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Written by **Bob Adelmann** on January 20, 2011

Is the Housing Market Beginning to Clear?

It's enough to "cross a Rabbi's eyes," as Tevye profoundly concluded in *Fiddler on the Roof.*

It is true that the sales of existing homes increased by 12 percent in December, but not all those homes belonged to their owners. As banks begin to clear out their REO (Real Estate Owned) inventory and investors begin to tip-toe back into the market to take advantage of foreclosures and short sales that have resulted in price declines of 30- to 50-percent or more since the housing bubble burst, it's no surprise to see such nibbling around the edges of the market. Lawrence Yun of the National Association of Realtors (NAR) said the rise in interest rates of nearly one-half of a percent in long mortgage loans has "provided some urgency" as the increase in borrowing costs "generally induces people to make a decision [to buy] earlier." Yun pointed out, however, that more than a third of those sales were distressed properties. Said Yun:

> December was a good finish to 2010…. The pattern over the past six months is clearly showing a recovery. The December pace is near the volume we're expecting for 2011, so the market is getting much closer to an adequate, sustainable level. The recovery will likely continue as job growth gains momentum and rising rents encourage more renters into ownership while exceptionally affordability conditions remain.

Aaron Smith, an analyst at Moody's Analytics, Inc. put it succinctly:

> Home sales are improving slowly, but surely. We [still] need to see job creation pick up to ensure [that] housing continues to recover. Housing clearly is still a weak spot in the economy.

Exogenous improvements in other parts of the economy, such as the drop in the number of workers filing for unemployment, an increase in an index of leading economy indicators, and some evidence of industrial expansion (at least on the eastern seaboard) as reported by the Federal Reserve Bank of Philadelphia, also build a case that, finally, perhaps the economy is beginning to turn upward.

When it was announced that building permits in December spiked up nicely in December by nearly 17 percent, some were inclined to take heart that the worst was behind them. Bob Nielsen of the NAR put a nice spin on that number: "Builders are preparing for an anticipated improvement in buyer demand in the spring buying season by pulling more permits." He failed to mention that most of the increases in permits were in California, New York, and Pennsylvania where much tighter "green" codes became effective on January 1.

In his efforts to put these numbers into perspective, Patrick Newport, U.S. economist at HIS Global Insight, concluded "Housing in the past has always been one of the key drivers getting the economy back on track. It is not going to happen this time because there is a huge glut of homes out there." Consequently, homebuilders' plans to start construction on 529,000 new homes (annual rate) are scarcely a third of the "normal" 1.5 million built in a healthy economy. Newport says he doesn't expect new construction to reach that level until at least 2014.

The report from Standard and Poor's didn't help dispel any gloom. At present there are 1.7 million homes either owned by a bank or are in some stage of foreclosure. It would take, according to S&P, 44 months at the current rate of sales to clear the market. And the "shadow inventory" hasn't been fully considered, either. Shadow inventory is defined as "properties whose borrowers are (or recently were) 90 days or more delinquent on their mortgage payments, ones currently or recently in foreclosure or that are back in the hands of the banks." The numbers are staggering: the Mortgage Bankers Association estimates that there are two million Americans seriously delinquent on their payments and there are another two million bank-owned homes.

And the banks themselves don't seem to be in any particular hurry to make loans, either. As noted in *The New American*, banks are still suffering and remain disinclined to make new loans with so many bad ones remaining on their books. As Rex Nutting at MarketWatch put it:

> If you look at the housing-starts data, you'd think housing was collapsing anew. But if you looked at the building-permits data, you'd think a strong recovery had kicked in. The truth is someplace in the middle….

Building activity is still down more than 75 percent from the bubble years, and is only a third as strong as it was in the late 1990s. [Housing] is depressed, however you look at the data.

It's going to be a long slow slog to daylight as reluctant buyers and desperate sellers continue to wait for prices and other market conditions to improve sufficiently for them to finally clear the market.