

Signs Point to Housing Recovery in 2008

Advice by Kenneth Harney

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Queen Elizabeth II once famously referred to her "annus horribilis" — a horrible year during which almost everything went badly, from royal family scandals to a raging fire that destroyed parts of Windsor Castle.

The American housing market experienced its own form of annus horribilis in 2007 — a year when all the sins and excesses of the prior six years were visited upon nearly everyone in the system:

- Homeowners lost \$160 billion in net equity in their homes from just the first quarter of 2007 through the third, according to the latest "flow of funds" data from the Federal Reserve. Homeowners' equity stakes — their property value less their mortgage balances — dropped to 50.4 percent, down from 56.1 percent as recently as 2002. Both numbers could be worse when the Fed's fourth-quarter survey is completed.
- Foreclosures on single-family homes hit 1.69 percent in the third quarter — the worst in decades — and 5.6 percent of all home mortgages in the country were delinquent by 30 days or more. One out of five subprime adjustable-rate loans nationwide was delinquent by the end of the third quarter, but the proportion was even higher in a handful of states: 26.2 percent in Michigan and nearly 23 percent in Massachusetts.
- Home sales tanked in almost every local market that had seen hyperinflation in home prices during the boom years of 2001 to 2005. Local declines in excess of 50 percent year-to-year are not unusual in parts of California, Florida, Nevada and Arizona. In many of the same markets the sales booms had been propelled by speculative investors looking for quick payoffs. Now one-quarter of all new foreclosures in California, Arizona and Nevada involve investor units — frustrated flippers sending back the keys.
- The national inventory of unsold houses jumped to 10.8 months, a level that even the most optimistic economists concede is a drag on the overall market.

Enough!

Everybody knows these tales of woe — and more. It's been a lousy year. Could 2008 be better? I think the odds are reasonable that it will. Here's why: Even through the grimmest headlines of 2007, there were a number of positive underlying economic forces propping up real estate and keeping it from a true bust. If those forces continue, they should help cut the time needed for the correction cycle to bottom out and the historically inevitable recovery cycle to begin.

Take mortgage rates. Had the cost of money been significantly higher in 2006 and 2007, does anyone doubt that the delinquencies and foreclosures stemming from the toxic vintages of subprime loans would have been much worse? But the 30-year fixed rates that hovered in the low 6 percent range for much of the year — even in the high 5s for a couple of weeks — allowed many borrowers to refinance into alternatives such as FHA or conventional Fannie Mae/Freddie Mac loans. The recently announced national loan modification and rate-freeze effort should keep at least some — no one knows how many — struggling subprime homeowners out of foreclosure in the new year.

Steady, moderate national growth of new jobs, economic expansion and low inflation also helped the national housing market in 2007 and could do the same in 2008.

By the way, despite all the scary statistics, sales of existing and new homes in 2007 totaled an estimated 6.5 million, which would make it the fifth-largest sales year in American real estate history.

Another fact that often got lost amid the bad headlines in 2007 and offers reason for hope for a better 2008: Vast swaths of the country never experienced the excesses of the boom years, and have not endured the pains of the crunch under way in the most volatile markets.

At some point in every correction cycle, even in the most depressed markets, consumer psychology begins to change. People who need or want houses look around, see lower prices, affordable financing, and say: Hey, this is a smart time to buy. The cycle has done its work.

It won't be everywhere, but that psychology should begin taking hold in a growing number of local markets sometime in 2008.