



## Housing Markets

After another year of healthy growth in 2013, the housing market paused in the first quarter of 2014. The renewed weakness in residential construction, sales, and prices raised fears that the recovery is still fragile. Nevertheless, there has been convincing progress toward normalcy, with the number of delinquencies, foreclosures, and underwater mortgages trending down and non-distressed home sales trending up.

### CONSTRUCTION RECOVERY

Residential construction posted another year of strong growth in 2013, with permits, starts, and completions up by double digits (**Figure 7**). Construction starts jumped 18.5 percent from 2012, to 925,000 units. Even so, this was the sixth consecutive year that starts failed to hit the 1.0 million mark—unprecedented before 2008 in records dating back to 1959. Indeed, annual starts are running far below their historical average of 1.46 million.

Although up a solid 15 percent from 2012, single-family activity remains depressed. Starts increased by just 82,300 units in 2013, to a total of 618,000—a record low prior to 2008. In addition, the pace of growth last year was considerably below the 24 percent gain in 2011–12. The cooldown continued in early 2014, with first-quarter starts down 3 percent from a year earlier.

Meanwhile, multifamily construction had its third consecutive year of solid growth in 2013, up fully 25 percent (62,000 units) to 307,000 units (**Figure 8**). Still, having fallen to such low levels during the housing crash, annual starts only pulled even with the 2000s average (310,000 units) last year and remained well below levels in the 1970s (625,000 units) and 1980s (507,000 units). Given that renter household growth far exceeds the pace in those decades, overbuilding in the multifamily market—at least on a national scale—is unlikely to be a concern. In fact, following increases of 54 percent in 2011 and 38 percent in 2012, last year's growth in multifamily starts represents a considerable slowdown in activity. This moderation continued in the first quarter of 2014, when harsh winter weather helped hold starts at year-earlier levels.

About one-third of total residential construction (310,000 units) in 2013 was intended for the rental market. While this is the highest rental share posted in records dating back to 1974, it primarily reflects the weakness of single-family construction (41 percent below the annual average since 1959) rather than the strength of multifamily starts (still 27 percent below their annual average). The share of multifamily units intended as rentals, however, was also at a record 92.8 percent.

Owner spending on improvements to existing homes also rose over the past year. Benefiting from strengthening house sales,

FIGURE 7

## After Another Strong Year, the Housing Market Recovery Slowed in Early 2014

	2013	Percent Change	
		2012-13	2013:1-2014:1
<b>Single-Family Home Sales</b>			
New (Thousands)	429	16.6	-3.0
Existing (Millions)	4.5	8.6	-6.8
<b>Residential Construction (Thousands)</b>			
Total Permits	991	19.4	3.5
Total Starts	925	18.5	-2.4
Single-Family	618	15.4	-3.5
Multifamily	307	25.3	-0.4
Total Completions	764	17.7	15.2
<b>Median Single-Family Prices (Thousand of dollars)</b>			
New	268.9	8.1	2.8
Existing	197.4	9.8	8.6
<b>Construction Spending (Billions of dollars)</b>			
Residential Fixed Investment	507.5	16.3	9.3
Homeowner Improvements	130.9	2.4	12.8

Note: Dollar values are adjusted for inflation using the CPI-U for All Items.

Sources: Bureau of Economic Analysis, National Income and Product Accounts; US Census Bureau, New Residential Construction and New Residential Sales; and NAR, Existing Home Sales via Moody's Analytics.

homeowner expenditures rose 2.4 percent in 2013, to \$130.9 billion. Although just 17 percent above the 2010 low, improvement spending has recovered much more fully than residential construction and stands only 10 percent below the recent peak. By comparison, investment in new single-family construction remains 61 percent below its peak while investment in multifamily construction is off 39 percent.

As of March 2014, expenditures for homeowner improvements thus contributed 39 percent of total residential construction spending—well above its historical average of 30 percent. Homeowner spending is likely to continue to drive a disproportionate share of residential investment again in 2014. According to the Leading Indicator of Remodeling Activity, homeowner outlays should increase during the first three quarters before slowing in the fourth quarter partly in response to weakening home sales early in the year.

With steady growth in improvement spending and solid increases in new residential construction, the housing sector helped to bolster the overall economy in 2013. The Bureau of Economic Analysis reports that increases in residential fixed investment (RFI, which includes homebuilding, improvements, and related activities) contributed 14 percent of total growth in gross domes-

tic product (GDP) last year, raising hopes that housing investment will finally propel a stronger expansion. The sizable contribution of RFI is noteworthy given the modest scale of housing construction. Indeed, RFI made up just 3.1 percent of GDP in 2013, well below its historical average share of 4.7 percent.

### GEOGRAPHIC CONSTRUCTION TRENDS

Last year's rebound in homebuilding was widespread. Single-family starts were up sharply across the country, with growth ranging from 11 percent in the Midwest and 15 percent in the South, to 18 percent in the West and 19 percent in the Northeast. More than half (53 percent) of single-family starts were located in the South, with another fifth concentrated in the West.

Single-family permitting also rose in 90 of the nation's 100 largest metropolitan areas, jumping at least 20 percent in more than half of these markets. At the top of the list of major metros with strong single-family permitting are Atlanta (up 62 percent), Los Angeles (up 52 percent), and New York City (up 49 percent). Despite these large percentage gains, though, total single-family permitting in the 100 largest metropolitan areas was still 48 percent below average annual levels in the 2000s. In addition, only 12 metros issued more permits last year than the 1990s (pre-boom) annual average.

On the multifamily side, construction starts were up by double digits in every region of the country, while permitting increased in 67 of the top 100 metros. Among the 20 largest metros, the markets with the most growth in multifamily permits in 2013 were Atlanta, Baltimore, Detroit, and Riverside. In contrast, the metros issuing the largest number of permits were New York (30,000), Los Angeles (17,700), and Houston (16,800).

### COOLING HOME SALES

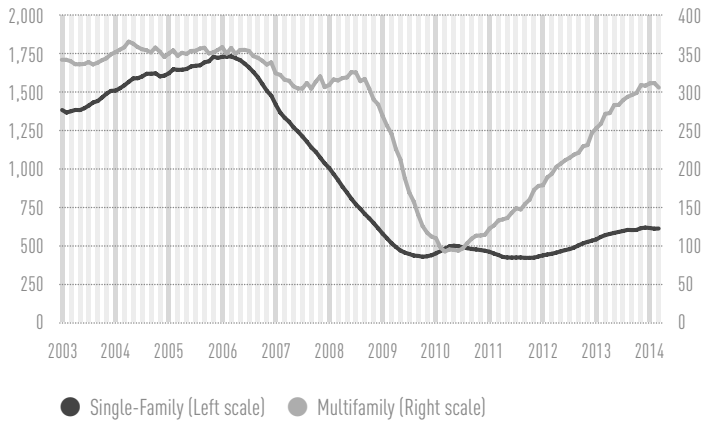
Home sales continued to climb in 2013. NAR reports that sales of existing homes increased 9.2 percent, to 5.1 million—marking the second year that growth exceeded 9.0 percent and the first time since 2007 that annual sales topped 5.0 million. While slowing somewhat from 20 percent in 2012, annual growth in new home sales was still strong at 17 percent, bringing the total to 429,000 units.

Starting in the fourth quarter, however, existing home sales were just 1 percent above year-earlier levels. The slowdown continued in the first quarter of 2014, when year-over-year sales were off 7 percent. New home sales also had a slow start to 2014, down 3 percent from the first quarter of 2013. This cooldown is significant because the pace of sales already lagged well below normal. This is particularly true for new homes, with 2013 sales just 17,000 units above the lowest annual level recorded between 1963 and the housing bust. Indeed, new home sales are fully 67 percent below the recent peak, while existing home sales are down 28 percent.

FIGURE 8

### Unlike Single-Family, Multifamily Construction Now Approaches Pre-Boom Levels

Starts (Thousands of units)

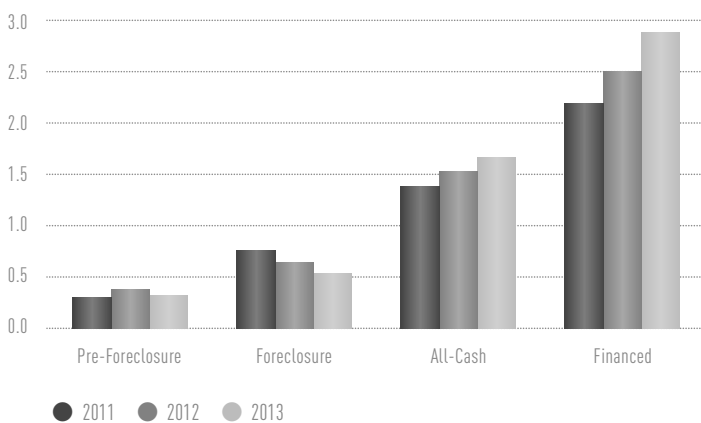


Note: Levels shown are seasonally adjusted annual rates averaged over 12 months to reduce volatility. Source: JCHS tabulations of US Census Bureau, New Residential Construction data.

FIGURE 9

### With Distressed Sales Down and Mortgage Lending Up, Home Sales Are Slowly Returning to Normal

New and Existing Home Sales (Millions)



Notes: Sales categories overlap and do not sum to total. Pre-foreclosure sales are short sales. Foreclosure sales are bank-owned/REO sales. All-cash and financed sales exclude transactions where the presence of a mortgage is unknown. Source: JCHS tabulations of Metrostudy and Corelogic data.

The composition of home sales does, however, point to improving conditions. Traditionally financed sales increased 15 percent in 2013, while REO sales of foreclosed properties fell 17 percent and short sales were down 13 percent (Figure 9). Moreover, distressed sales numbered less than 1.0 million, reducing their share of all existing home sales from 22 percent to 18 percent.

Still, cash sales were unusually high for the fifth consecutive year. Metrostudy data indicate that cash sales accounted for 37 percent of home sales last year, nearly matching the 39 percent peak in 2011. By comparison, the all-cash share was just over one in five before the housing market downturn.

#### CONSTRAINED INVENTORIES

Homes for sale continued to be in scant supply in 2013. According to the National Association of Realtors, the average number of existing homes for sale dropped to 2.1 million last year, a decline of more than 200,000 from 2012 and more than 600,000 units below the monthly average since 1999 (Figure 10). With the pickup in sales, the supply of homes on the market shrank from 5.9 months in 2012 to 4.9 months in 2013.

Inventories are low across the nation. As of March 2014, Zillow indicates that homes for sale in 129 of the 226 largest metros were below year-earlier levels. Indeed, several large metropolitan areas were still posting significantly lower supplies of for-sale homes, including Boston (down 27 percent), Memphis (down 24 percent), and Denver (down 17 percent), plus several metros in Texas, including Houston (down 25 percent), San Antonio (23 percent), and Dallas (down 19 percent). With these declines, the numbers of homes for sale in several of these metros are less than half their levels in 2010.

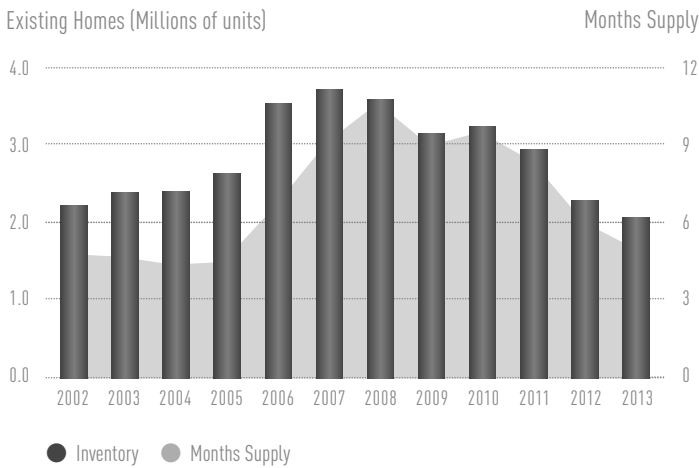
The shortages in some markets may, however, be easing. From just 33 in 2012–13, the number of metros with growing inventories nearly tripled to 97 in 2013–14. The metros reporting the most rapid growth in for-sale units include Phoenix (up 34 percent), Las Vegas (up 33 percent), Riverside (up 26 percent), and Orlando (up 22 percent). Even in these areas, though, inventories were still more than 30 percent below March 2010 levels.

Several conditions have contributed to the persistent weakness of for-sale inventories. Many sellers are unwilling to accept today's prices, given how low they are relative to the market peak. Expiration of the Mortgage Forgiveness Debt Relief Act at the end of 2013 also created a significant disincentive for underwater homeowners to sell because these households now face taxes on any debt forgiven in a short sale. In addition, owners that refinanced recently would have to pay higher interest rates if they moved to new homes. Longer-term factors are also at play, including the aging of the population and the consequent decline in the number of households that move each year.

Tight inventories feed on themselves by limiting the options for potential trade-up buyers, in turn preventing those households from listing their own homes for sale. Indeed, just 38 percent of respondents to the Fannie Mae National Housing Survey in March 2014 believed that now is a good time to sell. The shortage of new homes for sale is also constraining trade-up options. Between 2004 and 2013, the number of new home completions and mobile home placements reached just 12.6 million—the lowest decade-long total since the data series began in 1974 and

FIGURE 10a

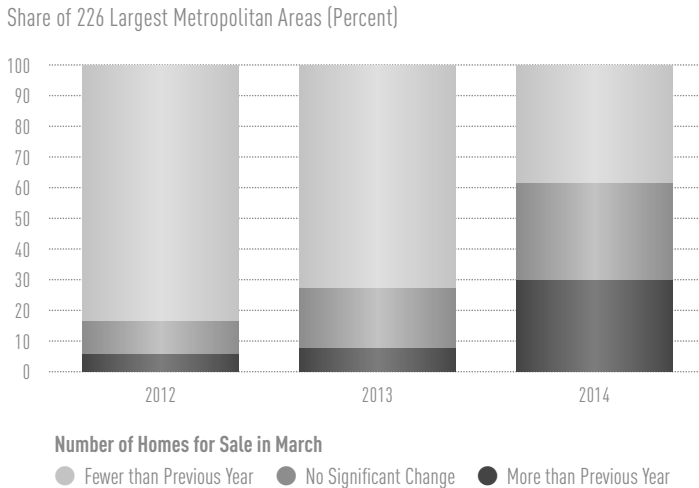
### Inventories of Homes for Sale Remain Tight in the Nation as a Whole...



Notes: Data include existing single-family, condo, and co-op units for sale. Annual data are seasonally adjusted monthly averages. Source: NAR, Existing Home Sales via Moody's Analytics.

FIGURE 10b

### ...But Are Starting to Build in a Growing Number of Metros



Notes: A significant change is defined as more than 5 percent. Largest metros are ranked by for-sale inventory in 2010. Source: JCHS tabulations of Zillow Real Estate Research data.

fully 4.4 million units below the 17.0 million median level for all 10-year periods.

Moreover, since the housing crisis, millions of formerly owner-occupied units have been converted to rentals. At last measure, approximately 1.9 million homes switched on net from the owner to the rental stock between 2009 and 2011. This was on

top of a 1.1 million unit net shift between 2007 and 2009, which took an estimated 3.0 million units out of the owner-occupied housing stock.

Yet another reason for the shortage of inventory is that millions of homes have been taken off the market and are sitting empty. According to the Housing Vacancy Survey, the number of vacant homes held off market spiked to over 7 million units during the housing downturn and is only now beginning to level off. If the vacant/held-off-market share of the housing stock (currently 5.6 percent) were the same as in 2001 (4.5 percent), an additional 1.4 million homes would now be available for sale or rent.

#### METRO HOME PRICES ON THE UPSWING

With the supply of homes for sale so tight, home prices rose sharply last year. The CoreLogic index climbed 11.0 percent from December 2012 to December 2013, while the NAR median existing home sales price rose 11.5 percent, to \$197,000. Meanwhile, the Zillow Home Value Index (ZHVI) registered a 6.7 percent gain in 2013—a more modest rise but still the largest year-on-year increase in the index since 2005. Nevertheless, the CoreLogic index indicates that the national home price in March 2014 was still 16 percent below the previous peak, while the ZHVI reports that the March 2014 price was 13 percent below peak.

The recovery in home prices continued to spread across the country, with the number of the nation's 100 largest metros posting increases up from 73 in 2012 to 97 in 2013. Some of the price gains were significant—better than 10 percent increases in 27 metros, and better than 20 percent in 7. Many areas with the largest price gains had also recorded the steepest declines during the housing bust, such as Las Vegas and Phoenix as well as several California metros. As a result, prices in these markets still have far to go to make up for previous declines (Figure 11). For example, home prices in Las Vegas at the end of 2013 were a little over half their previous peaks.

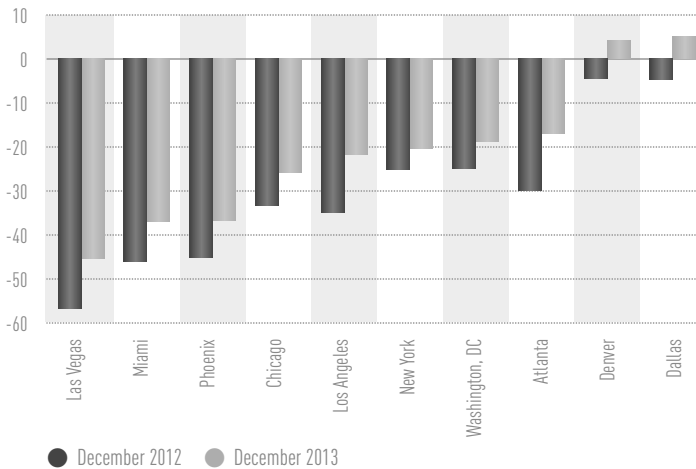
The uptick in prices dramatically reduced the number of homes with negative equity (worth less than the outstanding mortgages). For example, Atlanta and Phoenix had two of the highest negative equity shares of any housing markets at the end of 2012. After strong home price gains in 2013, however, the share dropped from 38.1 percent to 19.9 percent in Atlanta and from 36.6 percent to 22.1 percent in Phoenix. Such improvements added up to significant progress for the US as a whole. According to CoreLogic data, the total number of negative equity homes fell from 10.5 million in the fourth quarter of 2012 to 6.5 million a year later. With this sharp 38 percent decline, the underwater share of all mortgaged homes shrank from 21.6 percent to 13.3 percent.

Home prices in a handful of large metros—Austin, Denver, Honolulu, Houston, Nashville, Raleigh, and San Jose—have now reached or exceeded previous peaks. With the exception of high-flying San Jose, all of these markets posted price apprecia-

FIGURE 11

## House Prices Climbed Sharply in 2013 But Remain Well Below Peak in Most Metros

Difference in Home Prices from Mid-2000s Peak (Percent)



Source: JCHS tabulations of S&P/Case-Shiller Home Price Indices.

tion in the 4–10 percent range in 2013. The current strength of home prices in these metros is therefore less a measure of soaring appreciation today than of the modest declines they experienced during the housing bust. For example, prices in Austin fell just 5 percent during the downturn.

Like home construction and sales, home price appreciation appears to be slowing. Zillow’s ZHVI hit 6.9 percent year-over-year in August 2013, then decelerated slightly to 5.9 percent in March 2014. Zillow also notes that the number of metros where sales prices were higher than asking prices peaked in mid-2013, indicating that competition had cooled. If inventories continue to expand and mortgage rates trend upward, price increases should continue to moderate over the coming year.

### MORTGAGE MARKET SHIFTS

While still near historic lows, interest rates on 30-year fixed mortgages jumped from 3.6 percent in the first half of 2013 to 4.4 percent in the second half. This upturn precipitated a 53.5 percent drop in refinancing applications. Applications for home purchase mortgages also fell 10 percent. As a result, the refinancing share of total lending shrank from 70 percent in the first half of the year to 49 percent in the second half. Both the Mortgage Bankers Association and Freddie Mac expect the refinancing share to dip near 40 percent in the coming year,

dragging mortgage volumes significantly below 2013 levels. Indeed, with interest rates on the rise, homebuyers rather than refinancers will drive the mortgage market for the first time since the 1990s.

The government still had an outsized footprint in the mortgage market in 2013, purchasing or guaranteeing 80.3 percent of all mortgages originated. The FHA/VA share of first liens, at 19.7 percent, was well above the average 6.1 percent share in 2002–03, let alone the 3.2 percent share at the market peak in 2005–06. Origination shares of Fannie Mae and Freddie Mac were also higher than before the mortgage market crisis, but less so than that of FHA. According to the Urban Institute’s Housing Finance Policy Center, the GSEs purchased or guaranteed 61 percent of originations in 2012 and 2013, up from 49 percent in 2002 and 2003.

Portfolio lending, however, has begun to bounce back, rising 8 percentage points from post-crisis lows and accounting for 19 percent of originations last year. While improving, this share is far from the nearly 30 percent a decade earlier. In contrast, private-label securitizations have been stuck below 1 percent of originations since 2008. Continued healing in the housing market and further clarity in the regulatory environment should set the stage for further increases in private market activity.

The ongoing drop in delinquency rates should help to improve lender confidence. The number of loans that are 90 or more days delinquent or in foreclosure has receded in each of the past 17 quarters, leaving the first-quarter 2014 share at 5.0 percent—its lowest level since mid-2008. As a result, the number of troubled loans has fallen by half, to 2.1 million, since the fourth quarter of 2009. This downtrend is likely to continue, given that the share of mortgages 60–90 days past due has dropped to 1.0 percent and the share 30–60 days past due has retreated to 2.7 percent.

### THE OUTLOOK

The US housing market continues its gradual return to normal, with far fewer delinquencies, foreclosures, and underwater mortgages than a year ago. The shares of all-cash and investor sales are also declining while traditional mortgaged, market-rate home sales to owner-occupants have picked up steam. But the weakness in home construction, sales, and prices in early 2014 suggests that the housing market recovery has more ground to gain. Over the short term, housing markets will benefit most from a continued economic recovery that increases employment and raises incomes, particularly among younger adults hardest hit by the recession. Over the longer run, future decisions about the government’s role in backstopping mortgage markets will have significant implications for the cost and availability of credit.