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Where Are Home Prices Going? Risks Lurk Despite Gains

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Housing isn't out of the weeds yet. A shadow inventory of foreclosed homes remains and is apt to drag on prices. Here a row of vacant new homes sits... View Enlarged Image

Are housing prices finally rebounding for good, or are recent upticks just seasonal gains, with more home price pain to come?

Market watchers are weighing in with their pluses and minuses. But most say any recovery in the housing market will be uneven and slow.

"We're out of the nose-dive, but I wouldn't build any great expectations for prices soaring," said Lanny Baker, CEO of **ZipRealty Inc.** (ZIPR) "It's going to be a long slow trudge."

Some economists got excited when Standard & Poor's/Case-Shiller index data showed home prices rising monthly in both April and May. The index of 20 metro areas lifted 0.9% in May, seasonally adjusted, in Tuesday's report. That's after a 0.7% rise in April. Year over year, prices are still declining but at a slower rate, down 0.7% in May and 1.9% in April.

"With May's data, we saw a continuing trend of rising home prices for the spring," David Blitzer, Index Committee chairman at S&P Dow Jones Indices, said in a statement.

In April and May even hard-hit cities such as Phoenix and Miami showed improvement in the index, which tracks repeat sales of existing single-family homes. And the median price of a single-family home was $190,100 in June, up 8% from a year ago, according to the National Association of Realtors.

Other positive signs for housing? Rents are rising again, making buying more attractive to people who want to own instead of rent and to investors buying rental properties.

"Prices are very attractive relative to interest rates, and in 85% of markets it is better to own than to rent," Richard Green, director of the University of Southern California Lusk Center for Real Estate, said in a statement.

Chipping At Distress

Improved rents also help distressed owners rent out their homes vs. short-selling or defaulting on underwater properties, says Daren Blomquist, vice president at foreclosure follower RealtyTrac.

Reduced levels of homebuilding, and housing formation going back up to normal, are factors helping the market eat through foreclosure inventory, Green said in an interview.

Some inventory may never come to market, as banks opt to tear down properties in outlying areas that "have no value," he said. It's already happening in Detroit and Cleveland. Green says it may occur in parts of California and Arizona, too.

Housing will go through a "sawtooth recovery," Green predicts.

Big risks to a housing price recovery include shadow inventory, pent-up selling demand, slowing economic growth and a large volume of distressed sales.

Shadow Dwellings Loom

The "shadow inventory," the number of homes in or approaching some stage of foreclosure but not currently listed for sale, is still a "significant problem," Blomquist said.

He says RealtyTrac estimates that nationwide about 80% of June's roughly 629,000 REO properties — "real estate owned" by banks due to repossession — are not currently listed for sale.

Adding homes in the foreclosure process not for sale — but apt to be — shadow inventory rises to 950,000, RealtyTrac estimates. Factoring in the number of seriously delinquent loans likely to become a short sale or repossession brings the shadow inventory to 1.95 million. That's at least a two-year supply at the current sales pace of foreclosure homes, RealtyTrac notes.

Along with the huge inventory of distressed properties lurking, Blomquist also believes that there is "pent-up inventory" from regular sellers who are waiting for any sign of a price uptick to put their homes on the market.

Distressed-home sales will continue to push down on prices, he says.

"In the first quarter 26% of all sales that occurred were REOs or short sales. As long as we have such a high percentage of distressed sales I don't think you can see a sustainable recovery in home prices," Blomquist said. He adds that for the market to normalize, distressed sales need to get below 10% of total sales.

Seasonal effects and skewed statistics may be boosting home prices.

ZipRealty's Baker says some of the Case-Shiller index improvement in April was simply due to an overall increase in the size and price of the homes sold in the spring. It's often the strongest homebuying season, he notes. Buying often slows into late summer and fall.

However, banks must continue to move their REOs and they don't slow the volume coming onto the market even though buying slows. So as we move into fall, Baker says, there will be more supply — and more supply of lower-priced distressed homes — thus putting downward pressure on home prices.

It's not all doom and gloom. Baker says three markets look "rock solid encouraging": the San Francisco Bay Area; Austin, Texas, and Denver. Boston, Philadelphia and the Northeast look "OK, but not as good." Phoenix, Orlando, Fla., and Las Vegas have gotten a lot of attention recently — but in those markets "the pendulum is still swinging."

Real estate analysts may be divided on the future of the Phoenix market, but real estate agent Andrew Robb of RE/Max Renaissance Realty in Peoria, Ariz., is very bullish.

"On virtually every property I call on now, I ask, 'How many offers do you have on this property and how many cash offers do you have?' ... It's a whole new set of questions," he said, adding that buying in Phoenix and nearby is dominated by U.S. and foreign investors.

Many homeowners, in denial about how much their homes are worth, overstate the value — and that may be aiding the market. New York University's Furman Center for Real Estate and Urban Policy is doing a study about the market value owners place on homes.

"People tend to psychologically benchmark the value of their house to what they paid for it ... (which) makes it difficult for people to acknowledge losses," said center co-director Ingrid Gould Ellen.

Is Ignorance Bliss?

The mindset may be one explanation for why the market hasn't seen more strategic defaults — homeowners deciding to walk away from mortgages they can still afford to pay when the value of the home is less than what's owed.

If that's keeping a lid on strategic defaults, it means one less factor pushing down on home prices.

The real estate center at NYU also tracks New York City real estate sales. Ellen says home prices there are up on average 3.5% in the first quarter of this year vs. a year earlier. But she says that on average, prices are "still off 25% from their peak," and sales volume is still down.

An improved economy, high rents and strong demand from foreign buyers aid that market, she says.