Housing Prospects in 50 States

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Executive Summary

After separating distressed sales, prices of standard house sales stabilized in 2011. Most estimates of housing price declines in 2011 are based on combining distressed and standard sales.

Stable standard sales prices, and rising house values in many states, have created more housing development opportunities than many analysts realize.

Foreclosures remained high in 2011, although down from 2010, and are projected to remain high in 2012. But in most housing markets, distressed sales may not reduce prices of standard sales significantly. These conclusions are based on examining price trend data from CoreLogic, Zillow, Case-Shiller, and FHFA and distinguishing distressed from standard sales in Federal Reserve and local real estate association reports.

Sales price differences between distressed and standard sales ranged from 1 percent in Las Vegas to 72 percent in Charlottesville (Table 15). A number of estimates have placed the national average between differences of 15 and 20 percent. In a national sample, Zillow found standard sales prices were 28 percent higher than distressed sales prices.

These standard sale price trends are consistent with home owners' estimates that house values by 2010 were on a path to be near pre-housing bubble norms of ratios between house values, family incomes, and rents in most states by 2012 (Tables 1, 2, 3, and 5).

Census data reveal a major surprise, given the claims that house values have plummeted nationwide. According to U.S. Census data, median value of owner occupied housing was stable or increased relative to family incomes in 29 states from 2007 to 2010. House values may have been supported by high percentages of home owners with no mortgage debt (Table 6). This confidence in home values by residents' estimates in these states should support steady and perhaps rising consumer spending.

In 2010, three categories of state housing markets can be discerned in census data.

1) High Foreclosure States. The four states with the highest foreclosure rates from 2007 to 2010—Nevada, Florida, Arizona, and California—were returning rapidly to pre-housing bubble norms of house value to family income and house value to gross rent relationships, and foreclosure rates in those states have declined significantly, but remained high at one foreclosure per 65 housing units (Table 5).
2) Volatile States. Seventeen Volatile States continued in 2010 to have high house values to family incomes and rents, and foreclosure rates tended to have risen due to unemployment,

although in high income states foreclosure rates remained low at an average one foreclosure per 350 housing units (Table 5).

3) Stable and Improving States. Twenty-nine states had either stable (10 states) or increasing (19 states) house values relative to family incomes from 2007 to 2010, contrary to national average trends. Many of these states had modest increases in house values from 2000 to 2007 and continued to have stable or rising house values since 2007. Foreclosure rates were low at one per 578 housing units (Table 5).

These trends support prospects for housing construction to increase and for sales prices to be stable or increase in a majority of states in 2012 and 2013. Negative housing headwinds will continue from substantial foreclosure rates in some states and from on-going high unemployment.

In addition, prospects for renewed housing construction will be influenced by age demographic changes and by changes in location preferences which have emerged since 2000.

The demographic challenge concerns the increase in older households and the decrease households in prime home buying years. From 2001 through 2010, households headed by someone 55 and over increased by 8.9 million. Conversely, the number of households headed by someone 30 to 45 decreased 3.7 million. Eighty percent of the 55 and over households are home owners. Fifty-eight percent of the age 30 to 45 households are home owners on average, reading about 75 percent owner occupants by age 45 (Table 10).

Therefore, more 55 and over households lead to more existing houses for sale. Fewer age 30 to 45 age households leads to fewer buyers. These demographic changes, in addition to foreclosures, have been contributing to excessive inventories of houses for sale, many of them in outer suburbs.

On the other hand, changes that have occurred in residential location preferences have opened more infill development opportunities. Since the mid-1990s, family incomes have gone up in old neighborhoods in cities and inner suburbs relative to incomes in middle aged neighborhoods. Since 2000, per capita incomes of non-Hispanic whites have averaged five to eight percent higher in central cities than in suburbs (Table 13). In a majority of central cities in large metropolitan areas, per square foot sales prices of housing higher in 2011 than in their metropolitan areas, higher on average by 17 percent (Table 12).

These altered age demographics and greater interest by middle income residents in convenient accessible locations have changed real estate development markets from the norms before the housing bubble. Cheap money that fueled the housing bubble obscured changes in location preferences. But since the housing collapse, foreclosure rates have been higher in low density outer suburbs than in most central cities and inner suburbs due to low demand for houses in outer areas.

Numerous development opportunities have emerged from changes in demographics and location preferences. To take advantage of these opportunities, lenders, developers, national regulators and secondary mortgage purchasers, and local officials should become more aggressive and nimble in seeking out the new opportunities that have emerged.

Introduction

Two momentous economic questions for 2012 are: When will housing prices stabilize and begin to increase? When will housing construction and construction employment increase?

Economists' answers typically are vague, include expressions of frustration, and refer to obvious obstacles, such as: housing prices will stabilize when employment increases, foreclosures diminish, and the large inventory of foreclosed houses is worked through. Unfortunately, employment increasing is a key part of the answer. Most economists believe that low housing activity is the largest remaining drag preventing employment from rebounding vigorously.

There is no easy way out of this dilemma. But the standard interpretation of obstacles to housing revival, while pertinent, is incomplete. A satisfactory interpretation requires analysis of basic economic relationships between house prices, incomes, and rents. It also requires analysis of differences between standard sales prices and distressed sales prices, and how future housing prospects will be influenced by altered age demographics and location preferences.

This report addresses those subjects—changes in relationships between house values, family incomes, and gross rents from 2000 to 2010 in the 50 states, location variations in foreclosure rates from 2008 to 2012, and relationships between demographic changes and preferences for housing locations from 2000 to 2011.

I will begin with recent evidence about housing prices which is immediately pertinent to the question whether housing prices already have stabilized in national averages and in some states and metropolitan areas

Trends in 2011 and Estimates for 2012

U.S. Census American Community Survey data about house values, incomes, and rents for 2011 will not be available until Fall 2012. But housing sales data are available for 2011 and they permit some guestimates for 2012.

Case-Shiller (2012) estimated price changes for repeat sales through November 2011 at a decline of 3.7 percent from November 2010 for its sample of 20 metropolitan areas. The Federal Housing Finance Agency (FHFA) estimate of price changes for its larger sample also was a 3.7 percent decline through the Third Quarter of 2011.

Zillow, Inc. (Inman News 2011) estimated a three percent decline in house values for 2011 ($681 billion out of $21.0 trillion in house values), with a two percent rate of decline during the last six months of 2011 ($454 billion annual rate). Zillow chief economist Stan Humphries was quoted as saying in 2010 that 20 percent of sales were foreclosures and they averaged about 28 percent less than standard sales prices, after controlling for location and physical conditions (Zillow UTube Interview 2010). On February 22, 2012, Humphries said that 20 percent 2011 sales were foreclosures and another 20 percent were other types of distressed sales. If standard sales were 28 percent higher than distressed sales prices in 2011, then standard sales prices were slightly higher in 2011 than in 2010, using Zillow's data. Lee (2012)

and Fears (2012) also have reported that studies have shown 15 to 20 percent higher prices for standard than distressed property sales.

If the Case-Shiller sample had similar conditions—about 20 percent foreclosures and 28 percent higher prices for standard sales—then the 3.7 percent decline with foreclosure sales would translate into basically flat prices for standard sales. Neither the monthly report summarized in a news release January 31, 2010, nor the Case-Shiller annual review of 2010, nor the FHFA House Price Index Report contained information on the percentage of sales which involved foreclosed properties, the difference in prices between distressed and standard sales, and any geographic distribution of price differences from center to outer edge within any of the 20 metropolitan areas it covers.

CoreLogic (2012) produced data that provides additional guidance about standard and distressed sales price differences. CoreLogic found that for single family residences, sales prices declined 4.7 percent in 2011 from 2010 levels for a combination of standard and distressed house sales. When distressed sales were excluded, prices declined 0.9 percent year over year for its sample which was limited to repeat sales of the same properties. If distressed sales were 20 percent of total sales, as Zillow found, then the difference between distressed and standard prices in the CoreLogic sample would be about 19 percent in 2011.

CoreLogic (2012) found that prices for standard sales increased in 19 states, when distressed sales were excluded. In addition, 12 states had sales price declines of 0.9 percent or less, excluding distressed sales, in 2011, compared with 2010, according to CoreLogic.

Consequently, after reinterpreting Case-Shiller, FHFA, Zillow, and CoreLogic sales price trends for differences between distressed and standard sales prices, it appears that standard house sales prices probably were stable or rising in most states and many metropolitan areas during 2011. The Case-Shiller Index was pulled down by foreclosed properties, which were prevalent in its 20 metropolitan sample. The FHFA index with its larger sample may have had a smaller percentage of foreclosed properties.

These calculations for 2011 reinforce the interpretation here that emphasizes house value, family income, and annual rent relationships through 2010. These conditions and trends lead to a belief that by 2012 the fundamentals of housing demand were close to balance. This general balance sets the stage for a rebound in housing values with some increase in new housing construction during 2012. Revitalizing the housing sector, however, requires coming to grips with changes that have occurred in age demographics and location preferences, which will be discussed later in this report.

House Value, Income, and Rent

Because average housing prices drifted sideways during 2011, assessments of potential for halting and reversing price declines and reinvigorating housing construction continue to be skeptical and pessimistic. Federal Reserve Board Chair Ben Bernanke (2012) repeatedly has lamented that housing is a lagging economic sector that is inhibiting employment revival.

Uncertainty about prospects for unemployment dropping weighs on market psychology, restraining consumer confidence and consumer spending, therefore limiting consumer demand for goods and services, which is the basis for about 70 percent of economic activity in the U.S. Low consumer demand, in turn, inhibits employers from adding employees, which perpetuates high unemployment. High unemployment perpetuates foreclosures which reduces average sales prices and continues negative housing market psychology in which too many potential buyers hesitate to purchase residences, because they believe prices may continue to decline, putting their housing investment at risk of losing value.

I argue here that additional and, in some respects, more fundamental economic relationships provide guidance about potential for housing to rebound. These fundamental relationships have been returning to historic balance proportions. Analyzing them provides clues about where housing prices and housing construction will rebound. This approach is more multi-faceted and nuanced than most housing market analyses. I will examine relationships between:

House values and family incomes

House values and rents

Unemployment and foreclosures

House values and paid-off mortgage debt

Household ages and the number of houses for sale

Location preferences and house prices per square foot

These relationships will be analyzed here for each of the 50 states with data for a period of rising housing activity starting in 2000, the bubble of housing prices that peaked in 2006 and 2007, and conditions that existed in 2010, 2011, and 2012 as adjustments unfolded following the recession and housing collapse of 2008. A future analysis will examine conditions in 35 large metropolitan areas, because housing markets are primarily metropolitan in scale. Analysis of state-by-state comparisons and trends, however, is a considerable improvement over national average trends which are misleading and contribute to excessive pessimism. One metropolitan case of sale prices per square foot by county and central city will be described later to illustrate insights about housing prospects that emerge at that scale of analysis.

Trends in 50 states will demonstrate that housing market conditions have been tending toward normalcy. They also will demonstrate large variations in state trends that reveal housing conditions are stable or improving in some states, while conditions continue to be problematic in other states.

Changes in household ages and location preferences also create a challenge for actors engaged in providing housing, because market opportunities and risks have been changing. Pre-housing bubble business models will not produce the same results going forward as they achieved in the previous decade of housing growth spurt.

One striking finding in this 50 state analysis is the discovery that three categories of states reveal distinct and significant trajectories since 2007. These state categories vary by foreclosure rates, ratios of house values to family incomes, and ratios of house values to rents.

1) The broadest trend has been for house values to fall since 2007. Large house value declines occurred in the four highest foreclosure states—Nevada, Arizona, Florida, and California.
2) House value declines also have been prominent in 17 other states in most of which values had increased substantially between 2000 and 2007.
3) But in the third group of states, 29 in all, house values apparently increased or were stable from 2007 to 2010 relative to income, at least as perceived by owner occupants themselves.

As for house value to rent relationships, they have been readjusting in the direction of historic norms since 2007, in national averages. But these three groups of states above experienced dramatically different trends. And these differences reveal housing opportunities that do not conform to one-size-fits-all interpretations of national housing conditions. These differences will be described and interpreted below.

House Values Relative to Family Incomes

In 2007, many states, but not all, had relationships between housing values, family incomes, and rents that were distorted compared with historic norms.

Unbalanced relationships in many states between owner occupied housing values, family incomes, and rents led to collapse of their housing markets in 2008. The collapse was so severe that four years later, housing markets in some states still are struggling.

Since 2007, owner occupied housing has featured large declines in sales prices. According to the Case-Shiller monthly survey of repeat sales in 20 metropolitan areas, average sales prices declined by 31 percent from 2006 to the second quarter of 2011 (USHUD 2011, Exhibit 10). The Case-Shiller Index is over-weighted to high foreclosure states, with seven of its sample 20 metropolitan areas being in high foreclosure states of California, Florida, Nevada, and Arizona. In some states, such as Nevada, price declines of more than 50 percent have occurred. This sampling bias in the Case-Shiller Index, exaggerates price declines relative to the nation and relative to low and average foreclosure states.

In the broader Federal Housing Finance Agency (FHFA) analysis of repeat sales, average prices declined by 19 percent from 2007 to the second quarter of 2011 (USHUD 2011, Exhibit 10).

These average price declines do not describe trends in many states.

The housing finance collapse occurred from 2008 through 2011 in part because prices rose too high relative to incomes from historic norms. In 2000, owner occupied housing values were 2.4 times median family income. This ratio was the same, or lower, in 1990 and 1980, according to U.S. Census data.

Among the 50 states, there was some divergence from this national norm. This ratio in 2000, for example, was 2.8 or above in nine states (Hawaii was highest at 4.8 with California next at 4.0), and it was 2.0 or less in 14 states (Iowa, Kansas, Oklahoma, and North Dakota were lowest at 1.7). In general, the house value to family income ratios of 2.8 and above occurred in higher income Western and Northeastern states and the lower ratios of 2.0 or less occurred in lower income Plains, Southern, and Midwestern states (Table 1). Ratios in these calculations are based on median family income, not median household income.

After 2000, housing price increases were extraordinary—80 percent from 2000 to 2006 in the Case-Shiller Index of 20 metropolitan areas, 58 percent from 2000 to 2007 in the broader FHFA index of repeat sales, and 39 percent, 2000 to 2007, in the Census Bureau's tracking of Constant Quality Houses (HUD, U.S. Housing Market Conditions, Exhibits 8 and 10). The housing price bubble did not burst solely, however, because prices rose too rapidly. It also occurred because incomes were lagging behind housing price increases.

Housing finance institutions also were major contributors to the housing collapse, especially because of risky mortgage loans. Risk of house price declines could have been mitigated, if few houses had been purchased, mortgage interest rates had been low, and borrowers were well qualified. But the number of house purchases rose to record heights, Adjustable Rate Mortgages (ARMs) often jumped one to several percentage points after two or three years of low rates, down payments were negligible, many borrowers were not qualified financially, and many of these borrowers were given expensive sub-prime mortgage loans. These risky financial practices contributed to rapid price increases relative to incomes by pumping more money into housing, contributing to a psychology that housing prices would continue to increase.

As house value to family income ratios escalated, there were 27 states with ratios of 2.8 or more by 2007 (compared with nine states in 2000), with California at 8.3 and Hawaii at 7.5 and 10 other states above 4.0 (compared with only one state, Hawaii at 4.8, above 4.0 in 2000). In 16 other states, the ratio remained at 2.4 or less. The national average ratio, however, had increased to 3.2.

This 33 percent increase in the national average was based on owner occupants, who reported what they believed was the value of their residence, in census surveys. The increase was similar to the Census Bureau's tracking of Constant Quality Houses (39 percent increase), but it lagged well behind the Case-Shiller (80 percent increase) and FHFA (58 percent increase) indices. These indices, however, were based on repeat sales of the same houses. They may have been ratcheted up by repeat sales by speculators who were cashing in on rapid price increases.

After 2007, high house value to family income ratios, except for Hawaii, were associated with relatively high foreclosure rates, led by Nevada, Florida, Arizona, and California in 2008. These states also were where housing prices declined most from 2007 through 2011.

Price declines after 2007 were bringing perceived house values relative to family incomes closer to historic norms. In Nevada, house value estimates relative to family income declined from 5.1 to 1 in 2007 to 2.9 to 1 in 2010. In Arizona the decline was from 4.2 to 3.0, in Florida from 4.2 to 3.1, and in

California from 8.3 to 5.7. Thus, in unbalanced and declining housing markets, home owners were aware that house values had declined rapidly, and they reported lower house values in census surveys.

House Value to Rent Ratios

Households' decisions to purchase rather than rent are partially calculations of trade-offs between costs of owning and renting. Other factors are involved in these decisions. They include issues about controlling one's living space, housing style and location preferences, investment prospects, and advantages and disadvantages of forced savings involved with paying mortgage debts that build equity relative to potential future sale prices. Other concerns include estimates of uncertainty related to future moves, maintenance and repair costs, family size and composition, and future income. Many of these concerns involve predictions about the future which are vague and subject to change.

One calculation that can be facilitated by current information is the monthly and annual cost of rent versus the cost of owning a residence. This general relationship is captured in the ratio of owner occupied house values to gross rent in U.S. Census data. These data can be tracked over time, including during the rise housing prices from 2000 to 2006 and their fall from 2008 to 2010.

In 2000, the national median value of owner occupied housing was 16.5 times gross rent. Although this ratio was higher than the 15 to 1 ratio in 1990, it was low enough to motivate many households to buy residences during the next several years. Ownership motivations were strong, as evidenced by the run-up in the national ratio to 20 to 1 by 2006, when median house values were 20 times annual median gross rents.

The national averages obscured variation. In 2000, the lowest state ratios were in Texas, 12 to 1, and Arkansas and Oklahoma 13 to 1. Sixteen states had ratios of 15 to 1 or less. The highest ratios were in Hawaii 29 to 1, California 24 to 1, and Massachusetts 23 to 1 (Table 2).

By 2006, the ratios had increased to a high of 43 to 1 in California with 18 states equaling or exceeding a 23 to 1 ratio (Table 2). The lowest ratio states, however, experienced little change. Texas increased to 13 to 1 and Arkansas and Oklahoma increased to 14 to 1, although only six states remained at 15 to 1 or lower ratios.

High Foreclosure States

Foreclosure rates have been highest in Nevada, Florida, Arizona, and California. In 2000, three of these states—Nevada, Florida, and Arizona—had low house value to rent ratios. By 2006, each state experienced large increases—Nevada 29 to 1 up from 17 to 1, Florida 22 to 1 up from 14 to 1, and Arizona 26 to 1 up from 16 to 1. California also saw a large increase to 43 to 1 from 24 to 1 (Table 2).

These high ratios signaled a home ownership bubble in which prices had risen to unsustainable levels. With such high housing purchase prices, fewer households would choose the purchase option over the rent option. This judgment would affect housing markets, prices, and foreclosures.

If owners have difficulty paying their mortgages, the first option is to put their houses up for sale. But if prices are too high, potential buyers will be scarce. If little or no cash was paid as a down payment, mortgage amounts owed will approximate purchase prices. If purchase prices are judged to be too high relative to rents, then there will be fewer buyers. If, in addition, lending rules change so that down payment requirements increase and more income must be demonstrated, potential purchasers will decline. These adjustments in incentives and motivations occurred nationwide in 2008, with special strength and volatility in states where ownership values had escalated relative to rents.

Renting became more attractive when ownership to rent ratios increased. When borrowing rules became stricter, renting was the only option for more households.

Potential sellers, mainly sellers who were underwater with mortgages exceeding purchase offer prices, found themselves trapped. They were unable to pay their mortgages and they were unable to find buyers. A downward economic spiral ensued. Unemployment increased due to declines in housing construction, lower sales in building supply and furniture stores, fewer realtors earning sales fees, and fewer mortgage bankers writing mortgages. Then sales of most goods and services declined, and a considerable part of economic activity disappeared in previous high growth metropolitan areas and states.

Collapse of house purchase markets was reflected in rapid adjustments in house value to rent relationships as house values fell. From 2006 to 2010, the house value to rent ratio declined in Nevada from 29 to 1 to 15 to 1, Florida from 22 to 14 to 1, Arizona from 26 to 17 to 1, and California from 43 to 27 to 1.

Lower house value to rent ratios in 2010 indicated that housing markets were being repaired and rebalanced in high foreclosure states. In terms of motivation, lower house value to rent ratios provided a foundation for more households becoming potential buyers. As more households return to making potential purchase calculations, housing prices will be on the road to stabilizing. More potential purchasers also set the stage for housing construction to renew where it collapsed. Construction will be restrained, however, by residual effects of numerous foreclosed properties for sale, many potential purchasers under 2007 lending rules who have been eliminated from the market under current stricter lending rules, as well as by more households with impaired credit from the ravages of the Great Recession in 2008.

Foreclosures and Unemployment

Because unemployment reduces household incomes, more unemployment should be related to higher foreclosure rates which mainly are caused by insufficient income to pay mortgage obligations. Foreclosure is a process that begins with owner occupants becoming delinquent on monthly payments, followed by default when a state law threshold is passed which enables lenders to begin the legal foreclosure process. Some foreclosures are completed and properties become lender-owned. Often foreclosure processes come to a halt and may be dropped temporarily or permanently. Because of time lags in the foreclosure process, current unemployment rates may not be intimately connected to current foreclosure rates, even if there is a general connection.

The national average foreclosure rate has declined. In November 2008, 0.79 percent of U.S. occupied housing units were in foreclosure processes (Table 3), compared with 0.67 percent in January 2012. The unweighted 50 state average of foreclosure rates in January 2012 was 0.54 percent of occupied housing units.

In January 2012, foreclosure rates were at 0.70 percent or more of occupied housing units in 16 states (Table 4). These rates ranged from 0.70 percent in Tennessee to 1.97 percent in Nevada, which had the highest rate. In these 16 states, the unemployment rate in December 2011 was an unweighted average of 8.9 percent, which compared with a national unemployment rate of 8.5 percent. Unemployment rates were well below the national average in five of these 16 states—6.0 percent in Utah, 7.1 in Wisconsin, 7.4 in Delaware, 7.9 in Colorado, and 8.1 in Ohio. Overall, a connection between unemployment and foreclosures was present but modest.

Compared with 2008, foreclosures in the highest foreclosure rate states (Nevada, Florida, Arizona, and California) had declined substantially, despite high unemployment (a four state average of 10.6 percent in December 2011). On the other hand, foreclosure rates had increased by January 2012 in a majority of states—36 in all (Tables 3 and 5). Why?

The highest foreclosure rates in 2008 were related to where population growth was high and subprime and low or no down payment mortgages were common. These conditions led to rapid unemployment increases when the housing bubble burst in 2008. Unemployment rose more gradually in most other states, but by 2009 unemployment had increased in most states and remained elevated into 2012. During this period, sustained unemployment contributed to increasing foreclosure rates in 36 states, even as foreclosure rates declined in most of the early high foreclosure states.

Housing Stability in Most States

One of the surprising findings in this 50 state analysis is that between 2007 and 2010 perceived housing values actually were stable or increased relative to family incomes in a majority of states. This is counterintuitive, because of findings that housing prices declined by 31 percent (Case-Shiller) or 19 (FHFA) percent from 2007 to 2011. It may be a phenomenon related to methodology.

The house value, income, and rent information in the U.S. Census American Community Survey are self-reported data by residents to surveys. House value estimates may lag behind falling prices, just as they may lag behind rising prices. One estimate for the Washington, D.C. area is that sellers estimated their houses were worth 12 to 14 percent more than their actual sales value (Harney 2011).

This phenomenon might be more prevalent in metropolitan areas and states where price declines have been most precipitous. That would mean house values in Nevada, Arizona, Florida, and California, in particular, may have been lower in 2010 than survey respondents estimated. If house values were lower relative to income and rents than the ratios reported here for those states, then that pattern would make it more likely that house value to income and rent relationships have returned closer to historic norms than is indicated by data in this study. Consequently, prospects for stabilization

of house prices and a gradual return to new construction are more promising than one might infer from data in these tables.

What would be the economic significance of home owners having overly optimistic estimates of their house values? For the economy, the effect might be similar to having accurate estimates. If home owners believe their houses are valuable, they will be more willing to spend on other goods and services, as well as being more willing to reinvest in maintaining or improving their property. With 70 percent of economic activity flowing from consumer spending, over optimism about house values should translate into more spending, increasing demand and supporting employment and other economic activity.

In other states, where 2007 house value to family incomes approximated historic norms, house values were more stable after 2007. Surprisingly, from 2007 to 2010, owner occupied housing values were stable (10 states) or increased (19 states) in 29 states relative to median family income, according to U.S. Census Bureau data. Rather than declining, housing values were increasing or stable relative to family income in these states (Table 6). In 22 of these 29 states, house value to family income ratios had remained at 2.6 or less in 2007 (U.S. Census Bureau 2007 and 2010).

Therefore, during the peak of house values to family incomes in 2007, many states had retained relationships similar to historic house value to income relationships. In these states, house prices had lagged behind the rapid increases that were common in high growth states. Housing finance did not need major reform, and households were less vulnerable to foreclosure and loss of housing investment wealth.

In these 29 states with stable or rising house values relative to income from 2007 to 2010, only one state had a foreclosure rate in excess of the 2007 national average of 0.79 percent of foreclosures of total housing units (Utah at 1.03 percent) and only one other state among these 29 was anywhere close to the national average (Georgia at 0.58 percent) (Table 5).

House Value to Rent Ratios in Stable House Value States

In the 29 states in which house value to income ratios were stable or increased from 2007 to 2010, house value to rent ratios had a moderate trend line compared to national averages, and, in particular, compared to the high foreclosure states. These 29 states averaged house values 16 times rents in 2000. The house value to rent ratios remained at 16 to 1 in 2006. By 2010, these house value to rent ratios had increased to 18 to 1 (Table 6).

Therefore, in the 29 states where perceived house values were stable or rising relative to income between 2007 and 2010, house values also were rising relative to annual median gross rents. Home owners perceived their residences to have retained, even increased, their value relative to rents, even as Case-Shiller and numerous national media were trumpeting declines in house prices nationwide as though all parts of the nation were negatively impacted. In his summary statements, Federal Reserve Chairman Bernanke also has lacked nuance by state or metropolitan geography in his dour assessment of potential for housing revival.

Incentives to buy or rent were modestly affected in these 29 states during the national run-up of owner occupied prices from 2000 to 2007. When the national downturn in housing prices occurred from 2007 to 2010, these states were not affected as much, because they had not experienced major ownership price increases. The relative stability in housing markets in these 29 states was reflected in house value to rent ratios, as well as in house value to income ratios.

House Value to Rent Ratios in Volatile States

In 17 states, perceived house values declined relative to family incomes from 2007 to 2010. These states had high house value to family income ratios in 2007, 4.0 to 1.

They also had high house value to rent ratios. They were high before the launch of rising prices. In 2000, these 17 states had a house value to annual rent average ratio of 19 to 1. This ratio rose rapidly to 27 to 1 in 2006 (Table 6). (West Virginia was an anomaly in this group of states.) Just as precipitously, the ratio fell to 21 to 1 by 2010. Consequently, in these states a more balanced economic relationship between ownership and renting was occurring. But these states were contending with higher than normal house values relative to income.

It would seem likely, based on high house value to family income ratios, that they would be subject to high foreclosure rates. But they were not high foreclosure states in 2012 (Table 5). Their average foreclosure rate was only 0.50 percent of housing units subject to foreclosure or preforeclosure in 2012. This was the same rate as in the 10 states with stable house values from 2007 to 2010. These states also were below the national unemployment rate of 8.5 percent in December 2011 at 7.7 percent in these states.

Moderate foreclosure frequency and unemployment after 2007 seemed consistent with housing markets that had adjusted to high proportions of disposable income being used for housing before 2007. If home buyers planned for this type of spending, and maintained employment, then they would be able to cope with higher house prices, keeping foreclosure rates moderate. High volatility in house value to income and rent ratios was not associated with high unemployment and high foreclosures, contrary to what occurred in the four high foreclosure states of Arizona, California, Florida, and Nevada.

Underwater Mortgages and Income Effects

High foreclosure rates have been fueled, in part, by houses being “underwater.” Mortgages are “underwater” if the amount owed to a mortgage lender exceeds the sale price of a house. If owners need or want to move, and they are unable to sell for more than the mortgage amount, they have an incentive to walk away from paying the mortgage, leading to foreclosure by the lender. Rapid price declines, therefore, are associated with higher foreclosure rates. This process tends to be self-reinforcing. A Federal Reserve analysis found evidence that in areas with numerous foreclosed properties, other home owners who had been paying their mortgages were more likely than other home owners to decide it was in their economic interest to abandon their homes and turn them back to the lenders (Lee 2012).

More foreclosures lead to more rapid price declines, which lead to more underwater properties, which lead to more foreclosures, and so on. One result is more households with impaired credit who have difficulty qualifying for mortgages on other, including less expensive, properties. Another result is less construction of new houses, and less employment in construction, because some foreclosed properties are for sale for less than the cost of constructing new houses. Then construction employment falls, and unemployment and its related social welfare and health costs increase. State budgets are impacted negatively by lower revenues and higher health and welfare expenditures.

This sequence of negativity also may contribute to lower incomes. In three of the highest foreclosure states—Nevada, Florida, and Arizona, median family income declined between 2007 and 2010. The declines were 2.1 percent in Nevada, 2.5 percent in Florida, and 0.6 percent in Arizona.

Large declines in house values relative to median family income ratios occurred from 2007 to 2010. In Nevada, Florida, and Arizona, 2010 house value to income ratios were closing in on 2000 levels. In 2010, this ratio in Nevada was 2.9 compared with 2.8 in 2000 and down from 5.1 in 2007; in Florida it was 3.1 in 2010, down from 4.2 in 2007, but still higher than its 2.3 ratio in 2000. In Arizona it was 3.0 in 2010, down from 4.2 in 2007, but still higher than 2.6 in 2000. In California, a major decline had occurred, but the ratio in 2010 still was elevated at 5.7, down from a high of 8.3 in 2007, and higher than its 4.0 rate in 2000 (Table 1).

These states continued to experience house price declines in 2011, and, house value to income ratios probably declined in 2011. Therefore, their housing markets should be close to historic house value to income relationships in 2012. Average price declines in these four states may continue in 2012, however, because many foreclosed houses still are available for sale, which tends to depress prices. Small differences between distressed and standard sales prices tend to occur in areas, like Las Vegas, where foreclosures are numerous, constituting about 50 percent of sales in the Law Vegas area. When many foreclosed properties are for sale, they are more likely to represent the size, quality, and location preferences of buyers, similar to the array of standard properties for sale. In this circumstance, standard houses have little appeal that surmounts the low prices of foreclosed properties, thus tending to lower standard prices.

No Mortgages Support Value Stability

These negative dynamics related to underwater mortgages apply, by definition, to houses with mortgages. Some houses lack mortgages, generally because mortgages have been paid in full over 30 years, although sometimes due to cash purchases. The national average of owner-occupied houses with no mortgages is quite high—32.8 percent in 2010 (U.S. Census 2010).

The absence of mortgages may have contributed to stable or rising house value to family income ratios in 29 states from 2007 to 2010. States with more owner occupants lacking mortgages would have more potential to resist tendencies for house prices and values to fall, including during periods of high unemployment.

In the highest foreclosure states, fewer houses typically lacked mortgages—except in Florida where retirees who moved in and paid cash may have supported a high no mortgage rate—36.1 percent in 2010. The other three states, however, had comparatively low no mortgage rates in 2010—24.0 percent in Nevada, 24.9 in California, and 30.1 in Arizona.

In contrast, the states which retained relatively balanced housing markets during the 2007 to 2010 period usually had higher than average no mortgage rates. The absence of mortgages tends to support higher sales prices, and hence house values, because of decisions by sellers and potential sellers. The absence of mortgages gives potential sellers more flexibility, hence control. They feel less pressure to sell. They have more choices. With high prices, some potential sellers see opportunities to sell, provided they get a high price. Failing to approximate their price target, they can withdraw their property from the market. Demographic changes, discussed below, had led to more empty nest and elderly households who may want to sell at some time, and can choose the best time. These households are prime candidates for the role of opportunity sellers. Many of these households also may lack mortgages, further augmenting their sense of control over sale prices.

In the 29 states where house values were stable or increased relative to median family income from 2007 to 2010, the average no mortgage rate was 36.4 percent of all owner occupied houses. In the 19 states where house value to income ratios increased, the no mortgage rate was 38.3 percent (Table 6).

One can expect that the absence of mortgages would be associated with lower sales rates, and, of course, lower foreclosure rates. Lower sales and foreclosure rates would mean fewer pressured sales.

Support for house values also would be associated with preserving household wealth, because much of household wealth is equity in owner occupied housing. Stable household wealth also would be associated with relatively stable employment and income. This tendency also could be reflected in income trends in states.

Indeed, in the 29 states with stable or rising house value to income ratios from 2007 to 2010, median family incomes increased in 27 states. The range was from a median family income increase of 17.7 percent in North Dakota to 0.7 percent in Ohio. The exceptions were Georgia, which had a relatively high foreclosure rate (0.58 percent) and Indiana, which suffered manufacturing job losses, which experienced median family income declines of 1.6 and 0.7 percent.

Home Ownership Rates and House Values

The national home ownership rate peaked at 69.0 percent in 2004. By 2010, it had declined to 66.9 percent.

In the 29 states with rising house values to income ratios from 2007 to 2010, the average home ownership rate in 2010 was 68.2 percent, close to the national home ownership peak in 2004.

In the highest foreclosure states, however, the home ownership rate in Nevada fell from 61.2 percent in 2004 to 57.2 percent in 2010. In Arizona it fell from 68.7 to 65.2 percent. In California, it

dropped from 58.6 to 55.6 percent. In Florida it fell from 70.5 to 68.1 percent. Nevada's decline was the fastest in the nation, followed by Arizona, and then California. Between Florida and California in home ownership decline rates were Vermont, Colorado, Idaho, and Maryland, but Vermont in particular remained high at 70.4 percent despite declining from its 2007 level (Table 7).

In the 29 states with stable or rising house value to income ratios from 2007 to 2010, home ownership rates remained high in 2010—68.2 percent. These states also had a high average no mortgage rate in 2010—36.4 percent. High home ownership and high no mortgage conditions meant many owner occupants were not under pressure to sell, they were not underwater, and, if they wanted to sell, they tended to be choice and opportunity sellers, able to withdraw properties from the market if they failed to receive satisfactory purchase offers.

Population Growth and Market Balance

The 29 states with stable or rising house value to income relationships from 2007 to 2010 tended to be slower growth states compared with the other 21 states before 2007. From 2000 to 2007, these 29 states increased in population by 6.3 percent. The other 21 states increased by 7.6 percent (Table 8).

Faster average growth occurred in states that subsequently became high foreclosure states. The highest rates of foreclosures in Nevada, Florida, Arizona, and California increased by an average 18.5 percent from 2000 to 2007--Nevada 28.4, Arizona 23.5, Florida 14.2, and California 7.9 (Table 9).

Faster growth created more housing construction activity. Faster growth of households led to more demand for new units. If supply lagged behind demand, prices would be bid up. Fast rising housing prices in these states probably expressed this lag in supply, even though supply increased substantially.

Some of the rise in prices, however, was fueled by speculators attracted by opportunities to "flip" houses before they were occupied. Flipping means that a buyer will make a purchase, hold the property for a few months or a year, and sell it again at the prevailing higher price range. With prices increasing rapidly from 2000 to 2007 (80 percent in the Case-Shiller Index and 58 percent in the FHFA Index), speculators found many "flipping" opportunities. This practice, however, added a potential cause of oversupply when demand lagged.

Negative psychology can diminish market demand rapidly just as positive psychology associated with rising prices can feed on itself. With negative psychology, potential buyers wait, because declining prices may continue to fall. A declining price environment creates risks of buying and quickly being "underwater" with a mortgage larger than potential resale prices. When the economy also is declining, with unemployment rising, capacity to pay mortgages diminishes, and interest in moving to more promising labor markets increases. These factors augment negative psychology, further depressing prices.

Supply has several dimensions—quantity, quality, cost, type, size, and location. If any of these aspects of supply are inconsistent with buyer preferences, sales may lag despite overall demand being

sufficient to purchase available units. As discussed below, some misallocations of supply by location and type may have occurred during the 2004 to 2007 period.

In the 29 states with stable or rising house values relative to income from 2007 to 2010, average population growth was moderate from 2000 to 2007 (6.3 percent). Population growth from 2007 to 2010 (3.5 percent) actually was faster per year than from 2000 to 2007, 1.2 percent annually instead of 0.9 percent. After 2007, these states had faster population growth than the other 21 states (0.7 percent annually) and faster than the four highest foreclosure states (1.0 percent annually).

Moderate to slow growth put less stress on housing supply participants to provide effective combinations of quantity, quality, cost, type, size, and location. A more placid construction and land development environment may have eased adaptations to evolving buyer characteristics and preferences. But relatively rapid growth from 2007 to 2010 in the stable and rising house value states, also provided some demand for new housing. Housing construction demand in some of those states should be reviving.

Demographics of Demand and Location

Public policy consequences of aging of the Baby Boom generation born from 1945 to 1964 are well known. An imminent bulge in population over age 65 raises anxiety about the cost of supporting Social Security and Medicare systems for Baby Boomers who began to reach age 65 in 2010. Public policy-makers attention to effects of a larger elderly population relative to the working age population has not focused on housing market consequences, except for awareness that more demand will emerge for assisted living and other smaller quarters for retirees.

Demand is influenced by the number of households in younger age groups, because in younger households home ownership rates increase and then peak in older age categories.

Above age 55, about 80 percent of households own their residences. Many of these households are “empty nesters,” with no children living at home. Consequently, relatively few households in these older age groups are buyers of new single unit detached dwellings with four or more bedrooms farther from metropolitan population centers—the standard suburban and exurban house built since 2000. In particular, few of these empty nest households will be seeking remote houses with more land to maintain—and they will pay less attention to school district reputations when considering alternate locations.

An increase in the number of these older households will impact preferences for housing by quantity, quality, cost, type, size, and location. Similarly, the number of younger households in the prime house buying years will affect demand characteristics.

Household age changes have been dramatic. From 2001 through 2010, the number of households with an occupant 55 or over increased by 8.9 million (Table 10).

During this 2001 through 2010 period, the number of households with an occupant age 30 through 44 declined by 3.7 million. This younger age group averaged about 58 percent owner

occupants—lower at age 30 and higher at age 45. The ownership rate for age 25 to 29 year old households was 37 percent. Therefore, this group comprised the prime house buying group, historically moving toward 75 percent owner occupancy above age 45.

Fewer households age 30 through 44 from 2001 to 2010 diminished demand for four bedroom detached houses. More households age 55 and above increased supply of existing four bedroom detached houses for sale.

Thus, the period of rapid increase in supply of new houses during the 2000 to 2007 period combined with an increase in existing houses for sale by age 55 and over occupants to create an oversupply of existing and new large houses for families with children (Nelson 2006).

Census Bureau adjustments of population estimates based on results of the 2010 census has confirmed these transitions from a related perspective—changes in labor force composition. The working age population 55 and over increased by 1.29 million, while population in the prime employment years 25 to 54 dropped by 299,000 (Kowalski 2012).

Changes in Location Preferences

Moreover, location preferences seemed to be changing. From 1990 to 2000, old neighborhoods in cities and inner suburbs often rose in income relative to other neighborhoods. This change meant that more households with substantial income and location options that accompany more income were choosing older neighborhoods rather than middle aged and relatively new neighborhoods (Lucy and Phillips 2006).

From 1960 through at least 1990, non-Hispanic whites had led the shift in middle income households' location preferences in favor of suburbs. Evidence for 1990 through 2010 pointed to another shift in location preferences toward older neighborhoods and cities rather than more remote suburban locations (Tables 11-14)(Fishman 2005, Leinberger 2008, Nelson 2006).

From 2000 to 2010, increased interest in old neighborhoods was reflected in locations of more affluent white residents. In 35 large metropolitan areas, per capita incomes of non-Hispanic whites averaged five percent higher in central cities than in suburbs of these cities in 2000. By 2010, this per capita income gap had increased to eight percent higher per capita incomes of non-Hispanic whites in central cities (Table 13) (Lucy 2010).

Thus, demographic changes—more empty nest and elderly sellers and fewer younger household buyers—were coinciding with altered location preferences. These changes put stress on decentralized and dispersed housing markets which became apparent after 2007 but which were obscured by cheap mortgage loan money and unrealistic positive housing investment psychology from 2000 to 2007.

These location preference shifts were coinciding with housing developers and builders continuing to emphasize outer suburban locations during the 2000 to 2007 period.

The disconnect between dispersed development of new houses and demand preferences for older neighborhoods may have been strongest in high population growth states. The unwinding of positive purchasing psychology had the most devastating effects in these high growth states partly because developers had built too much housing in outer locations where demand was diminishing.

This hypothesis receives support from price per square foot sales comparisons for 2011 between central city and suburban sales in large metropolitan areas. In 33 central cities in 29 metropolitan areas, per square foot sales prices averaged 17 percent higher in central cities than in their metropolitan areas. This city advantage is more striking when seen in sequence in Table 12 where the prior years' comparisons are based on median value of owner occupied housing as reported in census data. Median value estimates lack controls for variation in size, as well as other conditions. While cities were gradually doing better on this median perceived value indicator from 2000 to 2010, they still lagged eight percent behind the metropolitan average in 2010. When the basis of comparison was shifted in Table 12 to sales prices per square foot, in effect controlling for size differences, central city sales were substantially higher than the metropolitan average in 2011.

A Metropolitan Case Analysis

How do age changes and foreclosures translate into spatially differentiated price changes and values of different types of housing? Housing sales data reported by price per square foot for the City of Charlottesville and six surrounding counties provide insights (Table 15).

Four findings are most striking. First, sales prices per square foot stabilized in only one jurisdiction, the central city Charlottesville, and, in fact, ticked up one dollar from 2010 to 2011. The nearest county, Albemarle, to the center of the region (Charlottesville), declined least among the counties. Charlottesville and Albemarle dominated sales so that the region's sales prices increased one dollar per square foot from 2010 to 2011. Second, prices per square foot were highest in the central city, and, in 2011 reached the biggest percentage difference from the counties during the 10 year period, reaching 15 percent higher than Albemarle in 2011. Third, prices per square foot were slightly higher in 2011 for attached ($141) than for detached ($139) housing units, reversing the relationship from 2006 when detached housing was $15 higher per square foot sales prices.

These trends and relationships are consistent with expectations from age demographics and location preference shifts. Old households are more likely to prefer more convenient locations, especially when they have amenities such as the amenities in Downtown Charlottesville. Older households and younger households are more likely than large households with children to be interested in condominium ownership (Charlottesville added unrelated individuals and lost families with children between 2000 and 2010). These trends are useful for interpreting trends among the 50 states and anticipating potential for enhancing demand for home ownership, including for new construction.

Perhaps most significant is the fourth finding—the price difference between standard low pressure sales with foreclosed property sales for which lenders typically are under more pressure to sell and can offer lower prices to obtain quicker sales (less days on the market). The difference was very large--$88 per square foot for foreclosed properties and $151 per square foot for standard sales.

Standard sales went for prices 72 percent higher than foreclosed sales. This difference occurred partly because foreclosures were more frequent in outer counties where per square foot prices were much lower than in Charlottesville and Albemarle.

The significance of foreclosure locations has been noted by economist Mark Zandi of Moody's Analytics (2012): "Prices of nondistressed homes also are holding up better than they did earlier in the foreclosure crisis, according to CoreLogic and FNC. Many distressed properties may be in less desirable areas and no longer in direct competition with nondistressed properties."

This finding is significant for two reasons. First, it indicates the distortion in national, state, and metropolitan average price reductions that have been revealed in same house sales that occur in the Case-Shiller Index and the FHFA Index. The Case-Shiller Index is based on repeat sales of the same properties. This practice exaggerates price declines due to being overweight with foreclosed property sales which tend to be large proportions of sales in the 20 metropolitan markets studied by Case-Shiller. These markets also are overweight with foreclosures, because seven of the 20 metropolitan markets are in high foreclosure states (Los Angeles, San Francisco, San Diego, Las Vegas, Phoenix, Miami, and Tampa-St. Petersburg).

The second reason the price difference between foreclosed and standard sales is important is that foreclosures need not have a major impact on non-foreclosure properties. In the Charlottesville case, standard prices were 72 percent higher than foreclosure prices. A difference, although not necessarily this large a difference, is to be expected, because these are pressured sales (foreclosures) versus choice and opportunity sales (most standard sales), in which owners can sell if they get a "good" price or they can keep the property on the market or withdraw it if they do not like any offer.

Thus, choice and opportunity sales can be a radically different market from foreclosed sales, rather than one which is penetrated and distorted by foreclosure sales. Whether this distinction is borne out in specific metropolitan areas, jurisdictions, and neighborhoods depends partially on how sales data are interpreted by lenders, appraisers, assessors, realtors, and buyers. If they interpret local markets as being overwhelmed by price deterioration influences from foreclosures, then they are more likely to be influenced negatively than if these market participants interpret the interactive influences of foreclosures on standard sales to reflect differences between pressure, choice, and opportunity sales.

Current and Future Prospects

Demographic and location preference changes probably are related. Empty nesters and the elderly usually prefer to remain where they are. If they move, and many will eventually, few of them are likely to move to new four bedroom or larger residences farther out in suburbia and exurbia. This large home owner group has many residences to sell to the smaller number of 30 to 45 year old households who want larger homes but would prefer to avoid long commutes. Some of the demand for central city and inner suburb living is related to convenience, walking, and transit. After a certain age, long night drives home in the dark become daunting aftermaths of dining out and evening entertainment.

From 2000 to 2007, condominium ownership increased 93 percent in central cities of the 35 largest metropolitan areas. This trend reflected a desire for ownership separated from maintenance responsibilities as well as convenient access to diverse destinations.

Higher down payment requirements, closer scrutiny of income, and more skeptical appraisals of house values have contributed to lower owner occupancy rates nationwide. Diminished incomes and impaired credit after 2007 contributed to a decline in owner occupancy nationwide. The 30 to 35 year age group has been especially hard hit. Its owner occupancy rate declined from 57.4 percent in 2004 to 51.6 percent in 2010 (USHUD 2011, Exhibit 27).

These conditions have been more problematic in high foreclosure states. Ratios between house values, incomes, and rents also were more distorted from historic norms in the high foreclosure states.

Substantial adjustments of house values, incomes, and rents have occurred, especially in high foreclosure states. In a majority of states, these basic relationships were not substantially distorted and unbalanced during the national rapid housing price increases from 2000 to 2007. Consequently, in a large majority of states by 2012, house value, incomes, and rents probably were close to their historic balance.

Balance in these basic economic relationships suggests that housing construction will pick up from lows around 650,000 units in 2010 and 2011. The average 1.8 million units built annually from 2000 to 2007 will not return soon, perhaps never. Eventual construction of 1 to 1.5 million units per year is more realistic. The mix of type, size, cost, and location should evolve to reflect changing demographics and altered location preferences.

Such changes are difficult. They do not fit neatly into lending habits of banks or mortgage purchases by Fannie Mae and Freddie Mac. Nor do they fit neatly into the construction traditions of large suburban house developers. The new development normal will include more condominiums, more rentals, more infill mixed use projects, and more transit-oriented development, as well as some single unit detached projects in outer areas. These modified development activities also must navigate local governments' zoning and site plan regulations, and, sometimes, affordable housing and green construction requirements. In addition, Federal Reserve Chairman Bernanke (2012) has identified lending practices as bearing significant responsibility for housing's slow recovery, saying "many lending institutions have tightened underwriting conditions dramatically."

These development and redevelopment complications make a construction target of one million units by 2014 more realistic than 1.5 million units. As experience accumulates with altered housing types, sizes, prices, and locations, more construction consistent with preferences can emerge. Gradually, housing construction will increase. Construction employment, which was the type of employment hit hardest by recession and financial turmoil, will increase steadily. The housing impediment to economic revival will be on the road to recovery.

The number of new constructed units will be influenced by changes in housing finance, changes in age group numbers of potential buyers and sellers, and changes in residential location preferences.

These conditions may keep new construction closer to 1 million than 1.5 million units while lenders, developers, builders, government officials, and borrowers adjust to new conditions. More housing construction will increase construction employment, which has plummeted by more than two million workers from 2007 levels. By 2013, housing revival will be contributing to general employment and economic revival. Housing revival can begin in 2012, if the main actors in development and housing adjust to altered demographic, location, and credit dynamics.

Who Should Do What?

Housing construction increases will not occur automatically as housing fundamentals—house values, incomes, and rents—return to traditional normal ranges. Key actors must act effectively.

As Federal Reserve Chairman Bernanke has indicated, mortgage loan underwriting standards should be adjusted. Adjustments, however, should be based on realism. The housing and financial crisis of 2008 to 2012 probably has led to excessive gazing into the rearview mirror. Ken Fears (2012) in Realtor Magazine, for example, has questioned whether the FICO score increases sought by Fannie Mae (719 average in 2005 and 756 in 2011) and the Federal Housing Agency (632 average in 2007 and 700 in 2011) have become excessive. Realism should take more account of returning balance among house values, incomes, and rents, plus changes in age demographics and location preferences.

The most obvious conclusion from this prescription is that one-size-fits-all policies by national policy makers, national institutions, and international banks are as likely to be problems as solutions.

Low mortgage interest rates, of course, will be helpful. But house value estimates based on national trends are worse than useless. They are gross distortions of reality. Moreover, state and metropolitan averages, while better than national averages, also are distortions. They do not take into account sufficiently differences between foreclosure sales and standard sales, changes in age demographics that alter supply and demand potential, and location preferences that increase house values in some locations and decrease them in others. Too many housing market actors probably are stuck in demographic stereotypes of two parent and two child families looking for four bedroom outer suburban houses and not enough awareness that convenience and accessibility for smaller households are an underserved market. At the same time, the traditional four bedroom house market is oversupplied due to the 8.9 million more households age 55 and over and the 3.7 million fewer households age 30 to 45.

Each of the actors needs to change. Presidents need more nuanced guidance from their technical advisors. Congress needs a wake-up call that national policies need some reform but should not be totally abandoned. Fannie Mae and Freddie Mac need to adopt realistic policies toward condominiums and avoid impeding their construction and sale. Lenders need to analyze metropolitan and submetropolitan housing markets and not assume that conditions in New York, Charlotte, and San Francisco apply everywhere—nor is the summary guidance from sale price tracking services sufficient for basing lending practices. Appraisers need to take distinctions between foreclosed sales and standard sales into account and take a more positive attitude toward future prospects rather than project past average declines into the future. Regulators need to encourage local and regional analysis rather than

invoke formulas created during the 2008 housing and finance collapse. News media should halt one fact short-cuts to projecting housing prospects—the latest percentage decline or increase in average housing prices is not useful knowledge. The Federal Reserve should stop saying housing health depends on rescuing underwater mortgages—which in most states and metropolitan areas are a small proportion of houses and a minor problem for housing markets although they are a problem for some households.

The largest burden, however, falls to developers, builders, and local planning, development, and elected officials to plan, design, propose, review, and support projects that will appeal to emerging market demand. Responsiveness to altered age demographics and location preferences will require more infill redevelopment projects and fewer remote greenfield projects. More of these projects will be mixed use. More of them will be close to neighbors. More of them will alter familiar settings. More of them will be larger than the structures they replace. More of them will increase traffic on site while they reduce traffic elsewhere by accommodating more public transit, biking, and walking trips. More political skill will be required, as well as more planning and design skill.

These problems are not going to be solved in Washington, D.C. and Wall Street and its extensions. But Washington and Wall Street have crucial roles. Each of them needs to step up. The first step is to get in touch with altered realities.

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