Residential Housing Ready to Awaken?

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Posted By: Albert Bozzo | Senior Features Editor
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After half a decade of withering sales and slumping prices, there are strong and diverse signs that the single-family housing market is poised for a rebound.

In some metropolitan areas, the market has bottomed, with both sales and prices on the rise and foreclosures on the decline.

This contrarian — and largely overlooked — thesis flies in the face of the persistent gloom that has nagged the industry since 2007, when the subprime crisis flared.

Industry analysts and players cite a number of reasons — some traditional (employment), others unique to the post-credit bubble era (foreclosures) — for the long-awaited sea change. An analysis of industry and government data also support the forecast.

"It has become increasingly apparent to us that the pieces for a housing rebound next year are beginning to fall into place," declared Barclays Capital analyst Stephen Kim in a recent note to investors.

Proponents admit that the nascent rebound could easily be derailed, but stress that after years of government efforts to support sales and prices as well as the volatile impact of foreclosures, the market has regained a measure of normalcy.

"With the exception of really hard-hit markets, the vast majority is ready to turn around," adds Jerry Howard, president and CEO of the **National Association of Home Builders, NAHB**. "The Washington, D.C., area is not only ripe for recovery, they need to start building units."

The **iShares Dow Jones US Home Construction Index Fund** , for example, is up some 38 percent, while the **S&P 500** is up about 21 percent.

Nevertheless, skeptics overwhelmingly outnumber the optimists, given the false-starts of previous years, the economy's sub-par performance, a new wave of distressed properties and the capacity for the European debt crisis to spook business, consumers and investors.

"I think it's premature," says Richard Smith, CEO of **Realogy**, the nation's largest real estate company, whose brands include Century 21, Coldwell Banker and Sotheby's International. "We see little indications here and there. Transaction volume is improving. Prices are still under pressure. This isn't going to be one of those spiked robust recoveries."

Smith is echoing the conventional industry calculus: that price increases follow sales growth amid consistently strengthening demand.

There's been little conventional, however, about this housing slump, which is one reason it's had so many false bottoms. Among its many firsts — housing starts fell through 1 million annual units, foreclosures topped 2 million in three consecutive years, and home prices declined on a national basis.

The catalysts to recovery are mostly the same: for potential buyers, residential rents have now risen enough to consider buying; existing-home inventory is the lowest in five years, while that of new homes is at a 40-year low; affordability is at a record high; delinquencies have peaked; **consumer confidence is on the rise** ; and **job growth is accelerating.**

For investors, with a continuation of the **gold rally** in question, real estate is beginning to look like a viable inflation hedge alternative, while rising rents mean greater profits.

That thinking may help explain why the **iShares Dow Jones US Home Construction Index Fund** , a broad barometer for the housing market, is up some **38 percent from the stock market's October bottom,** while the **S&P 500** is up about **21 percent**.

Finally, there's the intangible fatigue with bad news, and a desire to end the negative feedback loop.

"We believe there is sizable housing demand that could be released into the market," says Lawrence Yun, chief economist of the **National Association of Realtors**, **NAR**.

The NAR is forecasting existing home sales will rise 5 percent in both 2012 and 2013; prices will edge up 2 percent in each of those two years, then 4 percent in 2014.

The NAHB is forecasting a 5.1-percent increase in new home sales and a 10-percent increase for new home starts in 2012.

Jobs, Jobs, Jobs

A turnaround in the housing market will require continued improvement in the job market.

The economy has created jobs 13 months in a row for a total of almost 1.9 million. Weekly jobless claims have been routinely below the key level of 400,000, and the national jobless rate is down to 8.6 percent.

There are already signs in some markets that an improving employment picture is boosting housing demand and sale prices.

In cities such as Tampa, Fla., South Bend, Ind., Grand Rapids, Mich., Raleigh, N.C., Wichita, Kan., and Green Bay, Wis.., the median sales price of an existing single family home increased 1-2 percent in the third quarter, during which time the **jobless rate and/or payrolls growth improved dramatically.**

Even in the Cape Coral-Fort Myers, Fla. metropolitan area — considered the epicenter of the foreclosure crisis a few years ago — prices were just 1.4 percent lower in the third quarter than the previous year.

A new index by the **NAHB and First American, the Improving Markets Index, IMI**, launched in September, tracks housing markets throughout the country that are showing signs of improving economic health. Thirty cities – including San Jose, Pittsburgh, New Orleans and Winston-Salem, N.C. – are showing growth in permits, sales and employment.

In San Diego — where in the last year the jobless rate has fallen from 10.4 percent to 9.7 percent and 24,000 jobs have been added — home inventory is down to two months; in some areas of San Francisco (9.4 vs. 10.3 percent), it is one month.

More broadly, 40 percent of all states showed existing home sale increases on both a quarterly and annual basis in the third quarter, **according to National Association of Realtors data**. That includes high foreclosure-rate states, such as California, Georgia, Michigan and Utah. All but six states showed double-digit gains year over year.

Location, Location, Location

There's even a strong case to be made that the foreclosure crisis is easing.

"The pipeline of distressed property is plentiful but less than last year," when foreclosure activity hit a record 2.18 million, says Yun.

For the first nine months of 2011, foreclosure activity is down sharply from the same period last year (26.59 percent), whether it is the worst-off states — (Florida, 54.98 percent; California, 31.51 percent; Utah, 27.41 percent) — or better-off ones (New York, 46.57 percent; Mississippi, 33.25 percent; South Dakota, 26.59 percent), according to RealtyTrac, which tracks the data.

Third-quarter foreclosures (610,337) were up 1 percent from the previous quarter but down 34 percent from the year-ago period.

The wild card right now is an impending wave of new foreclosed properties on the market, following the removal of state moratoria and the settlement of state and federal lawsuits with lenders and loan servicers.

It's unclear how many properties will hit the market, but conservative estimates put the number at over a million.

Still, of **the top 20 markets in the new wave**, nine are in California, five in Florida and two in Ohio, according RealtyTrac, so the impact will be fairly concentated.

Another question is whether that wave will be a tsunami or merely a breaker. If the market is in fact recovering, why would banks want to weaken it again by deluging it with cheap properties.

"You could see them trying to gauge the market like speculators," answers Howard.

Kim of Barclays is among those who say the threat is exaggerated, perhaps misunderstood. He estimates that 40 percent of the foreclosed properties haven't had a payment made on them in two years, which means they are in poor condition and thus unattractive to many buyers.

"The deterioration has been great," he says. "It flies in the face of all the bearish arguments."

Kim's thesis is that there are now two kinds of buyers in the market; those who'll take a chance on a bargain-priced, distressed property and those who'll only make a conventional transaction. He says it helps explain why the Core Logic data he used for his latest report shows non-distressed prices flat or slightly higher in the past year.

"Even if the banks decide to move their inventory more aggressively, and I suspect they will, it's OK because the buyer is making a distinction," explains Kim.

"There's a ready appetite for it," adds Smith of Realogy, who agrees that there's substantial pent-up demand for housing in general but also great uncertainty. "If you can relieve consumers of some of that uncertainty, then I can see a nice little recovery."

That's the psychological dimension of the wild card — the negative feedback loop that has plagued housing.

Optimists say most of the uncertainty and fear is gone.

"The major driver of negative sentiment was that prices were going down across the market by large amounts," says Kim of Barclays. "Buyers need to see a stabilization."

A contributing element to that is the unwinding of government intervention — whether to artificially spur demand — as was the case with the first-time buyer tax incentive program of 2009 and 2010 — and/or to retard and prevent foreclosures.

Many regard those efforts as largely ineffective, if not counter-productive because they delayed the inevitable — a deep descent to a market bottom, which has finally been touched.

"The numbers you're looking at you can trust," says Kim. "There are no exogenous factors."

Though tight lending conditions and forthcoming regulations of the **Dodd-Frank legislation** are still an issue for some, sweeping housing finance reform is off the agenda for at least the next year.

"You're back to the natural forces of the market," says Howard of the builders association.

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