ECONOMIC SNAPSHOT

Utah Association of REALTORS®

SEPTEMBER 2012

What's in store for the real estate recovery?

2012 brings improved conditions for Utah's housing market

BY JAMES WOOD

DIRECTOR, BUREAU OF ECONOMIC AND BUSINESS RESEARCH, UNIVERSITY OF UTAH

Utah's real estate recovery is under way. Home sales are up, listed inventory is down and housing prices have stabilized. The recovery is widespread. Home sales are up in 24 of Utah's 29 counties with Salt Lake County leading the way.

What impact has improving demand had on housing prices? This article discusses changes in demand and prices as well as examines some of the lingering challenges for the state's real estate industry.

Improving Sales Activity

There is little doubt that demand for housing is accelerating. The strong anecdotal evidence from REALTORS® is confirmed by the 8.6 percent increase in sales statewide last year. Sales of homes and condominiums totaled 32,785 units in 2011. Since July of 2011, sales have increased every month and are currently on pace to exceed 34,000 units in 2012 *(see Table 1).*

Table 1
Closed Sales of Homes and Condominiums in Utah

	Prior Year	Current Year	Percent Change
July	2,316	2,847	22.9%
August	2,434	3,198	31.4%
September	2,335	2,907	24.5%
October	2,261	2,911	28.7%
November	2,286	2,616	14.4%
December	2,388	2,736	14.6%
January	1,868	2,044	9.4%
February	1,992	2,422	21.6%
March	2,757	3,007	9.1%
April	2,765	3,087	11.6%
May	3,028	3,440	13.6%
June	3,316	3,348	1.0%

Source: Utah Association of REALTORS®

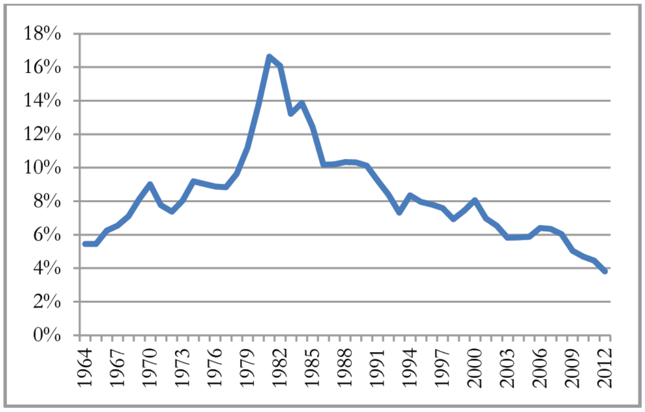
The greatest improvement has been in Salt Lake County where the number of sales has increased by 19 percent in the past year (July 2011-June 2012), an increase of 1,000 units. Davis and Weber counties have also experienced significant increases with sales up 17 percent and 18 percent respectively. In terms of homes sold, Davis County sales are up 250 units and Weber County sales are up 218 units. The surprises are Utah and Washington counties. Home sales in Utah County have increased only 4.6 percent, whereas in Washington County the number of homes sold has actually declined by 169 units or 9.1 percent.

Affordability: Low Interest Rates and Housing Prices

Buyers have finally been motivated by favorable interest rates. Throughout 2012, mortgage rates have been below 4 percent, the lowest level in more than 50 years *(see Figure 1)*. In fact, since World War II, the only time rates have been lower was in the early 1950s when mortgages were typically 20 to 25 years.

This historic interest rate advantage combined with depressed housing prices has created unusually favorable conditions for creditworthy buyers. For ex-

Figure 1
Mortgage Interest Rates 1964-2012



ample, at the peak of the boom, the median sales price for a home in the four Wasatch Front counties was $216,862. The interest rate at the time was 6.4 percent. The monthly payment to finance the mortgage on this median priced home was $1,340.

By 2012, the median sales price of a home had dropped to $180,000 and the interest rate was 3.8 percent. The monthly payment needed to cover the mortgage in 2012 was $836, nearly 40 percent lower than in 2007.

Improved housing affordability will continue to draw increasing numbers of buyers into the market, which will help sustain the recovery. A look at current listings for single-family homes in the Wasatch Front counties shows that 40 percent of all homes listed are priced below $200,000 while 70 percent are priced below $300,000 *(see Table 2)*.

According to the National Association of Home Builders Housing Opportunity Index, the median income family in the Salt Lake Metropolitan Statistical Area can afford 80 percent of all new and existing homes sold in the area. In the Ogden-Clearfield MSA, 92 percent of homes sold were affordable to the median income household compared to 84 percent in the Provo-Orem MSA. Housing affordability is at its highest level in decades.

Table 2
Single-Family Listings by Price for Wasatch Front Counties

Category	Listings	% Share
$0 - $49,999	25	0.3%
$50,000 - $99,999	410	5.0%
$100,000 - $149,999	1,127	13.7%
$150,000 - $199,999	1,587	19.3%
$200,000 - $249,999	1,452	17.6%
$250,000 - $299,999	1,040	12.6%
$300,000 - $349,999	625	7.6%
$350,000 - $399,999	536	6.5%
$400,000 - $449,999	286	3.5%
$450,000 - $499,999	224	2.7%
$500,000 - $749,999	479	5.8%
$750000-$999,999	200	2.4%
Over $1,000,000	243	3.0%
Total	8,234	100.0%

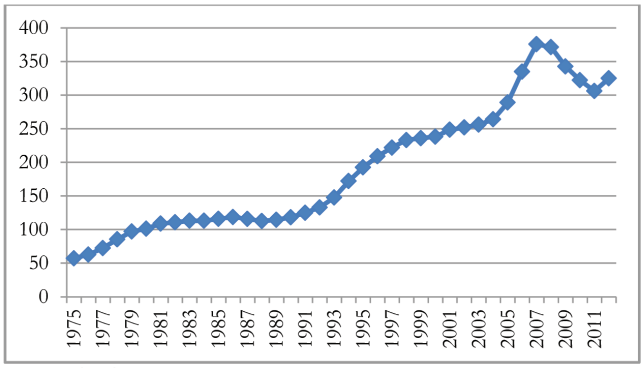
Source: UtahRealEstate.com

As favorable home prices and interest rates have brought buyers back into the housing market, prices have stabilized. But how quickly will housing prices in Utah recover? The median sales price of a home in Utah has fallen back to 2005 price levels. Recent data, however, strongly suggests that prices "bottomed out" in the early part of 2012.

Prior to 2008, Utah's housing market seldom experienced price declines. When they occurred, the duration was only one year. The last few years are unique in Utah's post-World War II housing history. All four price measures show declines in the median sales price from peak to trough of about 25 percent.[1] And these four measures now indicate that prices reached bottom in the first quarter of 2012. They also show that over the past 12 months prices have risen. Depending on the measure, the median sales price has increased anywhere from 2.5 to 7 percent in the past year.

1 The four measures include: Federal Housing Finance Agency Price Index, local MLS data, National Association of REALTORS® Median Sales Price of Homes in MSAs, and Utah Association of REALTORS® price data.

Figure 2
Housing Price Index for Utah
(1980=100)



Source: Federal Housing Finance Agency

Utah's real estate industry has no prior experience with price declines. Hence, the future behavior of housing prices is more difficult to predict. The last significant contraction in housing in Utah occurred in the early 1980s. This severe downturn followed the inflationary housing boom of the 1970s. But whether the 1980s contraction can tell us anything about price recovery in today's market is questionable.

Each housing cycle has its own unique characteristics, and the most dominant characteristic of the sluggish market of the 1980s was exceptionally high interest rates. Mortgage rates were above 12 percent for six years. But even with this huge interest rate drag, prices did not decline. Over the decade of the 1980s, housing prices in Utah increased about 15 percent, a little more than 1 percent a year. The housing price index in *Figure 2* shows the long, slow slog for prices in the 1980s.

Interest rates will have a significant effect on future housing prices. If rates remain in the 3.5 to 4.5 percent range and Utah's strong employment gains continue, sufficient buyer momentum should be generated to offset lower demand due to reduced creditworthiness.

Just how much creditworthiness has affected demand is not clear. Data from the Home Mortgage Disclosure Act for the Wasatch Front counties show that in 2006 about two-thirds of all mortgage applications (FHA and conventional) were approved. In 2010, the approval rate actually jumped to 75 percent, helped by the shift to the more favorable FHA loans.

In 2006, only 7 percent of all mortgage loans were FHA loans. By 2010, the share had jumped to 60 percent. While the loan makeup changed, it did not dampen loan approvals. Three out of four homebuyers applying for mortgages in 2010 were approved.

Buyers and the real estate markets are adjusting to financial market conditions, which bodes well for a recovery in prices. Despite improving conditions, it will likely take at least three years to recover the losses in home values from the Great Recession, provided financial markets remain favorable.

Challenges to Demand

There are two factors currently at play in the market that act to reduce housing demand and dampen price increases: (1) the large number of underwater homeowners and (2) low rates of net in-migration.

Negative Equity - Weak housing prices have eroded equity, leaving many homeowners "underwater." In Utah, there are currently about 480,000 mortgage loans, with at least 124,000 of these loans having a status of negative equity or near negative equity (within 5 percent of negative equity). A household whose home is valued at less than the mortgage is essentially trapped in that home. Moving up to a larger home is not an option for the vast majority of these households. This has hurt housing demand and contributed to sluggish home sales.

Traditionally, the move-up buyer has been a source of significant demand for both the existing and new home markets. The loss of a good share of the move-up market has been a major factor in the slow housing and economic recovery. Typically the housing sector leads the economy out of a recession, but this is not the case in the Great Recession due in part to reduced demand. And this reduced level of demand is bound to have some effect on the price recovery.

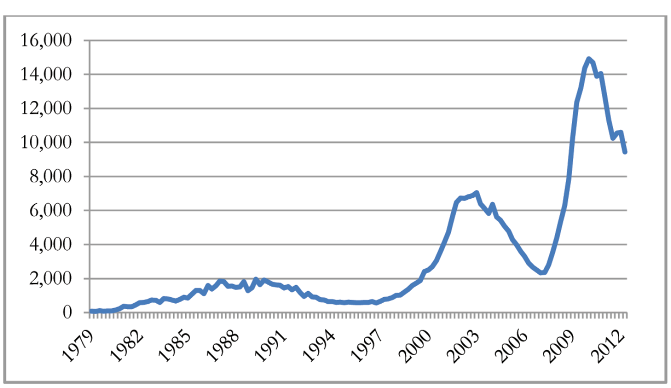
Net In-Migration - The demand for housing, both new and existing units, is driven by changes in the number of households. An additional household generally requires an additional housing unit. One of the most important components of household growth and subsequently demand for housing is net migration.

The Governor's Office of Planning and Budget produces migration estimates. In an average year, net in-migration creates an increase in population of 19,500 as well as an increase in households and housing demand of 6,000. At least in theory, each new household from net in-migration requires a housing unit. The housing stock must grow to accommodate the new households. In 2012, net in-migration created demand for only 1,200 units. In 2013, net in-migration is projected to provide demand for 2,000 units. The reduced levels of net in-migration will continue to hinder the recovery in housing prices and real estate sales.

Foreclosures and Housing Prices

The high rate of foreclosures since 2008 has played a major role in housing price declines. Foreclosures hit a peak in the first quarter of 2010 when nearly 15,000 homes in Utah were in the foreclosure process. Many of these homes were put on the market as REO properties with deeply discounted prices. In some years, as many as 15 percent of homes sold in major counties were foreclosed properties. With this level of foreclosure sales, substantial price declines were "baked in the cake."

Figure 3
Foreclosure Filings for Mortgages in Utah



Source: Mortgage Bankers Association

But the foreclosure problem appears to be ebbing. It's clear that foreclosed properties have had a high rate of absorption. Since 2008, UtahRealEstate.com has listed 9,869 REO/foreclosed residential units in Wasatch Front counties. Through August, nearly 90 percent of all REO properties had been sold. In 2012, there is not a huge inventory of foreclosed properties depressing prices. Currently, there are only 121 active listings of foreclosed single-family homes in Wasatch Front counties. These listings account for less than 2 percent of the 8,200 homes listed.

In the second quarter of 2012, the Mortgage Bankers Association reported the percentage of mortgages in the foreclosure process in Utah had dropped to 2.2 percent of all mortgage loans, the lowest rate since the fourth quarter of 2008 *(see Figure 3)*. With 430,000 mortgages statewide, that means about 9,400 homes are currently in the foreclosure process, a decline of 37 percent from the first quarter of 2010.

Conclusion

After four years of dismal real estate conditions, the market is finally improving.

- **The record level of affordability, due to low interest rates and reduced prices, has at last brought a wave of buyers into the market.**

- **The increased demand has halted price declines and is now pushing prices up. Housing prices will likely increase more than 5 percent in 2012 with an outside chance of a double-digit increase. But price increases will stall out if interest rates should rise above 5 percent.**

- **A full recovery in prices is not foreseen for a few years due to the drag on demand of "underwater" homeowners and low rates of net in-migration.**

- **The downward pressure on prices from foreclosed homes is subsiding as the market absorbs these troubled properties.**