TALKING BUSINESS

Widespread Fear Freezes Housing Market

By Joe Nocera
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You have to wonder sometimes what they're smoking over there at the National Association of Realtors.

On Tuesday, the self-proclaimed "voice for real estate" released its "existing home sales" figures for July. They were gruesome. Sales were down 27 percent from the previous month, and down 26 percent from a year ago. Annualized, the July sales figures would translate into fewer than 3.9 million homes sold this year a staggeringly low figure. (The record high occurred in 2005, when more than seven million houses were sold.)

The months-to-sale number was depressingly high; the Realtors group reported that it now takes more than a year to sell a typical house, compared with six months in a normal market. The amount of inventory is high.

Lest we forget, these awful numbers are coming out at a time when the financial incentive to buy could hardly be stronger: the fixed rate on a 30-year mortgage is at an incredibly low 4.36 percent, according to an authoritative survey conducted by Freddie Mac.

Yet here was Lawrence Yun, the association's chief economist, trying to turn lemons into lemonade: "Given the rock-bottom mortgage interest rates and historically high housing affordability conditions, the pace of a sales recovery could pick up quickly, provided the economy consistently adds jobs," he said in a news release.

Mr. Yun went on to attribute the weak July numbers to the expiration of the Obama administration's tax credit for home buyers. They had caused consumers to "rationally" jump into the market during the first half of the year at the expense of summer sales, he said. The post-tax-credit slump, he predicted, would be over by the fall, and by the end of the year, five million existing homes would be sold. ("To place in perspective, annual sales averaged 4.9 million in the past 20 years," he said.)

Mr. Yun also predicted that home values would not fall much further, since they were "back in line relative to income." In other words, the July numbers were a mere blip.

Izzy Buholzer, left, a Miami real estate agent, shows a foreclosed home to Louis Carrasquillo and his daughter Maria. Joe Raedle/Getty Images

Clearly, Mr. Yun needs to get out a little more often. Specifically, he ought to talk to people on the ground like mortgage lenders or prospective borrowers. Talking to these people would probably give him a more sober take on the larger meaning of the latest sales numbers for existing homes. Sometimes, you see, lemons really can't be turned into lemonade.

"In the financial markets, a lack of liquidity immediately leads to falling prices," said Lou Barnes, the founder of Boulder West Financial Services. (Boulder West was acquired last year by Premier Mortgage Group.) "In the real estate market, something different happens," he added. "Illiquid real estate markets freeze." That is what is happening now. For months, the Obama tax credit had been the only grease in the housing market. Now that it is gone, the buying and selling of houses is essentially grinding to a halt.

Why is this happening? Just as the subprime bubble of 2006 and 2007 required one kind of perfect storm   namely, incentives to throw underwriting standards out the window   we are now living through the opposite kind of perfect storm. Essentially, every participant in the housing market has a reason to be afraid. And that fear is paralyzing.

The prospective buyer, for instance, has two good rationales to fear buying a new home. One is the unemployment rate. “A major psychological thing happens with high unemployment,” says Dave Zitting, a veteran mortgage banker and founder of Primary Residential Mortgages. “Those with a job worry about whether they are going to keep that job”   which, in turn, prevents them from taking the plunge on a new home.

The second reason is that, Mr. Yun notwithstanding, most people simply do not believe that housing prices are even close to hitting bottom. “In the Bay Area, a house that was worth $300,000 a decade ago became a million-dollar home,” said Greg Fielding, a real estate broker and blogger. “Now it is listed at $800,000.” That price, he suggested, was still unrealistically high. The seller, meanwhile, doesn’t want to face the fact that his or her home is too richly priced, and won’t sell at a more realistic price   which may well be below his or her mortgage debt.

There is also an immense amount of inventory that has yet to hit the market but will, sooner or later. People in the real estate business have taken to calling this “the shadow inventory.” It consists of homes for which the owners have stopped paying the mortgage but the banks haven’t foreclosed on yet, foreclosed properties that have not yet been put up for sale, homes with modified mortgages that the owners still can’t afford and will soon default on and so on.

Mr. Barnes describes the shadow inventory as akin to “ranks of Napoleonic infantry, rows deep, hidden in the fog.” This inventory, estimated by Rick Sharga of RealtyTrac to be between three million and four million homes, is almost certain to drag down home prices for the foreseeable future. “The disinterest of buyers, in an interest-rate environment that may be the lowest ever, is striking,” Mr. Barnes said. But, he added, it makes perfect sense. Since 2007, housing prices have been in a deflationary spiral, and nobody can say when it will end. “It doesn’t matter if interest rates go down to 2 percent,” Mr. Barnes said   buyers won’t reappear in big numbers until they can see the light at the end of the tunnel.

So that is what it looks like for the prospective borrower. Now look at it from the lender’s perspective. Chastened by the excesses of the bubble, mortgage lenders have swung hard in the other direction, becoming excessively, almost insanely, conservative. They demand high FICO scores. They won’t lend to anyone who is recently self-employed   even if the potential borrower has socked away a lot of money in the bank, or is making a good income. They won’t count income from capital gains.

“I have wonderful people in my office every day who would have qualified for a loan prior to the bubble” but now can’t get one, Mr. Zitting said. Mr. Barnes said: “Underwriting standards are vastly tighter than any time in my lifetime. It is choking off buyers.”

Lawrence Yun, chief economist of the National Association of Realtors, told analysts on Tuesday that “the pace of a sales recovery could pick up quickly.” Carol T. Powers/Bloomberg News

Here’s the strangest part, though: it is really not the lenders themselves who are imposing the most draconian of these tight new underwriting standards. Rather, it is the federal government. That’s right, the government.

At the same time that the administration was offering a hefty tax credit to spur home sales, the government’s wholly owned subsidiaries, Fannie Mae and Freddie Mac, were imposing rules that made it increasingly difficult to buy a home. And Fannie and Freddie have the ultimate say these days because without their guarantee, Wall Street securitizers won’t buy a mortgage from a bank   because Wall Street is just as fearful as every other participant in the market.

“The government right now is insuring something like 85 to 90 percent of the country’s mortgages,” said Daniel Alpert, a managing director of Westwood Capital. And given the enormous losses Fannie and Freddie were saddled with during the financial crisis, they are in no mood to take risks, not even on borrowers who are normally considered creditworthy. So they are saying no a lot more than they used to even though this is having a terrible effect on the housing market.

It’s even become nearly impossible for well-heeled investors to buy rental properties. This is no small matter. At the peak of the bubble, the rate of homeownership approached 70 percent. Now it is falling toward 65 percent which is more or less where it was before all the housing madness of the last decade. That means that millions of Americans who were briefly homeowners need to become renters again. They need a place to rent.

But somebody has to buy the homes they are leaving behind and turn them into rental properties. The most likely buyer is a professional investor who purchases rental properties for a living. Yet, absurdly, government rules have made it exceedingly difficult to make loans to investors who want to buy up rental properties. This only adds to the shadow inventory.

A few weeks ago, some of the better known financial bloggers had a background briefing at the Treasury Department with officials who included Treasury Secretary Timothy F. Geithner. In their blog posts after the meeting, they did not, alas, describe a government strategy that called for loosening Fannie’s and Freddie’s overly cautious standards the obvious short-term solution. Instead they described a Treasury housing strategy that was essentially a play for time.

The tax credit for home buyers; the willingness to look the other way as banks refused to foreclose, pretending that the owners still planned to pay their mortgage; the half-baked government mortgage modification programs they were all aimed at buying time until the economy recovered and employment picked up. At which point, they hoped, the housing market would have achieved enough lift that it could take off on its own.

At the end of June, though, the tax credit disappeared and that’s when time ran out. On Friday, the new G.D.P. numbers came out, confirming what everybody already knew. The economy has not recovered not even close. If the housing market is like an airplane on a runway, it is far more likely to crash at this point than it is to take off. That is why the July numbers are so scary to those in the housing business.

On the ground, they don’t look like a blip. They look like a very painful future.

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