Housing: Positive Growth Expected for 2016

Douglas M. McCoy: Director of the Benecki Center for Real Estate Studies, Kelley School of Business, Indiana University

The single-family housing sector found its way back to stable growth in 2015, while the multi-family housing sector continued its strong run. Consumer confidence, job growth and low interest rates are the primary drivers that bring potential homebuyers to the housing market. Considering these factors, along with an important projected increase in new single-family inventory, the single-family housing market is forecasted to continue on a positive path in 2016.

For example, the National Association of Realtors forecasts that existing home sales will increase 3.5 percent from 2015 levels, and new single-family home sales will increase 29.3 percent nationally (see **Table 1**). Housing starts are projected to increase 17.2 percent, with single-family units increasing 23.2 percent and multi-family units up 6.5 percent. Median home prices for both existing and new homes are expected to increase 4.1 percent.

Looking closely at these numbers one sees the importance of new home sales in 2016 and the critical need for new housing starts. The excess of existing home inventory at favorable pricing, resulting from the recent economic downturn, is mostly gone. To achieve strong numbers in 2016, new inventory must be added. The U.S. is currently experiencing a housing shortage, but home builders have been cautious in bringing new homes to market even while low interest rates have persisted. The good news is that builder confidence has been "steady or increasing," according to a monthly survey conducted by the National Association of Home Builders.

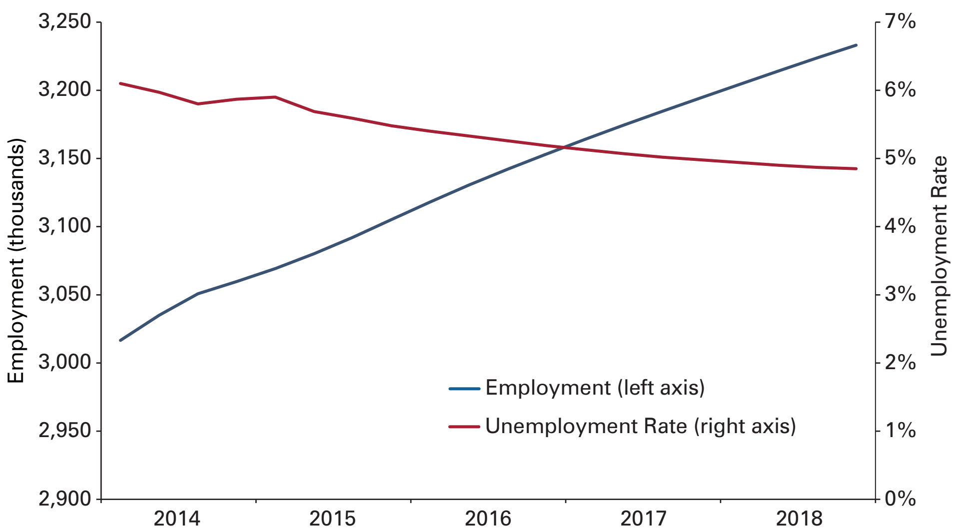
The likelihood of continuing improvement in the single-family housing market in our nation's cities and towns largely depends on job growth and how wages compare to that locale's housing prices. When differentiating single-family markets across the country, it is important to remember that a key factor of mortgage qualification is a household's monthly gross take-home pay relative to its payment for housing costs (the total of the mortgage payment, real estate taxes and home insurance). Holding all other things equal, communities with positive job growth and a favorable margin between wages and housing costs are more likely to experience a more stable single-family housing market than communities with narrower house affordability margins.

Table 1: National Housing Outlook

	History		Forecast	
	2013	2014	2015	2016
Home Sales (thousands)				
Existing Home Sales	5,090	4,940	5,284	5,468
New Single-Family Sales	429	439	527	682
Home Sales (% Change - Year Ago)				
Existing Home Sales	9.2	-3.0	7.0	3.5
New Single-Family Sales	16.3	2.3	20.1	29.3
Median Home Prices ($ thousands)				
Existing Home Sales	$197.1	$208.3	$220.3	$229.5
New Single-Family Sales	$268.9	$282.8	$288.9	$300.6
Median Home Prices (% Change - Year Ago)				
Existing Home Sales	11.5	5.7	5.8	4.1
New Single-Family Sales	9.7	5.2	2.2	4.1
Housing Affordability Index*	177	164	162	129

* The housing affordability index measures the ability of a family earning the median income to purchase a median-priced home. Higher index values indicate increased affordability.
Source: National Association of Realtors, "U.S. Economic Outlook: October 2015"

Figure 1: Indiana Employment and Unemployment Rate Forecast, 2014 Q1 to 2018 Q4



Source: Indiana University Center for Econometric Model Research and Indiana Business Research Center (released in June 2015)

Thus, a less positive trend for the housing market nationally is housing affordability. The National Association of Realtors projects a change in this index from 162 to 129 from 2015 to 2016. Because employment is expected to stay strong and interest rates—while increasing—remain relatively attractive, this trend shouldn't negatively impact 2016.

Another potential concern is the existence of bubbles in particular submarkets. In areas where demand was strong and supply was constrained, values may have increased to an unrealistic level considering the extended period of attractive mortgage rates.

How Does the Indiana Housing Market Fare with This Reasoning?

In terms of employment, Indiana is experiencing very positive trends. According to the Indiana Business Research Center and the Center for Econometric Model Research, Indiana's employment growth will continue at a pace of 43,000 jobs per year through 2018. In addition, unemployment is expected to decline during this period and Hoosier personal income will rise faster than the nation (see **Figure 1**).

In terms of existing home sales, Indiana beat the nation by 3 percentage points for the 12 months ending June 2015. In contrast, during this same period, Indiana lagged the nation in home price appreciation by 3.3 percentage points and in residential building permits by 13.2 percentage points (see **Table 2**). Considering these results together, they are probably the consequence of Indiana having a larger supply of existing inventory carrying over from the downturn—a positive for Hoosier homebuyers compared to others around the country that were facing a shortage of inventory.

Table 2: Mid-Year Comparison of Indiana and U.S. Housing Markets

	U.S.	Indiana
Existing Home Sales, July 2014 to June 2015, Year-over-Year Change	3.2%	6.2%
House Price Appreciation, 2014 Q1 to 2015 Q1	5.8%	3.5%
Residential Building Permits, July 2014 to June 2015, Year-over-Year Change	10.3%	-2.9%
Foreclosure Rate, 2015 Q2	2.1%	2.3%
Housing Affordability Index, 2014*	164	239

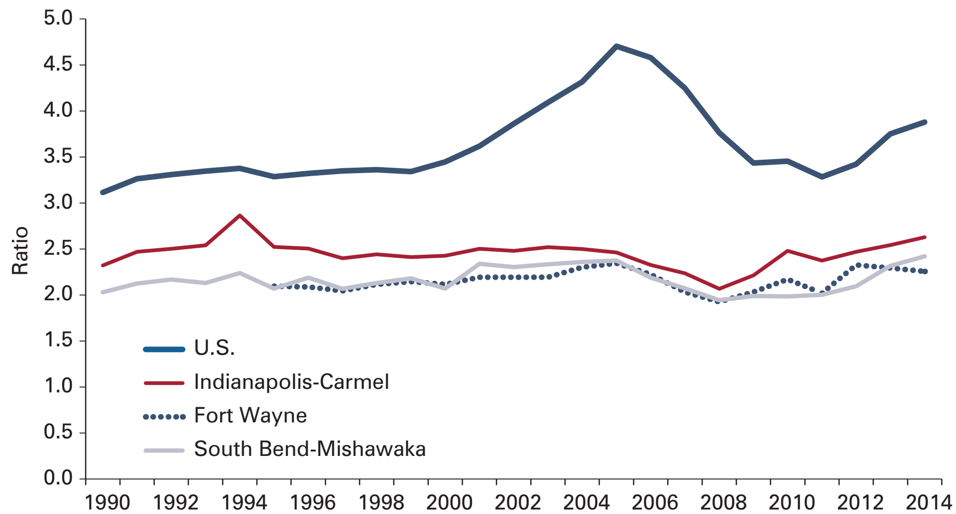
* The housing affordability index measures the ability of a family earning the median income to purchase a median-priced home. Higher index values indicate increased affordability. The value shown for Indiana is for the Indianapolis metro.
Source: IBRC, using data from the Indiana Association of Realtors, National Association of Realtors, Federal Housing Finance Agency, U.S. Census Bureau, Mortgage Bankers Association and CoreLogic

Table 3: Indiana Housing Overview

	September 2014	September 2015	Percent Change	Year-to-Date 2014	Year-to-Date 2015	Percent Change
Closed Sales	6,958	7,282	4.7%	56,752	61,509	8.4%
Median Sales Price	$128,000	$132,500	3.5%	$126,500	$134,000	5.9%

Source: Indiana Association of Realtors

Figure 2: Ratio of Median Sales Price to Median Household Income, U.S. and Select Metro Areas



Source: Joint Center for Housing Studies at Harvard University, using data from Moody's Data Buffet®

According to the Indiana Association of Realtors, Indiana's year-to-date 2015 closed sales is trending higher than 2014, while its median sales price increased 5.9 percent to $134,000 (see **Table 3**).

When looking at housing costs, Indiana typically has stable housing values. That is, Indiana homeowners usually experience small swings in value as economic conditions and world events take hold year to year.

While Indiana trailed the country in home price appreciation over the past year, as seen in **Table 2**, its housing affordability remains attractive, with an affordability index value of 239 for the Indianapolis metro area, as interest rates remain low.

Considering the ratio of sales price to income has remained stable (see **Figure 2**), it follows that Indiana generally provides a stable job base and a good wage relative to housing costs.

If Indiana's economy continues its positive run through 2016, with more jobs and better wages, it will mean positive results for the housing market. On the other hand, if job growth slows, wages stagnate or interest rates rise more than expected, Hoosiers will still fare well compared to less stable parts of the country.

Summary

Overall, the 2016 single-family housing market is looking positive for Indiana and the country. Job growth is improving and other economic fundamentals are positive. Thus, consumer confidence should be high. 2016 should see the single-family housing market remain strong for both Indiana and the nation.

Indiana's Outlook for 2016

John Lynch: Research Associate, Indiana Business Research Center, Kelley School of Business, Indiana University

Timothy F. Slaper, Ph.D. Director of Economic Analysis, Indiana Business Research Center, Kelley School of Business, Indiana University

Last year, in the fall of 2014, when we were forecasting the year ahead, the world and nation were being contorted by several forces. The Ebola outbreak in West Africa caused panic and galvanized a global response. There were border confrontations between Ukraine and Russia reminiscent of the worse Cold War tensions. And the wars in Afghanistan, Iraq and Syria provided a constant dental-drill drone. The engines of global economic growth—the BRICS (Brazil, Russia, India, China and South Africa)—were slowing, and no one was looking to Europe to provide any buoyancy to the global economy.

Domestically, the politics of race once again became part of the country's consciousness, daily conversation and recriminations. The Republicans took control of the Senate in midterm elections. Closer to home and just a few months later, Indiana gained unwanted attention with the passage of the Religious Freedom Restoration Act, which many believed would place the state at an economic disadvantage.

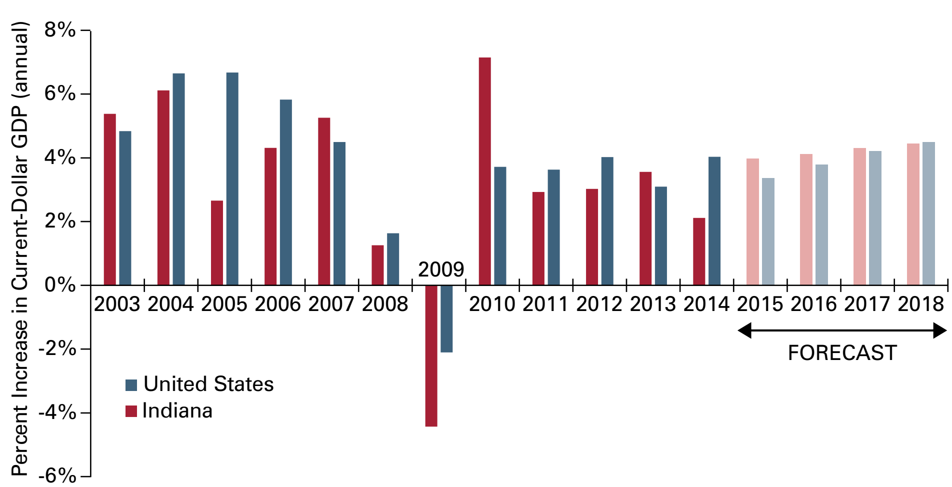
Last fall, we expected economic growth (measured in current dollars) to be close to 4 percent in Indiana for 2015, slightly higher than the (then) expectations for 2014. Expectations can disappoint. Turns out that 2014 did not end as well as anticipated, with Indiana's economic growth at 2.1 percent, nearly half of the national number of 4.0 percent. Indiana is likely to reverse that trend in 2015. At the time of this writing, we forecast current-dollar economic growth to be 3.7 percent in Indiana compared to 3.4 percent nationwide.

GDP Growth

Indiana has trailed the U.S. in GDP growth for three out of the past four years, but is expected to grow at a slightly faster rate than the U.S. through at least 2017. **Figure 1** shows the relationship between Indiana and U.S. GDP growth since 2003.

As GDP is an aggregate of the production totals from many different sectors with mixed performances, some sectors prosper while others don't. In 2014, the increases in manufacturing of both durable and nondurable goods outpaced the

Figure 1: Change in Indiana and U.S. Gross Domestic Product



Source: IBRC, using U.S. Bureau of Economic Analysis and Indiana University Center for Econometric Model Research data