

## U.S. Housing Market Forecast: No Gain, More Pain

By Don Miller

The U.S. housing market is already being pounded by the “perfect storm.” And the outlook for 2009 is for the stormy weather to continue – and probably to get worse.

As if a locked-up credit market and tidal waves of foreclosures weren’t already enough, we’re now watching unemployment climb and consumer confidence plunge.

But even when the housing market is taking on water, there *are* ways to stay afloat. Indeed, investors nimble enough to maneuver can even *make* money.

The watchword on this market, though, is *caution*. If an investor decides to test the waters, beware of the extraordinary financial undertow. Here’s a look at what’s happening now, and what the implications there are for investors in the New Year.

### **Rising Unemployment Feeds into Sinking Demand**

The grim reality is that skyrocketing unemployment is a major threat to the recovery of the U.S. housing market. And consumers shackled with record levels of debt are unlikely to ride to the rescue this time.

Since this recession is expected to be long and deep, economists are projecting high rates of unemployment. And the latest statistics released by the U.S. Labor Department show the crucial jobs market deteriorating at an alarmingly rapid pace.

The U.S. unemployment rate jumped to a 14-year high of 6.5% in October as another 240,000 jobs were cut – an uptick from 6.1% in September and the 10th month in a row the jobless rate has risen. Most forecasts are calling for unemployment to spike as high as 8.5%, which would be the worst showing since 1980.

A staggering 1.2 million jobs have disappeared. More than half the decrease occurred in the past three months alone, *Money Morning* reported in its “Outlook 2009” series economic forecast story. Even worse: A year ago, job cuts were concentrated in the financial-services and homebuilding sectors. Now they’re rising across the board; virtually every part of the economy is feeling the squeeze.

For instance:

- U.S. automaker Chrysler Corp., one of Detroit’s wheezing “Big Three,” is laying off 25% of its white-collar work force of 18,500.
- Appliance maker **Whirlpool Corp. (WHR)** recently announced it would cut 5,000 jobs to cope with declining sales.
- Worldwide shipping giant DHL, a subsidiary of Deutsche Post AG, is laying off 9,500 people, and threatening to close its U.S. distribution center.

- Onetime Internet search giant Yahoo! Inc. (YHOO) plans to let 1,100 workers go – on top of the 1,000 already jettisoned in January – the result of several botched merger attempts.
- Ailing banking giant Citigroup Inc. (C) heaped more bad news on the financial sector, announcing whopping 50,000 layoffs in the next 12 months.

Layoffs of this magnitude are more than a mere shot across the bow of the housing market – they’re actually a direct hit amid ship. People who are unemployed cannot buy homes. Period. But even consumers who are afraid that they might be joining the jobless ranks are loath to take on the added risk – making them unlikely candidates to buy a new home.

### **Foreclosures Still Rising**

As unemployment climbs, foreclosures will continue to multiply. That only exacerbates an already unappealing combination – more houses being dumped onto the market even as the pool of potential buyers grows increasingly smaller.

RealtyTrac Inc. reported that more than 81,000 homes were foreclosed on last September – a 71% increase from the same period just a year ago. For 2008, foreclosures rose to a record 765,558.

“I wouldn’t be surprised to see foreclosures increase as the economy slows down,” said Rick Sharga, RealtyTrac’s vice president of marketing. “The people living paycheck to paycheck are at risk if they lose their jobs. It will cause more people to lose their homes.”

And while foreclosure volumes are outpacing projections, the cumulative losses by banks on bad mortgages may have yet to hit their books. Since loan losses don’t get recorded until the property is sold, it’s likely there’s a lot of bank-owned inventory that hasn’t been unloaded – meaning there may be more foreclosures out there investors don’t yet know about.

“We are in uncharted waters,” said Brian Bethune, an economist at research firm Global Insight (IHS).

Making the waters even rougher was the decision by Standard & Poor’s Inc. (MHP) to cut the ratings on \$34.1 billion of “Alt-A” residential loan packages that had been issued in 2006 and 2007. Alt-A mortgages are those written with little or no documentation, i.e., without proof of income or assets. Even worse, S&P put an additional \$351.7 billion of Alt-A securities up for possible review reflecting the rating company’s “belief that further declines in home sales will depress prices further and push loss severities higher than we had previously assumed.”

On top of all that, record numbers of borrowers are already “underwater,” or “upside down” on their mortgages, making it more attractive for them to default by simply walking away, than to hang around and drown.

About 18% of homes nationwide are now “upside down,” according to a report from First American CoreLogic. Almost two-thirds of those homes are in just seven states: Arizona, California, Florida, Georgia, Michigan, Nevada and Ohio. In Mountain House, Calif., an unincorporated planned housing community located in the foothills of the Diablo mountain range, the housing crisis right now has nearly 90% of the homeowners owing more on their houses than they are worth – the highest percentage in the country, *The New York Times* reported on Nov. 10. The average homeowner is underwater by \$122,000, the newspaper said.

Other areas are suffering almost as much: In Nevada, alone, borrowers owed a whopping 89% of the value of their homes.

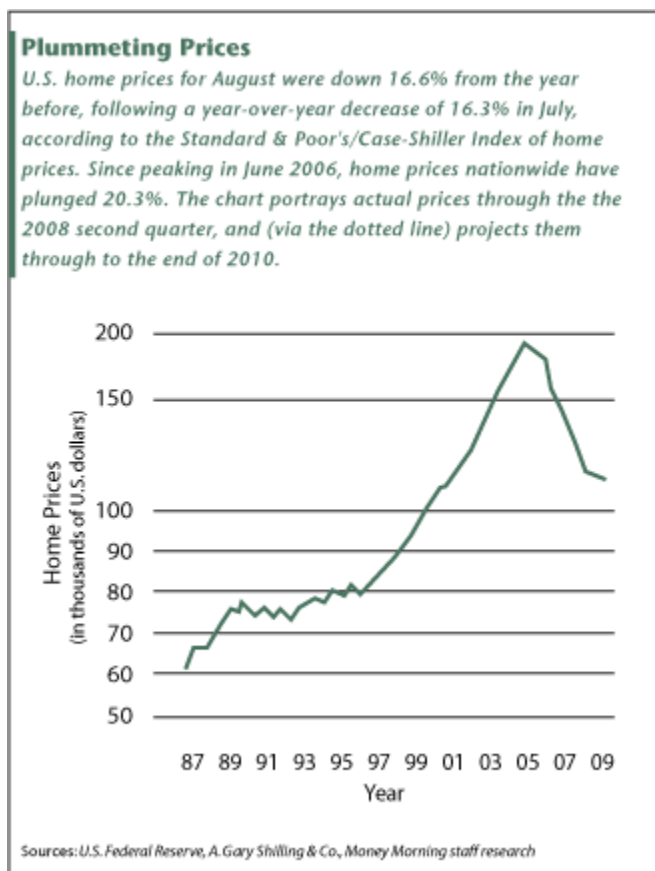
Despite such dramatic anecdotes, this housing slump is nationwide in nature. It’s more severe than any other such downturn since World War II, mostly because of the risky lending practices that inflated the real-estate bubble in the first place.

### **The Downturn in Housing Prices**

Meanwhile, while unemployment rises, the downward spiral in housing prices is gaining momentum.

“The No.1 thing that drives housing values is incomes,” said Todd Sinai, an associate professor of real estate at the Wharton School at the University of Pennsylvania. “When incomes fall, demand for housing falls.”

The S&P/Case-Shiller Index of home prices plunged 16.6% in August from the year before, following a 16.3% drop in July. The index has fallen every month since January 2007 (See accompanying chart, “Plummeting Prices.”).



Prices were lower in all 20 of the major cities the index covers, with Phoenix and Las Vegas down nearly 31% from last year.

Nationwide home prices have fallen 20.3% since peaking in June 2006. And the skid isn't over.

**According to Fitch Ratings Inc.**, U.S. home prices will fall another 8% to 10% before they show signs of stabilizing. According to a Fitch forecast, the peak-to-trough price decline will be 30%.

And still one other reliable indicator of housing prices seems to confirm that, in many cities, home prices still have further to fall.

According to analysis by Moody's Investors Service (MCO), Miami houses are right now priced at about 22 times annual rental income – versus an average of just 15 over the past two decades. This suggests that a home currently priced at \$350,000 is actually worth only \$238,600 – meaning the price would have to drop 32% to reach the fair-value point.

### **The Forecast for 2009: More Pain Before Any Gain**

No matter what happens in the U.S. housing market, until a large inventory reduction takes place, housing prices will not stabilize.

In a recent *Forbes* magazine column, A. Gary Shilling, president of an economic consulting firm of the same name, said the worst is yet to come. Says Schilling: “Excess inventory, the mortal enemy of prices, now amounts to 1.8 million homes, which is a huge number relative to the net demand (new families minus departures due to deaths and moves to nursing homes) which is only 1.5 million a year.”

And one of the architects of the U.S. housing debacle – former U.S. Federal Reserve Chairman Alan Greenspan – is also downbeat: “At a minimum, stabilization of home prices is still many months in the future,” Greenspan said in an October speech.

The question that needs to be answered, then, is this: In the current atmosphere, does anyone believe we actually need homebuilders to add even one new home to the market?

*Don Miller is contributing writer to Money Morning. The Money Morning free e-letter is published daily by Monument Street Publishing, and is part of the company's Money Map franchise. For more information please e-mail*

*customerservice@money Morning.com, phone 888-384-8339, or visit  
www.money Morning.com.*