

## Housing Hopes: Is the Housing Bust Over?

*Despite some hopeful signs, the U.S. housing market likely has a long and winding road to travel before it fully recovers.*

The latest news on the housing front has been encouraging. Sales volumes have risen in some of the hardest-hit areas such as Las Vegas, southern Florida, and parts of California, and prices in some areas appear to be bottoming out. What's more, mortgage rates are now at historical lows, sparking a boom in refinancing. The low rates, together with more affordable prices promise to reinvigorate demand, especially among first-time buyers who can take advantage of a new \$8,000 tax credit.

But a closer look at the fundamentals tells a different story. Nationally, existing home sales in March were down 7% from last year according to the National Association of Realtors -- a slowing decline, but still a decline. The supply of unsold homes remains over nine months, a number that has changed little over the last year and continues to be abnormally high. Moreover, about half of the sales volume in recent months has consisted of foreclosures or distressed properties. Sellers of non-distressed properties continue to be reluctant to lower prices, preferring to bide their time. Meanwhile, many would-be buyers simply cannot get financing now that banks have significantly tightened lending standards.

A Glimpse at the Fundamentals<sup>1</sup>

	% Change		
	March 2009	March 2008	2006
Existing home sales (units)	4.1 million	-5.8%	-27.8%
Median sales price, existing homes	\$174,900	-11.5%	-21.2%
Existing home inventory	9.3 months	-3.1%	45.3%
Median home price to median income	3.4	-14.0%	-26.3%

An in-depth look at the data on housing starts, sales, inventories, and prices shows signs that the housing market is stabilizing. S&P sees combined sales for new and existing homes this year likely to level off at around 4.2 million and remain near that rate through 2010 before accelerating to 5.0 million in 2011. But sales volume tends to recover long before prices. The huge inventory of unsold homes makes it likely that prices will decline further. S&P expects prices to continue to drop for another year, falling 11% from current levels and bringing the total decline to 37% from the July 2006 peak in the S&P/Case-Shiller index.

The worst of housing's bursting bubble appears to be behind us. But the fundamentals suggest that it's not over yet and that prices are likely to remain weak for a while longer.

## Portfolio Strategies

Lower prices and record-low mortgage rates have improved affordability and attracted more homebuyers. However, the high inventory of unsold homes suggests that prices are likely to remain weak.

- **Don't look for house prices to spring back to bubble levels.** Most industry professionals agree that a return to the inflated values of 2006 any time soon is unlikely -- especially in overbuilt areas such as Las Vegas, Phoenix, and south Florida. More likely, there will be a gradual leveling off and eventual uptick in prices once the economy improves.
- **Housing is only one segment of the real estate market.** Prices of commercial real estate -- office buildings, malls, hotels, apartment complexes, warehouses, etc. -- are determined by different factors than residential real estate, and run in different cycles. Office properties, for example, are just now beginning to weaken after years of strong returns.
- **A housing recovery is not an economic or a market recovery.** Even if the residential real estate market does improve in the coming months, this does not mean that the economy -- or the stock market -- will follow suit. The recession is not over, and many economists expect unemployment to continue to climb. What's more, stock markets are affected by myriad factors unrelated to housing, as was all too evident in the 2000-2002 bear market.
- **Real estate markets are local.** If you're considering investing in a property, remember that real estate markets vary widely from region to region, city to city, and block to block. For instance, Charlotte, NC, has seen only a 4.3% drop in median sales prices since July 2006, while Phoenix has experienced a 45.5% decline.<sup>2</sup>
- **Keep an eye on the fundamentals.** Whether you invest in residential or commercial real estate, keep in mind that real estate investment performance is largely a function of the property being invested in -- its type, location, condition, and market, as well as leasing status and management for commercial properties. How an individual property performs will ultimately depend on all these factors, so remember to look closely at the property or portfolio before investing.

<sup>1</sup>*Sources: National Association of Realtors (home sales/prices), Bureau of Economic Analysis, U.S. Census (income).*

<sup>2</sup>*Source: Standard & Poor's. Decline in S&P/Case-Shiller house price index from July 2005 through December 2008.*