Demanding Environment Challenges Housing Recovery

While supply metrics continue to improve, the homebuilding industry is tested by stagnant sales in most metros save for those with structural supply-constraints and significant job recovery.

By RICHARD M. GOLLIS and BRIAN A. FOGARTY

The continued sluggish pace of new-home sales has delayed recovery for most markets and the nation on the whole. Research by The Concord Group (TCG) has concluded inventory levels are at three to five years in the event sales remain at its current stagnated rate.

A modest increase in demand, however, will reduce those levels to a more manageable 15 to 30 months in most markets. The industry's challenge, therefore, is to identify both the contributing factors to the flagging demand and the hurdles to reach supply-demand equilibrium. These factors will reveal themselves when households will begin to purchase new homes again in significant numbers.

Undoubtedly, the momentum relied upon to drive a market recovery waned last summer. The culprits are well explored: both the expiration of government tax incentives and slow employment growth diminished consumer appetite. These conditions contributed to the 18-percent year-over-year decline in the sales rate for new single-family homes. The 300,000-plus new single-family homes sold over the last 12 months is the lowest volume recorded since the Census Bureau began reporting sales in 1963.

The historically low sales volume has coincided with the lowest household formation total on record dating back to 1948. In 2010, new households measured 357,000 — a figure representing less than one-third of the long-term annual average of 1.2 million. While market observers are already seeing growth among renter households, growth in owner households requires more prolonged economic recovery. Lastly, counter-cyclical tightening in mortgage underwriting continues to negatively impact home sales.

While the demand side of the equation remains stalled, the supply overhang continues to be absorbed. The economics behind lot development remain challenged, allowing the market to absorb the lots developed during the market peak. And in most markets, the foreclosures have been absorbed sufficiently, and estimates on the size and delivery of the remaining pipeline depend greatly on the future economic picture and policy levers. Most heartening is the sense that this competitive supply will come to market at a manageable rate over time.

Despite improvements in the supply overhang, The Concord Group is revising the recovery estimate back one year to second quarter 2013, given the last 12 month's slackened demand. TCG defines "sales recovery" as low single-digit annual home price appreciation and sustainable monthly sales performance (i.e., one sale per week per community). TCG measures excess supply of over 1 million for-sale housing units comprised of active builder communities, ready-to-go lots and recently constructed foreclosure inventory that must be absorbed prior to a national new-home sales recovery. Critically, these inventory forecasts indicate demand for newly improved lots starting in 2012 in most markets — approximately 12 months prior to a new-home sales recovery.

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Modest demand gains will be aided by affordability levels at historic lows. New-home prices appear to have found bottom, and together with low interest rates and nominal income growth, households purchasing homes in the short-term will likely be rewarded by attractive housing costs over the lifetime of their mortgage. The impetus to purchase homes will be guided by improved consumer confidence and consecutive quarters of strong job growth.

In fact, sustained employment growth and structurally limited inventory in top-tier markets like Washington D.C., San Jose, Calif., and Orange County, Calif., are stimulating significant new-home demand. In more challenged metro areas, specific "core" submarkets with access to employment and transportation are outperforming the greater whole, creating investment opportunities in otherwise challenged metropolitan areas. While TCG forecasts the next 12 to 24 months to remain demanding, investments requiring longer recovery horizons will reward those with patience and insight. B&D

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Fast Facts

- The expiration of government tax incentives and slow employment growth are the reasons for a momentum-lacking market recovery.
- Sustained employment growth and limited inventory in some markets are stimulating significant new-home demand.
- In 2010, new households measured 357,000 — a figure representing less than a one-third of the long-term annual average of 1.2 million.