAHB's measure of homebuilder confidence ended 2015 at its highest level since 2005. Homeowners are also feeling encouraged, with nearly half of all respondents to the latest Fannie Mae National Housing Survey believing it was a good time to sell—a sign that for-sale inventories may be set to expand. All of these indicators, along with measures of income and employment growth, will be important to watch in 2016 because of their direct implications for household growth and housing demand.