

Kansas City and the Housing Crunch

Overview

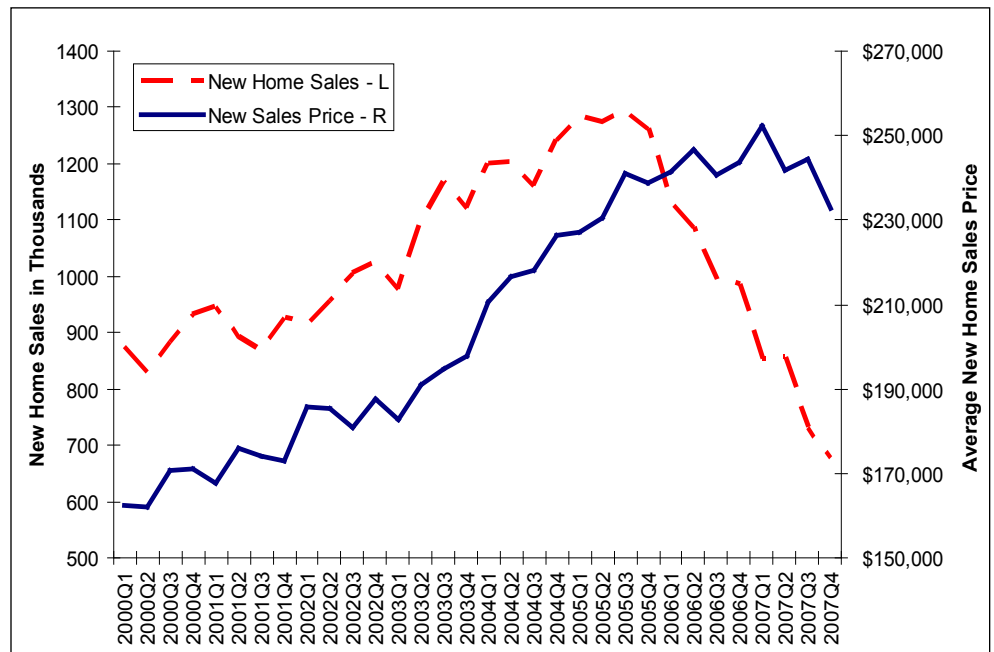
Seemingly every economic recession or slowdown has a scapegoat.

The 2001 recession was blamed on the bursting dot-com bubble. Subsequent lackluster economic performance was blamed on the Iraq War or concerns over the Enron accounting scandal. As of this writing we have not yet dipped into another recession, but economic growth has certainly slowed to the point where many economists across the country are forecasting a 2008 recession. Undoubtedly much of the blame for this recession, if it occurs, will fall on the housing market.

Housing traditionally has been seen as a safe investment. Housing was generally steady. It did not appreciate in value rapidly, but it also rarely lost value. So after investors were stung by the dot-coms, many sought a safer place for their money and housing fit the bill.

At the same time, interest rates (including mortgage rates) dropped lower as the Fed tried to lessen the impact of the economic slowdown. This inspired many people who were considering home ownership to go ahead and enter the housing market. Some with riskier credit scores were enticed with low-interest adjustable rate mortgages (ARMs) or interest-only loans.

Figure 1. National New Home Sales and Prices, 2000-2007



Source: www.economy.com

With home values going up and up, even these riskier mortgages seemed safe, because the home could always be sold in the future for a profit.

Figure 1 illustrates the steady increase in new home sales and new home prices between 2000 and 2005. By the end of 2005 however, it became apparent that the increases in sales and price could not go on forever. Adjustable rate mortgages were beginning to be adjusted upwards, putting many families in a financial bind. Some homeowners were forced to put their homes back on the market, since they could not afford the new monthly payments. This flood of homes to market lessened demand for new homes and in some cases led to a drop in home values as seen from 2005 to 2007.

Kansas City's Housing Story

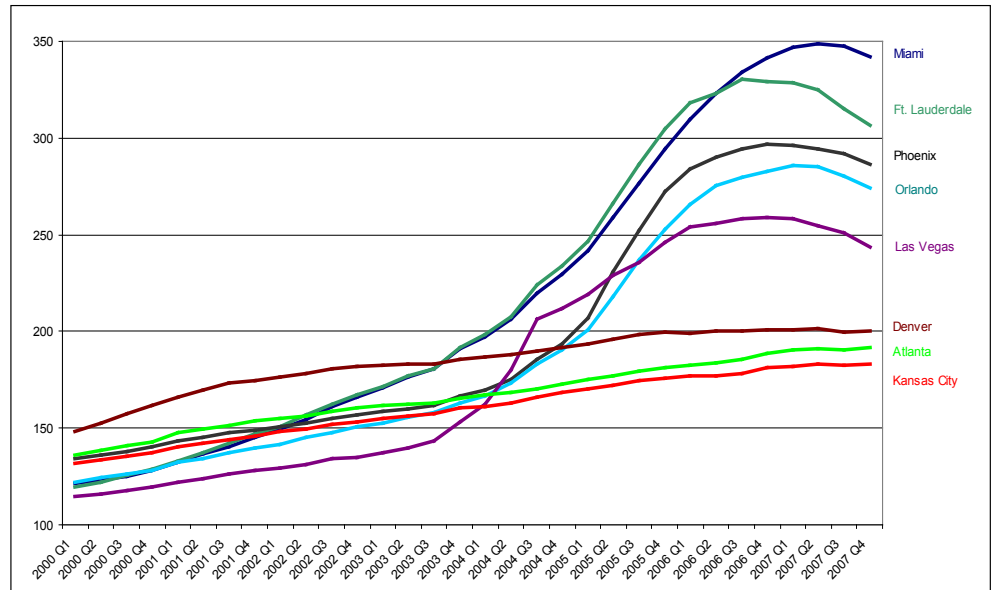
While housing prices in Kansas City have increased steadily since 2000, the increase was modest relative to some other metro areas.

Figure 2 shows Kansas City's housing price change since 2000 relative to some sun-belt metropolitan areas that saw dramatic increases in home values. Kansas City's home prices increased on a par with these other metros until 2004, when home prices skyrocketed in places like Miami, Phoenix, Las Vegas, Fort Lauderdale and Orlando. Since the fourth quarter of 2006, housing prices have stabilized or, in some cases, started to decline.

Kansas City, Denver and Atlanta saw more modest price increases from 2000 through 2006, and as a result, they have not experienced as significant a decline in prices since 2006 as the other metros.

A closer look at recent Kansas City area data from the Regional Association of Realtors shows that

Figure 2. OFHEO Housing Price Index (1995=100)

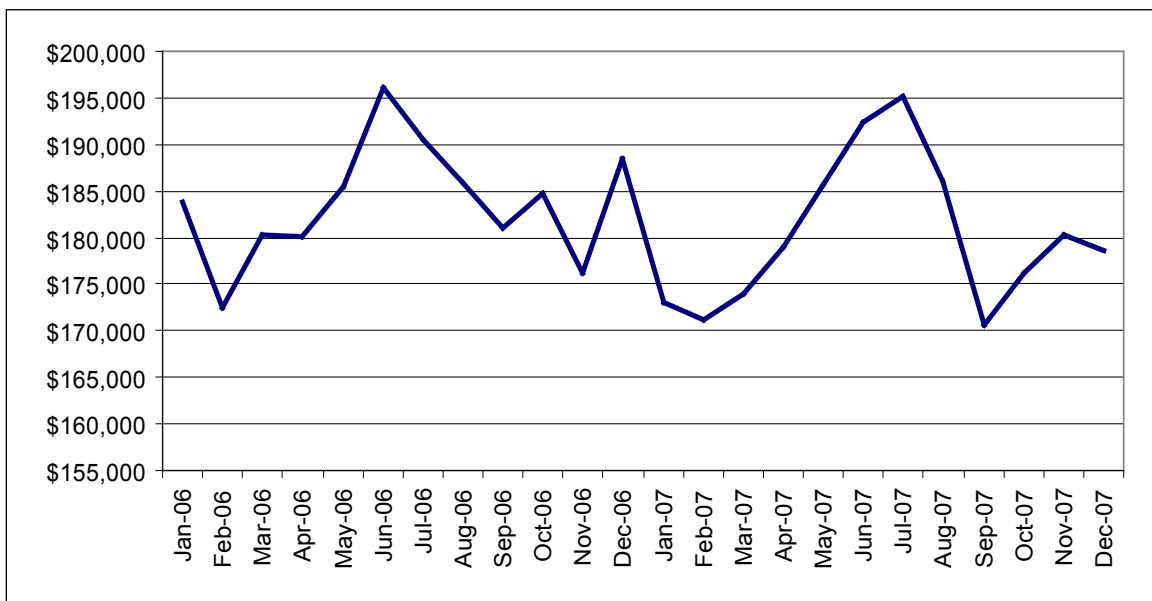


Source: Office of Federal Housing Enterprise Oversight (OFHEO)

trends have been overall stable over the past two years (Figure 3).

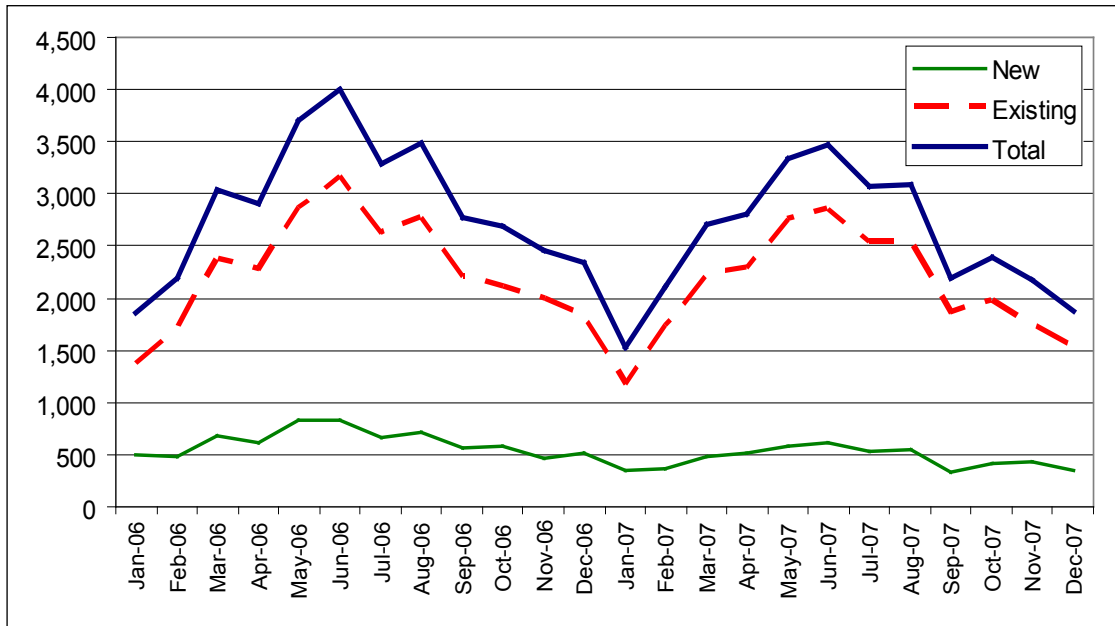
Average home sales prices peaked during the more active summer months but on average stayed around the \$180,000 mark. An annual growth rate of around 4 percent was typical between 2000 and 2006.

Figure 3. Average Home Sale Price, Kansas City MSA



Source: Kansas City Regional Association of Realtors

Figure 4. New, Existing and Total Home Sales, Kansas City MSA

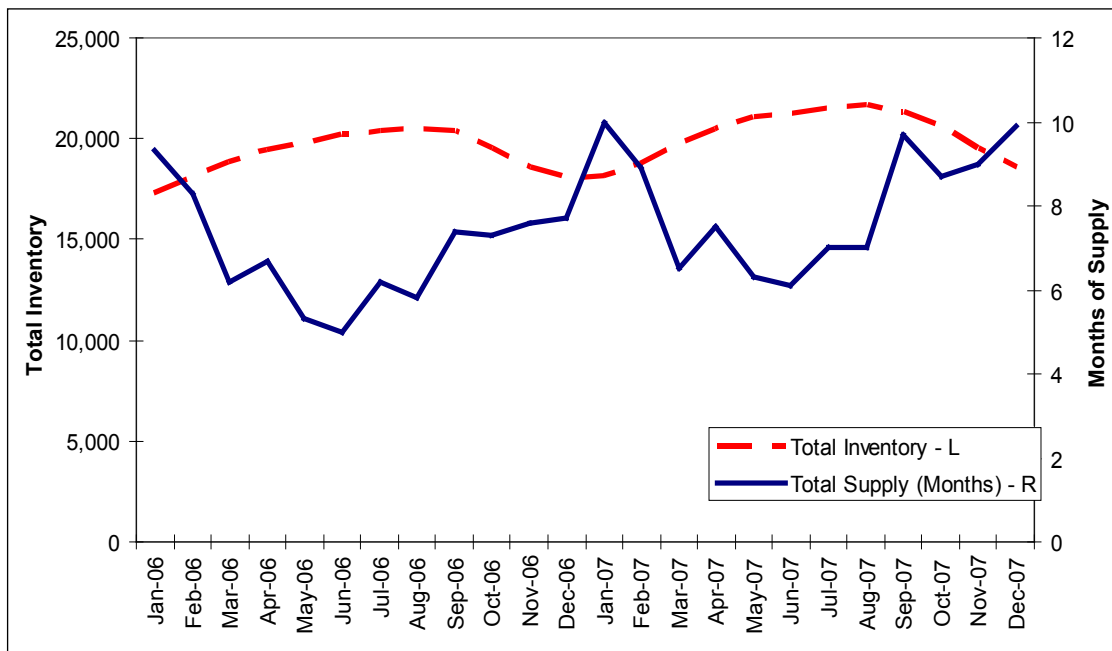


Source: Kansas City Regional Association of Realtors

The same summer-month spikes are evident when looking at home sales (Figure 4). Overall there were roughly 4,000 fewer total home sales in 2007 than there were in 2006. The decline was fairly evenly split between new home sales and existing home sales, with both categories falling by about 2,000 sales in 2007.

Figure 5 shows that the inventory of homes for sale in the local market has been fairly stable at around 20,000 units. Currently, there is an estimated 10-month supply of homes available on the market.

Figure 5. Total Home Inventory and Housing Supply, Kansas City MSA



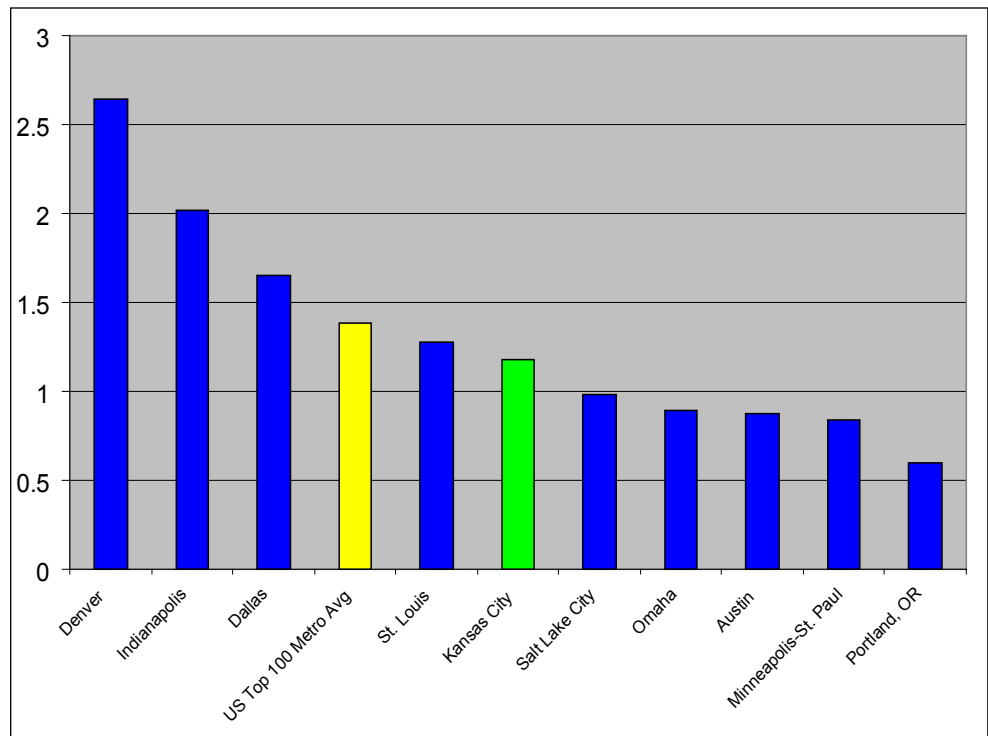
Source: Kansas City Regional Association of Realtors

The housing crunch has led to an increase in foreclosures nationwide. According to RealtyTrac, foreclosure filings increased 75 percent between 2006 and 2007.

Again, the sunbelt areas like Las Vegas, Phoenix, Florida and California saw high numbers of foreclosures. Other areas like Ohio and Michigan also saw high foreclosure rates.

Kansas City's foreclosure rate of 1.17 percent was below the average rate for the largest 100 metros in the country. When ranked against peer metros, Kansas City's foreclosure rate was in the middle of the pack.

Figure 6. 2007 Foreclosure Rate
(Percent of properties that were in some stage of foreclosure in 2007)



Source: RealtyTrac

Conclusion

It appears that Kansas City will avoid a bursting housing bubble as prices never accelerated to the point where home values were out of line with reality. This does not mean we will be isolated from the seemingly imminent economic slow-down. Housing market concerns across the nation will slow the national economy, which in turn will slow Kansas City's economy.

The housing market will eventually recover, but it may take some time. First, the threat of recession will need to abate. Even with lower home prices, potential buyers are reluctant to commit to a new home until they are more confident in their economic future.

Recent action by the Federal Reserve (lowering interest rates) and congress (tax rebates) should help boost economic spirits.

Once the economy is again on solid footing, buyers may enter the housing market to take advantage of the lowered home prices. The return of buyers may be gradual, as lenders are going to be more selective in evaluating credit risks. Eventually, housing inventories (currently at a 10-month supply) will be brought down and we should see the housing market begin to grow more normally again in 2009.