Whither the housing market

While unemployment and fiscal priorities occupy most headlines related to the economy, the housing market has profound psychological effects on the entire population. Even if a family has not experienced unemployment, they have experienced this region’s falling home values. The median price of homes sold in the region fell from a high of $235,500 in 2006, to $205,000 in 2010, and that number has continued falling in the first quarter of this year. Another measure of home prices, the Federal Housing Finance Agency (FHFA) Home Price Index which measures multiple sales of the same home, indicates that prices in Hampton Roads have declined by 11.34% since Q2 2007. This raises three questions that impact both households and local government finances:

1) when will home prices begin appreciating;
2) what will housing prices do in the meantime, and
3) what will the impact be on this region’s economic recovery.

National models that focus on national labor market conditions, mortgage rate forecasts and national housing prices suggest that the nation’s housing market looks bleak, with some questioning whether the nation will experience a “double dip” in the housing market. Goldman Sachs recently updated its baseline forecast to include declines of between 5% and 10% in the national home values over the next few months. But housing markets are “local markets”, which means that national models will do a poor job of providing perspective for Hampton Roads. In order to understand what will happen to the regional housing market, one must explore residential supply and demand.
Demand Issues-

Demand for housing is primarily driven by a growth in the number of households (a function of population growth), growth of employment, and growth in the region’s income.

The population of Hampton Roads increased by 87,256 between the 2000 and the 2010 census, a moderate annualized growth rate of 0.54%, which is likely to continue through the near term. At this rate of population growth, the region would be expected to add between 3,200 and 3,500 households per year, with this divided between renters and home buyers. This accounts for approximately 16% to 20% of housing transactions in recent years, which helps to maintain home prices. This rate of growth is not sufficient to drive demand to an extent that home prices will begin to appreciate through this region’s population growth alone.

The other area that drives demand is increases to both income and employment. Hampton Roads experienced robust income growth throughout the decade, which contributed significantly to home price appreciation in the region, but that income appreciation tailed off between 2008 and 2009 just as it did for the nation. Added to this, payroll employment still languishes at 50,000 jobs below the July 2007 regional peak, and a sustained employment recovery has yet to take hold in the region. This affects both demand and supply side issues, as it places further pressure on delinquencies and foreclosures.
Supply Side Issues-

One aspect of supply side issues concerns delinquent mortgages and foreclosures. While in the earlier phase of the crisis most foreclosures were driven by subprime and alternative loans, the Richmond Federal Reserve indicates that 57.9% of foreclosures inventory is prime mortgages, and that income shocks resulting mainly from unexpected changes in employment play a large role in mortgage delinquencies. Hampton Roads continues to experience elevated initial unemployment claims, and coupled with the significant decline in payroll employment, this indicates that there will continue to be foreclosure issues in the region. This will add more homes (supply) to the total market, and put further pressure on falling home prices. 2.34% of Hampton Roads’ prime mortgages which are 90+ days past due, and a further 1.50% that are in some part of the foreclosure process; nationally 2.58 percent are 90+ days past due and 3.33% are in foreclosure, but this reflects some of the worst housing markets in the nation. The Mid-Atlantic States have maintained significantly lower rates however, as the states in this section of the country vary in percent past due from 1.51% to 2.25% except for Maryland with a rate of 3.34%. This accounts for 10,822 homes with prime mortgages that are likely to enter the market in the near future, with a further 8,526 that are distressed with subprime or interest only mortgages.

A second area for home supply to enter the market comes from new construction, but measures of new homes built over the last year through permitting shows that new capacity is only slowly being added through that channel. An average of 651 single family permits have been issued per month since 1995 (not all of the permits are for home sales, nor are all permits turned into completed housing units). Hampton Roads has averaged an additional 361 units per month or 4,332 for the last year (April 2010-March 2011), much lower than the long term trend of 7,824 a year.

In conclusion-

Regional home prices will begin appreciating when demand for housing has worked through the excess supply of homes in the housing market. The most recent national survey indicates that more than half of the population does not expect the housing market to recover before 2014 (Source: Tulia/RealtyTrac/Harris Interactive foreclosure attitude poll). Even as mortgage rates stay low ensuring that monthly payments remain affordable, the number of months supply of housing will need to drop below the six month threshold before prices begin to appreciate in Hampton Roads (6-7 months is the average months of supply, and below that level real home prices typically begin to appreciate). If new home permitting and new household formation remain approximately equal (as they have in the recently year), that would require 3.3 years to clear an excess supply of approximately 34,000 homes, assuming that home sales maintain their current average rate of 10,500 a year.
Housing prices will continue to decrease in the short term, but modeling this decrease would be quite difficult. If Hampton Roads home prices should appreciate at levels consistent with the 1980-2000 time period, then home prices remain overvalued, but this would fail to account for the increase in incomes the region experienced. Inflation will also play a role in how far home prices will fall, with increased inflation propping up home values. The national forecast of a further 5-10% decline in home prices seems reasonable.

The home building market seems to have stabilized for the medium term, albeit at a lower rate than was previously experienced. Until the housing market clears, likely in 2014, it seems unlikely that home building will contribute significantly to growth or that construction employment will recover.

As the region’s housing market swings back toward equilibrium, there two remaining considerations. First, housing markets are truly local markets, and housing market conditions can vary from one neighborhood to the next. Second, when compared to rental housing, the relatively low cost of homeownership can be an attractive option for those who are in the market to purchase a home.

Hampton Roads Economic Outlook:

Where is the Growth?

Neither the Nation nor Hampton Roads has embarked on a path of robust economic growth. The nation achieved GDP growth for the seventh quarter in a row, but in only one of those quarters did that growth exceed long term trends, which makes this the most lackluster recovery in American history. While most economists do not expect a double dip recession, the economic recovery has been hampered by lagging consumer confidence and slow recovery in the jobs market.

Furthermore, while the nation has experienced steady employment growth since March of 2010 (if you exclude the impact of Census hiring), Hampton Roads has not experienced more than two consecutive months of employment growth since July 2007, and still faces a gap of almost 50,000 workers in payroll employment when compared to pre-recession levels. While the region’s unemployment rate has declined in part because fewer persons are unemployed, it is not clear if increasing employment that has yet to be evident in payrolls or an increase in the self-employed drives this trend. Unfortunately, we do not have the varied measures of unemployment available at the national level (U1 – U6) available for the region, and local area unemployment statistics are measured consistently with the U-3 level nationally (the most commonly reported unemployment rate).
A positive sign of stabilization has been the recent decline in initial unemployment claims, with unemployment claims tending back to the normal level, but Hampton Roads also lags in job creation, and Hampton Roads was 39th out of the top 50 metros in job postings per capita (49 per 1000 people, Source: Indeed.com 1st Quarter 2011 Survey).

As noted in previous quarterlies, economic recoveries are typically lead by fixed residential investment and increased personal consumption expenditures. Unfortunately, retail sales in the region have yet to establish steady growth, and because of the nature of the housing bubble, residential investment is expected to stabilize, but not to be a source of job creation.

It is important to also consider the several areas of risk to regional and national economic growth.

- Exports had been a source of strength, but continuing debt issues in Europe as well as Japan’s contraction after the earthquake/tsunami have put the economic health of the nation’s trading partners into question.
- Gas prices have started to ease again recently, but higher gas and oil prices are a significant risk to economic growth. Enhanced stability in the Middle East will do much to ease gas prices in the face of current economic weakness.
- The fiscal issues at the local, state, and national levels threaten spending in the region, with a particular threat to the region’s military assets.

### Hampton Roads Economic Indicators

**GDP, Annualized Growth Rate**

*United States, 2001Q1 – 2011Q1, Quarterly*

![GDP Growth Chart](chart1)

**Retail Sales, Year over Year Growth**

*Hampton Roads, Jan 2001 – Mar 2011, Monthly*

![Retail Sales Growth Chart](chart2)

**Source**: Bureau of Economic Analysis, HRPDC

GDP: Gross Domestic Product combines consumption, investment, net exports, and government spending to determine the size and general health of the economy. Changes in the nation’s GDP tend to be reflected in Hampton Roads’ gross regional product. U.S. GDP grew by 1.8% in the first quarter of 2011 according to advance estimates, well below the long-term trend of 3.1%, and very weak for an economic recovery. Real personal consumption expenditures (PCE) continue to be a major driver of economic growth, and the lower growth in the beginning of 2011 was related to a slowdown in PCE growth.

**Retail Sales**: Retail sales, as measured by the 1% local option sales tax, serve as an indicator for consumption in the region. Since consumption composes 70% of economic activity in the US, the growth or decline of retail sales gives a strong indication of the direction of the local economy. Year over year sales growth has yet to consistently return to the region, and monthly sales are still down between 8-12% as compared to the same month in 2010. This reflects both lower levels of consumption expenditures, as well as greater online purchases as people search for better deals over the internet.

**Source**: Virginia Department of Taxation, HRPDC

Retention of local businesses and creation of new jobs will be critical to the continued recovery of the region. The region’s military assets, defense contractors, and national security are important contributors to the local economy, so it is important to keep these factors in mind when determining the long-term economic health of the region.
Hampton Roads Economic Indicators

Employment, Year over Year Growth
Hampton Roads, Jan 2001 – Mar 2011, Monthly

![Employment Growth Chart]

Source: Bureau of Labor Statistics, HRPDC

Employment: Non-agricultural employment is considered the best estimate of labor market activity by the National Bureau of Economic Research. Hampton Roads payroll employment grew strongly in March on a seasonally adjusted basis, but it also shrank just as strongly in Feb. The labor market continues to be highly volatile, Even once a pattern of sustained growth is achieved, it will take a significant amount of time to make up the 49,100 job deficit that the region has developed since the recession started.

Unemployment Rate, Seasonally Adjusted

![Unemployment Rate Chart]

Source: Bureau of Labor Statistics, HRPDC

Unemployment Rate: This is the percentage of the population which is actively seeking work, but is unable to obtain a position. The unemployment rate in Hampton Roads has declined significantly since its peak in November at 7.57%, but unlike the nation, the region’s labor force has remained constant and the improvement was driven by the decline in the number of unemployed. The region’s unemployment rate remains 2% lower than the U.S.’s.

Initial Unemployment Claims, Seasonally Adj.
Hampton Roads, Jan 2001 – Apr 2011, Monthly

![Initial Unemployment Claims Chart]

Source: Virginia Department of Labor, HRPDC

Initial Unemployment Claims: The number of Initial Unemployment Claims is a leading economic indicator, reflecting those who are forced to leave work unexpectedly and thus revealing the strength of the job market with little lag time. Initial unemployment claims have declined significantly from their peak in June 2009, and while they remain slightly above their long term average, this signals an end to an elevated period of unexpected separations. The long term average is 4,370 new claims a month.

Single Family Housing Permits, Seasonally Adj.
Hampton Roads, Jan 2001 – Mar 2011, Monthly

![Single Family Housing Permits Chart]

Source: U.S. Census Bureau, HRPDC

Single Family Housing Permits: Permit data indicates the level of construction employment and confidence regarding the future trajectory of the local economy. Hampton Roads single family permits are still below the long term average, but have been over 400 units per month, which represents progress. While home builders will not drive the current economy, it is important that the sector stabilize and not prove a drag on economic growth.