

# Harvard study: Housing slump worst in 50 years

## Growth in households to drive recovery

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[Inman News](#)

**The current housing slump is far from over and is shaping up to be the worst in 50 years, according to an annual report on the state of the nation's housing markets from the Joint Center for Housing Studies of Harvard University.**

Drastic production cuts and deep price discounts in 2005-2007 helped shrink the inventory of unsold new homes from a mid-2006 peak of more than 570,000 to less than 500,000 in early 2008. But the number of homes entering foreclosure nearly doubled to 1.3 million last year, and vacant homes for sale rose 46 percent over two years, to 2.12 million.

"Until the number of vacant for-sale units on the market ... falls enough to bring vacancy rates back down, house prices will remain under pressure," the report said. **"Working off the oversupply will require some combination of the following: housing starts fall even further, prices decline enough to bring out new bargain-seeking buyers, interest rates drop enough to improve affordability, job growth improves, consumer confidence returns, and mortgage credit again becomes more widely available."**

Single-family home prices in the first quarter of 2008 were down 12 percent from their October 2005 peak -- 18 percent in real terms, after adjusting for inflation. A "dispiriting picture" of housing affordability issues nevertheless remains.

The report, "[The State of the Nation's Housing 2008](#)," is more optimistic about medium- to long-term prospects, estimating that unless there's a serious, prolonged economic decline or a marked cutback in immigration, the nation will gain 14.4 million new households between 2010 and 2020, compared with 12.6 million between 1995 and 2005.

For now, center director Nicolas Retsinas said mortgage rates have "barely responded" to aggressive easing by the Federal Reserve. While the supply of for-sale vacant units continues to grow, tighter underwriting standards have locked many would-be home buyers out of the market. And with home prices falling in most metropolitan areas, homeowners are remaining on the sidelines, he said.

"At some point demand will bounce back," Retsinas said in a press release announcing the release of the report. "Historically, housing markets recover only after the economy has entered a recession and a

combination of falling mortgage interest rates and house prices have improved housing affordability. It is difficult to judge how far away from these conditions we may be. It will take longer this time to rebound given the unusually high levels of foreclosures and constrained credit markets."

If the economy slips into a severe recession, the prolonged contraction could drive down the sustainable level of housing demand by slowing the loss of older units, forcing more households to double up, and reducing sales of second homes, the report said. But in the case of a mild downturn, which most economists expect, the fundamentals of demand are likely to drive a strong rebound in housing once prices bottom out and the economy begins to recover.

How bad is the downturn? The report noted that sales of existing homes fell 13 percent in 2007 to 4.9 million, and sales of new homes were down 26 percent to 776,000, the lowest level since 1996.

The 500,000 unsold new single-family homes available in early 2008 was down from a mid-2006 peak of more than 570,000, but the slower rate of sales translates into an 11 month supply -- an overhang not seen since the 1970s. A supply of more than six months is considered a buyer's market, and the inventory of existing single-family homes rose to 10.7 months in April.

Housing permits fell 24 percent nationwide in 2007, with single-family permits down 29 percent and multifamily permits down 9 percent for the year. The total decline from the 2005 peak was 35 percent, including a 42 percent reduction in single-family permits.

The report said that it's hard to gauge with certainty how far home prices have fallen, as each of the three most commonly used measures paints a different picture.

The National Association of Realtors (NAR) national median single-family home price declined 6.1 percent from the fourth quarter of 2006 to the fourth quarter of 2007, while the S&P/Case-Shiller U.S. National Home Price Index fell 8.9 percent during the same period.

The narrower purchase-only repeat sales index from the Office of Federal Housing Enterprise Oversight - which excludes mortgages too large or too risky for purchase by Fannie Mae and Freddie Mac -- fell 0.3 percent during that time.

The national statistics don't reveal the larger price drops in many metro areas, the report said, and mask the speed declines spread across the country. At the beginning of 2007, quarterly data collected by NAR showed prices rising in 85 of 144 metro areas. By the end of the year, only 26 metro areas were still seeing price appreciation. In the fourth quarter, prices in 33 metro areas had fallen by 10 percent or more from their peak.

NAR's figures showed fourth-quarter nominal house prices falling back to 2006 levels in 12 metros, to 2005 levels in 35 metros, to 2004 levels in 19 metros, and to 2003 or earlier levels in 16 metros.

How does the current downturn stack up against others in recent memory? The 12 percent drop in national home prices since the October 2005 peak (18 percent in real terms) exceeds the downturns of the early '80s and early '90s. Two and a half years after real prices peaked in November 1989, the real median price was down just 4 percent and the nominal price was up 6 percent. Two and a half years after the May 1979 peak, the real median price had fallen 8 percent and the nominal price had increased by 20 percent.

Those price drops may not have produced meaningful improvements in affordability, the report said.

Between 2001 and 2006, the number of "severely burdened" households spending more than half of their income on housing grew by nearly 4 million, to 17.7 million -- or 16 percent of households. Another 39 million households were "moderately burdened" paying more than 30 percent of income on housing.

At current interest rates, the national median price would have to fall an additional 12 percent from the end of 2007 to bring the monthly payments on a newly purchased median-priced home back to 2003 levels, the report said. In 40 metros, prices would have to fall more than 25 percent.

If interest rates were to come down by a full percentage point, the report estimated that the national median home price would still have to decline by 2 percent, or by more than 25 percent, to return to 2003 affordability levels.

Repeat home buyers would not see affordability gains from such price drops because they would have to sell their homes at discounts similar to those on the home they would buy, the report said.

The boom-bust housing cycle has been reflected in the home-ownership rate. From 1994 to 2004, the home-ownership rate surged by five percentage points, peaking at 69 percent. Since then, home-ownership rates have fallen back for most groups, including a nearly two-point drop among black households and a 1.4-point drop among young households. The number of renter households increased by more than 2 million from 2004 to 2007, lowering the national home-ownership rate to 68.1 percent.

Once the oversupply of housing is worked off and home prices start to recover, the use of automated underwriting tools, a return to more traditional mortgage products, and the strength of underlying demand should put the number of homeowners back on the rise, the report said.

Although the short-term prospects for a recovery remain uncertain, in the long run the downturn is unlikely to slow down the creation of new households -- unless the economy enters a sharp, prolonged recession that dampens immigration or slows household formation, the report said.

A weak economy could slow the rate of immigration, which is largely driven by the availability of U.S. jobs. The report identifies the main risk to the long-run outlook as a dip in the level of immigration from its recent 1.2 million-a-year pace due to weaker labor markets.

Minorities contributed more than 60 percent of household growth in 2000-2006, and they now account for 29 percent of all households, up from 17 percent in 1980 and 25 percent in 2000. The minority share is likely to reach about 35 percent by 2020, the report said.

The report projected that minority household growth among 35- to 64-year-olds should remain strong in 2010-2020, while the number of white middle-aged households will begin to decline after 2010 as baby boomers reach retirement age.

People living alone are expected to account for 36 percent of household growth between 2010 and 2020, and 75 percent of the 5.3 million projected increase in single-person households will be among those 65 and older.

**Courtesy of JB Goodwin**