



nerej

Residential recovery? Could be longer than anticipated

August 12, 2010 - Appraisal & Consulting

Just as we thought things might be improving in the residential markets, there seem to be a few speed bumps in this twisty road.

The first is the most recent news that housing starts just fell to the lowest level since October, 2009. Starts were down 5.8% from the same month last year, and building permits decreased 2.3%. Second, in the most recent National Association of Realtor surveys, home builders showed lower confidence than in the same month last year, and much lower than was expected.

This recent negative news was in contrast to several previous months of better news, with rates of sale and pricing improving in our area, as well as in many parts of the rest of the country. According to past Case-Schiller reports, most of the country had showed at least modest sales improvements over the last few months. The reasons why the residential market had previously improved, according to the reports, hinged largely on continued low interest rates, a typical increase in the spring market, lowered pricing and perhaps most importantly the housing credit available to first home buyers up until April 30th.

So why the switch? The problem most people think has caused the slow down is loss of the housing credit. Combined with that, foreclosures have increased about 35% during the second quarter over the same period last year, and consumer confidence is once again turning downwards, the lowest level in 11 months (Univ. of Michigan Index of Consumer Sentiment).

Probably the most important factor is, however, the economy itself. While the stock market has improved modestly, and corporate profits are up, unemployment is virtually unchanged. Most people agree that until there are jobs, there will be a lack of consumer confidence, and thus lack of spending. Without extraordinary incentives such the housing credit, people will choose to remain as renters, or feel less need to sell their houses in order to move and buy other houses. They will stay put, hunker down.

In a prescient article over a year ago by Shiller, he basically suggested why home prices could keep falling. His major premise was that a real estate decline can be longer than expected and lag other improving factors. He cited the case of Japan where, after its housing bubble burst in 1991, land prices in major cities fell every year for 15 consecutive years. He posited that homeowners have many reasons for being slow in the recovery process. They don't have a speculative sense of urgency; they don't like changes; there are many decision makers in the process (e.g. family). In short, they have emotional reasons not to do something if they don't have to. At the end of it all, however, he also acknowledged that he and his colleagues believe that any trend could suddenly be reversed or accelerated by a significant market factor change. In other words, if corporate profit led to more hiring, and unemployment started to come down, things could shift more quickly to the positive once again.

Short of this reversal in unemployment, however, improvement in the residential market could take

longer than expected. Clearly, the Southwest, Midwest and Southeast will take a long time. Foreclosures will continue as banks recognize their losses; supply will increase; people will be fearful of making major changes that cost money.

The positive news that we have had over the last several months, largely spurred by the home buyer tax credit, potentially enhanced housing demand at the expense of future sales, not unlike the cash for clunkers program, which is now resulting in slower auto sales. However, unlike the clunkers, excess housing has not been destroyed, reducing excess supply. With a large inventory of existing homes and a rising rate of foreclosure, there is a steady stream of supply that will keep downward pressure on pricing for the relative near term future.

Daniel Calano, CRE, is the managing partner and principal of Prospectus, LLC, Cambridge, Mass.

New England Real Estate Journal - 17 Accord Park Drive #207, Norwell MA 02061 - (781) 878-4540