Housing Prices Hit New Low: Is There a Bottom in Sight?

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When the S&P/Case-Shiller Home Price Index released new data on May 31, it showed a decline of 4.2% for the first quarter of 2011. After having fallen 3.6% in the fourth quarter of 2010, these latest numbers represented a new post-recession low and an annual decline of 5.1% versus the first quarter of 2010. Nationally, home prices have fallen back to their mid-2002 levels.¹

"This month's report is marked by the confirmation of a double-dip in home prices across much of the nation," said David Blitzer, chairman of the Index Committee at Standard & Poor's. "Home prices continue on their downward spiral with no relief in sight."¹

Among the 20 metropolitan areas tracked, 12 cities - Atlanta, Charlotte, Chicago, Cleveland, Detroit, Las Vegas, Miami, Minneapolis, New York, Phoenix, Portland (OR), and Tampa - fell to their lowest levels of the current housing cycle. Washington, D.C., was the only city displaying positive trends with an annual growth rate of more than 4.3%.¹

False Positive

Some analysts believed that home prices had bottomed in 2009 when the first-time homebuyer tax credit spurred a surge in demand. While the incentive program was in place, first-time buyers increased to 42% of all buyers, up from a normal range of approximately 20%.² But, in the summer of 2010, it became clear that any rebound in housing was to be short-lived. Excluding the temporary effects of that policy, there has been no recovery or even stabilization in home prices since the end of the most recent recession. Economists at S&P now expect prices to drop another 5%, bottoming out sometime this quarter.²

House Prices Fall Back Toward "Normal"

(Ratio of average home price to average household income)

Sources: National Association of Realtors; Bureau of Economic Analysis; S&P projections.
The presumed upside to the drop in home prices is the fact that homes are once again affordable and realigned with borrowers' incomes (see chart above). The price boom from 1997 through 2005 sent average home prices up 72% and increased the price of the average existing home to 3.35 times the average household income - a clearly unsustainable level. However, the 23% drop in existing home prices since mid-2006 into 2009 reduced the average existing home price to 2.26 times the average income - below the historical average of 2.66.²

Yet, despite normalized home prices and historically low mortgage rates, the current pace of pending home sales for April - the time of year when housing transactions typically begin to pick up - is down more than 11% from its March level.³

Broader Economic Influences

With significant positive factors at play, why aren't more Americans lining up to stake their claim to the great American dream? Broader economic issues are complicating the current situation. Many Americans remain unemployed. Some are in foreclosure or stuck in homes currently worth less than their mortgage. Even among those who are interested in purchasing a home, many are finding it difficult to secure credit. All the while, banks are pushing more foreclosed properties on the market, many of which are being sold at discount prices, which can erode the value of all homes in a given neighborhood. This backlog of homes being trickled onto the market by banks and developers is often referred to as the "shadow inventory" and adds downward pressure to prices.

Holding On

The news is not all bad, however. Homes are undeniably affordable, apartment rents (the most likely alternative to home ownership) are on the rise, and the job market is improving, albeit slowly. All of these conditions should help sales of both new and existing homes to rise about 3.6% and 5.7%, respectively, this year.²

It is all but certain that the U.S. housing market will likely continue to experience ups and downs as the economy improves. But after its worst downturn since the 1930s, it seems to be stabilizing - and Americans' irrepressible optimism has surfaced once again. A recent study from Pew Research Center found that despite the prolonged slump in the housing market, 81% of homeowners still believe that purchasing a home is the best long-term investment a person can make.⁴

Many conceded, however, that it will take years for their property values to recover to pre-recession levels, lending new credence to the notion that as with any investment, past performance is no guarantee of future returns.


²Source: Standard & Poor's Ratings Direct, "To Housing, the Recovery Is a Fair Weather Friend," May 24, 2011.
