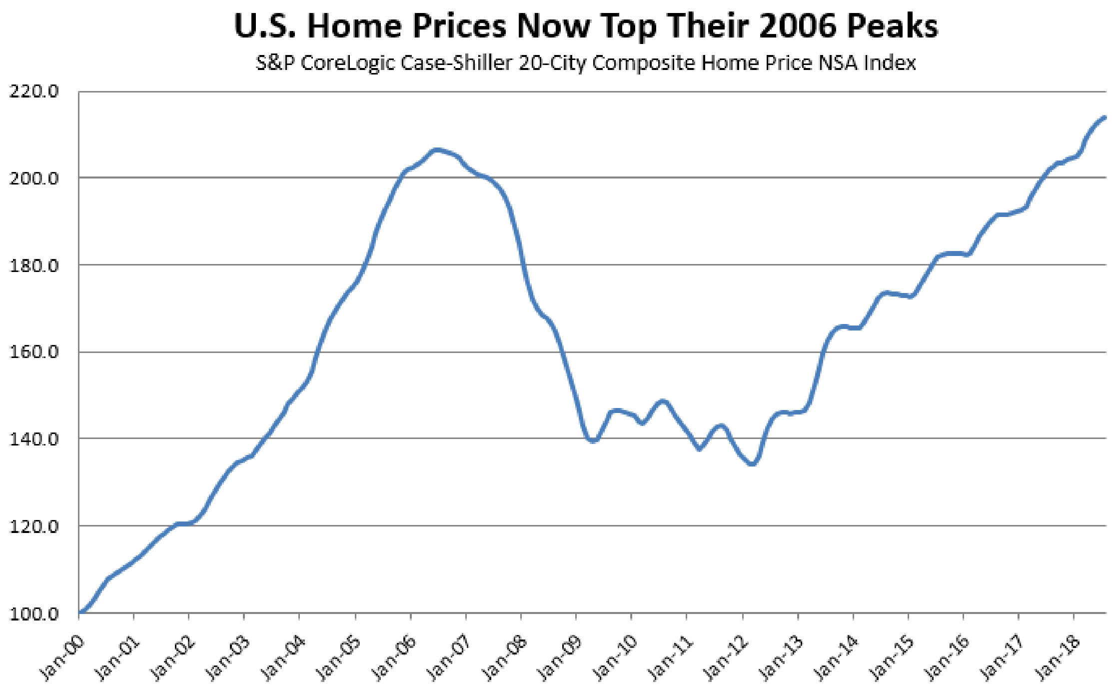
Residential Real Estate: Is the Party Over?

Home sales are down across the country. Does this signal a downturn in real estate or is it just a pause in the upward march since 2012?

Sales of new and previously owned homes fell in September, their fourth and sixth respective monthly declines in a row.

For homeowners, it's been a heady time. Since hitting a nadir six years ago, average home prices in the U.S. have climbed almost 60%, from $134,069 in March 2012 to $213,760 in July 2018.[1] Inventories are down, bidding wars are commonplace, and house-flipping is back in vogue.



Source: S&P, CoreLogic Case-Shiller, July 2018 (latest available).

But recently, there are signs of a slowdown. Sales of new homes fell 5.5% in September -- their fourth consecutive monthly decline -- to their lowest level since December 2016.[2] Sales of existing homes also dropped, falling 3.4% from August, their sixth consecutive monthly decline. Existing home sales are now down 4.1% from a year ago, to the lowest level since 2015. Average prices are still rising, up 4.2% from a year earlier -- the 79th straight month of year-over-year gains -- but not at the double-digit paces seen earlier in the housing recovery. Time on the market has also been creeping up. Unsold inventory is at a 4.4-month supply at the current sales pace, up from 4.3 in August and 4.2 months a year ago.[3]

What's behind it?

The consensus among real estate professionals and economists alike is that homebuyers are reaching a breaking point. Years of healthy price increases have far exceeded income gains, making homes less affordable, especially for first-time buyers. As the market continues to move up, buyers are simply being priced out. The NAR's (National Association of Realtors®) affordability index, which measures whether a typical family earns enough income to qualify for a mortgage loan, shows a 9% decrease in housing affordability between the second quarter of 2017 and the same quarter in 2018.[4]

What's more, interest rates are on the rise. In September, the Federal Reserve announced its seventh increase in the federal funds rate in two years, with more in the offing. Mortgage rates have followed suit. The average 30-year fixed mortgage rate was 4.63% as of September, 2018, up from 3.81% a year earlier.[5] On a $200,000 year mortgage, that rate increase translates into additional interest of $1,637 in the first year and $34,494 over the life of the loan.

The good news is, unlike the speculative bubble of the mid-2000s, the run-up in prices has been driven primarily by economic fundamentals. And those fundamentals remain strong. The U.S. economy is firing on all cylinders, with third quarter GDP growth coming in at a robust 3.5% and unemployment at its lowest level since 1969.

What can you do?

Most real estate analysts do not foresee any collapse in real estate prices even remotely along the lines of the mid-2000s routing. But many do warn of a slowing, as incomes catch up to prices.

Current or prospective homeowners may wish to consider the following:

- If you are a potential buyer, you may want to keep a close eye on prices in your target area, taking advantage of any leveling or even lowering of prices.
- If you are a potential seller, you may face longer times to sell and more price competition.
- If you are tapped out on home equity lines of credit, or your loan-to-value ratio is high, you might want to consider ways to lower your indebtedness.

Keep in mind that real estate conditions vary widely from one area to the next. Even neighborhoods blocks away from each other can have widely divergent fundamentals. So it pays to monitor conditions in your particular area.

[1]Source: S&P CoreLogic Case-Shiller, July 2018 (latest available).
[2]Source: Reuters, October 24, 2018.
[3]Source: National Association of Realtors, Existing-Home Sales Decline Across the Country in September, October 19, 2018.
[4]Source: National Association of Realtors, Quarterly Housing Affordability Index, second quarter 2018.
[5]Source: FreddieMac. Monthly Average Commitment Rate.