RESEARCH RAP Special Report

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Third District Housing Market Conditions*

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By many measures, the economy of the Third District closely tracks the national economy. Thus far in the current housing cycle, this appears to be the case in the region's housing market.

It is clear that the widespread boom in the U.S. housing market that began around 1991 came to an end over the last few years. By many measures — house prices, housing permits, and housing starts among them — this nationwide housing cycle has been mirrored to a greater or lesser extent in the residential real estate industries of the Third District states.

However, the Third District did not experience as large a housing boom as the rest of the nation during the rising phase of this cycle. Pennsylvania, in particular, saw slower growth in housing starts and housing prices than did the country as a whole. By contrast, New Jersey and Delaware cycled more or less in line with the nation.

The nationwide downturn in the housing cycle lagged the corresponding downturns in Delaware and New Jersey and led that of Pennsylvania, but almost all of the most recent data indicate downward trends in the Third District. House price inflation over the past decade has been about the same as in the U.S. as a whole but lower than in some metropolitan areas in the West and South. Deceleration in house prices has followed a path similar to that of the nation. Mortgage delinquencies are now higher than they have averaged over the past three years, but in general, they are not at historic peaks in the Third District.

Starts

Housing starts have been falling significantly in the U.S. and in the three states of the Third District since the first quarter of 2006. Each of the states in the Third District experienced declines between 24 and 30 percent in the fourth quarter of 2007, the latest available data, similar to the nation's 25 percent decline. (See Figure 1 below.)

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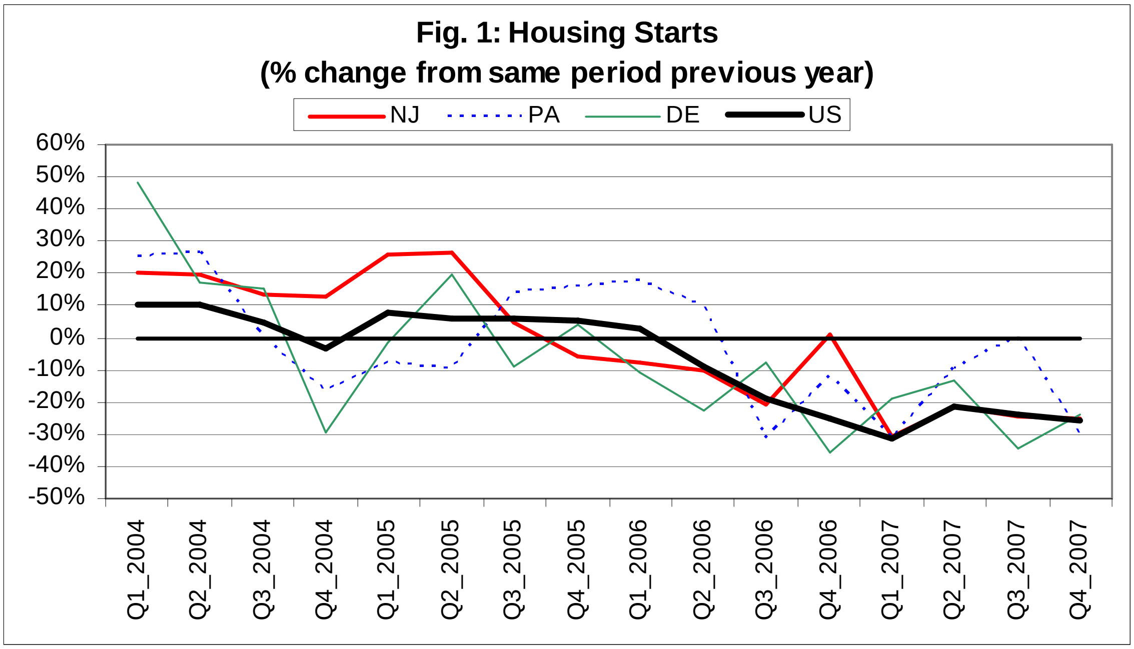
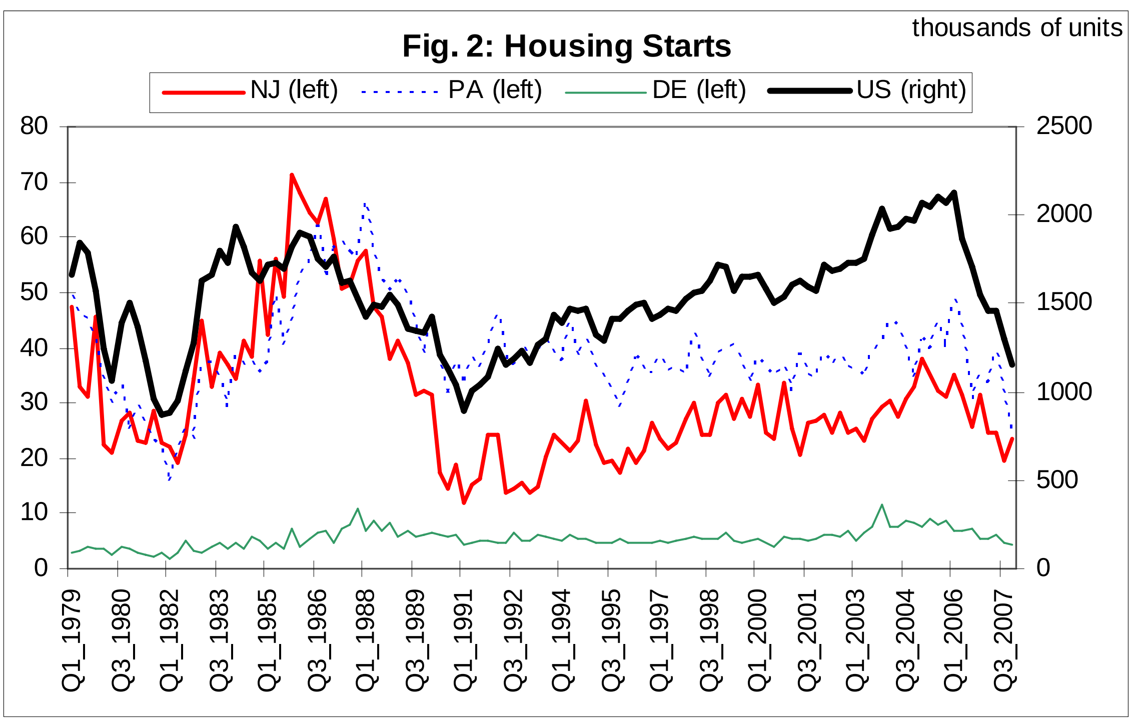
* The views expressed here are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. Nathan Brownback is a research associate in the Research Department of the Philadelphia Fed. E-mail: nathan.brownback@phil.frb.org



Source: Census Bureau Last quarter plotted: Q4 2007

Over the most recent period of the housing cycle the pattern of change in housing starts in the Third District has differed from the country as a whole. While starts in the U.S. reached a peak comparable to the peak reached in the mid-1980s at the high point of the last housing cycle, starts in New Jersey and Pennsylvania never approached their previous peaks. Further, while the downturn in the U.S. has been dramatic, monotonic, and negative (see Figure 2 below), the declines in the three states have not been quite as precipitous; indeed, in Pennsylvania it has become obvious only in the last two quarters that starts were trending downward.

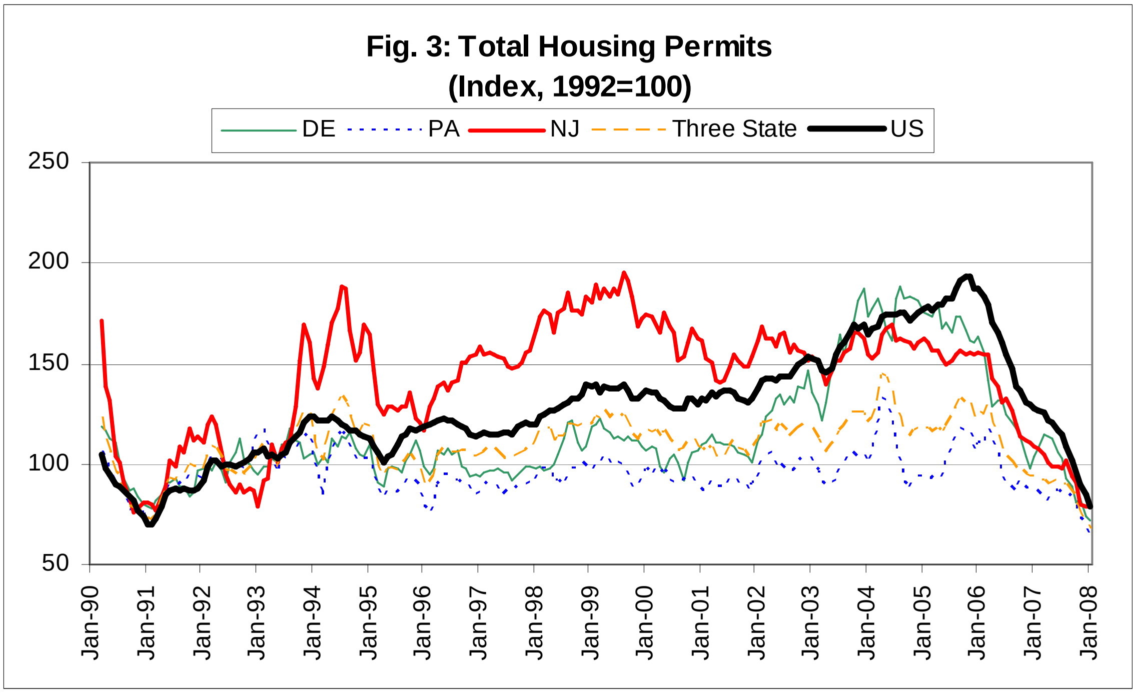


Source: Census Bureau Last quarter plotted: Q4 2007

Since the 1960s, declines in housing starts, once they begin, usually take several years – sometimes as long as five – to bottom out, and the cumulative declines are typically about 56 percent. Thus, the current cyclical downturn, in which housing starts have declined about 50 percent since January 2006, is about normal in historical context – but the current cycle may or may not have yet reached a trough.

Permits

Building permits also show the downward trend in the housing market. In the U.S., and in the three states, individually and together, permits show significant declines from 2005 highs. (See Figure 3 below.) In the three states, the number of permits is now more than 30 percent below its 1992 level and is down nearly 50 percent from its 2005 high.

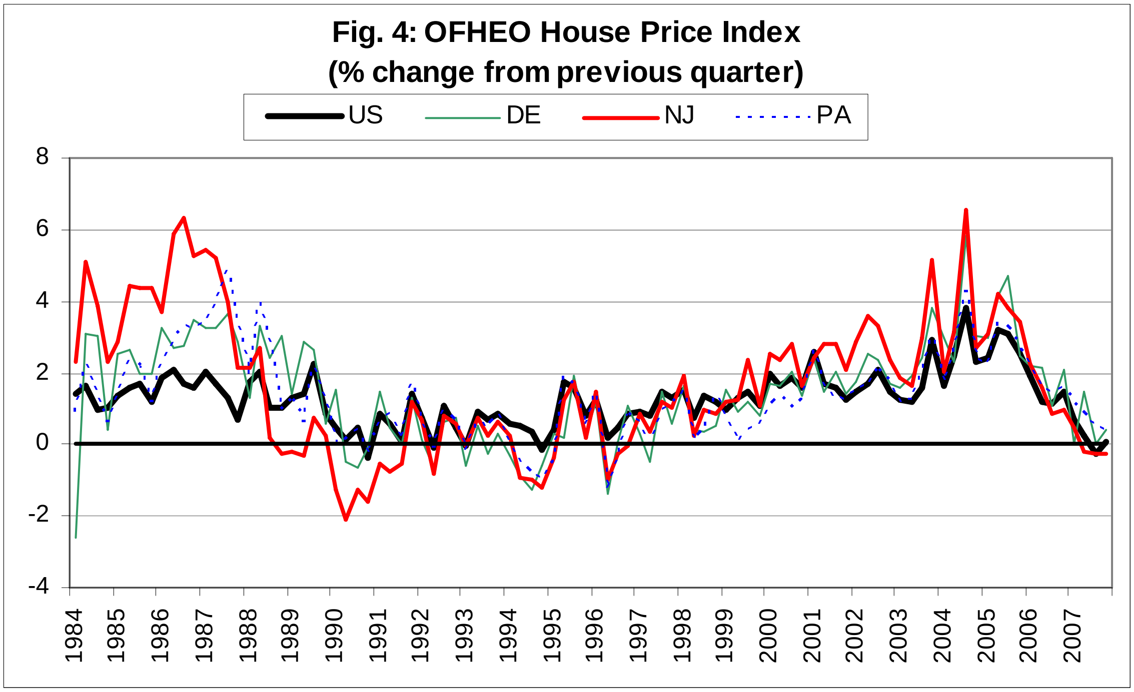


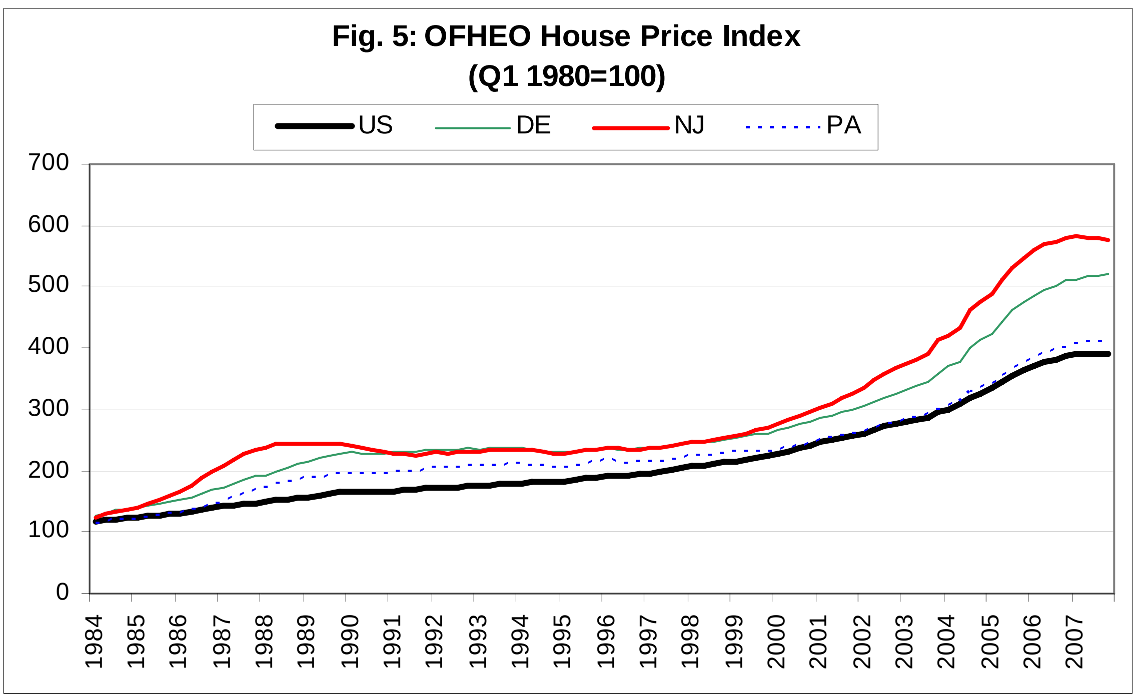
Source: Census Bureau Last month plotted: January 2008

Prices

House price increases, as measured by the OFHEO house price index, have decelerated significantly from the strong pace seen in 2003-2005. In the fourth quarter of 2007, prices were flat in the U.S. In New Jersey, they declined, while prices grew at less than half a percent in Delaware and Pennsylvania.

After the last housing downturn in 1987-1990, it took about 10 years for house prices to exceed quarterly growth of 2 percent (see Figure 4 below), and in that 10 years — roughly the 1990s — the average increase in the house price index was less than 1 percent. After this period of slowly rising house prices, the first part of this decade saw significant increases. The level of house prices peaked around the first quarter of 2007. (See Figure 5 below.)





Source: Office of Federal Housing Enterprise Oversight Last quarter plotted: Q4 2007

Mortgage Types, Composition, and Delinquency

In the U.S., the composition of mortgages serviced has changed significantly since 1999. The percentage of total mortgages backed by the Federal Housing Administration (FHA) has declined by roughly the same magnitude by which the percentage of subprime mortgages has increased. The Third District has a lower rate of subprime mortgages than the country as a whole, but this difference comes entirely from New

Jersey and Delaware — Pennsylvania has a higher percentage of subprime mortgages than the country as a whole. Pennsylvania also trails the country and the Third District significantly in prime adjustable-rate mortgages.

Table 1: Percent of mortgages serviced (Q3 2007)

	US	DE	NJ	PA	Three states
All	100.0	100.0	100.0	100.0	100.0
Conventional Prime	77.6	81.6	83.1	76.9	79.8
Prime FRM	60.8	63.3	69.4	68.1	68.4
Prime ARM	14.0	17.5	13.3	6.9	10.2
Other prime	2.8	0.8	0.4	1.9	1.2
Conventional Subprime	13.2	10.1	11.0	13.7	12.4
Subprime FRM	6.1	5.8	5.5	8.7	7.2
Subprime ARM	6.5	4.3	5.5	5.0	5.2
Other Subprime	0.6	0.0	0.0	0.0	0.0
FHA	6.8	5.7	5.1	7.5	6.4
FHA FRM	6.1	5.0	4.8	5.9	5.4
FHA ARM	0.4	0.2	0.3	0.3	0.3
Other FHA	0.3	0.4	0.0	1.3	0.7
Veterans Administration	2.5	2.7	0.8	1.8	1.5

Table 2: Percent of mortgages serviced (Q3 2007)

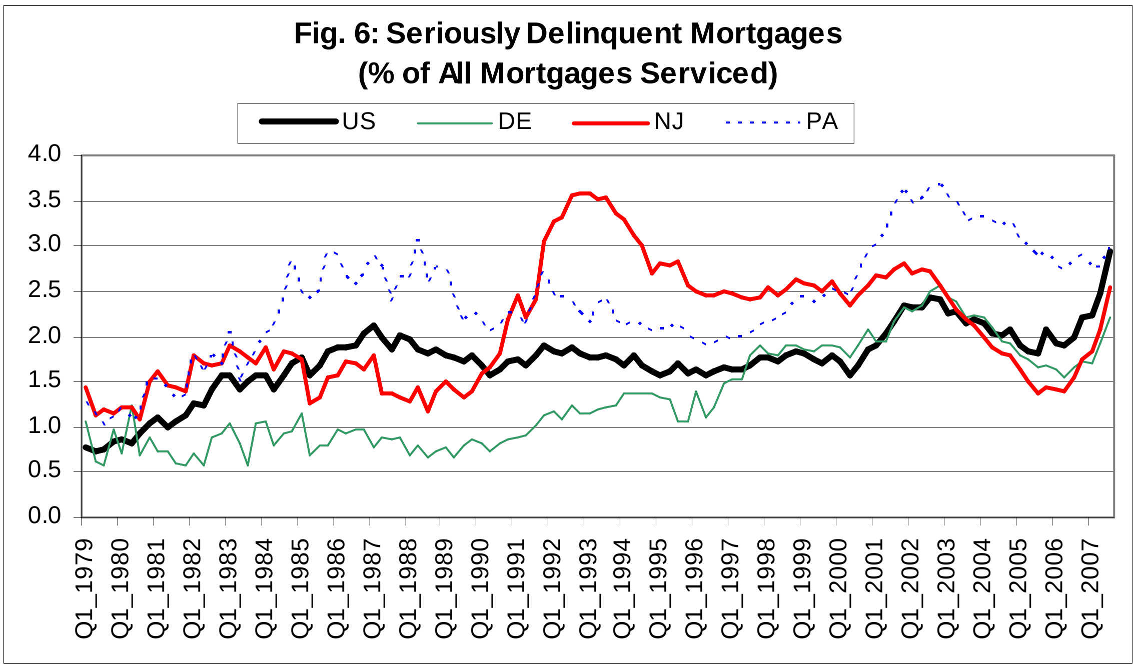
	US	DE	NJ	PA	Three states
All	100.0	100.0	100.0	100.0	100.0
Conventional Prime	77.6	81.6	83.1	76.9	79.8
Conventional Subprime	13.2	10.1	11.0	13.7	12.4
FHA	6.8	5.7	5.1	7.5	6.4
Veterans Administration	2.5	2.7	0.8	1.8	1.5

Percent of mortgages serviced (Q4 1999)

	US	DE	NJ	PA	Three states
All	100.0	100.0	100.0	100.0	100.0
Conventional Prime	72.6	75.9	79.6	78.2	78.7
Conventional Subprime	1.9	2.4	1.3	2.2	1.8
FHA	18.0	14.2	15.2	15.1	15.1
Veterans Administration	7.5	7.4	3.9	4.6	4.4

Source: Mortgage Bankers Association Note: “Other” categories are residuals.

Mortgages are considered seriously delinquent either when they are in the legal foreclosure process or when installment payments are at least 90 days behind. The rate of seriously delinquent mortgages has increased since 2005 in the country as a whole, in Delaware, and in New Jersey. (See Figure 6 below.) Again, Pennsylvania is the exception, but Pennsylvania's rate of serious delinquency remained elevated after the 2001 recession, while the other states recovered. In the U.S. as a whole, the rate of seriously delinquent mortgages is at its historical high, while the rate in Delaware is approaching its historical high, reached in 2002. The rate of seriously delinquent mortgages in New Jersey is also increasing quickly and is at an elevated level, though not at its peak in the early 1990s. Pennsylvania's rate has begun to turn upward in the most recent quarter as well.

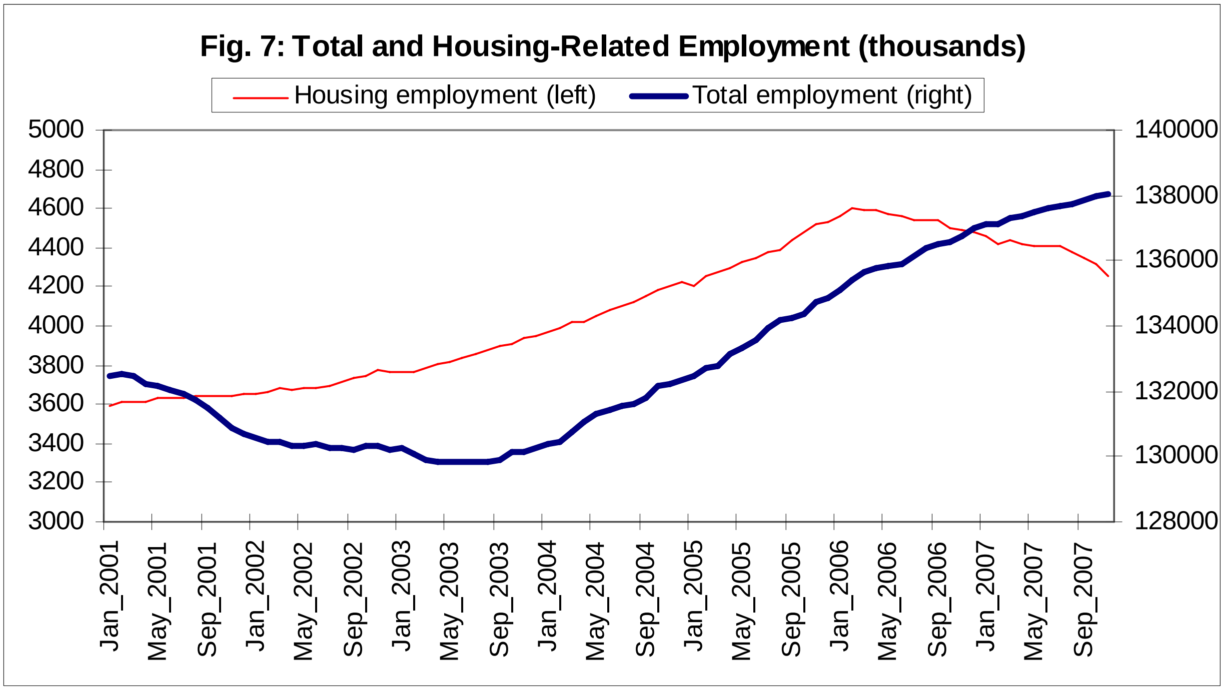


Source: Mortgage Bankers Association Last quarter plotted: Q3 2007

Housing-Related Employment

Another channel through which a major downturn in the housing market can affect the economy is the employment of workers dependent on the housing industry. The Bureau of Labor Statistics (BLS) provides breakdowns of employment by industry. Thus, it is possible to look at industries, such as residential construction and residential specialty trade contractors, that are directly affected by downturns in the housing market, as well as categories of employment that are only slightly less directly dependent on the sector. These categories, as defined by the BLS, could include lessors of residential buildings, offices of real estate agents and brokers, residential property managers, offices of real estate appraisers, and other activities related to real estate.

During and immediately following the last recession, job growth in the U.S. was negative for 25 of the 30 months from March 2001 through August 2003, and only once were there two consecutive months of positive job growth. (See Figure 7 below.) On average, payroll jobs declined by 90,000 jobs per month over this 30-month period. The construction-related industries did not post particularly impressive job gains over the period (they averaged 9,000 new jobs per month), but they were not a drag on overall U.S. employment. By comparison, in the period from March 2006 through November 2007 (the latest data available), U.S. payroll job growth started out strong but slowed, including a negative initial job growth number in January, and housing-related jobs have declined by an average of 16,200 jobs per month. This key industry has now become a drag on overall employment growth.



Source: Bureau of Labor Statistics Last month plotted: November 2007

Outlook

The outlook for housing, both in the Third District and in the nation as a whole, is both uncertain and, according to business contacts in the industry, somewhat grim. As indicated in the Federal Reserve's Beige Book of January 16, 2008, industry experts "do not expect a broad recovery to get under way soon." This echoes the previous two Beige Book reports from the Third District, which said that "contacts among builders and real estate agents expect sales to remain flat well into next year, and the most optimistic expect any spring pickup to be slight. According to one agent 'the glory days are over'." A builder quoted in the Beige Book described the outlook for 2008 as "anemic." The January Beige Book echoes this characterization of the housing situation for the nation as well, saying that "conditions in most housing markets remained quite weak through year-end. The pace of sales continued to be sluggish, and inventories persisted at historically high levels… contacts anticipate that housing markets will remain weak during the first part of 2008."