The State of Indiana's Housing Market

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Five years after the bottom fell out of the Indiana housing market, there are finally some signs of a recovery.

In 2011, the number of houses sold in Indiana increased for the first time since 2006 and the median sales price climbed for the second consecutive year. The state's foreclosure rate is still far too high, but the number of homes in the later stages of mortgage delinquency has declined of late.

Of course, a recovering patient is not necessarily a healthy one. The modest improvements in some housing market indicators spring from very weak positions. Existing home sales in Indiana, for instance, are still more than 30 percent off the 2006 peak and the share of mortgages that are 90 or more days overdue is only about half-way back to the state's pre-crash level. Meanwhile, residential construction—another key facet of the housing market and the economy in general—has fallen to levels last seen in the early 1980s and seems stuck there.

So where does the Indiana housing market stand? This article examines some of the latest data to try to answer that question.

Housing Demand on the Rise

After slipping for four straight years, Indiana finally saw an uptick in existing home sales in 2011. Spurred by historically low mortgage interest rates and modest improvements in the economy, sales in 2011 increased by 0.4 percent over the previous year.

Existing home sales in the state had declined by an average rate of 9.5 percent per year between 2006 and 2010. The improved pace of sales is even more encouraging when one remembers that 2011 marked the first year since 2008 that the market stood on its own without government incentives designed to boost sales.

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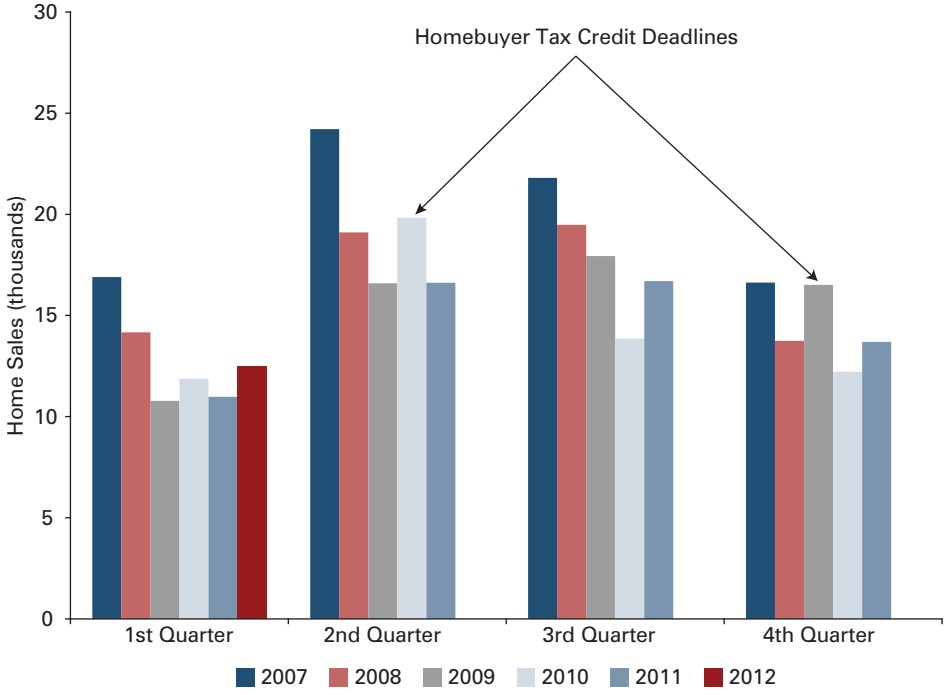
The homebuyer tax credits of 2009 and 2010 almost certainly pulled-forward some home sales that otherwise would have occurred in 2011.

As **Figure 1** illustrates, sales surged to beat the tax credit deadlines in the fourth quarter of 2009 and the second quarter of 2010 but then declined sharply afterward. Because of this distorted pattern, sales were down year-over-year in the first half of 2011 but then increased in the second half of the year. The rebound appears to be picking up steam in early 2012. Data from the Indiana Association of Realtors shows that sales in the first quarter of 2012 are up 15 percent over the same period a year ago and are the highest first quarter total since 2008. The extremely mild weather conditions this past winter likely helped to boost demand during what is typically the slow season for home sales. Housing market activity over the spring and summer should tell whether a true rebound is underway.

With the exception of the Michigan City-La Porte area, each of Indiana's

Figure 1: Indiana Home Sales by Quarter, 2007:1 to 2012:1



Source: Indiana Association of Realtors

metro areas had an increase in home sales over the 12-month period ending in March 2012 (see **Figure 2**). The Columbus area led the way with an 11 percent increase in sales when compared to the same period a year earlier. With a 7.9 percent increase, the Indiana portion of the Louisville metro had the second-largest uptick in sales followed by the Indianapolis-Carmel area (7.3 percent), South Bend-Mishawaka (5.9 percent) and Fort Wayne (5.4 percent). The 45 Indiana counties that are outside of metro areas combined to post a 2.4 percent increase in sales. Statewide, sales are up 4.7 percent over this period.

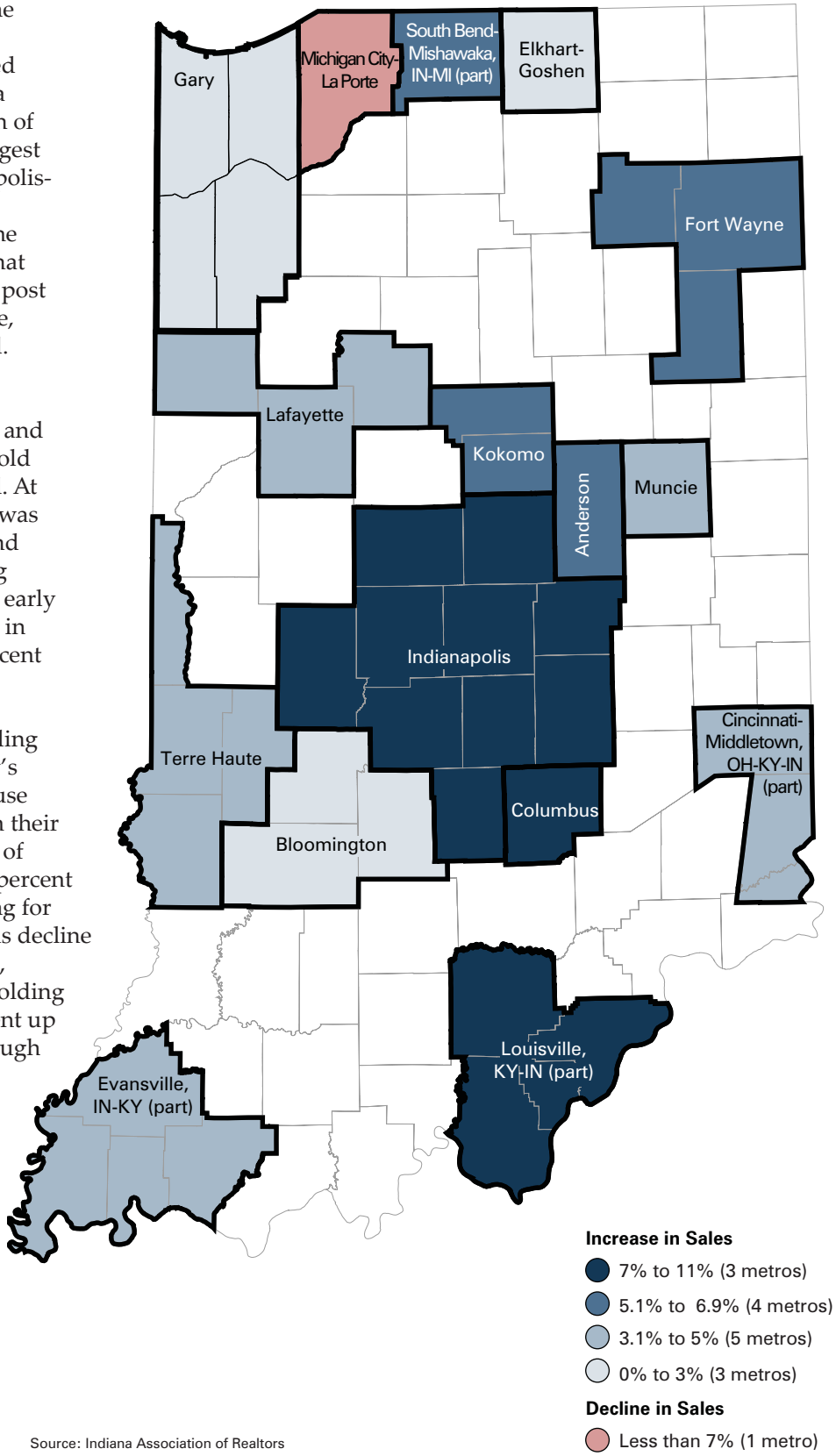
House Prices Find Their Footing

After declining each year between 2005 and 2009, the median sales price of homes sold in Indiana continues to rebound as well. At $112,900, last year's median sales price was a 0.8 percent improvement over 2010 and 2.6 percent above 2009. As with housing demand, price gains continued into the early months of this year as the median price in the first quarter of 2012 improved 3 percent year-over-year.

Other measures show that Indiana's house prices are stabilizing, too. According to the Federal Housing Finance Agency's House Price Index (HPI), the state's house prices have declined by 10 percent from their peak in early 2007 to the fourth quarter of 2011.[1] The U.S. index value is down 25 percent over this same period. Most encouraging for Hoosier homeowners is that most of this decline occurred by early 2009. Since that point, Indiana's house prices have been in a holding pattern, showing no sustained movement up or down. In contrast, the U.S. HPI—though declining at a slower rate in recent years—continues to fall.

Indiana's 10 percent drop in house prices from 2007 to the fourth quarter of 2011 actually ranks as the 14th best peak-to-current price change performance among states. With a 62 percent decline in prices that began in early 2006, Nevada has the nation's largest peak-to-current loss followed by Arizona (-54 percent), California (-50 percent) and Florida (-49 percent). Among Indiana's neighbors, Michigan (-43 percent),

Figure 2: Total Home Sales by Metro Area, April 2011 to March 2012, Year-over-Year Change



Source: Indiana Association of Realtors

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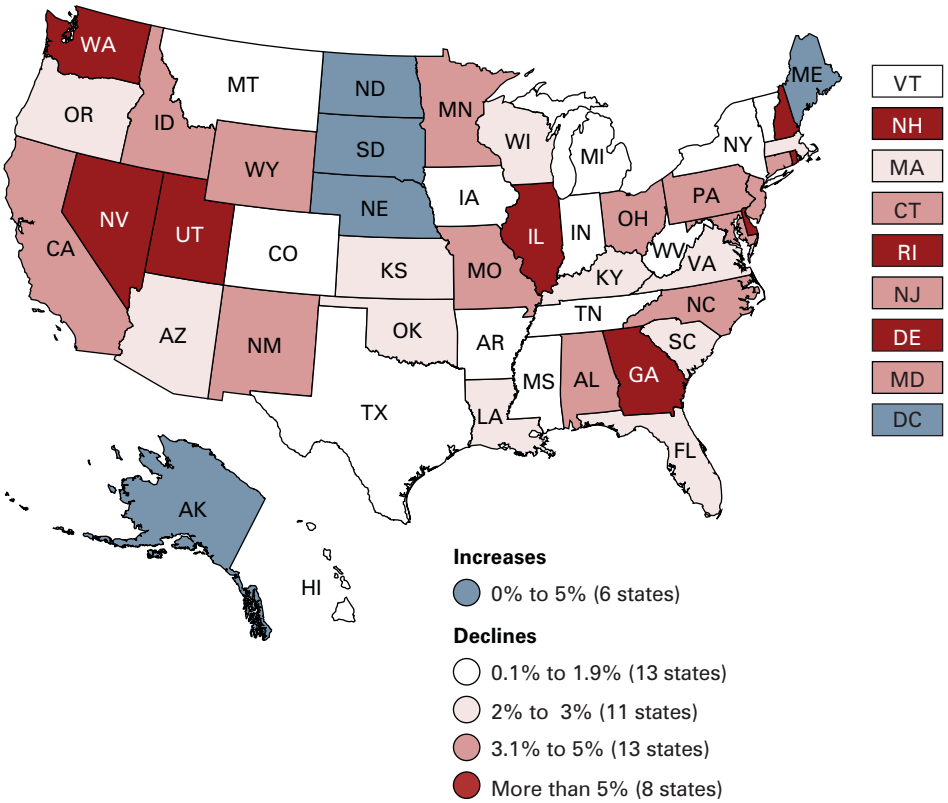
Illinois (-30 percent) and Ohio (-25 percent) have also had dramatic house price depreciation since their respective peaks; meanwhile, Kentucky's 6 percent decline has been comparatively mild.

Looking over the past year, Indiana's HPI value increased in the last two quarters of 2011 but the state's fourth quarter mark was 0.9 percent below the same period in 2010 (see **Figure 3**). Delaware had the largest house price decline at 10.2 percent, followed by Nevada (-9.7 percent), Georgia (-8.1 percent) and the state of Washington (-7.6 percent). Only five states and the District of Columbia had an increase in house prices year-over-year in the fourth quarter of 2011.

House prices around the country have fallen for five years simply because it has taken that long for the bubble to deflate fully (see **Figure 4**). That is, at the end of 2011, the national HPI had just reached the "pre-bubble" trend for price appreciation, meaning that house prices at the national level are about where one would expect had the run-up in prices never occurred. In this sense, the decline in prices—though painful for many homeowners and an economic drag for the U.S.—has been a necessary correction.

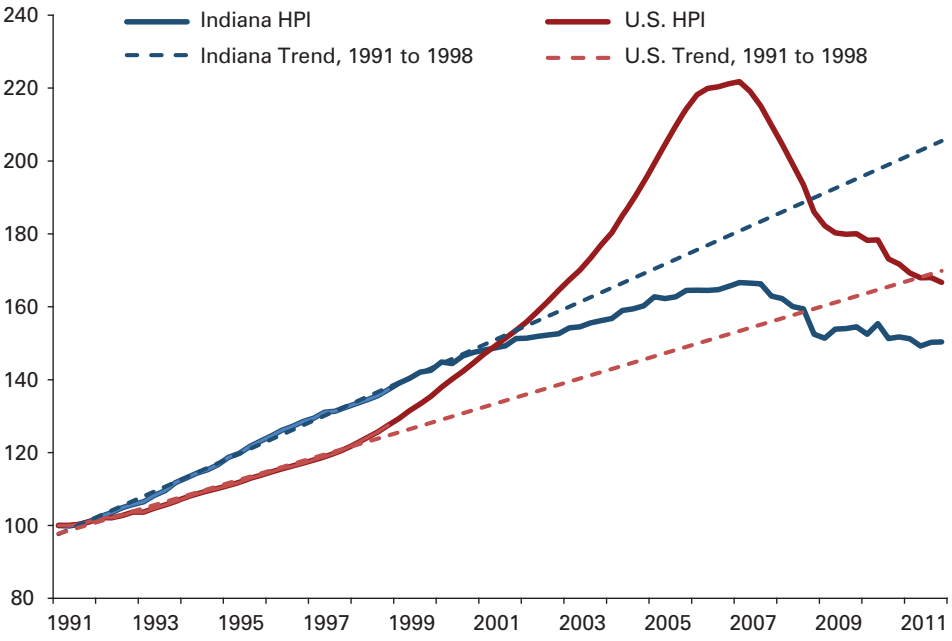
Indiana's experience has been far different. According to the Federal Housing Finance Agency (FHFA), price appreciation in Indiana

Figure 3: Change in House Price Index by State, 2010:4 to 2011:4



Source: Federal Housing Finance Agency, House Price Index (expanded data series, seasonally adjusted)

Figure 4: House Price Index Compared to Pre-Bubble Trend, 1991 to 2011



Source: Federal Housing Finance Agency, House Price Index (expanded data series, seasonally adjusted)

outpaced the national average through the 1990s but then began to slow while prices elsewhere were taking off. After falling since 2007, Indiana's home prices now sit well below the trend set during the 1990s. However, comparing current prices to earlier trends isn't necessarily meaningful for Indiana—or at least not in the same way. Whereas the HPI data for the U.S. clearly illustrate the magnitude of the housing bubble, this measure for Indiana shows the state had no price bubble at all. Instead, changes in Hoosier house prices have gone hand-in-hand with the state's economic performance.

As a case in point, one important reason that Indiana's house price appreciation outpaced the U.S. during the 1990s was that household incomes in the state increased at a greater rate than for the nation as whole. Between 1991 and 1998, Indiana's median household income grew at an average annual rate of 5.6 percent compared to 3.7 percent for the nation. During the housing bubble years of 1998 to 2006, Indiana's median household income growth slowed to an average rate of 1.7 percent per year and the state's pace of house price appreciation slowed in turn. By contrast, household income growth in the U.S. also slowed over this period (2.7 percent annually) but house prices increased by an average rate of 8 percent per year. Since 2006, the average annual rate of median household income growth for both Indiana and the U.S. has dropped to roughly 0.5 percent.

The ratio of incomes to house prices over time clearly illustrates how prices in many parts of the country became detached from economic fundamentals. Among the states that headlined the housing bubble, the price-to-income ratios in Florida and Nevada more or less doubled between 2000 and 2005 while prices in California soared to nine times its median household income

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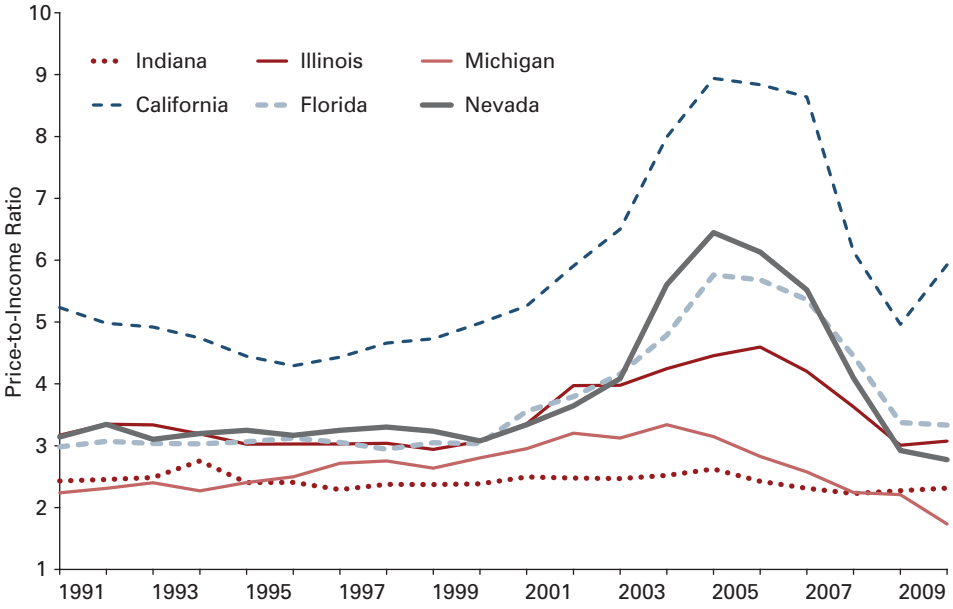
(see **Figure 5**). Looking at some of Indiana's neighbors, Illinois also saw a significant jump in this measure and even struggling Michigan's ratio climbed modestly.

Since the onset of the housing slump, however, the price-to-income ratio in each of these states tumbled back to the more sustainable levels seen during the 1990s, although the ratio did tick up in California and Illinois in 2010. All the while, Indiana's ratio held steady, rising just two-tenths of a percentage point between 2000 and 2005—a smaller increase than all but four states. Indiana and Michigan had the nation's lowest price-to-income ratios in 2010 while Ohio's was the fourth-lowest, suggesting that this region offers some of the most affordable housing in the country.

Foreclosures Remain High

The still-large numbers of mortgage defaults is one of the primary obstacles to a house price rebound in many areas. States like Florida, Nevada and Illinois—which have had some of the nation's steepest declines in house prices—also have some of the highest rates of mortgage

Figure 5: Ratio of Median Home Price to Median Household Income, Indiana and Select States, 1990 to 2010



Source: U.S. Census Bureau and Moody's Economy.com

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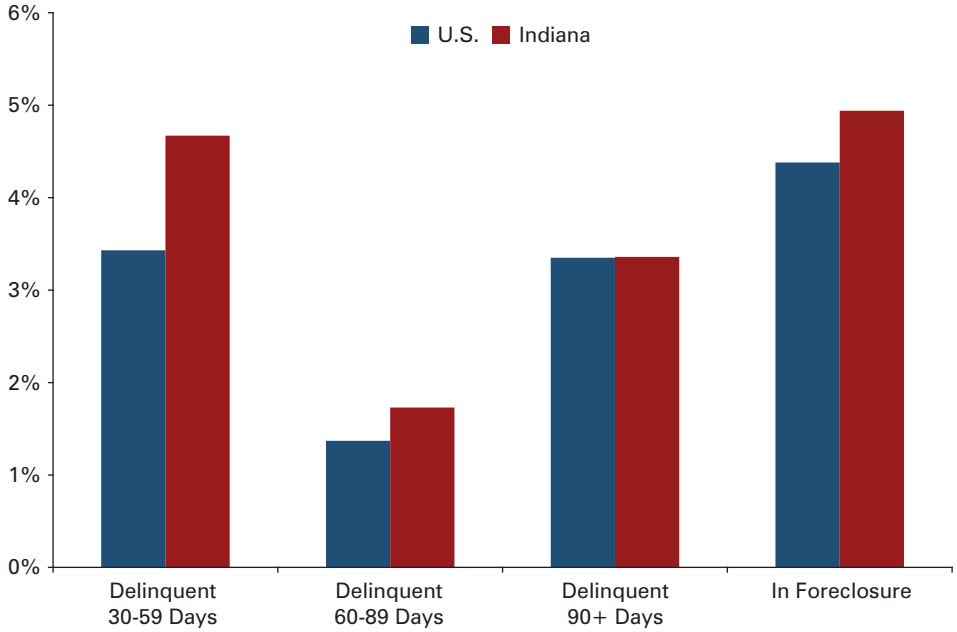
delinquency and foreclosure. The drop in Indiana's house prices has not been as dramatic as in other areas, but the state's delinquency and foreclosure rates remain high.

As **Figure 6** shows, Indiana and the U.S. have a similar share of mortgages that are 90 or more days delinquent but Indiana's foreclosure rate (4.9 percent) is higher than the U.S. mark (4.4 percent). The state's foreclosure rate at the end of 2011 was its highest on record. Indiana has a higher rate of loans in the early stages of delinquency, too. As of the fourth quarter of 2011, 6.4 percent of all Indiana home loans were up to three months past due compared to 4.8 percent nationally. In all, 14.7 percent of Indiana mortgages were past due or in foreclosure at last measure compared to 12.5 percent nationally.

For a variety of reasons, high foreclosure rates have been a persistent problem in Indiana for more than a decade. Indiana had little trouble with foreclosures through much of the 1990s, but the state's foreclosure rate began to rise in 1996 and truly spiked around the 2001 recession (see **Figure 7**). The state's foreclosure rate remained well above the U.S. average until the housing bust.

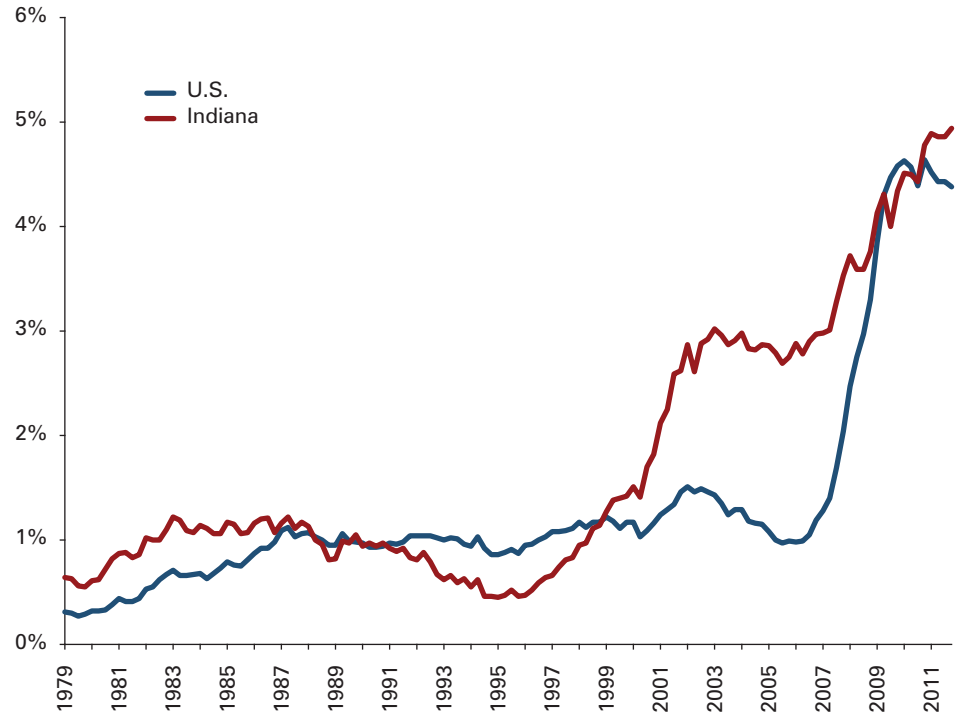
A mix of factors that include weak economic conditions, a surge in high-risk mortgage lending, a rising homeownership rate and a slow pace of house price appreciation combined to give Indiana one of the country's highest foreclosure rates through the early and mid-2000s. However, it's important to note that Indiana was not alone in its high foreclosure rates before the bust. Neighboring Michigan, Ohio and Illinois joined

Figure 6: Percent of Mortgages in Various Stages of Delinquency, 2011:4



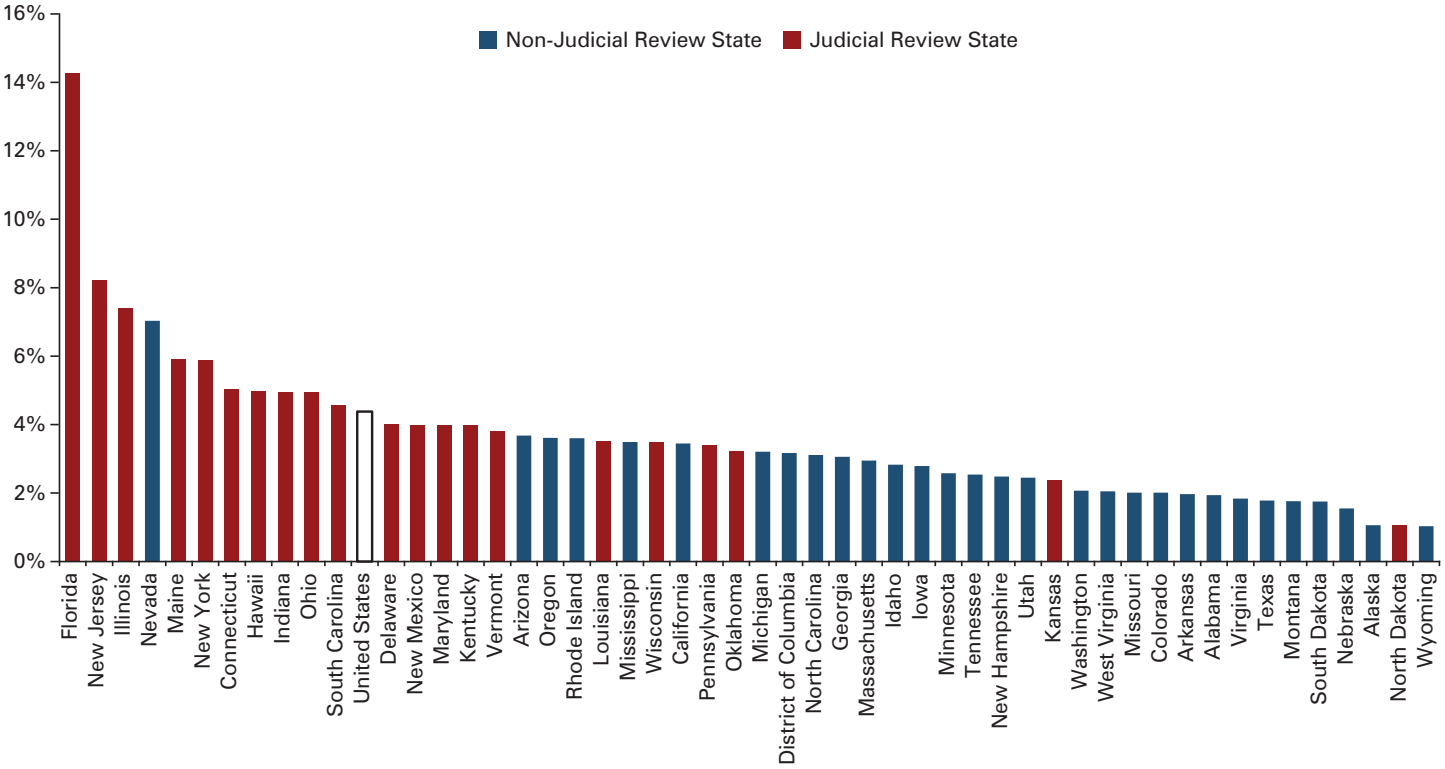
Source: National Delinquency Survey, Mortgage Bankers Association

Figure 7: Share of Mortgages in Foreclosure, 1979:1 to 2011:4



Source: National Delinquency Survey, Mortgage Bankers Association

Figure 8: Share of Mortgages in Foreclosure by State, 2011:4



Source: National Delinquency Survey, Mortgage Bankers Association

Indiana to form a distinct block of high foreclosure states.[2] Each of these states, no doubt, shared the same mix of factors that drove Indiana's trend.

The Role of Foreclosure Laws

It's important to note that the comparison of foreclosure rates across states can be misleading because foreclosure laws vary by state. According to the Mortgage Bankers Association (MBA), Indiana is one of 21 states that require a judicial review of all foreclosures. In all other states, lenders may proceed with a foreclosure without court oversight. While there are many reasons for these different approaches, one practical effect is that judicial review lengthens the time a given property spends in the foreclosure process, which can then inflate a state's foreclosure rate. As of January 2012, loans in the foreclosure inventory of judicial review states had been delinquent for an average of 24 months while the average length of delinquency in non-judicial states was 17 months—a 41 percent difference, according to Lender Processing Services (LPS).[3]

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As a result, judicial review states have a greater backlog of foreclosures. Of the 16 states with the highest foreclosure rates at the end of 2011, 15 were judicial review states (see **Figure 8**). Nevada is the lone non-judicial review state to crack the top 15 while other non-judicial states that were at the epicenter of the housing bust like Arizona and California have comparatively low foreclosure rates. According to LPS, the combined foreclosure rate in judicial states as of March 2012 (6.5 percent) was more than two-and-a-half times greater than the rate in non-judicial states (2.5 percent).

The current foreclosure situation in Indiana—while still a major problem—is somewhat better than the foreclosure rate suggests. The share of the state's mortgages that

are at least three months past due has declined sharply since peaking in late 2009 (see **Figure 9**). At the end of 2011, this measure was about halfway back to its average rate between 2003 and 2007. This decline has leveled-off in the last three quarters of 2011 but Indiana's trend in this pre-foreclosure category has been nearly identical to the U.S. trend over the last two years.

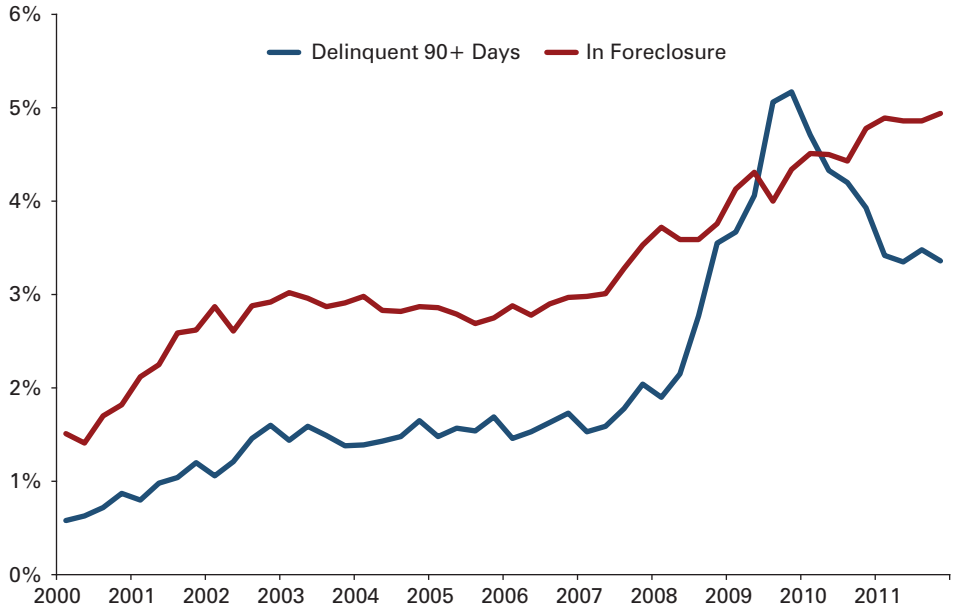
So while Indiana's foreclosure inventory remains high, the flow of homes into foreclosure is on the decline. And when comparing across states, it's the flow into foreclosure that offers a clearer contrast. In the fourth quarter of 2011, 0.99 percent of Indiana's home loans entered foreclosure, according to the MBA. This mark was identical to the U.S. rate and ranked 17th among states (compared to 9th for the total foreclosure rate). Florida (1.7 percent), Arizona (1.5 percent), Nevada (1.4 percent) and Georgia (1.4 percent) had the nation's highest foreclosure start rates at the end of 2011.

Residential Construction Still Slow

Along with acting as a weight on prices, another key effect of the foreclosure crisis has been to undercut demand for new construction. This is a trend that the economics blog *Calculated Risk* has termed the "distressing gap," in reference to the large number of distressed home sales in recent years. Over at least a dozen years leading up to the housing bust, there was a consistent ratio of five or six existing home sales for each new home sold at the national level. Since the beginning of 2007, however, the housing demand that still exists has tilted even more heavily toward increasingly affordable existing homes. As a result, the ratio of existing home sales to new homes has climbed to roughly 14 by early 2012. The price discount on existing homes brought on by the large inventory of foreclosures and other distressed properties at least partially explains this widening gap.[4]

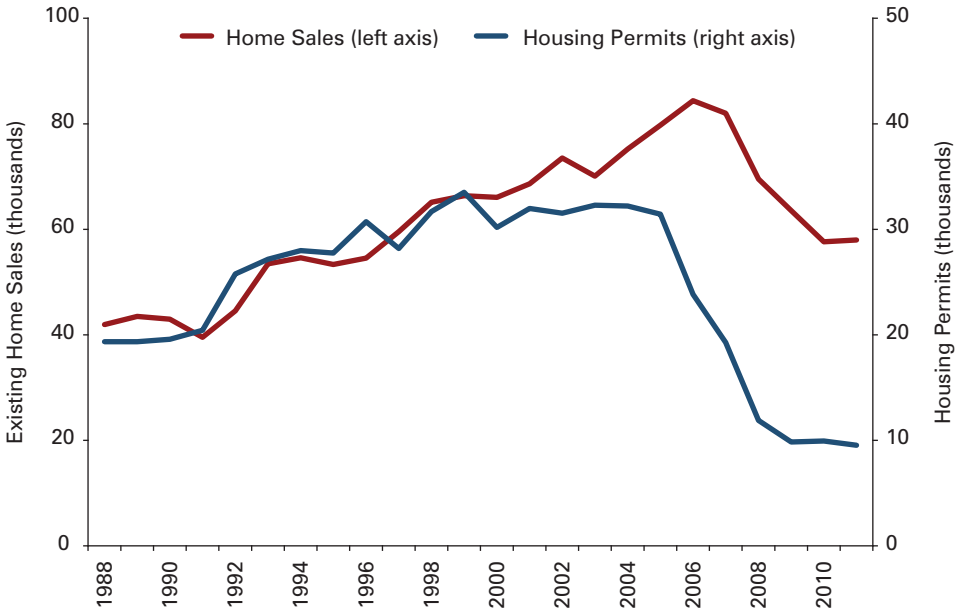
New home sales data are not available for states so we are unable to confirm if this relationship holds in Indiana. However, a comparison of existing home sales and annual housing construction permits suggests that the same dynamics are

Figure 9: Share of Indiana Mortgages 90+ Days Past Due or in Foreclosure, 2000:1 to 2011:4



Source: National Delinquency Survey, Mortgage Bankers Association

Figure 10: Indiana Existing Home Sales and Single-Family Housing Permits, 1988 to 2011



Source: U.S. Census Bureau, Moody's Economy.com

at play (see **Figure 10**). From 1988 to 2005, there were approximately two existing home sales for each single-family housing permit in Indiana. Even through the 1990s when the number of annual housing permits increased by 14,000, there was a corresponding increase in existing home sales. Since 2006, the number of housing permits has plummeted but existing home sales have not dropped in proportion—resulting in a ratio of six existing home sales for every permit in 2011. Since finding a bottom in 2009, single-family residential construction activity has been stuck at a level last seen in the early 1980s.

Conclusion

There are finally some positive signs in the Indiana housing market. Most notably, housing demand is up slightly and the flow of homes into foreclosure is on the decline. Other indicators, such as house prices and residential construction, however, have reached a bottom and stayed there. So, is a recovery underway or will the housing market languish for some time in a new normal?

In all likelihood, the market's separate issues will have to be resolved in turn. That is, housing demand and the foreclosure situation must continue to improve before there can be a true rebound in prices and construction. Of course, none of this will happen until there is progress in the broader economy. There are hopeful signs on this front too. As of April 2012, Hoosier businesses have added more than 50,000 jobs in the last year and the state's unemployment rate dropped below 8 percent for the first time since late 2008. Add in historically low mortgage interest rates and the pieces are in place for a housing recovery. To be sure, the Indiana housing market continues to face challenges and progress may be slow, but most signs point to a market on the mend. ■

Notes

1. An HPI like this one from FHFA is conceptually different from the median sales price indicator discussed earlier. The HPI is a repeat-sales index, meaning that it measures the change in sales price for properties when they are resold. A median sales price simply indicates the median price of all homes sold in a given period and, thus, is influenced by the mix of homes sold in that period. In 2011, for instance, homes with four or more bedrooms accounted for 28.3 percent of Indiana's sales compared to 25.9 percent in 2009. The different mix of homes sold likely explains part of the increase in median sales price.
2. "Report to Congress on the Root Causes of the Foreclosure Crisis," U.S. Department of Housing and Urban Development, January 2010.
3. "LPS Mortgage Monitor," Lender Processing Services, February 2012, www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/Pages/Mortgage-Monitor.aspx
4. "Home Sales: Distressing Gap," Calculated Risk (blog), March 23, 2012, www.calculatedriskblog.com/2012/03/home-sales-distressing-gap.html.