Freddie Mac

We make home possible®

Office of the Chief Economist

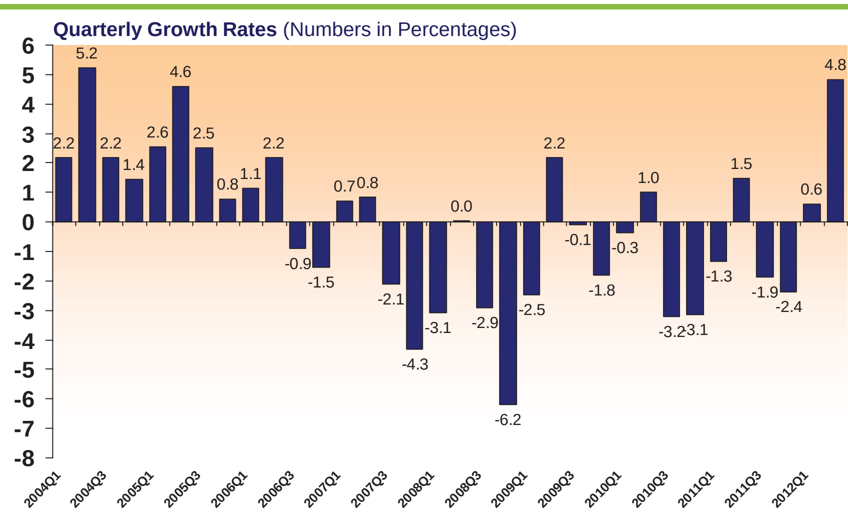
August 2012 U.S. Economic & Housing Market Outlook

The Shadow

The ominously termed “shadow inventory” is casting a pall of uncertainty over recent signs that home values have bottomed out. What’s behind it, and is it as threatening as it sounds?

That’s an important question because house-price news has been decidedly good over the past quarter. The Freddie Mac House Price Index for the U.S. showed a brisk 4.8 percent gain from March to June 2012, the largest quarterly pickup in eight years; the national index posted a June-to-June rise of 1 percent, the largest annual appreciation since November 2006. Further, the improvement was relatively broad-based. In fact, 34 states and the District of Columbia posted higher home values during the 12 months through June 2012, the largest number of states registering positive annual appreciation since April 2007.

Freddie Mac’s U.S. House Price Index Experienced a 4.8% Increase from March to June



Note: The Freddie Mac House Price Index for the U.S. is a value-weighted average of the state indexes where the value weights are based on Freddie Mac’s single-family portfolio. The U.S. index is a monthly series; quarterly growth rates are calculated as a 3-month change based on the final month of each quarter.

Office of the Chief Economist

Source: Freddie Mac House Price Index

Other house-price metrics also suggest the market is strengthening. The CoreLogic index for the U.S. was up 2.5 percent June-to-June (and up 3.2 percent when distressed home sales were excluded), and the Federal Housing Finance Agency House Price Index posted year-over-year gains through May.

So, have we arrived at the house-price inflection point or is there a shadow inventory lurking ready to send house prices tumbling again?

Various measures of the housing inventory suggest that there is a shadow but it's not so foreboding. In fact the so-called shadow inventory has shrunk. And even if some local markets continue to be lopsided, the nation as a whole may shortly return to a healthy supply-and-demand balance.

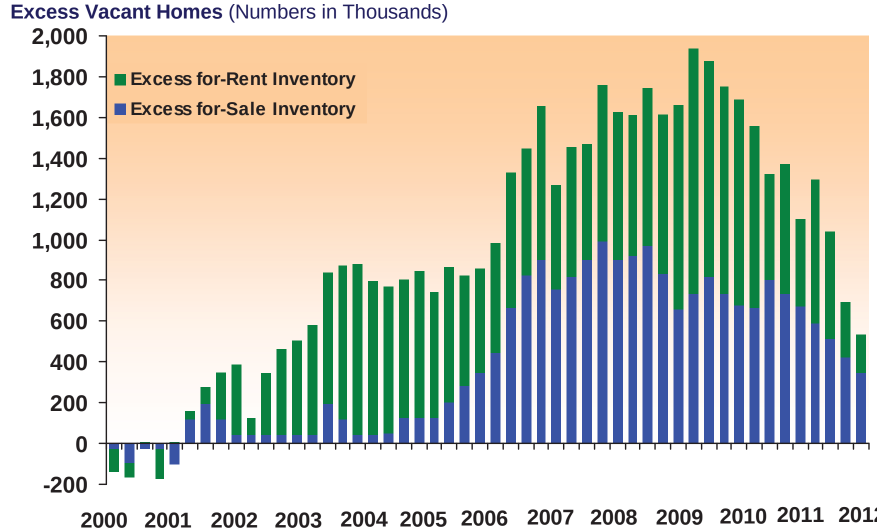
"Shadow inventory" does not have a generally accepted definition within the industry. One simple metric is the stock of single-family loans that are seriously delinquent; that is, at least 90 days past due or in foreclosure proceedings. Seriously delinquent borrowers are clearly experiencing financial distress and in jeopardy of losing their homes through foreclosure, with the property entering the real-estate-owned (REO) inventory of a financial institution. The subsequent sale of an REO property often occurs at a discounted price and can weaken surrounding property values, which is central to the concern that any current home-value gains may be fleeting. The Mortgage Bankers Association's National Delinquency Survey places the stock of seriously delinquent loans around 3.6 million (after adjusting for an estimated 88 percent survey coverage) as of March 31, 2012. While down about 1.4 million from its peak at year-end 2009, it remains substantially above the pre-2008 levels and casts a long shadow across the market.

Although the shadow persists, there is an important difference between today's market and that of recent years: the excess supply of vacant homes is substantially reduced. The Census Bureau vacancy data showed a continuing decline in overall vacancies in U.S. homes that are for rent and for sale through the second quarter. Rental vacancy rates have fallen to 8.6 percent, the lowest since the second quarter of 2002. The for-sale vacancy rate has dipped to 2.1 percent, the least since the second quarter of 2006.

To gauge the degree of excess vacant inventory, we computed the average vacancy rate in the for-rent and for-sale markets from 1994 to 2003, a decade in which the housing and mortgage markets were generally regarded as healthy. Using these average 10-year vacancy rates as a benchmark, we computed the excess amount of vacant for-rent or for-sale housing stock by comparing actual quarterly rental and homeowner vacancy rates with the 1994-2003 benchmark. As shown in the accompanying chart, the excess vacant "overhang" grew rapidly -- to close to two million dwellings -- from 2006 through 2009.

Such an unprecedented oversupply of housing stock exerted considerable downward pressure on rents and home values during much of the middle to end of the first decade of the 2000s. This housing "hangover" suppressed homebuilding. But the relatively small amount of new construction, coupled with increased household formation, has allowed much of the excess vacant inventory to be absorbed over the past couple years. The national data obscure the fact that some local markets have clearly tightened (that is, with rents rising and home-value gains) while others continue to have excess vacant stock. Nationally, the for-rent market now appears to be in relatively good balance, with the rental stock close to overall rental demand, resulting in "normal" vacancy levels.

Oversupply of Vacant Housing is Lowest in Almost 10 Years



Source: Freddie Mac calculations using U.S. Census Bureau data. Negative values reflect undersupply. The under/oversupply of vacant housing was estimated based on the average vacancy rate from 1994Q1 to 2003Q4.

Office of the Chief Economist

This continuing shrinkage in excess vacant stock is important because it means that in most markets the REO homes on the for-sale market are not competing with an oversized vacant housing inventory. Thus, REO homes may be more attractive to investors and first-time buyers because fewer vacant homes are available, and REO sales will have less effect on other home sales or home values. Further, with the pickup in overall home sales so far this year, REO represents a smaller share of all sales: CoreLogic's sales database revealed that REO had declined to 13.5 percent of all U.S. sales in May, the lowest share since March 2008. That's good because a smaller share of REO sales typically boosts home values, because either buyer demand bids up REO prices or easing REO volume lessens downward price pressure on other homes on the local market. (It's worth noting that while REO disposition remains a large part of many markets, short sales, loan modifications, and other foreclosure alternatives have helped to reduce the flow of properties into REO inventory.)

Less excess vacant stock plus fewer REOs enhances market values. Recent data continues to suggest that the bottom in the U.S. house-value cycle may have been reached. Even if national indexes dip in the seasonally weak autumn and winter months, the declines probably won't be big enough to erase the good second-quarter news on home values. This means the housing recovery may finally be coming out from the shadows.

Frank E. Nothaft
Chief Economist
August 8, 2012

August 2012 Economic and Housing Market Outlook

Revised 8/8/2012

Major Economic Indicators

Indicator	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2007	2008	2009	2010	2011	2012	2013
Real GDP (%)	0.1	2.5	1.3	4.1	2.0	1.5	2.5	2.5	2.8	2.8	3.2	3.2	2.2	-3.3	-0.1	2.4	2.0	2.1	3.0
Consumer Prices (%) a.	4.5	4.4	3.1	1.3	2.5	0.7	1.9	1.5	2.0	2.0	2.0	2.0	4.0	1.6	1.5	1.2	3.3	1.7	2.0
Unemployment Rate (%) b.	9.0	9.0	9.1	8.7	8.3	8.2	8.2	8.1	8.0	7.9	7.8	7.7	4.6	5.8	9.3	9.6	9.0	8.2	7.9
30-Year Fixed Mtg. Rate (%) b.	4.9	4.7	4.3	4.0	3.9	3.8	3.5	3.6	3.8	3.9	4.0	4.2	6.3	6.0	5.0	4.7	4.5	3.7	4.0
1-Year Treas. Indexed ARM Rate (%) b.	3.3	3.1	2.9	2.9	2.8	2.8	2.8	2.8	2.8	2.9	3.0	3.1	5.6	5.2	4.7	3.8	3.0	2.8	3.0
10-Year Const. Mat. Treas. Rate (%) b.	3.5	3.2	2.4	2.1	2.0	1.8	1.6	1.7	1.8	1.9	2.0	2.1	4.6	3.7	3.3	3.2	2.8	1.8	2.0
1-Year Const. Mat. Treas. Rate (%) b.	0.3	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	4.5	1.8	0.5	0.3	0.2	0.2	0.3

Housing and Mortgage Markets

Indicator	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2007	2008	2009	2010	2011	2012	2013
Housing Starts c.	0.58	0.57	0.61	0.68	0.72	0.74	0.74	0.78	0.83	0.88	0.93	0.98	1.36	0.91	0.55	0.59	0.61	0.75	0.91
Total Home Sales d.	4.63	4.48	4.55	4.69	4.92	4.90	4.92	5.00	5.10	5.20	5.30	5.40	5.81	4.59	4.72	4.51	4.57	4.94	5.25
FMHPI House Price Appreciation (%) e.	-1.3	1.5	-1.9	-2.4	0.6	4.8	0.0	-4.2	0.0	2.5	0.5	-1.0	-4.9	-11.7	-2.3	-5.6	-4.1	1.0	2.0
S&P/Case-Shiller® Home Price Index (%) f.	-4.0	4.1	0.0	-3.9	-2.0	3.0	0.0	-0.9	0.0	2.5	0.5	-1.0	-8.4	-18.4	-2.5	-3.7	-3.9	0.0	2.0
1-4 Family Mortgage Originations g.																			
Conventional	$263	$220	$277	$373	$327	$335	$336	$277	$246	$262	$262	$230	$2,312	$1,310	$1,549	$1,300	$1,133	$1,275	$1,000
FHA & VA	$77	$70	$73	$72	$83	$95	$114	$83	$74	$78	$78	$70	$120	$290	$451	$377	$292	$375	$300
Total	$340	$290	$350	$445	$410	$430	$450	$360	$320	$340	$340	$300	$2,432	$1,600	$2,000	$1,677	$1,425	$1,650	$1,300
ARM Share (%) h.	8	11	12	14	12	11	14	14	15	15	15	15	10	7	3	5	11	12	15
Refinancing Share - Applications (%) i.	69	70	78	81	81	77	73	70	70	65	60	50	42	48	70	76	75	75	62
Refinancing Share - Originations (%) j.	71	56	65	75	76	74	72	70	70	65	60	50	49	50	68	67	67	73	62
Residential Mortgage Debt (%) k.	-2.7	-2.4	-2.0	-1.8	-3.2	-1.0	-1.0	-0.5	1.0	2.0	2.0	3.0	7.1	-0.4	-1.6	-3.0	-2.2	-1.4	2.0

Note: Quarterly and annual forecasts (or estimates) are shown in shaded areas; totals may not add due to rounding; quarterly data expressed as annual rates.
Annual forecast data are averages of quarterly values; annual historical data are reported as Q4 over Q4.

a. Calculations based on quarterly average of monthly index levels; index levels based on the seasonally-adjusted, all-urban consumer price index.
b. Quarterly average of monthly unemployment rates (seasonally-adjusted); Quarterly average of monthly interest rates (not seasonally-adjusted).
c. Millions of housing units; quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).
d. Millions of housing units; total sales are the sum of new and existing single-family homes;quarterly averages of monthly, seasonally-adjusted levels (reported at an annual rate).
e. Quarterly growth rate of Freddie Mac's House Price Index (FMHPI); not seasonally-adjusted; Dec.to-Dec. for yearly data.
f. National composite index (quarterly growth rate); not seasonally-adjusted; Q4-to-Q4 for yearly data.
g. Billions of dollars (not seasonally-adjusted).
h. Federal Housing Finance Agency (FHFA); quarterly averages of monthly shares of number of loans of conventional, home-purchase mortgage closings (not seasonally-adjusted).
i. Primary Mortgage Market Survey®; quarterly averages of monthly shares of all single-family mortgage applications (not seasonally-adjusted).
j. Home Mortgage Disclosure Act for all single-family mortgages (not seasonally-adjusted); Annual share is dollar-weighted average of quarterly shares.
k. Federal Reserve Board; growth rate of residential mortgage debt, the sum of single-family and multifamily mortgages(not seasonally-adjusted, annual rate)

Prepared by Office of the Chief Economist and reflects views as of 8/8/2012 (MAS); Send comments and questions to chief_economist@freddiemac.com.