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FINANCIAL MANAGEMENT



How To Spot The “Turn” In Real Estate Prices...

Housing contributes to economic activity in two ways. First, when folks invest money to build or buy homes. Second, when they spend money on utilities, rent, appliances, landscaping, and other housing services. The first contributes about 5% to GDP and the second about 12%, for a total of approximately 17% - which is quite a bit. So housing is a really important driver for the American economy.

In fact, many analysts look at housing data to gauge the health of our economy. Very simplistically, if folks are above-water on their homes, they feel confident and spend on all manner of things - new clothes, cars, home improvements, new businesses and so on. When their homes are worth less than what they bought them for, they feel less inclined to go out and spend or start new businesses.

The state of housing, in turn, depends on the following factors:

1. Employment. Sort of obvious, isn't it? Without jobs, people cannot take out loans to buy homes so housing demand drops, and home prices either stagnate or dip (as they have done since June 2006). So we must see meaningful job creation before a recovery in housing.
2. New Housing Loans. Take data on new mortgage loans, and then strip out refinancings (because they do not indicate new home purchases). What we're left with are mortgages for home purchases – compare this to historical numbers to see if loans are rising or falling, and at what rate. This is a two-way indicator. It tells us if Americans are taking out loans to buy homes and if banks are upbeat enough about the economic future to make loans to creditworthy buyers.
3. Housing Inventory. Basic supply and demand between homes available for sale versus home buyers. As a rule of thumb, if there are more homes for sale than buyers plan to purchase in 6 months, prices fall. When housing inventory is less than 6 months, prices typically rise. For example, during the housing bubble, inventory was often less than 4 months. When the housing market crashed, inventory exceeded 12 months.

If we factor in *shadow* inventory – properties which could come up for sale because borrowers are more than 90 days delinquent on their mortgages – housing may take slightly longer to recover

4. Price Trends. Watch housing prices for signs of strength or weakness. Rising prices bode well. Falling prices typically suggest economic weakness.
5. Construction Activity. When there is a lot of existing inventory of homes for sale, builders hold back on new home constructions. Builders may also hold back if they expect economic weakness because they wouldn't want to build homes with few takers down the road.
6. Lumber. 88% of all U.S. lumber goes into housing construction. Thankfully, the lumber market attracts few speculators, so lumber prices pretty accurately reflect *real* supply and demand. If prices start to go up, we can be pretty sure that construction activity is on the rise – a good early sign of a recovery in housing.

Knowledge is power! So... now that you're considerably wiser on the factors that impact housing, you will find yourself perking up every time you see them on paper or hear some talking-head spout these numbers. Almost subliminally, you will pick up information that earlier just went over your head. My hope is that, armed with this information, you will develop a keener sense on housing related signals, their implications for the economy, and more specifically, for your portfolio, and make better investing decisions.