C.F. WHITTELSEY HOLDINGS

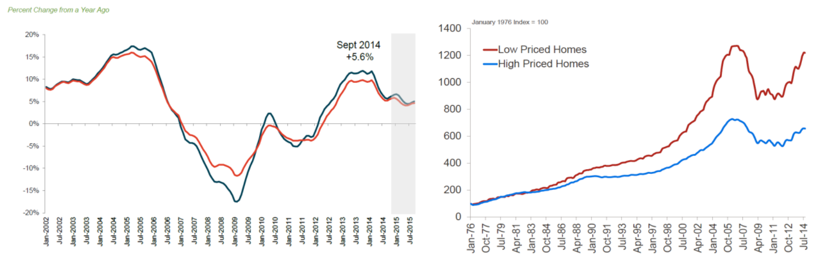
Weekly Market Review

November 10, 2014 — November 14, 2014

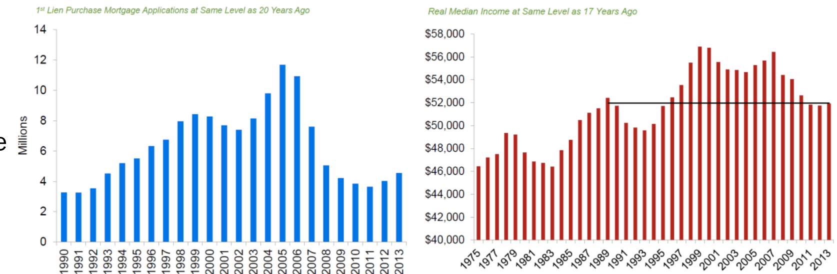
“Property now becomes the most easily recognized evidence of a reputable degree of success… it therefore becomes the conventional basis of esteem. Its possession in some amount becomes necessary in order to have any reputable standing in the community….therefore, it becomes also a requisite to that complacency which we call self-respect.” - Thorstein Veblen - Theory of the Leisure Class

To be fair, the above quote comes from Thorstein’s critique of the ‘Leisure Class’. However, it does speak volumes about the role that property plays in society, and how that role hasn’t much changed over the centuries. In that spirit, lets have a look at what is going on in the United States property markets ahead of next weeks glut of housing data (Housing Market Index, New/Existing home sales, Housing Starts, PPI and CPI). All the graphs here are from Core-Logic’s recent Data, Demand, and Demographics conference.

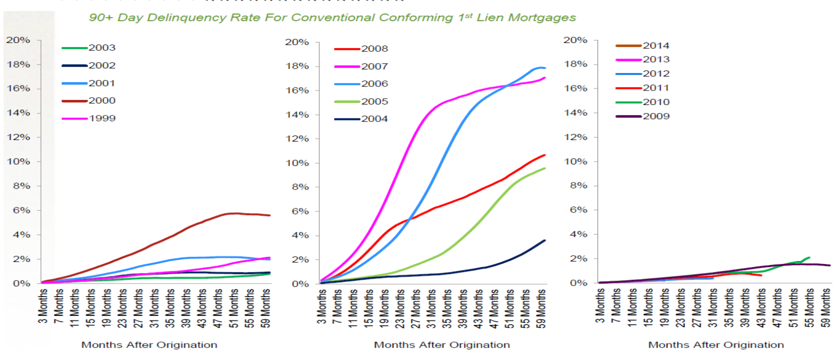
It appears the main story here is home prices are decelerating, but still positive. There seems to be a trend in the industry where lower priced homes are experiencing the most price gains. This either speaks to affordability issues (or perhaps the cost to construct outweighing the current market price for a home of that sort) or froth in that part of the market. But why the meaningful rise in low priced homes?



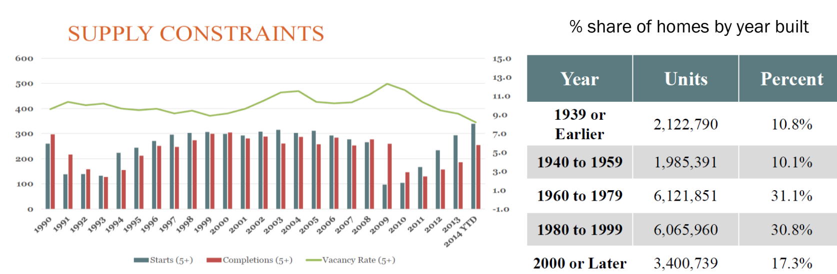
Prices rise because demand exceeds supply. So is it a supply problem or a demand problem? I have pontificated on the demographic reasons for low mortgage demand in past writings, so lets focus here on something new. It likely is not an accident that mortgage applications are the same as in the mid 90s—an observation similar to the real median income. Unless we see increases in real median household income, we will not see meaningful increases in housing applications unless credit opens up



Credit constraints will likely exasperate the migration toward renting as the years go on. The 90+ day delinquency rate for conventional mortgages by vintage speaks volumes to the conservative nature of lending in the post crisis era and forces one to think to the degree to which banks can take on more credit risk. Current GSE reform and legal battles over poor udnerwrting standards will keep mortgage originations pretty conservative for the time being.



There is a clear disconnect between starts and completions in the housing market. While I’m not certain as to what is driving that trend, or what the trend even means, its clear that we have an aging housing population with over 50% of homes built before 1980. I suspect that starts will begin to decline as the market feels out how much new capacity it can take on without compromising price.



% share of homes by year built

Year	Units	Percent
1939 or Earlier	2,122,790	10.8%
1940 to 1959	1,985,391	10.1%
1960 to 1979	6,121,851	31.1%
1980 to 1999	6,065,960	30.8%
2000 or Later	3,400,739	17.3%

Based on a study by Core Logic, homeowners believe that the value of their home is about 15% more than current prices. This creates a higher reservation price and an unwillingness to trade up, keeping volumes relatively subdued. To be sure, LTV ratios are very high relative to past default cycles so the supply of credit is limited which increases switching costs for buyers, especially those buyers that hold <640 credit score, for which there is very little credit. We should keep an eye on these credit trends. There is clearly room for more credit risk, as observed by delinquency rates in recent vintages, as well as the recovering LTV ratios and equity share driven by three years of positive home price appreciation.