TMO NEWS

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Surprise! Some Cities Are Actually Experiencing Housing Shortages

By Morgan Brennan

A condo unit in the New York City high rise I call home came to market. It was priced to sell and I was interested. Merely five days after a listing flyer hit my mail box, the unit was already in contract for the full asking price. The realtor told me this wasn't unusual.

Manhattan inventory levels have been diminishing, as the local population continues to expand and foreign buyers continue to plow cash into safe haven investments. The vacancy rate is around 1%, according to Citi Habitats, and new residential construction activity for the decade starting in 2010 is projected to be the slowest seen since the 1960s, according to the Real Estate Board of New York (REBNY).

In New York City, where building regulations mean new homes are slower to materialize, perhaps tight supply doesn't sound all that surprising. But a larger look at inventory levels across the U.S. indicates that the Big Apple is not alone.

Contrary to the post-bubble narrative of a buyer-less housing glut, inventory levels in some markets have contracted. Some have even begun to experience housing shortages for the most sought-after types of property. And a lack of new construction means those shortages may be prolonged.

Listing inventory is down nearly 20% from a year ago, according to Realtor.com, and for-sale inventories declined in all but two of the 146 metropolitan markets that the listing site tracks. The average time homes spend on the sale block has decreased too, down about 30% from a year ago, according to the National Association of Realtors. It's spurring bidding wars in certain neighborhoods and in some instances, sales in which buyers are paying more than the asking price for some highly prized properties.

The dwindling number of available homes is leading to price jumps in certain areas, even among foreclosure transactions (RealtyTrac reports a 6% increase in average foreclosure-related sales prices in the second quarter). Last week's S&P Case-Shiller 20-city composite index showed prices were up 1.2% in the first quarter from a year earlier in their first year-over-year gain since September 2010. The biggest gainers: Phoenix, Miami, Minneapolis and Denver.

But construction remains moribund. Despite an uptick in residential construction starts this year, activity is still about 50% lower than a healthy (non-bubble) market requires. The number of newly constructed homes is actually hovering near a 50 year low.

Such is the case in Phoenix. Residential inventory in Arizona's capital city is down more than 30% from last year. In the greater metro area, about 12,000 homes were listed for sale as of August (excluding listed homes with pending short sale offers); in a healthy market it's typically 34,000 or nearly three times that number.

"If you're a buyer, you feel short of product here because it's not unusual to find 10 or 20 or even more offers on every listing," says Mike Orr, director of the Center for Real Estate Theory and Practice at the W. P. Carey School of Business. This is particularly true in the lower price tiers, on homes listed at $250,000 or less (local luxury homes have experienced markedly less activity). The lack of lower priced inventory has led to a 29% jump in median sales prices for all homes as of June, compared to a year earlier.

Yet construction activity in the desert metropolis, which was hard hit five years ago by the housing bust, hasn't exactly resurrected from the dead. "Builders aren't really cranking out product like they were…they are stymied by constraints," notes Orr. Constraints include a lack of on-hand ready-to-build lots (the price of pre-developed land lots has skyrocketed), tight lending standards for small to mid-sized builders, and a notable shortage of construction workers since tradesmen fled the city several years ago and have not returned.

"Inventory levels are nowhere near enough to keep up with demand and that implies that price will continue to go up until we attract more sellers into the market," asserts Orr. He expects inventory levels, which eased slightly in August, to fall further during the city's February-to-June selling season.

"The home builders really need to start ramping up production because all of the inventory measures are trending down and the only way to resupply is with new building activity," asserts Lawrence Yun, chief economist of the National Association of Realtors. He is closely monitoring supply, particularly in western markets like Phoenix, Las Vegas and certain California towns where first-time buyers battle with investors at the lowest price points.

"Nationally, we have the lowest inventory of for-sale homes ever," echoes David Crowe, chief economist of the National Association of Home Builders. He says 38,000 completed new homes are currently for sale across the entire U.S. To put that in perspective, that's slightly less than the 40,000 homes that traded hands annually in Atlanta, Ga. alone during the early 2000s.

"There isn't a pipeline of developed lots that will feed new construction and that pipeline is long in the sense that it takes a long time to get approval," Crowe adds. In states like California, acquiring land, subdividing it and adding necessary infrastructure to enable development typically takes seven to 10 years. Even in states like Texas, where building regulations are minimal, that process takes two years. After the downturn, developers shied away from refilling their so-called pipelines in many parts of the country.

Despite these concerns, a number of economists doubt inventory shortages will last. After all, economic growth remains weak and the looming fiscal cliff could seriously hamper buying activity. Then there's the much-anticipated shadow inventory, or cache of distressed homes yet to hit the market. Shadow inventory totals 1.5 million units, according to CoreLogic, representing a four month national supply that could impact the supply side as well as prices. And 11.4 million, or 23.7% of all residential properties with mortgages, remain underwater, with owners still owing more than their homes are worth.

Frank Nothaft, the chief economist at Freddie Mac, addressed this argument in an August research note: "the relatively small amount of new construction, coupled with increased household formation, has allowed much of the excess vacant inventory to be absorbed over the past few years. The national data obscure the fact that some local markets have clearly tightened (that is, with rents rising and home-value gains) while others continue to have excess vacant stock."