

Housing: Risk Tolerance and Job Growth Are Key to 2015

Douglas M. McCoy: Director of the Benecki Center for Real Estate Studies, Kelley School of Business, Indiana University

Multifamily housing continues a very good run, but the single-family housing sector has continued to struggle. Job growth, consumer confidence, and access to attractive credit terms are the primary drivers that bring potential homebuyers to the market. Considering these factors, most experts believe the housing market will move in a more positive direction in 2015.

For example, the National Association of Realtors projects that existing home sales will increase 7.7 percent from 2014 levels and new single-family home sales will rise 33.5 percent nationally (see **Table 1**). Median home prices are also expected to increase slightly.

However, the housing market's risk tolerance is low (as seen in the disappointing results of 2014), and uncertainties abound. These uncertainties include unemployment, wage growth, access to credit, investor activity and tumultuous world affairs.

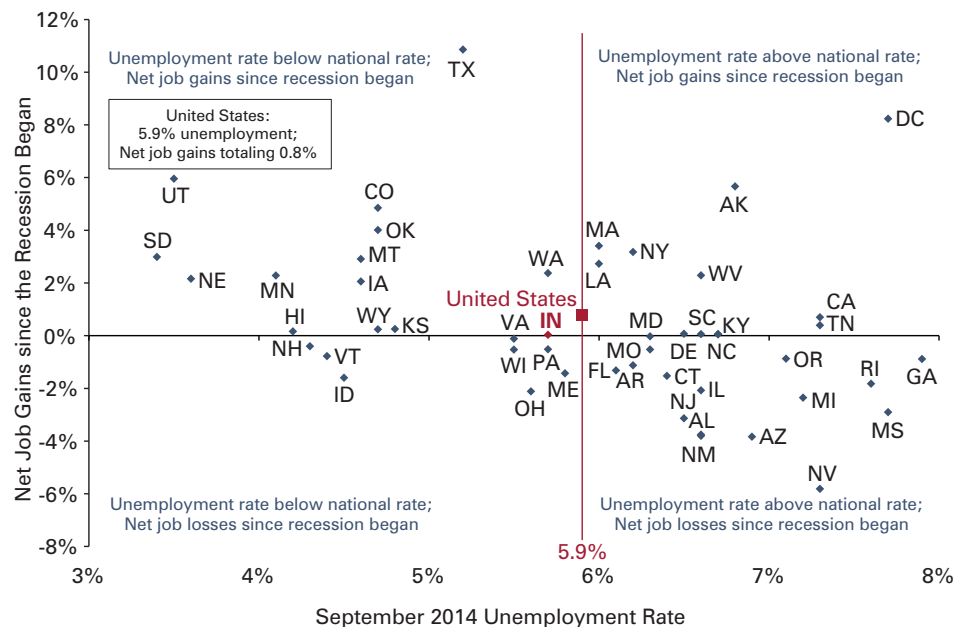
- Hiring is gaining momentum, but unemployment remains high—especially when including people who have given up searching for work.
- Wage growth has been moderate-to-negative for many Americans.
- Access to attractive credit is questionable, as market participants struggle to find the proper underwriting balance and the Federal Reserve ends its bond-buying program.
- Single-family investor activity has slowed, and the threat of investors selling their inventories into the market remains.
- Middle East unrest, Ebola and Europe's economic climate could negatively impact consumer confidence.

TABLE 1: National Housing Outlook

	History		Forecast	
	2012	2013	2014	2015
Home Sales (thousands)				
Existing Home Sales	4,660	5,090	4,938	5,316
New Single-Family Sales	368	429	459	613
Home Sales (% Change - Year Ago)				
Existing Home Sales	9.4	9.2	-3.0	7.7
New Single-Family Sales	20.3	16.6	7.0	33.5
Median Home Prices (\$ thousands)				
Existing Home Sales	\$176.8	\$197.1	\$207.3	\$215.9
New Single-Family Sales	\$245.2	\$268.9	\$277.0	\$283.3
Median Home Prices (% Change - Year Ago)				
Existing Home Sales	6.4	11.5	5.2	4.1
New Single-Family Sales	7.9	9.7	3.0	2.3
Housing Affordability Index*	196	176	165	134

* The housing affordability index measures the ability of a family earning the median income to purchase a median-priced home. Higher index values indicate increased affordability.
Source: National Association of Realtors, "U.S. Economic Outlook: October 2014"

FIGURE 1: Net Job Gains or Losses since the Start of the Recession and Unemployment Rate by State



Note: North Dakota is excluded as an outlier, with an unemployment rate of 2.8 percent and net job gains totaling 29.9 percent since the start of the recession.
Source: Joint Economic Committee of the United States Congress (prepared by the Vice Chair's staff)

So, while most industry sources support the notion of a more positive 2015, it could mirror the less-than-satisfactory 2014 should these uncertainties take a negative turn.

The probability for a better 2015 in the single-family housing market in our nation's cities and towns largely depends on job growth and how wages compare to that locale's median housing price.

One key factor in mortgage qualification is a household's monthly gross take-home pay relative to its payments for housing costs—the total of the mortgage payment, real estate taxes and home insurance. Holding all other things equal, communities with positive job growth and a favorable margin between wages and housing costs are more likely to experience a stronger single-family real estate market.

Likewise, the greater the margin between wages and housing costs, the higher the risk tolerance of potential buyers in that market. For example, if mortgage rates increase, communities with a wider margin (i.e., higher risk tolerance) would be less impacted and more likely to have stable home-buying markets relative to communities with smaller margins. Thus, risk tolerance and job growth are important indicators to consider when projecting 2015's housing market.

How Does the Indiana Housing Market Fare with This Reasoning?

In terms of job growth, Indiana is one of 14 states with net job gains since the recession began and an unemployment rate that fell below the national average in 2014 (see **Figure 1**).

In terms of existing home sales and residential building permits, Indiana has outpaced the nation by 0.6 percentage points and 8.5 percentage points, respectively (see **Table 2**).

However, according to the Indiana Association of Realtors, Indiana's year-to-date 2014 closed sales number

TABLE 2: Mid-Year Comparison of Indiana and U.S. Housing Markets

	U.S.	Indiana
Existing Home Sales, July 2013 to June 2014, Year-over-Year Change	1.4%	2.0%
House Price Appreciation, 2013:2 to 2014:2	6.2%	3.7%
Residential Building Permits, July 2013 to June 2014, Year-over-Year Change	8.1%	16.6%
Share of Mortgages That Are Seriously Delinquent, 2014:2	4.8%	5.2%
Share of Mortgages with Negative Equity, 2014:2	10.7%	5.1%
Housing Affordability Index, March 2014*	172	248

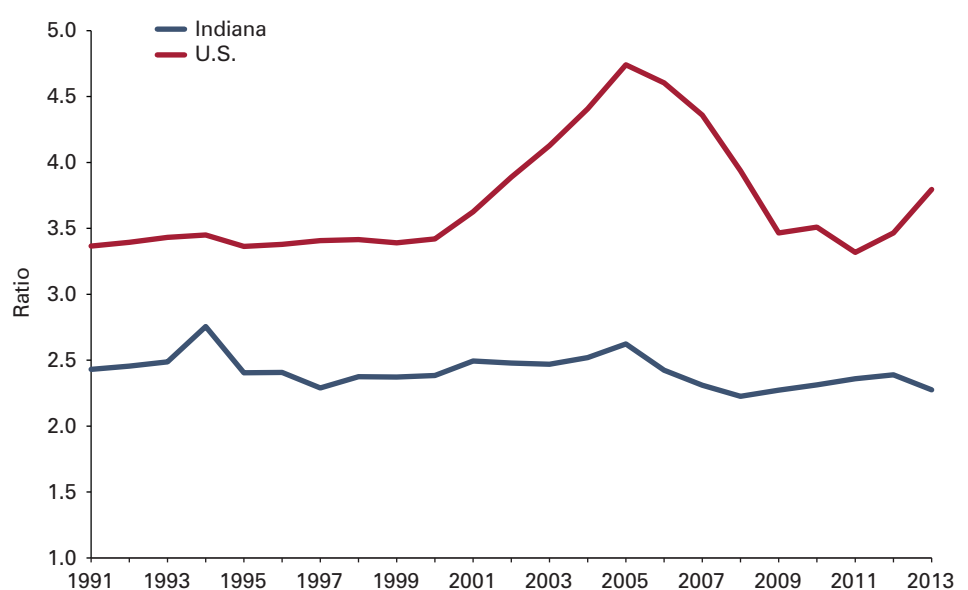
* The housing affordability index measures the ability of a family earning the median income to purchase a median-priced home. Higher index values indicate increased affordability. Source: IBRC, using data from the Indiana Association of Realtors, National Association of Realtors, Federal Housing Finance Agency, U.S. Census Bureau, Mortgage Bankers Association, CoreLogic and Moody's Economy.com

TABLE 3: Indiana Housing Overview

	September 2013	September 2014	Percent Change	Year-to-Date 2013	Year-to-Date 2014	Percent Change
Closed Sales	6,375	6,958	9.1%	58,868	56,752	-3.6%
Median Sales Price	123,500	128,000	3.6%	122,900	126,500	2.9%

Source: Indiana Association of Realtors

FIGURE 2: Ratio of Median Sales Price to Median Household Income



Source: IBRC, using U.S. Census Bureau and Moody's Economy.com data, "Indiana's Housing Market in 2014: Moving toward Stability"

is trending lower than 2013, while its median sale price has increased 2.9 percent year-to-date (see **Table 3**).

When looking at housing costs, Indiana typically has stable housing values. That is, Indiana homeowners usually experience small swings in

value as economic conditions and world events take hold year to year.

While Indiana has lagged the country in home price appreciation over the past year, as seen in **Table 2**, its share of negative mortgage equity is 5.6 percentage points lower.

Indiana's Outlook for 2015

Timothy F. Slaper, Ph.D.: Director of Economic Analysis, Indiana Business Research Center, Kelley School of Business, Indiana University

Perhaps most importantly Indiana's housing affordability remains attractive, with an affordability index value of 248, as interest rates remain low.

Likewise, the ratio between sales price and income has remained stable (see **Figure 2**). So it follows that, year to year, Indiana generally provides a stable job base and a good wage relative to housing costs.

If Indiana's economy improves in 2015 with more jobs and better wages, it should mean positive results for the housing market. On the other hand, if some of the negatives of the potential uncertainties mentioned earlier come to fruition, Indiana will weather the storm better than less stable parts of the country.

Summary

Overall, 2015 is looking more positive for Indiana and the country. Job growth is experiencing a positive trend and many other economic fundamentals have improved. Thus, consumer confidence should be high. 2015 should see housing market improvement both in Indiana and the nation as a whole—so long as mortgage rates remain generally favorable and there is no catastrophic event. ■

In the fall of 2013, when we were trying to forecast the year ahead, the country was swirling in uncertainty. There was a partial government shutdown, debt ceiling talks had turned acrimonious, the Federal Reserve was about to get a new chairperson, the Affordable Care Act roll-out was botched, and to make matters worse, it was getting *really cold* outside.

We expected real economic growth in Indiana to be about 2.3 percent for 2014, about the same as the growth rate of 2013. Now, at the close of the year, we expect 2014 growth in the state to close out slightly better—closer to 3 percent—and that even accounts for the big economic freeze in the first quarter of 2014 when output stalled.

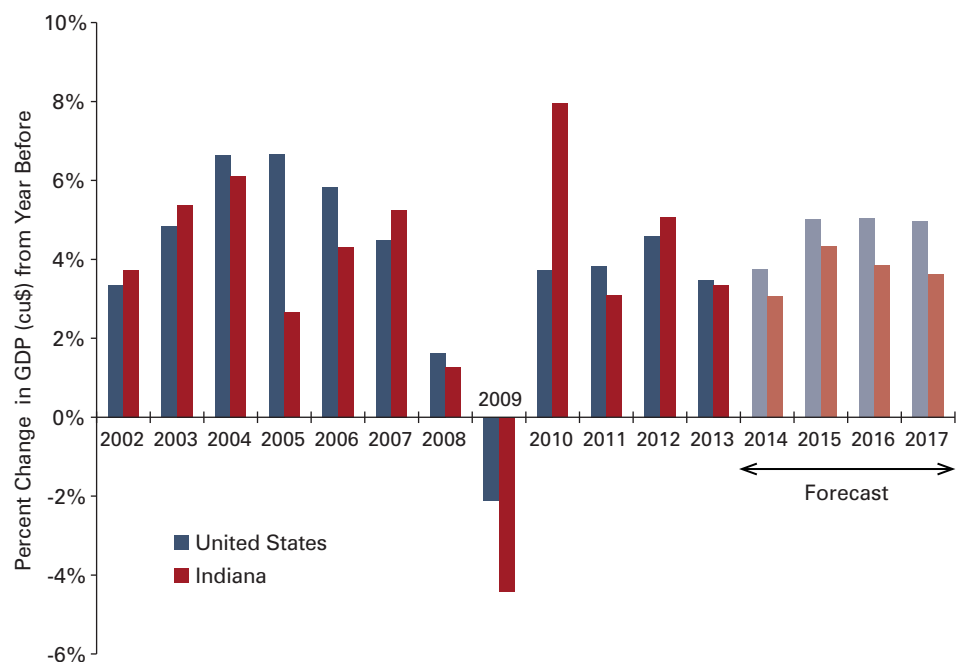
GDP Growth and Employment

Indiana's gross domestic product (GDP) growth in current dollars (cu\$)

is expected to follow the nation in terms of direction, but at a slightly lower rate. Indiana's GDP grew about twice as fast as the U.S. in 2010. In the three following years, Indiana's economic output growth was similar to the U.S. with some slight variation. As **Figure 1** shows, the 2013 growth rate was a tad behind the U.S. and 2014 is expected to close the year at just a fraction off the national rate. This trend—being just a step behind the national average growth rate—is forecasted to continue through 2017.

Forecasts are predicated on assumptions. Among other forces at play, two important drivers can make the state forecast either less or more rosy. Prospects of lower exports in 2014 and 2015—discussed in greater detail below—would reduce Indiana's economic and employment growth performance, while the persistence of robust auto

FIGURE 1: Annual Change in Indiana and U.S. Gross Domestic Product



Note: 2014 through 2017 data are projections.
Source: U.S. Bureau of Economic Analysis, Indiana University Center for Econometric Model Research and Indiana University Indiana Business Research Center