The Value of Value Measurements

Knowing which housing reports track what — and how — often aids planning efforts

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Editor's note: *Fiserv Inc., the bylined author's employer, has owned the Fiserv Case-Shiller Home Price Indexes since 2002. Although* Scotsman Guide*'s policy does not allow for company references in article text or for authors to write about their proprietary products, we have allowed references to the index in the text because of its popular, mainstream use and because of the objective nature of the piece.*

Economists agree that the housing market must stabilize before the U.S. economy can recover. With the nation's housing slump now in its third year, all eyes are searching for signs that a turning point has arrived.

Until the housing recession stabilizes and improves, the mortgage industry must work to stem the tide of foreclosures and recidivism on modified loans.

Home-price data and forecasting tools can help mortgage brokers make informed loan-modification decisions that will strengthen communities and the economy now and in the future.

Stability hard to gauge

Current home values are required to structure loan modifications. To establish present home values, many mortgage-industry participants use price opinions or list prices of comparable properties. Some methods that rely on using appraised or stated values provide a perspective on value, offering an educated guess about market trends, while others compare actual prices paid for the same property during subsequent sales.

One method of aggregating the purchase and resale prices of individual properties into market-specific price indexes was developed by economists Karl E. Case and Robert Shiller. The Case-Shiller Home Price Indexes continue to use the methodology, which investors and financial-industry participants follow widely.

Illustration: Dennis Wunsch

As important as it is to track these price changes through time, having an idea of what home values likely will be in the future is perhaps more important to lenders, investors, homebuyers and brokers. This is especially true in the current environment, as industry participants face a massive wave of mortgage loan modifications and refinancings. Home-price projections can include data such as local income trends, demographics, joblessness and changes in mortgage rates.

In addition to looking at home prices, looking at inventory levels of existing and new homes, measures of affordability and other macroeconomic factors provides important insights. While some of this data shows preliminary signs that the housing market is starting to stabilize, it's still too soon to say that the worst has passed.

One important data point — the inventory of unsold homes, tracked by the National Association of Realtors (NAR) — provides a glimpse of the uncertainty that remains. According to NAR, total housing inventory at the end of this past March fell 1.6 percent to 3.74 million existing homes. That represented a 9.8-month supply at the then-current sales pace, compared to a 9.7-month supply this past February. Thus, even though the inventory dropped, the months' supply increased.

Prices may be stabilizing

Housing affordability has improved because of steeply falling home prices and lower interest rates. The ratio of home prices to family income peaked in late 2005 into early 2006, when real estate activity reached bubble levels in Arizona, California, Florida and Nevada.

There also are signs that housing demand finally may be stabilizing. Single-family home sales began to level out at 4.3 million units per year early in 2008, but this steadying of demand came undone in the September 2008 meltdown in the financial markets.

Nevertheless, it appears that sales volume may be reaching a new bottom near 4 million single-family units a year. Downward pressure on prices likely will remain intense throughout this year, however, because distressed properties account for more than half of sales, according to March data from NAR.

Those properties typically sell for 20 percent less than other properties, NAR reported.

Affordability and inventory data may not fully reflect the direct effects of the credit crisis on mortgage lending or the indirect effects of a severe and sustained economic recession. Even when accounting for those detrimental effects,

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some forecasts show average U.S. home prices stabilizing in early 2010.

In many markets, prices are projected to vary for two to three years after they stabilize as mortgage markets recover and homebuyers regain the confidence to purchase in places where prices fell considerably.

In bubble states, however, home prices must decrease by another 15 percent to 25 percent to restore housing affordability to pre-bubble levels.

Further, these areas of the country have large inventories of unsold homes because of over-building and current high foreclosure rates. After they hit bottom, home prices in these areas likely will remain flat for four to five years as homebuyers recover from the shock of seeing prices drop by 50 percent or more in some areas.

It also is important to keep in mind that even when the housing-market collapse ends, home prices in nearly all markets still will be greater than they were in early 2000.

When they reach their trough — likely, later this year — U.S. home prices still are projected to be 21 percent more than they were at the start of 2000.

This offers some reassurance, but it also means that housing during the first decade of this century was not a good investment. Annual inflation likely will end around 3 percent by the close of 2010.

Then again, compared to stocks, which have lost about 30 percent to 40 percent of their value since the beginning of 2000, housing doesn't look so bad.

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According to current forecasts, when the home-price adjustment is complete, only 26 metropolitan markets — all of which are located in California, Nevada, Florida and Michigan — will revert to home prices below those seen in 2000. That's less than 7 percent of a total of 381 metropolitan market areas nationwide.

Those data points are small consolation for families with negative equity in their homes. But they remind us that economic downturns, however painful, eventually end.

Ultimately, before and after the downturn, brokers should seek the best data available and use it to help themselves and their clients.