Your House Might Be Underwater for Years: Michael Carliner

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Aug. 16 (Bloomberg) -- Michael Carliner, an independent consultant and research affiliate at the Harvard University Joint Center for Housing Studies, talks about the prospects for the housing market. Carliner speaks with Melissa Long on Bloomberg Television's "InsideTrack." (Source: Bloomberg)

The housing market has usually led the U.S. economy into and out of recessions. It certainly led us into the latest slump.

The same can't be said of the recovery. If anything, housing today is stifling economic expansion.

Rebounds in housing have typically been driven by declines in mortgage rates. Not this time. Rates on a 30-year mortgage have dropped to about 4.5 percent -- the lowest since the early 1950s -- with little effect. Tax credits and other programs to encourage buyers have provided only a modest, temporary boost.

Other traditional measures of value, such as the size of monthly mortgage payments relative to income, show that housing is a bargain now.

None of that matters because houses are bought with an eye toward the future and in anticipation of an eventual sale.

We saw what happened in the boom in the middle of the decade -- even though prices soared, demand increased as consumers thought about how much money they would have made had they bought sooner. People bought homes, often with no plans to occupy with an eye toward selling and making a quick profit.

In short, the housing market in the middle of the decade had all the characteristics of a bubble.

Bust Time

Now we're seeing the opposite mindset. If a potential buyer believes that housing prices may fall more, then mortgage rates of 4.5 percent won't attract home buyers. Rates could even drop to zero and it might not outweigh consumers' negative perceptions.

Household expectations of future U.S. home price appreciation aren't directly measured, and are probably based on recent experience.

If expectations reflect changes in home prices over the last three years, for example, consumers seem to anticipate annual house price declines of 3.7 percent to 10.4 percent, depending on which of the various house price indexes is used.

This pessimism is heightened by increased uncertainty, because home ownership typically ties up a high portion of an individual's assets. Diversification isn't likely to offset the risk associated with home ownership.

What will it take to turn this attitude around? Only a sustained flow of favorable information is likely to alter negative perceptions of housing as an investment. The market is unlikely to provide such good news in the near term.

Declines to Come

More likely, market conditions will reinforce expectations of further price declines. Even with new home construction declining, there are too many houses for sale. And when the bounce provided by the home buyer tax credit ends, there will be renewed pressure on prices.

It's true that the inventory of new homes for sale has been reduced. But this is offset by the glut of homes currently and potentially in the market. The homeowner vacancy rate, or empty homes for sale as a share of all homeowner units, was at 2.5 percent in the second quarter of 2010. Between 1956 and 2006, the rate never exceeded 2 percent.

Moreover, Census Bureau data indicate that there was a net increase of 1.4 million single family homes in the rental market between 2005 and 2009. Although some of those homes became rentals as deliberate long-term investments, many were rented out only because the owners couldn't sell. This is a hidden source of future downward pressure on prices: Should the market show signs of turning around, many of these homes will go back on the market for sale.

Foreclosure Pipeline

This doesn't even take into account the large number of homes with defaulted mortgages in the foreclosure pipeline.

On the demand side, while mortgage rates are low, plenty of households may have trouble meeting new, stricter lending standards. Then there are those consumers who would like to buy, but whose credit records were damaged by mortgage defaults or other difficulties repaying debt. They will be locked out of the housing finance system for years, so even if they want to buy their ability to borrow is nil, further limiting potential demand.

The attempt to stimulate housing demand with tax credits wasn't foolhardy, but could only have a temporary effect. It has been criticized as merely changing the timing of home purchases. That is no doubt true. Yet, if that meant home purchases now rather than in 2012 or 2013, it would represent an excellent trade-off.

As we have seen, though, much of the effect was only to shift sales from May or June to March or April, when the credits expired. Although existing home sales data, based on closings, haven't yet shown the effect of the end of the tax credit, new home sales and contracts on existing homes have both fallen to record lows following the end of the tax credits.

The reality is that the real estate market won't fully recover until builders and consumers start believing once again that housing is a relatively safe investment with reasonable returns, and that will take some time.

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