Home Price Trends

FALCON BRIDGE Capital

By Price Tier

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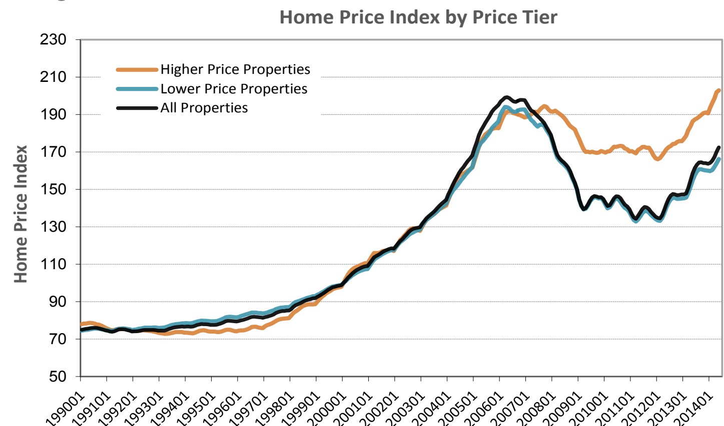
Property valuations have shown a steady trend of appreciation, with over 10% year-over-year (YoY) increases in the past 15 months (through April), and 8.78% in May. Though the growth of home prices is continuing at a modest pace, the forces at play within the housing market are changing. By means of analyzing sub-segments of the housing market we have been able to detail certain dynamics of the market that result in a disparity among the home price appreciation rates of lower vs. higher price tier properties and may affect overall price performance going forward.

Figure 1



For the purpose of this article, lower price tier is defined as properties with purchase price <= 1.25x the FHLMC loan limit, and the higher price tier is defined as properties with purchase price > 1.25x of the FHLMC loan limit.

Figure 2

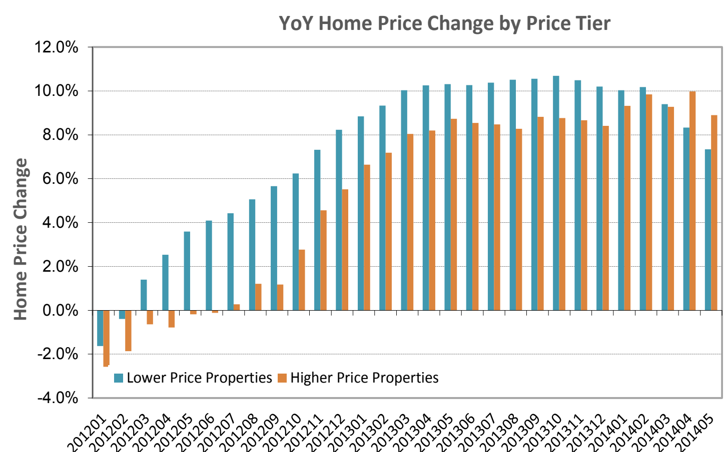


Figure 1 shows the historical trends of national home price indices of both price tiers and the combined index through boom, bust, and recovery phases of the housing market. The appreciation rates during the 2005-2007 time period were very similar across the identified property cohorts, however homes within the lower price tier experienced higher overall drop in value when compared to higher price tier properties during the housing crisis. Subsequently, the lower valued homes observed the strongest gains following the trough in February 2012 (Figure 2). **Many of these properties fell into the distressed property category and enjoyed the run-up in prices caused by foreign, individual and institutional investor demand.** Large companies, including the Blackstone Group, American Residential Properties, Silver Bay Realty Trust, and American Homes 4 Rent took advantage of the depressed home valuations and purchased single-family homes in bulk, with the intent to rent them and sell once they reached their target return on equity. Additionally, the supply in the lower end of the market has been consistently constrained as high level of negative equity of many existing homeowners prevented them from putting their homes on the market. This resulted in supply constraints and further price increases. It's important to note, however that the appreciation rates in the lower price tier have been slowing down. YoY price gains above 10% witnessed in 2013 slipped to 7.3% in May 2014. In contrast, the national price index of higher price tier properties has reached new highs in 2014, with May price index level being 4.34% above the pre-recession peak in 2007.

[1] *The FHLMC base conforming loan limit for single-family properties is $417,000 ($625,500 for Alaska, Hawaii, Guam & U.S. Virgin Islands) for 2013-2014. The limit for super conforming mortgages is $625,500 ($938,250 for Alaska, Hawaii, Guam & U.S. Virgin Islands).*

The recent slowdown in home price appreciation rates in lower tier properties vs. higher tier properties can be attributed to the combination of the following factors:

1. The shift in demand composition in the lower spectrum of the market as investor interest wanes and first-time home buyers fail to fill in the gap.
    - Investor share of the existing home sales averaged 21% in 2011-2012, but has declined to 19% in 2013 and 18% in 2014. Softening of the investor demand is a result of higher prices and tight inventory of lower priced properties for sale.
    - Decreasing affordability for first-time home buyers (who traditionally purchase homes in the lower end of the market), coupled with limited supply of homes for sale and competition from the all-cash buyers continue to be very challenging.
2. A surge of affluent buyers eager to buy in the higher price tier.

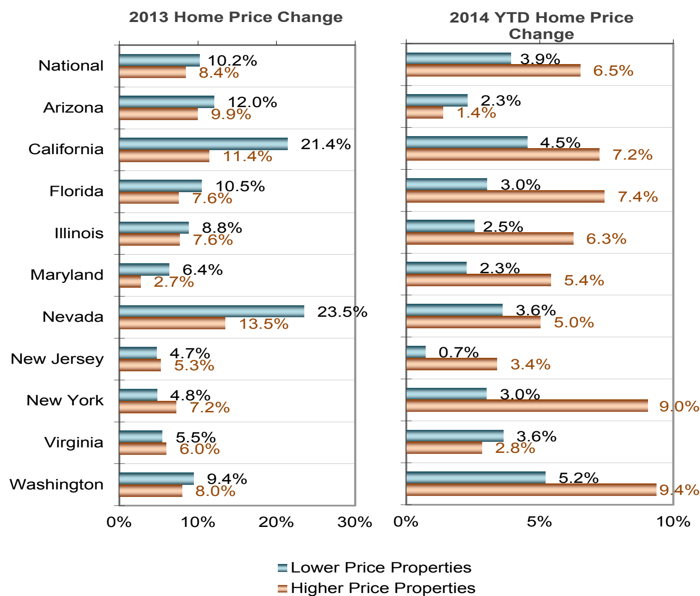
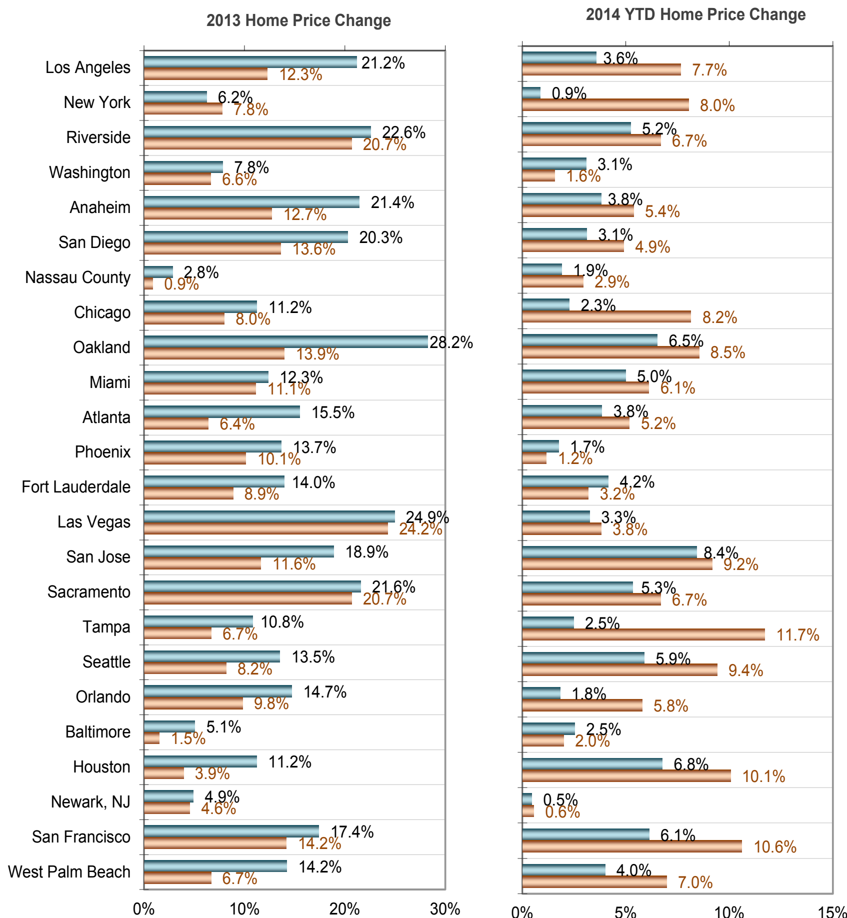


Figure 3. Home Price Change in Top 10 States

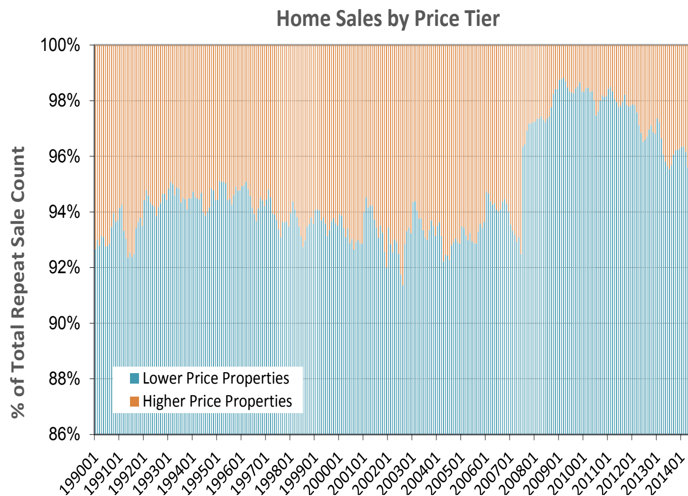
The reversal in pricing trends is also apparent on the State and CBSA/Metro level (Figure 3-4). California and Nevada show the most dramatic changes in lower price tiers when comparing data from 2013 and YTD 2014. Among the CBSAs in California, Oakland has the largest decrease in lower price tier home price appreciation, while San Francisco showed the strongest gains in higher price tier. This suggests that factor #1 has a greater effect in Oakland housing market while factor #2 is the main driving force in San Francisco.

Figure 4. Home Price Changes in Top CBSA/Metro Areas



In addition to the upward trend in home prices, the sales of higher priced properties have also been increasing since 2011 (Figure 5). The sales of higher end properties have jumped 60% in 2012, 45% in 2013, and 12% in 2014 (January through May), while the sales of lower price properties have been trending down (5.1%, 11%, and -4.3% for 2012, 2013 and YTD 2014, respectively). This once again confirms the slowing demand from Investors for lower priced, distressed properties.

Figure 5



Conclusion & Implications

Over the long-term and as the economy continues to improve, we expect the supply of homes for sale to gradually increase and first-time home buyers to replace the investor demand, both of which will result in normalization of home price appreciation across all segments of the market. In the short-term, more expensive homes will most likely continue to outpace price performance of lower valued properties given the recent market dynamic.

This has major implications for holders of Subprime securities that are typically backed by homes in the lower end price points of the housing market. Many investors have priced significant recovery rates for the remaining pipeline of distressed loans expected to liquidate through REO or Short-Sale over the next several years. Unfortunately, given the aforementioned factors, a substantial drop in loss severities in this market segment is unlikely. Furthermore, given persistently tight lending standards, Subprime borrowers will continue to face limited refinancing opportunities, especially if their equity position does not improve overtime. The fundamental challenges observed in this type of collateral will likely have an adverse effect on the valuations of Subprime securities.

Article's chart and data sources: CoreLogic, NAR, FBC

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