

Q&A: Explaining Myth Versus Reality About Today's Housing Market

Q: There doesn't seem to be an end in sight to the housing slump. By the time the market hits bottom, won't housing be down and out for the count?

A: If the truth be told, housing has always been a very cyclical business. In the mid 1970s and the early 1980s and 1990s, housing production and sales dropped by more than 60 percent in a matter of months. During those cycles, we confronted and overcame many of the same problems we face today – large numbers of unsold homes, skeptical and reluctant consumers, tight credit markets and shortages of money for certain borrowers, declining home values, and prospective buyers who had difficulty selling their existing homes. The important thing to remember is that over time the market corrected and we rebounded to production and sales levels that beat or matched the records of the previous cycle. Remember, those who purchased homes in the early 1990s during the last big economic and housing downturn came out as big winners. The message here is that housing is a very tough and resilient industry. We will be back – stronger and better than before.

Q: Hasn't the subprime crisis cut off the flow of mortgage money for qualified borrowers?

A: If you believed the headlines or the endless drum beat about subprime lending on cable television news, you would think that the pot of mortgage money has dried up completely. Nonsense! The vast majority of home buyers are seeking conventional, conforming mortgages at or below \$417,000. These loans are purchased by Fannie Mae and Freddie Mac, both federally chartered organizations. While underwriting standards may have been tightened for all loans, credit-worthy home buyers should have no problems in finding conventional, conforming mortgages at very attractive rates – in the range of 6 percent for fixed rate, 30-year loans.

And Congress has just passed a stimulus package that will allow Fannie Mae and Freddie Mac to purchase more mortgages in high-cost markets through the end of 2008. Plus, the Federal Reserve has moved aggressively in recent weeks to cut interest rates and inject more liquidity in the financial markets. These developments will increase the availability of money for jumbo loans, although rates on those loans are a bit above their usual premium over conforming loan rates and down payment requirements are higher. Nonetheless, these are the facts: Mortgage money is available at a very attractive price for credit-worthy borrowers.

Q: With the nation in a foreclosure crisis, why should I be looking for a new home?

A: While foreclosure rates have increased in the past year, almost all American home owners are making their mortgage payments on time. Nearly 97 percent of prime borrowers – the bulk of the mortgage market – are up-to-date on their payments. Most foreclosures are concentrated in the once super-heated markets in California, Florida, Arizona and Nevada and the upper Midwest states of Michigan, Ohio, Minnesota and Illinois, which have been hit hard by job losses, plant closings and depressed local economies.

We are concerned about the large wave of subprime loans that are due to reset over the next two years. That's a major problem that needs to be dealt with. But again, we need to put this problem into perspective. As noted above, California, Nevada, Arizona and Florida are at the epicenter of this problem. According to the Mortgage Bankers Association, these four states account for more than one-third of the nation's subprime ARMs and California and Florida alone account for one-third of the foreclosure starts on subprime ARMs. But nationally, 84 percent of subprime borrowers with ARMs are still paying on time every month.

It's also important to remember that 37 percent of all single-family homes are owned debt free—without any mortgage—and home owners nationwide have built up more than \$11 trillion in equity that provides a good cushion against any decline in values. Also, a high number of defaults on loans to date have been among speculators or investors who were looking for quick profits and subsequently walked away from their investments when the housing market cooled.

And the President's plan on foreclosures is an important step toward addressing the current situation. The plan is aimed at borrowers with loans that were originated between Jan. 1, 2005 and July 31, 2007, with rates that are scheduled to reset between Jan. 1, 2008, and July 31, 2010. Home owners with steady incomes who have been making timely payments on their mortgages, but who cannot afford the higher adjusted rate, could qualify for a freeze of up to five years on their current interest rate if they meet certain conditions. They could also be placed on a fast-track approach that would enable them to refinance or modify their loans. To ensure that the break is not granted to real estate speculators or investors, the plan would only be available for owner-occupied homes. The idea is that if borrowers are given a little breathing room, the number of foreclosures can be held down.

Q: In today's housing environment, isn't the smart move to keep waiting for prices to fall even further before venturing into the housing market?

A: The current housing price correction is helping to restore affordability. In parts of the country where the housing boom was not as strong, price declines have been marginal, and there have even been a few exceptional areas where prices have remained on the rise. The bottom line for most existing home owners is that their homes will be worth significantly more than they paid for them once the market begins to recover—a process that is expected to begin later this year. The repercussion for prospective buyers is that the market has provided some breathing room from the sky-high prices prevailing a year or two ago.

Q: Will housing drag the rest of the economy into a recession?

A: In a sharp departure from previous housing downturns, which coincided with economic recession, today's economy continues to move forward, although growth has slowed substantially in recent months. That's why Congress has passed a \$168 billion economic stimulus package—to help shore up housing and the economy. NAHB is currently forecasting that GDP growth will register a 1.7 percent annual rate in 2008 and 2.8 percent in 2009.

Another key economic indicator is interest rates, which remain highly favorable for home buying. While nobody can predict the course of interest rates, with the U.S. economy continuing to grow, the Fed in all likelihood will not be slashing interest rates aggressively later this year as

it did during the past several weeks. Prospective buyers who are waiting for dramatically lower interest rates from those that exist today will probably be disappointed. And with 30-year rates as low as they are now – in the 6 percent range -- whether they realize it or not, home buyers are already looking at a good thing.

Q: It seems that home prices will just keep going lower and never recover. What's to stop this from happening?

A: It is a virtual given that over time home values will stabilize and then edge upward with the next recovery. To argue that home values will continue to decline and will never recover, somebody has to make a convincing argument that it will cost less to build a new home five years from now than it does today. That's not going to happen.

Despite today's housing slowdown, the price of bricks, mortar, lumber, copper and other products used in home building continues to go up due to worldwide demand and upward pressure on commodity prices generally. Look at anticipated population and household growth; consider the increasing scarcity of available land in metro markets where jobs are located and where people want to live. And the cost of getting land entitled will continue to go up because of more and more restrictions and fees being added by local governments. As inventories wind down, demand will rise and so will prices. Over time, all these factors will help drive up the cost of housing.

Q: The S&P/Case-Shiller monthly home price index showed that home prices declined an average of 9.1 percent in the nation's 20 largest markets in 2007. If home prices are down in the 20 largest cities, doesn't this mean that the housing markets in these metro areas are in a major tailspin?

A: A closer examination of the facts reveals that home appreciation rates vary significantly among the nation's top markets. Among the top 20 markets, three showed positive home price appreciation rates over the past year, five posted declines of less than 5 percent, four had losses of between 5 and 10 percent and eight metro areas registered losses of between 10 and 17.5 percent.

Nearly all the markets that posted the largest average decline in home prices during the past year – Las Vegas, Los Angeles, Miami, Phoenix, San Diego, San Francisco and Tampa – have appreciated in value by more than 87 percent since January 2000. Four of these markets – Tampa, San Diego, Miami and Los Angeles – were up by more than 100 percent over this period. It makes sense that the most super-heated housing markets in California, Nevada, Arizona and Florida are now experiencing the most serious market corrections. Though housing is a cyclical business, experience shows that over time, home prices will stabilize and then move upward with the next recovery.