Housing Market Outlook for 2012

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

The housing industry continues to creep through the quagmire created by an inflated and leveraged economy hoping to find solid ground. Comparing current activity to its same period a year ago, economists generally agree the industry has hit bottom. On the other hand, there are still many challenges such as anemic job growth, a large inventory and strict lending standards.

U.S. Housing Industry

Job growth and consumer confidence are the primary economic drivers for bringing potential buyers to the market to take advantage of attractive credit terms and attractive housing prices; however, economic conditions remain weak, slowing a recovery. The following is an excerpt from an October 28, 2011 article published by the National Association of Home Builders (NAHB).

> *Economic conditions are expected to remain weak, slowing the housing recovery but not derailing it. At its Sept. 20-21 meeting the Federal Open Market Committee (FOMC) projected slower growth for the second half of 2011 and into 2012, based on weakening labor market conditions and consumer and business sentiment. The Oct. 19 Beige Book from the Federal Reserve depicted a slow and uneven economic recovery, with most bank districts reporting either weaker or less certain business outlooks.*[1]

The big question as we approach the end of 2011 is whether the housing slump has indeed bottomed. Sales of new single-family homes are forecasted to rise 4.5 percent in the third quarter of 2011 to a seasonally adjusted annual rate of 304,000 units, according to data released by the National Association of Realtors® (NAR). This increase follows downward revisions to the sales rate for the previous four quarters. The annual seasonally adjusted rate forecasted for 2011 is down 4.7 percent compared to -22.6 percent in 2009 and -14.4 percent in 2010.

Total existing-home sales—including single-family, townhomes, condominiums and co-ops—dipped 3.0 percent to a seasonally adjusted annual rate of 4.91 million units in September from a level of 5.06 million in August, but this is 11.3 percent above the 4.41 million-unit pace in September 2010.

The median price of existing homes sold in September was $165,600, down almost 3.9 percent from a year earlier. According to the October report from RealEstateabc.com, the median price dropped to $244,100 from $245,600 in July for the Northeast, and it fell 5.1 percent since August 2010. In the Midwest, the median price declined to $141,700 in August from $146,300 a year ago—a reduction of 3.5 percent. In the South, the median price moved lower to $151,000 from $152,600—down 0.8 percent for the year. The median price in the West made the biggest movement downward, falling to $189,400 from $208,300 in August—a 20.6 percent reduction from the prior year.

The supply of existing homes on the market is moving lower. This inventory moved 3 percent lower at the end of August to 3.58 million units. Considering the current pace of sales, this provides an 8.5 months supply of existing-home inventory, down from a 9.5 month supply from the preceding month.

Existing-home sales are forecasted to be fairly stable in the fourth quarter at 4.97 million compared to 4.75 in the fourth quarter of 2010—a 4.6 percent increase. New-home sales are expected to increase 4.4 percent in the fourth quarter to 313,000 from 300,000 one year ago. Fourth quarter housing starts should increase 4.3 percent to 562,000 from 2010's fourth quarter of 539,000.

> "Three important market indicators are improving in the Hoosier housing market: closed home sales, median sale price and average sale price."

Median home prices of existing homes are forecasted to end 2011 at $165,900, down from approximately $173,000 over the past two years—a 4.3 percent decline. Median home prices for new homes are expected to end 2011 at $225,000, which is a 1.8 percent increase over 2010 levels.

The 30-year fixed rate is hovering around 4.5 percent and likely to stay at that level or slightly higher during 2012. One-year adjustable rate mortgages should continue near 3 percent through 2012.

Existing-home sales are likely to finish 2011 at around 4.96 million, up slightly from 4.91 million during 2010. For 2012, sales are expected to be slightly higher at 5.2 million. New single-family sales are expected to be about 307,000 for 2011, down from about 322,000 in 2010; these sales are forecasted to increase to approximately 375,000 in 2012. Housing starts should end up at around 583,000 for 2011, down very slightly from 585,000 in 2010. Housing starts for 2012 are projected to increase to 630,000—an increase of nearly 8 percent from 2011.

Housing affordability is very favorable. The Housing Affordability Index, computed by the NAR is forecasted near 180 for 2011, up from 174 in 2010, an all-time high since the index was created in 1970.

TABLE 1: U.S. Homeownership Rate, 1965 to 2011

Year	Homeownership Rate
1965	63.0%
1970	64.2%
1975	64.6%
1980	65.6%
1985	63.9%
1990	64.0%
1995	64.8%
1998	**66.3%**
2000	67.4%
2005	68.9%
2010	66.9%
2011	**66.2%**

Note: Data are annual averages
Source: Census Bureau and Haver Analytics

This means that the median family has 80 percent more income than necessary to qualify for a mortgage on the median priced home. Thus, the index indicates it is a fantastic time to buy a home, except for a reality encountered by many would-be homeowners described in the following quote from Lawrence Yun, chief economist from the NAR.

"Existing-home sales have bounced around this year, staying relatively close to the current level in most months," he said. "The irony is affordability conditions have improved to historic highs and more creditworthy borrowers are trying to purchase homes, but the share of contract failures is double the level of September 2010. Even so, the volume of successful buyers is higher than a year ago and is remaining fairly stable—this speaks to an unfulfilled demand."[2]

Yun points out that the housing market is being excessively constrained because "a combination of weak consumer confidence and continuing tight lending criteria held back homebuyers even though the private sector added nearly 2 million net new jobs in the past 12 months."[3]

So has the U.S. housing industry reached bottom? Yun suggests it has when he presents the U.S. homeownership rate since 1965 (see **Table 1**). He reasons that since we are now at 1998 levels where there was no mention of bubbles or unsustainability, the figures may indicate a stable level for the U.S. market. Moreover, he argues that if we do stabilize at around 66 percent homeownership, the natural increase in the U.S. population (3 million a year) and households (about 1.1 million a year) will generate approximately 700,000 additional homeowners each year in addition to the turnover realized from the approximately 75 million home-owning families.

The U.S. housing market is an important contributor to the U.S. economy. For most homeowners, their home is their largest investment and serves as a source of money from refinancing. This money means consumer spending to an economy that is largely driven (around 70 percent) by personal consumption. Moreover, the housing industry employs thousands of workers through the labor, material and services it requires. Therefore, it is very important to reach dry ground and to start walking forward at a tolerable pace rather than continuing to slug through mud made especially deep from an inflated economy fueled by the irresponsible use of leverage.

Indiana Housing Industry

According to the September 2011 Indiana Real Estate Market Report from the Indiana Association of Realtors® (IAR), three important market indicators are improving (when comparing September 2010 to September 2011):

- The number of closed home sales increased 10.2 percent to 5,163.
- The median sale price of homes increased 5.5 percent to $115,000.
- The average sale price of homes increased 5.9 percent to $138,543.

The IAR went on to point out that another important indicator, pending sales, was slightly down 0.4 percent to 4,597.

The IAR notes that the federal homebuyer tax credit is in these numbers and that while foreclosures and pending foreclosures are not fully accounted for, they are a major player in the Indiana market.

The following excerpt from the IAR's October 24, 2011, release highlights a word that is all too familiar to Americans today: "jobs."

Whether market activity and value continue to grow depends upon a number of factors outside the real estate industry's control say REALTORS® across the state. The number one item on their list is more jobs, which drives number two and three on the group's list—available financing for qualified buyers and less foreclosure inventory.[4]

Notes

1. NAHB, "Eye on the Economy," National Association of Home Builders, October 28, 2011, www.nahbenews.com/nahbeye/issues/2011-10-28.html.
2. NAR, "Existing-Home Sales Off in September but Higher than a Year Ago," National Association of Realtors, October 20, 2011, www.realtor.org/press_room/news_releases/2011/10/ehs_sept.
3. NAR, "September Pending Home Sales Down, Still Higher Than a Year Ago," National Association of Realtors, October 27, 2011, www.realtor.org/press_room/news_releases/2011/10/phs_sept.
4. IAR, "Realtors Release 'Indiana Real Estate Market Report' for September 2011," Indiana Association of Realtors®, October 24, 2011, www.indianaishome.com/files/Press_Release_10_24_11.pdf.