

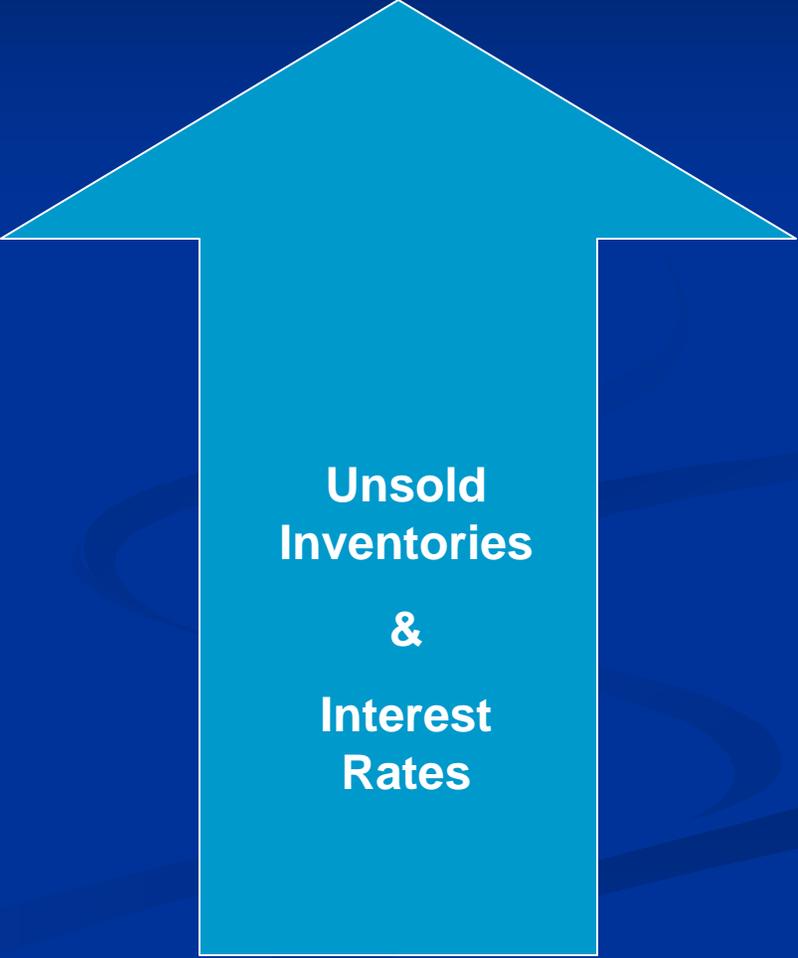
# Florida's Real Estate Market The Challenges

Presented to the House Interim Workgroup on Affordable Housing  
September 20, 2006

Legislative Office of Economic and Demographic Research

# Real Estate Market Conditions

- 
- **Builder Confidence**
  - **Existing Home Sales**
  - **New Home Sales**
  - **Permits/starts and new construction**
  - **Sale Prices**
  - **Rate of Price Appreciation**



**Unsold Inventories  
&  
Interest Rates**

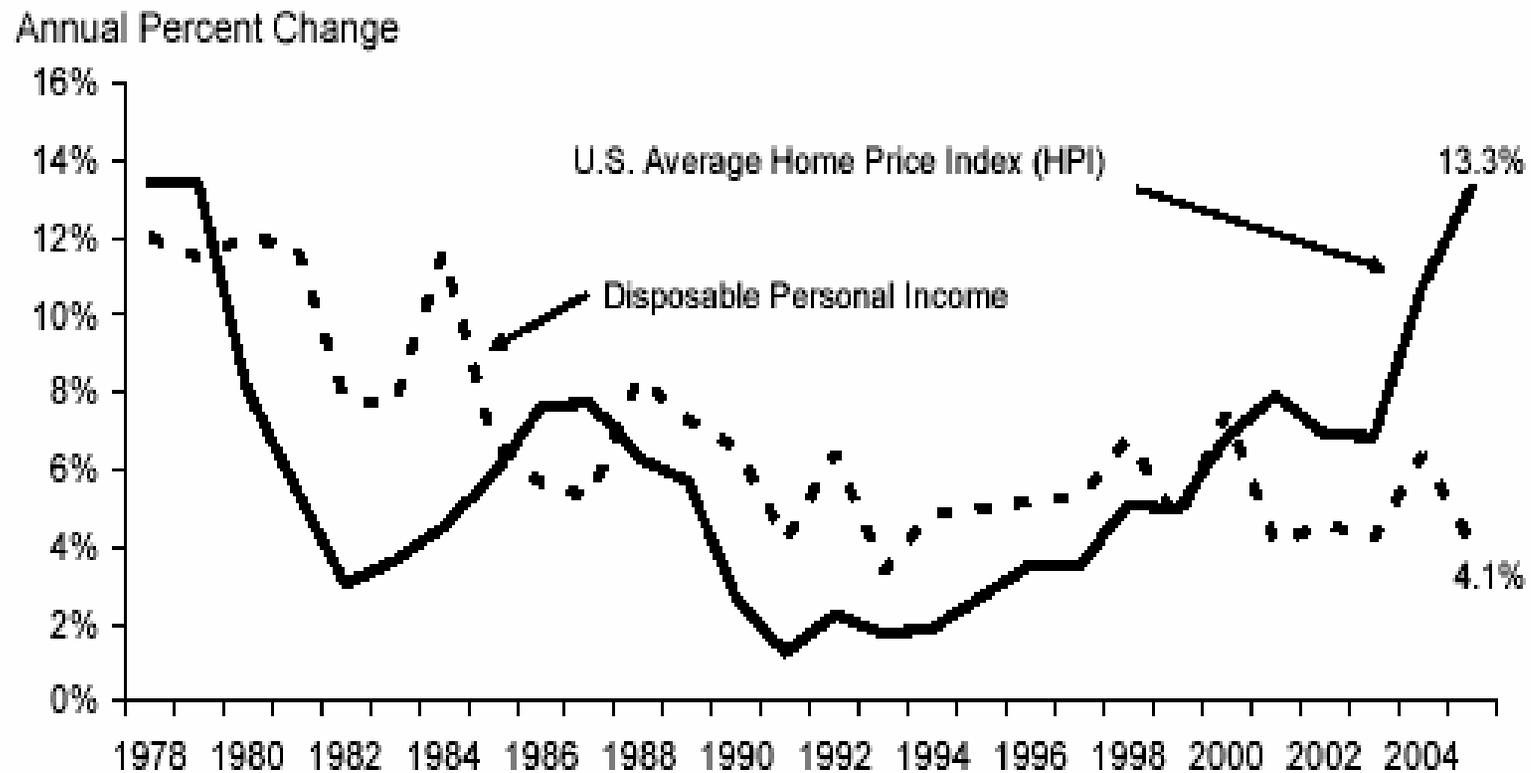
# Market Stagnation

- The real estate market has already weakened and will weaken further in the months ahead (through 2007).
- Existing home sales are forecast to fall 7.6% this year.
- New-home sales should drop 16.1% this year.
- The 30-year, fixed-rate mortgage is likely to rise to an average of 6.7% in the fourth quarter, according to the Realtors® forecast.
- The Florida forecast is for a soft landing, reflected in weak home prices and even weaker measures of housing activity.

# Price Appreciation

- Over the long-run, home prices grow at the pace of inflation, plus one or two percentage points.
- According to OFHEO, the second quarter of this year had the lowest rate of quarter-to-quarter appreciation since the fourth quarter of 1999. And the decline in appreciation over the past year is the sharpest since the beginning of the House Price Index in 1975.
- According to the National Association of Realtors, the national median existing-home price for all housing types is expected to grow 2.8% this year, to \$225,900, with the median new-home price rising only 0.2% to \$241,400

# Home Price Increases Outpaced Gains in Income

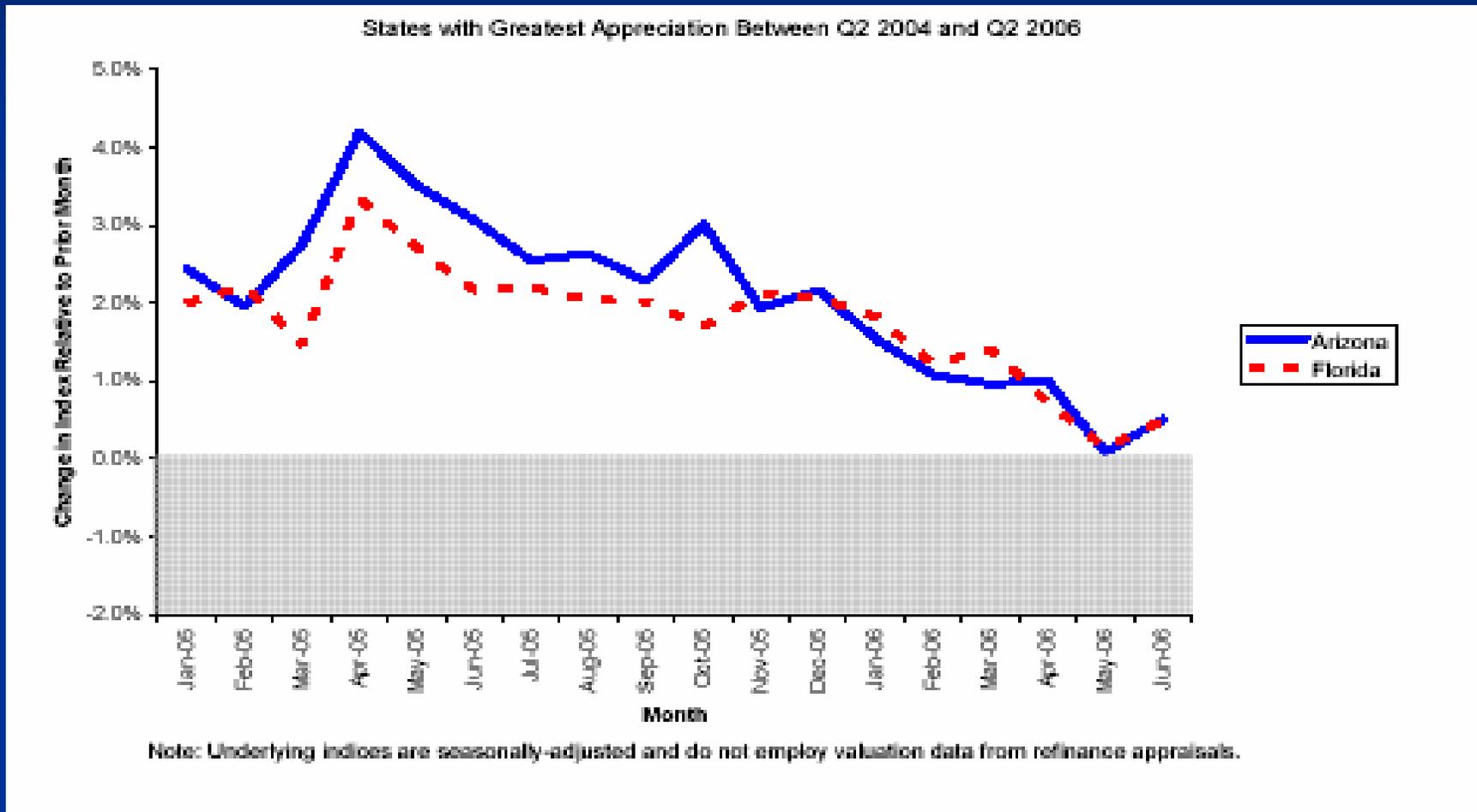


Source: OFHEO, Bureau of Economic Analysis.

# Florida Prices

- The median house price soared 90% from July 2001 to July 2006, nearly doubling.
- According to an FDIC study, Florida was home to 21 boom markets (metro areas) as of 2005.
- The housing boom actually lasted 5 years, but began turning a year ago when year-over-year sales volume began to fall.
- In March, year-over-year collections for the state's Documentary Stamp Tax dropped for consecutive months for the first time since the 2000-01 Fiscal Year.
- In July, statewide home sales were down 33% and the median sales price was only up 1% from a year ago.

# Recent Month-Over-Month Appreciation Rates



# Future Prices

*“In the past, significant nominal price declines generally have been associated with local or regional economic recession, but the exceptional size of some of the recent increases could make them vulnerable without a recession, especially if interest rates continue to rise.”*

OFHEO, 2006

*“National average price appreciation is likely to be quite limited in the near term. Indeed, some decline is a distinct possibility, and the rate of price appreciation should remain below trend for some time.”*

NAHB, 2006

*“These areas [Florida, California, Arizona, Nevada, Virginia, and Maryland] are vulnerable to outright price declines, particularly if interest rates were to rise further.”*

NAR, 2006

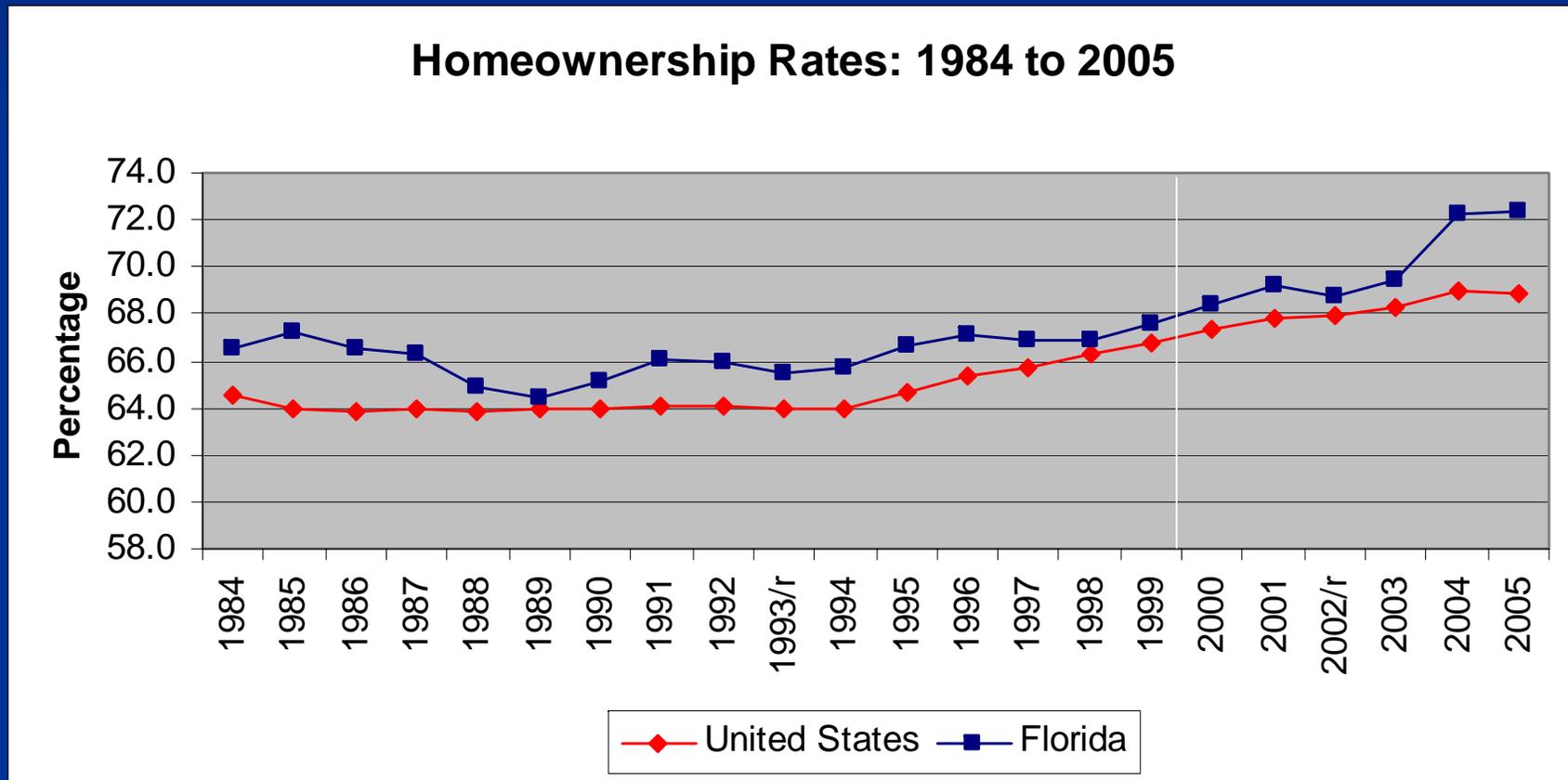
*“Prices of new and existing homes are also weaker, and actually decline in calendar year 2007. This will be the first nominal annual decline in the existing home sales price, a series that dates back to 1969.”*

Global Insight, 2006

# Florida Demographics – Pushing Up Costs

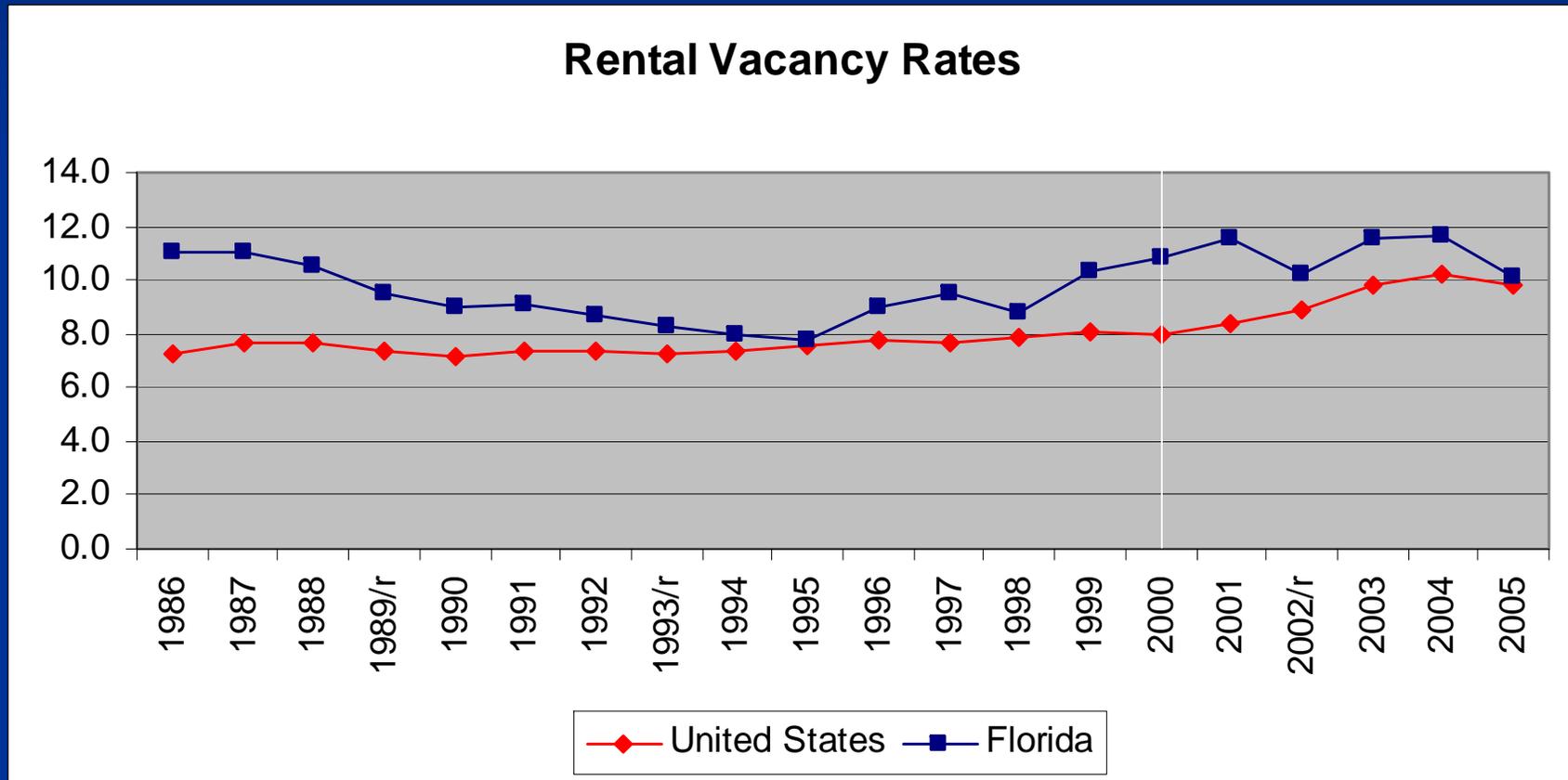
- The sales and construction associated with the housing boom well exceeded underlying population and income changes.
- The annual population growth rate is expected to stay above 2% through 2010.
  - In Fiscal Year 2006-07, there are nearly 7.4 million households, with household size fairly consistent at 2.5 persons per household.
- Aging boomers are reaching their peak earning and investing years, ultimately leading to higher demand for second homes.
- While real per capita wages and salaries have continued to rise modestly, not everyone has seen better times. Pay gains as measured by the employment cost index have fallen short of energy-driven consumer price inflation.
- The household financial obligations ratio climbed to a record high of 18.7% of disposable income in early 2006 and will continue to climb to a peak of 20.3% in 2008.

# Homeownership Rate at Historic Level



The homeownership rate is the proportion of households that is owner-occupied.

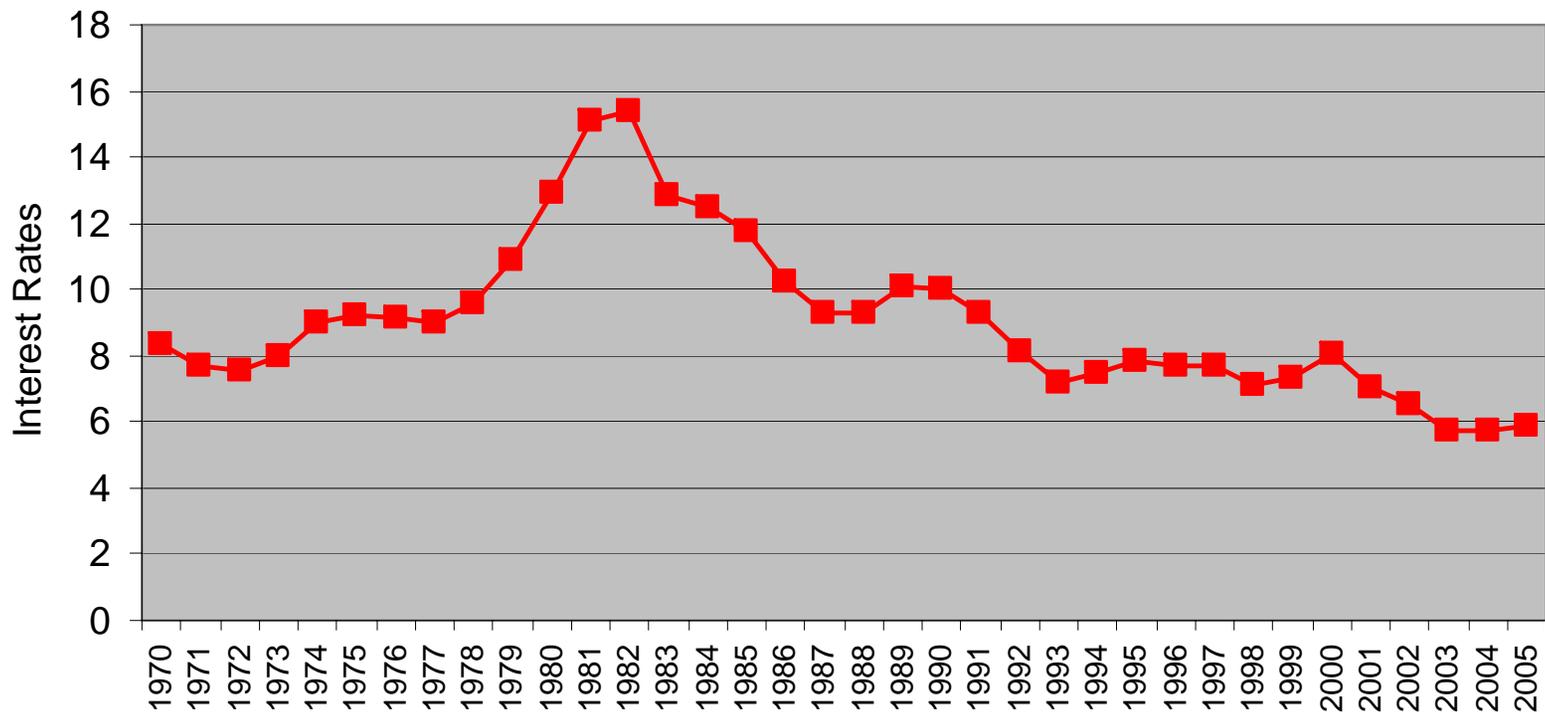
# Rental Supply is High, but Beginning to Tighten



The rental vacancy rate is the proportion of the rental inventory that is vacant.

# Historically Low Interest Rates

Monthly Mortgage Rate: 1970 to 2005



# Mortgages and Foreclosures

- The recent use of speculative financing arrangements is making Floridians particularly vulnerable to interest rate risks.
- Of the total mortgages written in Florida in 2004, over 30% were exotic mortgages, such as interest-only. 2005 was even higher.
- Exotic and subprime mortgages are more apt to default (loosened lending standards).
- First wave of rate resets and repayments of principal are hitting now.
- When the real estate market was hot, people in trouble could sell or refinance using increased equity from appreciation – those options are evaporating.
- The number of foreclosures in Florida is rising – the number of homes in some stage of foreclosure is up 62% compared to the nation's 53% (year-over-year).
- Florida's 16,533 homes in foreclosure leads all states.

# What is affordability?

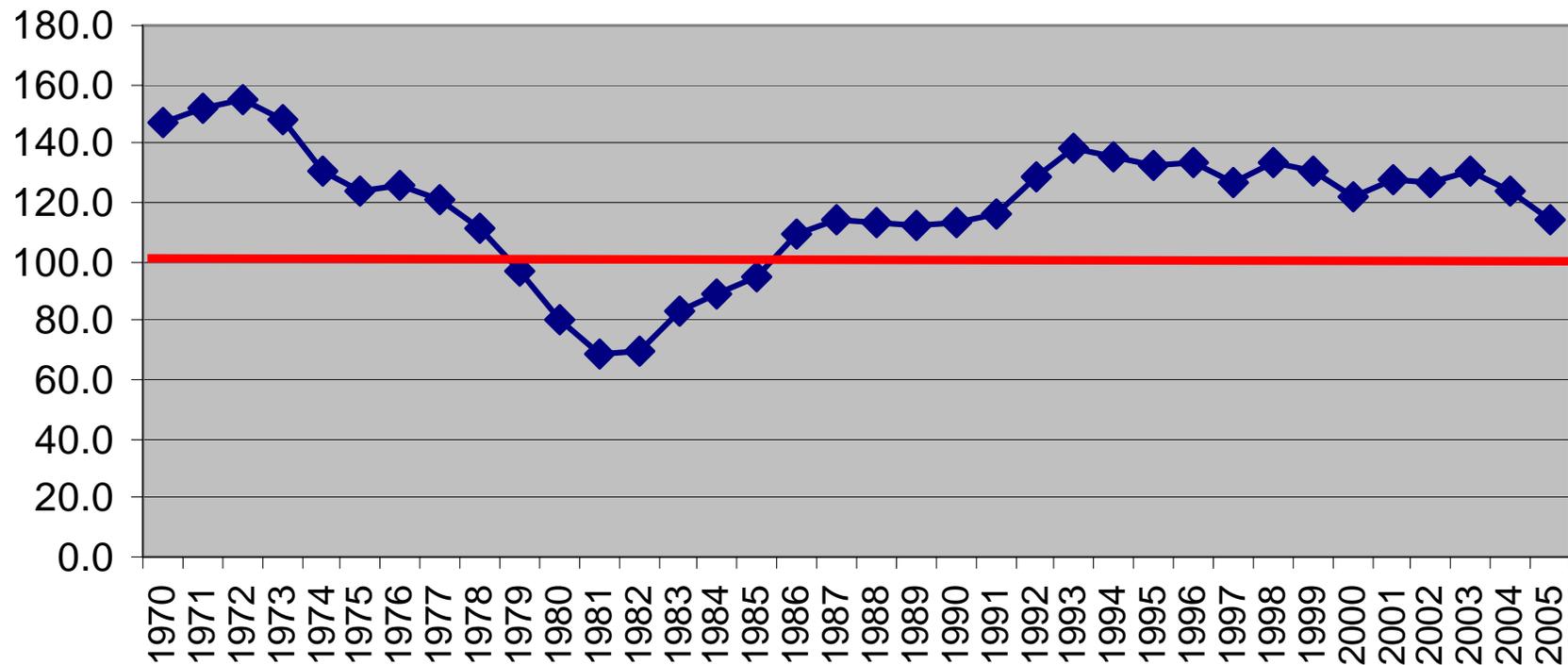
- Calculations are somewhat arbitrary because they are based on what households 'should' pay for housing.
- Most 'accepted' rule (used by HUD) is that spending more than 30% of household income on housing implies that housing is not affordable.
- Florida uses a similar definition.
- Economists use 'revealed willingness to pay,' that is, an observation of what people are actually paying.

# Affordability of Owner-Occupied Market

- National Association of Realtors' Housing Affordability Index measures whether a typical family could qualify for a mortgage loan on a typical home. (median family income  $\sim$  median-priced, existing single-family home  $\sim$  20% downpayment  $\sim$  qualifying ratio of 25%)
- 100 = exactly enough income; greater than 100 = more than enough income.
- It has been declining since 2003.
- In July, the Index was 102.8 or 102.8% of the income needed.

# Housing Affordability Index

Housing Affordability Index: 1970 to 2005



# Applying the Index to Florida

Median Sales Price (July)	\$250,800
20% Down	<u>- 50,160</u>
Amount to be Financed	\$200,640

Median Household Income*	\$ 45,736
25% Qualifying Ratio	\$182,944
Shortfall	\$ 17,696

\*EDR Estimation for July

# Affordability of Rental Market

- Renter households, especially the young and the poor, are spending a greater portion of income on housing than they did 10 and 20 years ago.
- As high interest rates and lower affordability continue to crowd out first-time homebuyers, vacancy rates in the apartment rental market will contract. Both increased demand and dwindling supply will push rental rates higher.
- An August survey of rental market builders reported rising occupancy rates, rising rents, and increased traffic at all classes of rental apartments.
- NAR expects the average rent to increase 4.8% this year, up markedly from 2.9% last year.

# Cost Drivers

- Continuing supply shortages, such as cement, steel, wall board and brick, have raised prices.
- Land use restrictions, environmental and economic impact studies, natural barriers and existing high densities in some areas have both lengthened the time to build and increased the cost of housing.
- Actual land shortages in some areas have driven up the price of land.
- New single-family houses are larger in size and have more amenities than ever before according to the recently released 2005 Survey of Construction data.
- Increasing property taxes, insurance and energy bills have increased the ongoing cost of housing.

# Conclusion – Below Trend Activity

- The **demand** for housing has dropped, at least partially due to higher prices and affordability issues.
  - Interest rates will likely increase, further dampening demand.
  - Recent buying surge likely pulled forward some demand.
  - Speculators / investors are pulling out of the market.
- The **supply** of **available** housing has increased, mainly because of the lower demand.
  - Some builders are turning from high end projects to more moderate projects, which will increase supply for certain demographic groups.
  - Condo-conversion is turning around, restoring the supply of rental units.
- The construction slowdown will drag down the economy, likely dampening wage-growth and job creation, and further lowering demand.
- House prices will fall on lower demand, but remain somewhat propped up by continued population growth, strong cost factors and tendencies to be ‘sticky downward.’

# Risks to Florida's Economy

- Housing Bust or more serious market contraction than currently forecast.
- Significant foreclosures or forced sales (dumping).
- Reduced consumer spending arising from 'payment shock' associated with exotic financing and from the loss of the wealth effect eroding the economy more than anticipated (recessionary).