

Home Price Analysis for Louisville

By the Research Division of the National Association of REALTORS®

Executive Summary

With home prices rising strongly in most parts of the country, there has been widespread media coverage on the possibility of a housing market bust. A thorough analysis of the Louisville metro market, as detailed below, reveals that there is very little danger of this. In fact, the local housing market is in excellent shape with a potential for significant housing equity gains, particularly for homebuyers who plan to remain in their house for the long run.

The local market has very favorable home price-to-income ratio and even better mortgage servicing cost-to-income ratio. The latter ratio is currently below the local historical average. It implies no widespread financial overstretching to purchase a home in the region. Any respectable gains in the local job market will translate into substantial home price gains.

	Louisville	Top 20 Metros	National Average	Comment
Price Activity				
Current Appreciation	3%	25%	13%	Modest
3-year Appreciation	9%	79%	32%	Modest
Affordability				
Home Price to Income Ratio*	1.5	3.8	2.3	Very Favorable
Mortgage Debt Servicing Cost to Income Ratio **	11%	30%	16%	Very Favorable
Local Fundamentals				
3-year Job Growth	-1.5%	7.2%	2.4%	Unfavorable
Housing Starts to Total Employment	1.4%	1.0%	1.5%	Neutral
Net Migration	5,700	19,100	0	Unfavorable
Risk Factor	Nationwide, there has been an increased use in exotic mortgage loans of interest only and adjustable rate mortgages. Though, such data are not readily available for the local market, it is likely following this national trend. Therefore, rising interest rates will place some homeowners in greater risk of default. But the risks are mitigated from recent healthy job gains. Given the favorable housing affordability, significant gains in home prices are certainly possible, particularly if the job market strengthens.			

* Income is per capita income times average number of person per household

** Servicing cost is the mortgage obligation relative to income at the prevailing mortgage rate

Price Activity

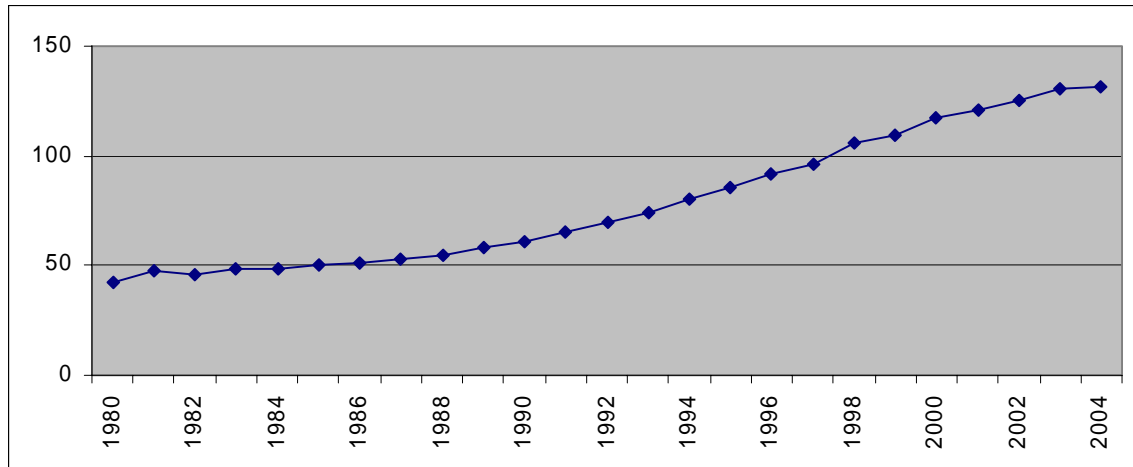
- The current price of \$ 136,800 is 30 % below the national average.
- The median home price grew 0.2 % in 2004 and by 9 % in the past three years.
- Past price trends have always been mostly steady - neither declining nor rising very fast.
- Home price is very affordable in light of improving job market conditions and from favorable in-migration trend into the region.

Annual Data	2005*	2004	2003	2002	2001	2000
Existing Home Price (in \$thousand)	136.8	131.2	131.0	125.1	120.6	117.7
% change	4.3%	0.2%	4.7%	3.7%	2.5%	7.5%

Quick Glance	3-year Price Appreciation	Home Price-to-Income Ratio	Mortgage Servicing Cost to Income	Historic Local Average on Mortgage Servicing Cost	12-month job gain	Local price vs national
	9%	1.5	11%	15%	7,300	0.7

* 2005 price is as of second quarter and is usually a good estimate of the annual average price.

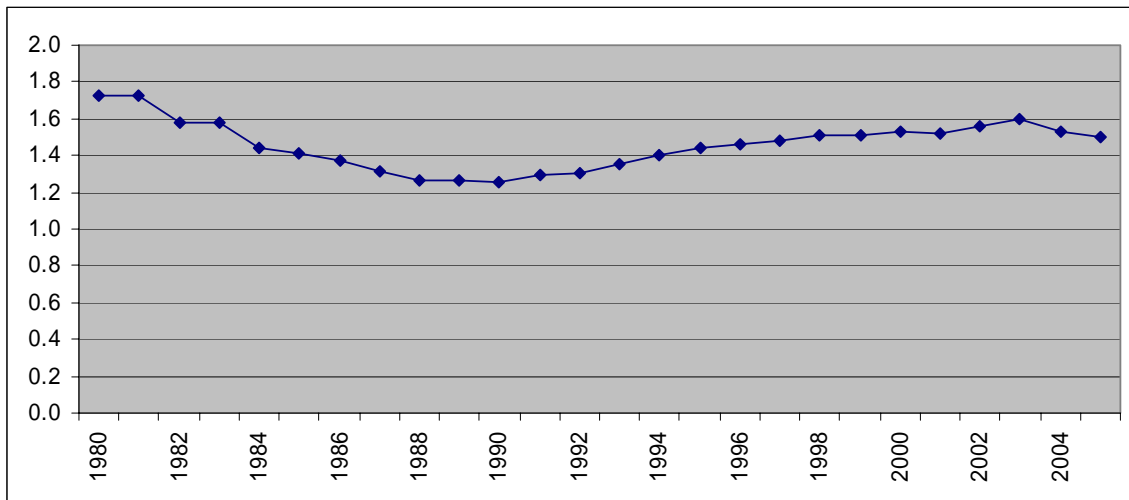
Home Price (in \$thousand)



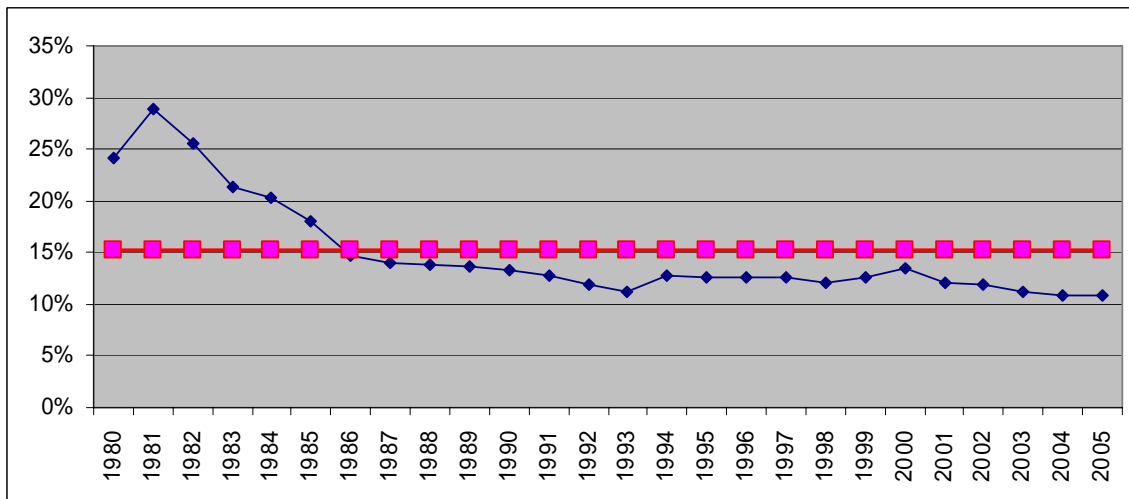
Affordability

- The ratio of price-to-income has fluctuated in a very narrow range over the past 20 years. By this measure, there is certainly no price bubble.
- Mortgage rates declining to 45-year lows have been a major force in boosting home prices in recent years. Lower rates allow homebuyers obtain a larger loan without necessarily increasing monthly mortgage payments.
- A more relevant measure for assessing the risk of a home price bubble is the median mortgage servicing cost relative to the median income. This ratio is currently well below the local historical average. It implies no widespread financial overstretching to purchase a home in the region and a huge potential for a significant price gains.

Price to Income Ratio



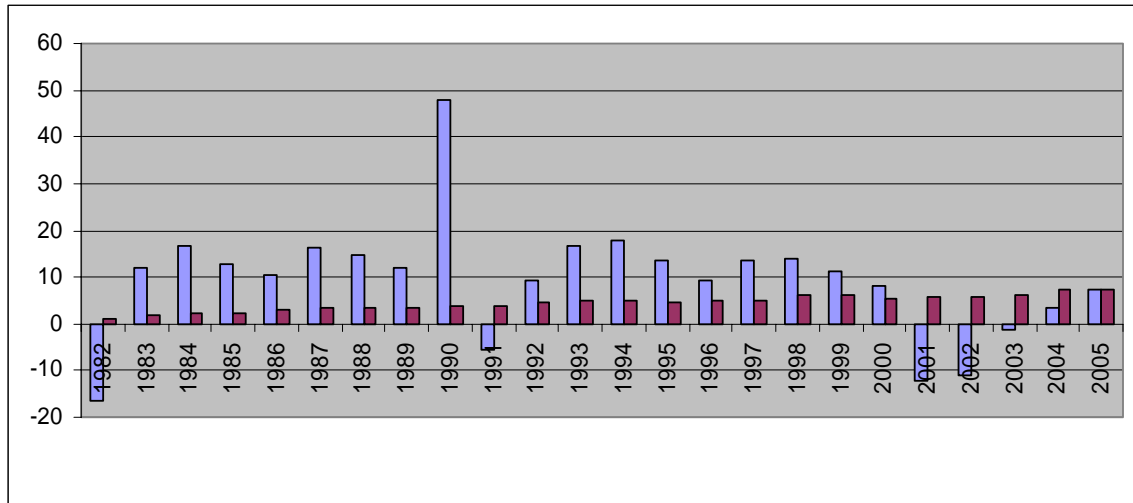
**Mortgage Servicing Cost to Income Ratio
(Historical average shown as square boxes)**



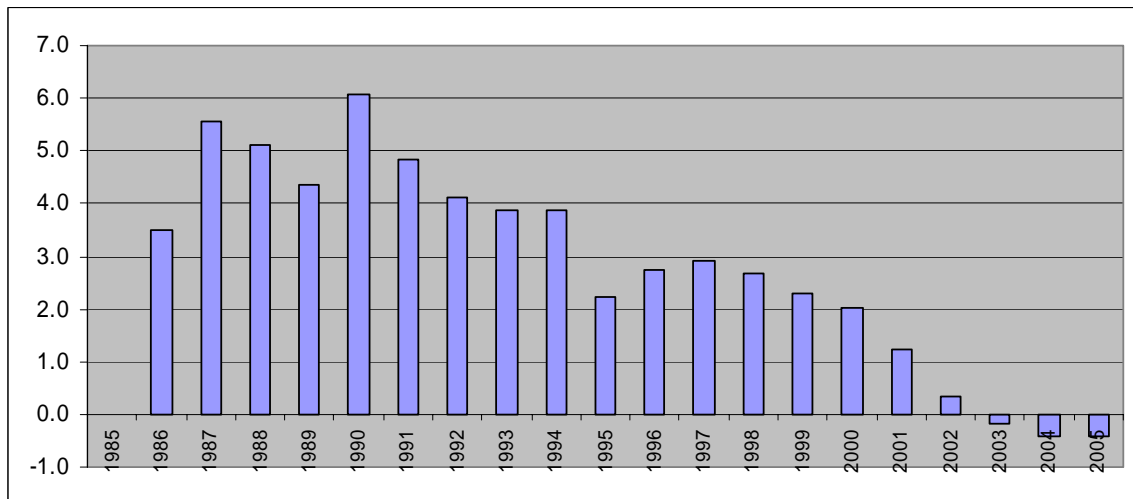
Local Fundamentals

- The job market has been improving after taking a sharp hit in 2001 and 2002. There have been 7,300 payroll job additions in the past 12 months. Many new job holders seek their own housing units.
- The region added in the past five years an estimated 38,000 new housing units of which about 33,000 were single-family units.
- The ratio of five-year job gains to five-year new home construction shows the “hangover” impact of the housing shortage, or housing surplus. In our case, the local market is a bit oversupplied as the ratio is less than zero. With recent job gains and the expected continued economic expansion, the jobs-to-new home ratio will likely increase over time.

Job Gains (light/blue) versus New Single-family Housing Starts (dark/red)

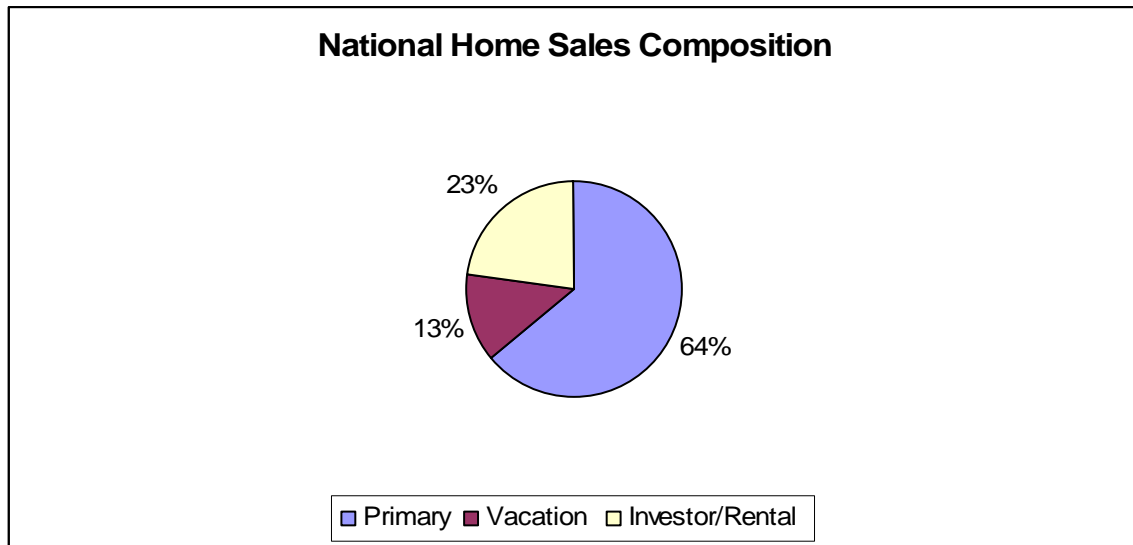


Ratio of 5-year Job Gains -to- 5-year New Single-family Home Construction



Other Factors

- There is no good information regarding interest-only loans in the local market. But if it reflects a national trend of a higher usage of interest-only loans, then some homeowners could feel the pinch of higher rates over time.
- The baby boomers in their peak earning years and have been active in purchasing second homes, which many consider their future retirement homes. The baby boomer impact could continue for another decade.
- With many top southern retirement destinations getting quickly unaffordable in the past five years, some retirees may turn to more affordable regions of the country. Perhaps, the local region gets a slight lift as a result.



Stress Test

- Price declines in the local market are unlikely according to our stress test.
- The local housing market will experience a price decline of 5% only under extreme unlikely scenarios of much higher mortgage rates. For example, mortgage rates rising to 19% in combination with 15,000 job losses could lead to a price decline. Job gains do not help at higher rates.
- Other scenarios that could lead to a price decline of 5% are shown below.

Mortgage Rate	Job Gains/Losses
19.0%	-15,000
20.0%	4,000
20.5%	11,000

- Such scenarios are highly unlikely. Most credible forecasts predict the region will create at least 7,500 jobs over the next 24 months and mortgage rates will hover around 7% by the end of 2006, which bodes well for future price gains.
- Even in the unlikely event of prices declining by 5%, most homeowners will maintain sizable equity build-up in their homes. The table below shows the home equity gains if prices were to fall by 5% by homebuyers at various years of purchase.

Year of Purchase	Housing Equity after 5% price decline (home price appreciation + principal payments on mortgage)
1980	\$108,409
1985	\$93,265
1990	\$81,645
1995	\$54,648
2000	\$17,933
2001	\$14,763
2002	\$8,988
2003	\$2,546
2004	\$490
2005	-\$6,840

- Housing equity will most likely continue to accumulate to local homeowners. The equity gains under three price growth scenarios are presented below. One scenario assumes a historical conservative price appreciation of 1.5% above consumer price index inflation. With most credible inflation forecasts pegged at 2.5%, home prices can expect to rise by 4% per year under normal circumstances. The two other scenarios assume slightly below (1.5%) and slightly above (6.5%) the normal rate of appreciation.
- The local market is more likely to appreciate at an above-normal rate because of the low business and very affordable housing cost conditions.

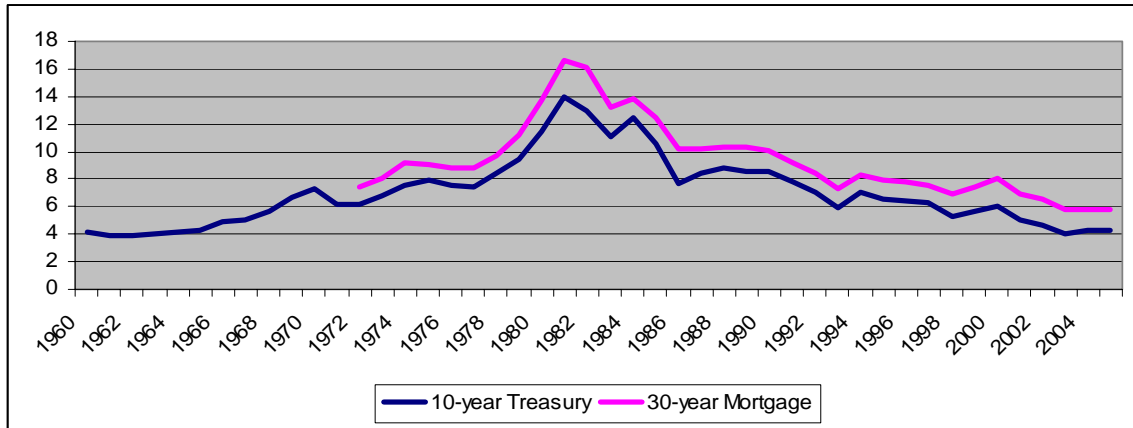
Housing Equity Gain			
Appreciation Rate	1.5%	4.0%	6.5%
2010	\$22,611	\$41,677	\$62,666
2015	\$44,260	\$87,996	\$142,291
2020	\$73,904	\$149,241	\$254,700
2030	\$156,081	\$322,278	\$618,021
2040	\$230,355	\$539,825	\$1,239,716

Additional Discussion Points

- Home price declines are very rare. In fact, the national median home price has not declined since the Great Depression of the 1930s. Stock market collapses, the OPEC oil crunch, economic recessions, and even wars have not negatively impacted national home prices since the 1930s.
- There have been few times when local prices declined. In nearly all these cases, the price declines were accompanied by sharp prolonged job losses. It is difficult to foresee a price decline in a job creating economy.
- Homes trade far less frequently than financial assets (about one home sale every 7 to 10 years for most homeowners). There are also larger transaction costs associated with selling a home due to the lengthy careful examination demanded by home buyers and sellers. Therefore, home prices are not prone to fluctuations as in the stock market. There are neither panic sells nor margin calls associated with homes.
- Many non-quantifiable factors could be important for this metro market in determining home prices. Access to cultural life, the quality of museums, nearby local and national parks, water views, exclusive neighborhoods, weather, the international airport, city vibrancy, restaurants, and a host of other non-quantifiable factors could have an important influence on the overall pricing.
- There are immense tax benefits to owning a home. These tax considerations were not considered in the analysis. For example, the 1998 law permitting primary owner occupants to trade down without having tax consequences. Also most home sales results in no capital gains tax. In addition, long-term capital gains tax rates were reduced in 2003, thereby providing higher return for home investors. These positive benefits, if accounted for in the analysis, would have shown an even stronger case for housing fundamentals in supporting home prices.

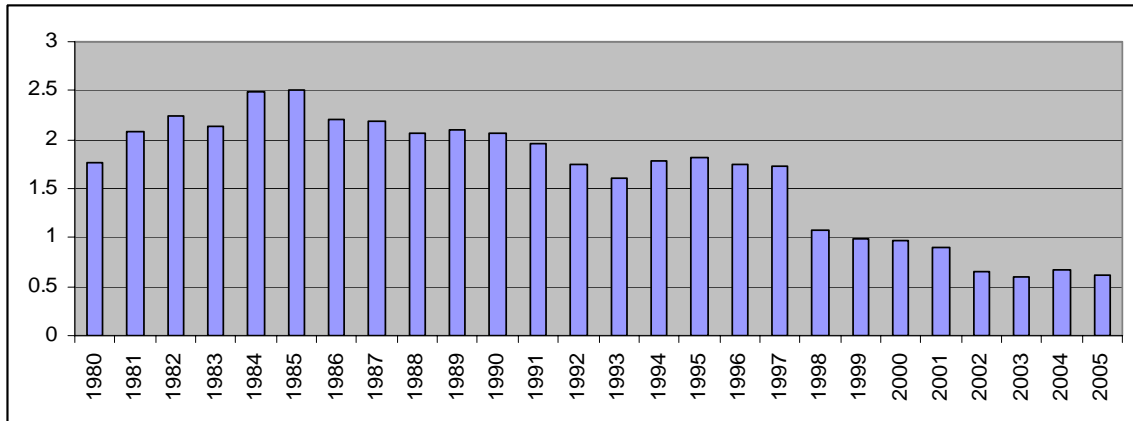
Additional Informative Charts

45-year Low Mortgage Rates



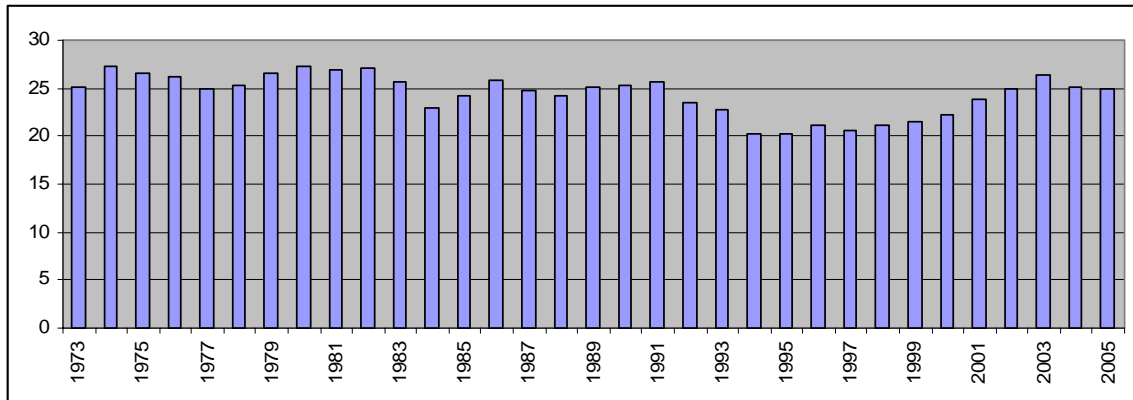
Source: Freddie Mac, Federal Reserve

Historic Low Fees and Points for Mortgage Origination



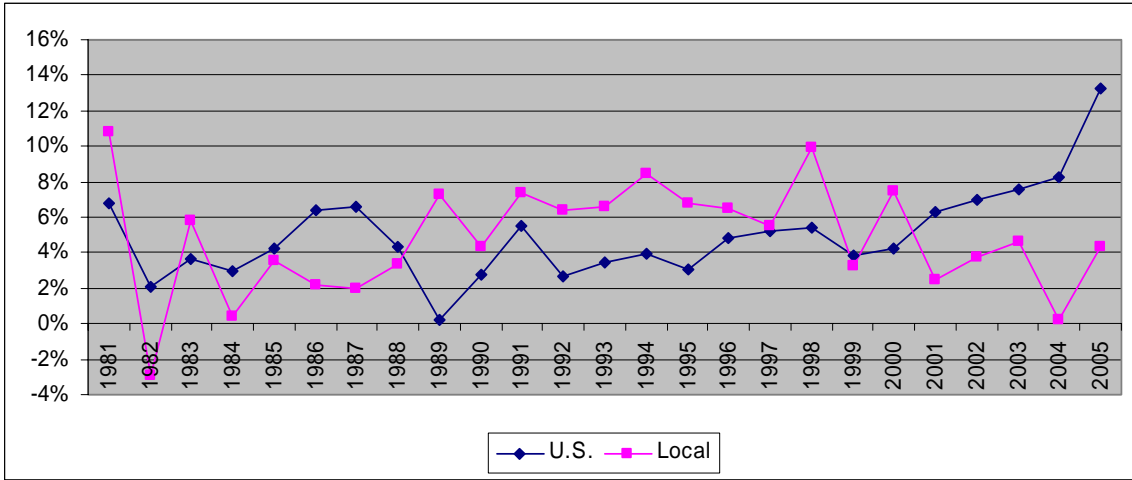
Source: Freddie Mac

Typical Down-payment Percentage Returning to Historic Norms



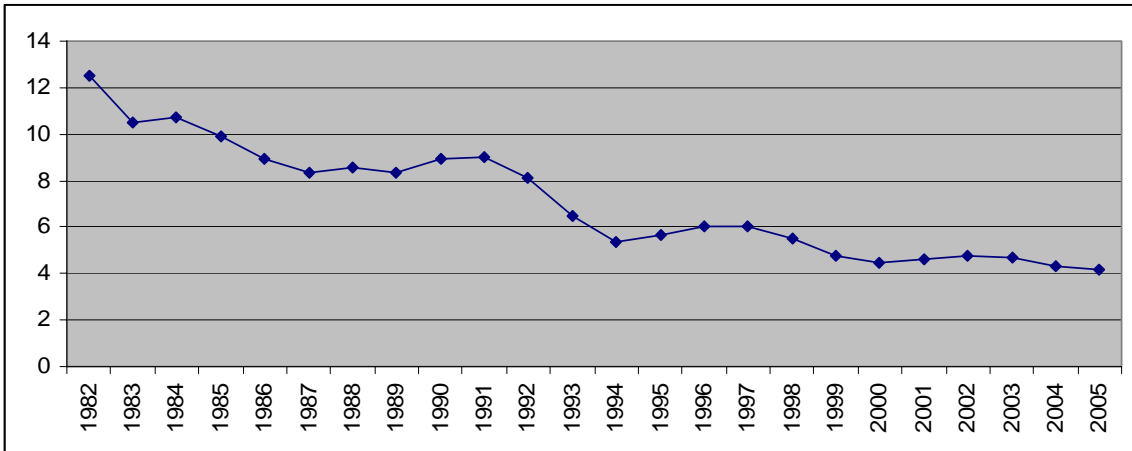
Source: Federal Housing Finance Board

Home Price Growth

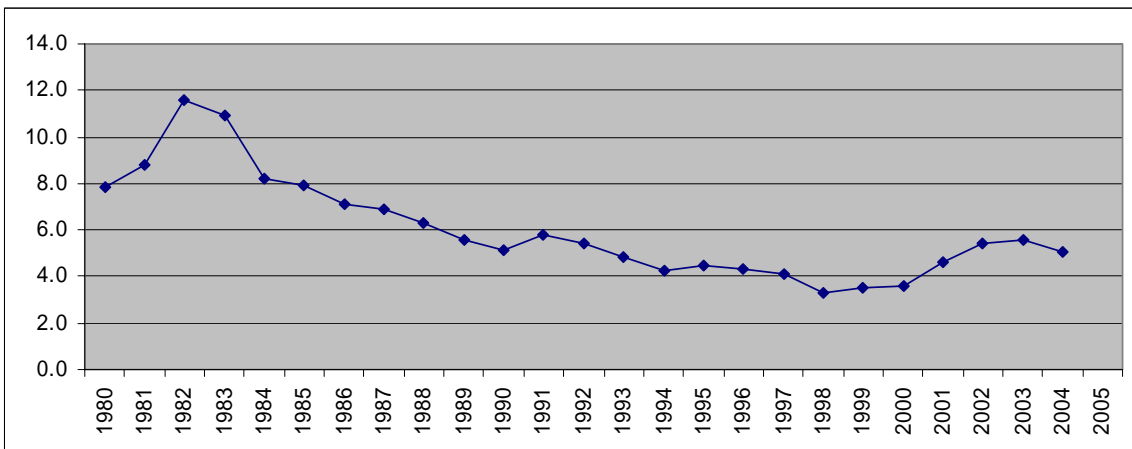


Historic Low National Months Supply of Homes on the Market

(The number of months it would take to sell all current homes on the market at the current sales pace)



Local Unemployment Rate



Source: BLS

NAR Research

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