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Record housing drop hurts coasts worst

A 291-city report finds broad declines, but the biggest pain is limited to California and Florida. Small towns in the South and West are holding up well, number crunchers say.

By Marilyn Lewis

U.S. home prices in the last quarter of 2007 fell 1.3%, a record drop, a new government report shows.

The survey, by the Office of Federal Housing Enterprise Oversight, also reveals a stubborn strength in most of the nation's local markets, a stability obscured by the national figures and one that is frequently overlooked in discussions of the dire shape of the housing market.

"The states suffering the most are on the coasts," says OFHEO chief economist Patrick Lawler.

The 291-city report finds widespread declines, but the worst pain is found in California, where homes on average lost 6.7% of their value over the year; Florida, where homes prices declined 4.7%; and the desert Southwest, where overbuilt Arizona and Nevada continue to writhe.

Despite the drama in those places, though, prices in most of the rest of the country held up relatively well, losing less than 2% or even, in a few places, growing. The stability is found in the middle of the country, which never saw the stunning boom-year price increases that now are unraveling in former boom markets like Florida, California, Arizona and Nevada.

In eight states, house prices rose year over year: Utah, 9.3%; Wyoming, 8.3%; North Dakota, 7.8%; Montana, 6.9%; Texas, 6.2%; New Mexico, 5.4%; Washington, 5.4%; and Oklahoma, 5.1%.

No one can promise that's the end of the story, though, Lawler says. Other economic developments have yet to play out, including the effect of a massive buildup of unsold homes in most markets. The inventory of houses for sale is historically large and still appears to be growing.

"How much further down that inventory will ultimately push prices will depend on a number of factors, including what happens to interest rates and the overall health of the U.S. economy," Lawler says.

"It's a perfect storm: Housing is heading down, and the economy is heading down with it," says economist James W. Hughes of Rutgers University. "2008 is certainly destined to be a lost housing year."

Closely watched indicators

A string of reports on the most recent statistics fleshes out the picture:

- **Prices.** The National Association of Realtors' report on fourth-quarter 2007 home prices (.pdf file) shows the median home price dropped to $206,200, down 5.8% from $219,000 the year before. More than half of the 150 cities tracked had falling prices compared with a year earlier. The latest S&P/Case-Shiller index shows prices plunging 7.7% year over year in the 20 cities tracked. Although it follows only a handful of cities, trend-watching economists favor this study because it includes all home sales, not just, as with OFHEO, those eligible for government mortgage insurance. Zillow, an online home-valuation company, reported single-family homes losing 5.5% of their value from the previous year in the fourth quarter; condominium prices dropped 7.4% in the fourth quarter.

- **Inventory.** In January, the backlog of existing homes for sale rose to 10.3 months, meaning that it would take that long to sell all of them at the current pace. (When supply and demand are balanced, inventories are at five or six months; the boom created inventories as low as three months' worth). That's considerably worse than December's 9.6-month supply and 53.7% more than at the same time last year, according to the National Association of Realtors. There's also a 9.6-month inventory of new homes on the market, 54.8% more than the year before, according to Census Bureau estimates. Foreclosed homes coming onto the market contribute to the swollen inventories.

- **Foreclosures.** Foreclosure filings -- including default notices, auction sale notices and bank repossessions -- continue to grow. In January, foreclosures grew by 8% from the previous month and 57% from the year before, according to RealtyTrac.

- **Home-builder confidence.** The National Association of Home Builders/Wells Fargo Housing Market Index takes the pulse of construction professionals every month. A number over 50 indicates their optimism for the new-home market. The index stands at 20 in February -- a bit better than a historic low, 18, in October and November, but 20 points lower than a year ago. The NAHB says members are cautiously optimistic because of slightly increased numbers of people touring model homes.

- **Delinquencies.** In the third quarter of 2007, 5.59% of mortgages (not including foreclosures) had late payments. It's the highest delinquency rate since the Mortgage Bankers Association report began 22 years ago and an increase of 0.92% from the same time in 2006.

- **Housing starts.** Builders began work on about a million new homes in January, slightly fewer than December and 27.9% fewer than the same time last year, according to the Census Bureau. "Eventually, such a huge drop in production will reduce inventory and allow the market to stabilize, but for now it's just pain, pain, pain," wrote Ian Shepherdson, chief economist for High Frequency Economics, in a recent newsletter.

The worst is concentrated

Bad as the national picture is, the national statistics are dragged down by some spectacularly poor local housing markets. For example, subprime adjustable-rate mortgage (ARM) delinquencies and foreclosures are rising in all states, but in most places the actual number of loans involved is fairly modest, says the Mortgage Bankers Association.

California alone has as many new foreclosures from subprime ARMs as 35 other states combined. And even in California, it's the overbuilt markets (such as San Diego, Stockton, Sacramento, Bakersfield, Chico and Fresno) that are seeing collapse while others are fairly stable.

The worst trouble is concentrated in California and Florida, where overbuilding and speculation drove prices beyond the reach of most buyers, and Ohio and Michigan, where failing local economies, job losses and shrinking populations mean there are more houses for sale than buyers.

All states are caught, to some extent, in the downdraft of these imploding markets. Yet homeowners should be unaffected if they have traditional fixed-rate loans and can stay in their homes until things turn around.

Economists stress the essential independence of each local economy. "There are clearly national forces such as the availability and the cost of mortgage money that are going to have influence on all the geographies," yet these affect each region differently, says Michael Feder, the president and CEO of Radar Logic, a housing analytics company. "To think of the housing market as a single entity that moves up or down is to belie the housing market principle: location, location, location."

Philadelphia is one example. There, homes are definitely are selling slowly and for a bit less, says Rutgers' Hughes, who lives there. But the Philly market appears to be holding stable, he says.

In a handful of metropolitan areas -- Charlotte, N.C.; Milwaukee; Seattle; and New York -- the per-square-foot price of real estate still is growing (though far more slowly than at the market's peak), according to Radar Logic.

Experts worry not so much that home prices are falling -- on the coasts they've still got far to go before reaching affordability -- but that they are falling too fast, helping pull the rest of the economy down.

"There's nothing troubling about a gradual correction of home prices," Yale University economist and Case-Shiller index founder Robert Shiller told an audience at the Reuters Housing Summit recently. "If we keep our incomes at the current level and home prices go down, we are richer, we can buy more housing." However, he said, "if they fall suddenly and fast, then that can bring on recession, and that is the worry right now."

To gauge whether that is happening, Celia Chen, director of housing economics for Moody's Economy.com, will be watching several key economic indicators, particularly those listed above.

"I think the key to a turnaround in home prices is that the mortgage markets do regain some semblance of stability within the next year. Given the fact that the credit quality problems are spreading beyond mortgages into student loans, auto loans and credit cards, there are risks that conditions in financial markets could be worse than we are anticipating and would delay the turnaround further," Chen says.

Delinquency rates will need to shrink for several months to signal that the worst is over, she says, and home builders' confidence will have to rise for three or four months.

She's also keeping a close eye on inventories -- a seven-month supply would demonstrate a turnaround beginning, and a six-month supply would indicate strong growth, she says.

And now, a few predictions

Because of the national economic instability, analysts say that it's particularly hard to predict when a turnaround will happen. The effect of a recent congressional stimulus, meant to pump money into housing markets by temporarily raising the limits on government-backed loans in higher-priced cities, is likely to be limited, analysts say. "The greatest increase in eligible transactions apparently will be on the West Coast," says Feder. Only 15 U.S. counties have median prices high enough to qualify, according to MarketWatch.

Several analysts see no end until at least the middle of next year:

- "We expect that home prices will bottom by mid-2009," Chen says. "I think by 2010 we'll see healthier price gains -- certainly nothing like we did over the last six years, but they probably reach about 4% price growth by 2010 or 2011."
- Wharton economist Jeremy Siegel, the author of "The Future for Investors: Why the Tried and the True Triumph Over the Bold and the New," predicts the economy will start improving in the middle of this year but home prices will keep falling until demand catches up with the vast oversupply. "I think they (prices) will stop dropping by the end of the year or early next year and then will remain stagnant for several years after that," Siegel says. "We won't have a general rise of home prices for a while."
- Morgan Stanley analysts give sliding prices another three years.

When real estate does finally awake, it will be to a much-changed world. Credit, at least for a time, will be much tighter. That will keep many people from participating in the housing market. Also, people holding off selling now will jump in when things improve.

"I think there are a lot of people holding off their sales because they know the market's bad, and as soon as they hear there are rising prices, they'll put their homes on the market and that (influx of homes for sale) will keep a lid on prices," says Siegel. "That's one reason I think the market's going to remain stagnant for a while. A lot of people will say, 'All right, I can finally get out.' and they're going to dump."

The last places to recover, analysts say, will be markets that inflated most during the boom, like Miami, Phoenix, Las Vegas and San Diego.

"As soon as everybody believes that the housing market will never turn around, just when it looks like we're doomed -- that's when it rebounds," says Hughes.

The 10 worst performers of the past year

Metro area	1 quarter	1 year	5 years
Merced, CA	-7.89%	-18.98%	53.69%
Modesto, CA	-6.60%	-15.48%	53.90%
Stockton, CA	-6.07%	-15.27%	50.15%
Port St. Lucie, FL	-6.06%	-14.45%	67.04%
Punta Gorda, FL	-4.66%	-13.30%	58.94%
Salinas, CA	-5.85%	-12.93%	56.94%
Cape Coral-Fort Myers, FL	-4.37%	-12.37%	67.38%
Bradenton-Sarasota-Venice, FL	-2.61%	-12.35%	64.80%
Naples-Marco Island, FL	-5.67%	-12.21%	79.64%
Santa Barbara-Santa Maria-Goleta, CA	-3.54%	-11.94%	44.57%

The strongest markets were smaller towns in the West and South with strong local economies and plenty of room to grow.

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The 10 best performers of the past year			
Metro area	1 quarter	1 year	5 years
Wenatchee, WA	0.54%	13.67%	77.93%
Houma-Bayou Cane-Thibodaux, LA	5.43%	12.15%	49.40%
Grand Junction, CO	0.85%	12.03%	66.15%
Ogden-Clearfield, UT	0.95%	10.80%	41.95%
Bismarck, ND	4.27%	10.72%	46.17%
Provo-Orem, UT	0.77%	10.46%	51.51%
Salt Lake City, UT	0.49%	9.68%	59.84%
Logan, UT-ID	1.55%	8.75%	31.98%
Idaho Falls, ID	0.28%	8.58%	48.42%
San Antonio, TX	1.36%	8.25%	39.59%