UTAH'S ECONOMY

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HOUSING DEMAND AND PRICES

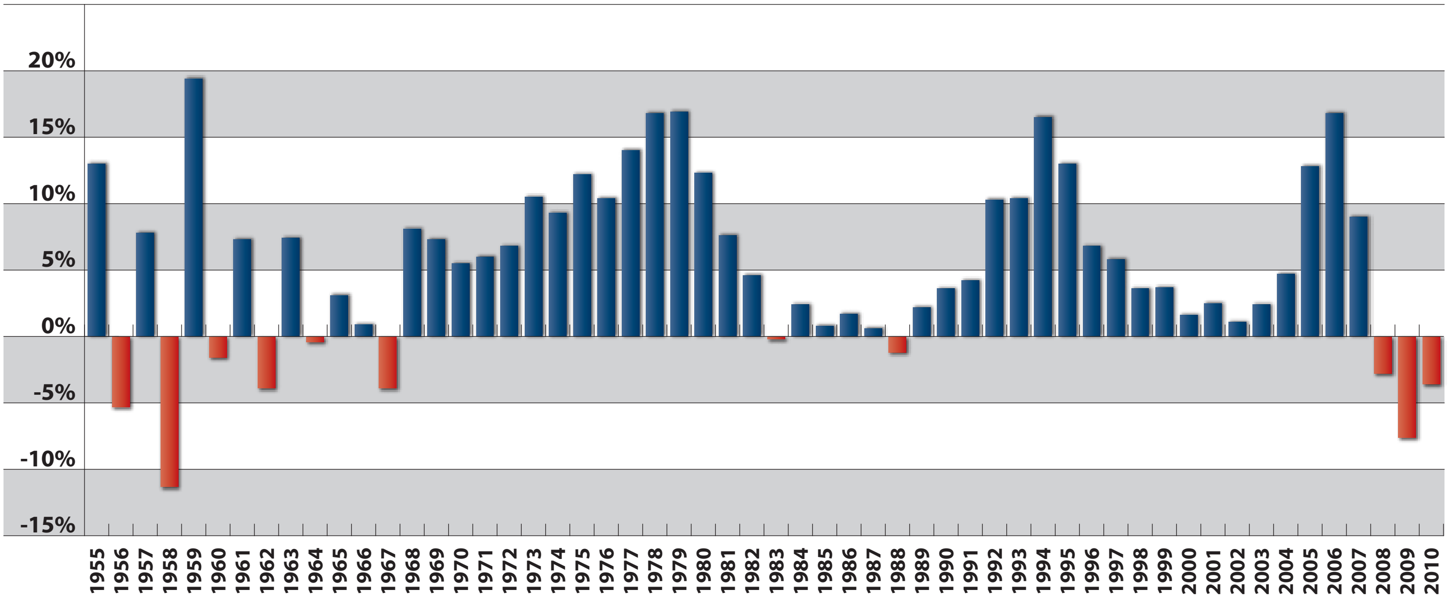
Since World War II there have been two severe contractions in the local real estate market; 1979-1982 and 2007-2010. The primary causes of the 1979-1982 collapse were severe overbuilding, 13 percent inflation rates, and 18.5 mortgage rates. Compare these conditions with the current contraction; modest overbuilding, two percent inflation rates and four percent mortgage rates. Remarkably, in the current contraction the lowest inflation and mortgage rates in 60 years, combined with 15 to 20 percent declines in home prices have done little to stimulate demand for housing. The current weakness in Utah's housing market is due primarily to a loss of demand, rather than any imbalance on the supply side.

Loss of Demand: The Causes

Employment Trends – In 2009 Utah suffered the most serious decline in jobs since the Depression. The deterioration in the job market and subsequent pessimism and loss of consumer confidence simply overwhelmed the benefits of low mortgage rates. In 2009 the Utah labor market lost over 60,000 jobs, a 5.1 percent decline in total jobs. Losses continued into the first half of 2010. However in May, after 22 months of declines, the number of jobs in Utah finally registered an increase of a few thousand. Since then, job gains have been reported every month, albeit at modest levels of one to two percent.

Household Growth – Household growth is essential for a healthy real estate market. When household growth slows down, housing demand and real estate sales drop off, which has been the story for the local real estate market. Mounting job losses and foreclosures have cut into household growth and wiped out much of the demand for housing over the past two years. In 2009 for example, the number of jobs in Salt Lake County fell by 30,000. Many of the households affected by job loss end up leaving (in most cases temporarily) the housing market. Loss of a job and income necessitates a return to family or friends and a doubling-up of households, which in effect reduces the number of households in the

Figure 1
Percent Change in Average Sales Price of Listed Homes Sold In Salt Lake County



Source: Salt Lake Board of Realtors and Wasatch Front Regional MLS.

market. If one-in-three of the 30,000 households with job losses resort to doubling-up, the number of households in Salt Lake County is suddenly reduced by three percent. Creating a demand for 10,000 housing units (owner and rental). This is a big number considering that the Salt Lake market in a very good year has 13,000 existing home sales and 7,000 new residential units. A short-term reduction of demand by 10,000 households becomes a huge headwind for the real estate and home building industry.

Migration – Net in-migration is an important component of housing demand and migration is driven by job opportunities. When opportunities vanish, migration rates fall, which in turn reduces housing demand. In most years Salt Lake County and the state benefit from net in-migration. Current data suggest that net in-migration is still occurring, but at much reduced levels. In 2010 the state had a net in-migration of an estimated 10,000 persons compared to 43,000 in 2007. These lower levels of net in-migration have without doubt hurt the demand for housing.

Foreclosures – Foreclosures have also caused doubling-up of households and further erosion of demand for housing. The number of Salt Lake County mortgage loans in foreclosure, based on estimates from the Mortgage Bankers Association, was about 7,000 in 2010. Those households that suffer a foreclosure are generally forced from the housing market often doubling-up with family or friends.

Housing Prices and Negative Equity – Unlike the 1979-1982 slump, a prominent feature of the current contraction is falling prices. Historically price declines are very rare in Salt Lake County. From 1967 to 2008 prices declined in only one year, 1988, *Figure 1*. However, over the past three years the average sales price declined by 2.8 percent in 2008, 7.6 percent in 2009 and 3.6 percent in 2010. (Historical median price data are not available prior to 1997, therefore in this case, average sales price was used). Unfortunately this rare decline in prices pushed many homeowners "underwater," e.g. owners owe more on the mortgage than their house is worth. There is a pretty good probability that any homeowner who has purchased or refinanced their home since 2006 is "underwater" or has negative equity. A homeowner with negative equity has little chance of selling their home and moving-up, which has traditionally been a common feature of the real estate market, a feature that stimulates real estate sales. The ability of a homeowner to move-up depends on two factors; a creditworthy buyer and a creditworthy seller. Negative equity has caused havoc with creditworthiness. The percent of homes with negative equity in Utah is estimated by First American CoreLogic at 22 percent, which ranked eleventh among all states in 2010. The emergence of negative equity in this contraction is another factor that has hurt the demand for housing.

Outlook for Prices

A look at the three measures of housing prices in Utah; Federal Housing Finance Agency Index, National Association of Realtors and Wasatch Front Regional MLS shows that over the past three years housing prices have declined between 11-21 percent, *Table 1*.

According to the local MLS the median sales price of a home in Salt Lake County peaked in the third quarter of 2007 at $256,000. Prices then drifted down over the next three years to $230,000 in second quarter 2010. However, the rate of price decline has narrowed substantially in the past two quarters as shown by the upward bend, *Figure 2*.

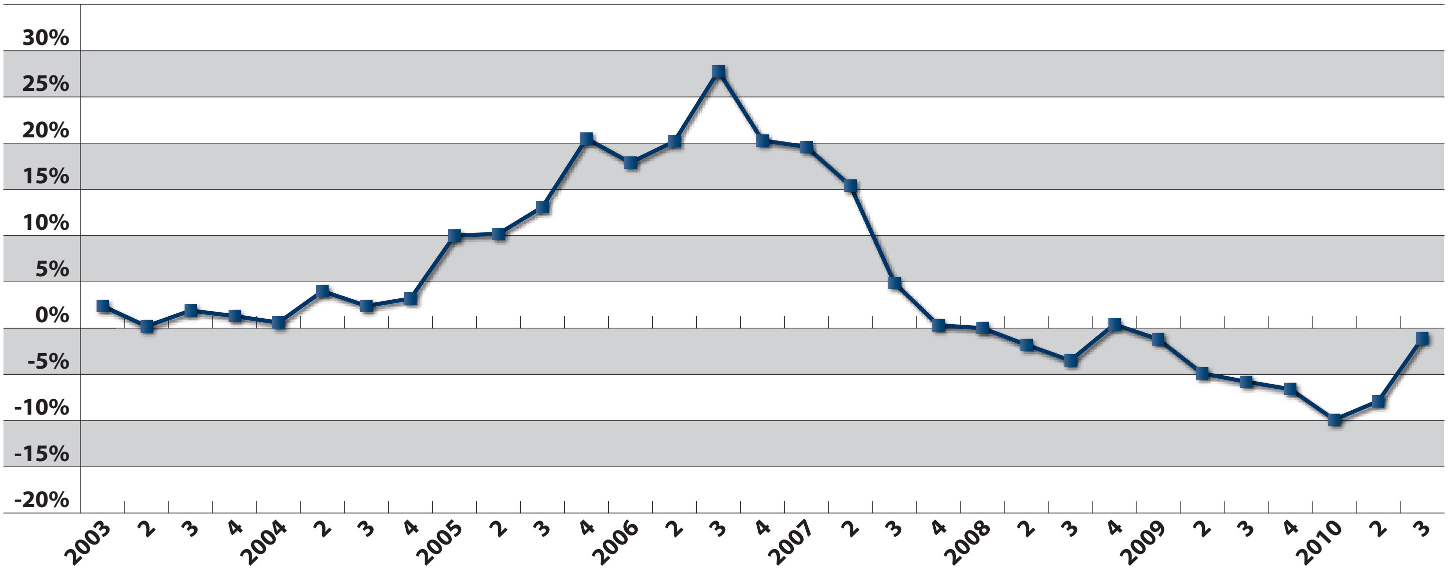
Prices will likely be unchanged through the first two quarters of 2011 with perhaps slight gains in the third and fourth quarters. Continued price pressure from foreclosures and short sales will prevent upward movement in prices in 2011. In the end, any meaningful rise in home prices depends on a pick-up in housing demand, which will require an improvement in the job market, higher levels of household growth and fewer foreclosures. These conditions will gradually be satisfied over the next few years but in the meantime housing prices are likely to remain stable, with more downside risk than upside potential.

Table 1
Change in Housing Prices

Source	Peak Value	Peak Quarter	3rd Quarter 2010	Percent Change From Peak
Federal Housing Finance Agency (State)	324.3 (Index)	3rd Quarter 2007	256.8	-20.80%
National Association of Realtors (Metropolitan Area)	$246,600 (Median Price)	3rd Quarter 2007	$215,600	-12.60%
Wasatch Front Regional MLS (Salt Lake County)	$256,000 (Median Price)	3rd Quarter 2007	$230,000	-11.10%

Source: Federal Housing Finance Agency, National Association of Realtors, Wasatch Front Regional Multiple Listing Service.

Figure 2
Percent Change in Median Sales Price of Existing Homes in Salt Lake County



Source: Wasatch Front Regional MLS.

