SCHWARTZ *Report*

November, 2018

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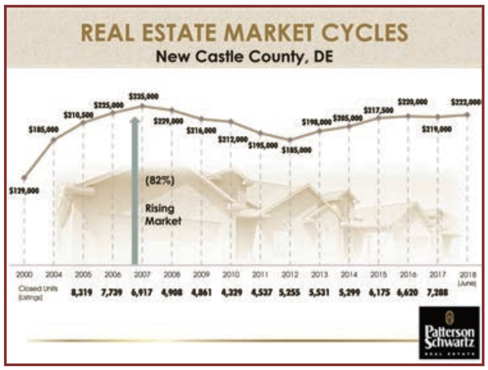
Ten Years Later

Did the Great Recession of 2008 cause the housing bubble to burst or was it the other way around? Here's how Holman Jenkins framed the question in one of his recent Wall Street Journal editorials: "Claims of a national housing bubble as the precipitating event always seemed dubious when referring to an asset class whose prime differentiator is location, location [and] location." Was there ever a housing bubble in the first place? He muses that what bubble there was confined itself to a few "subprime hot zones" mainly in the Northeast, West and Southwest. So, if those areas sneezed, why did the rest of the country get sick?



Now comes a data driven analysis by George Mason University's Kevin Erdman which concludes that some areas never stopped being hot because their restrictive building and zoning regulations make it "legally impossible to supply the housing demand by the non-rich." He labels them "Closed-Access Cities" in which prices shot up because even a building boom, which was not taking place, could not keep up with the demand. Mr. Erdman poses the interesting theory that tight housing supply and bourgeoning demand in these so called closed access areas foisted migration events into "Contagion Cities" most notably in the areas of inland California, Nevada, Arizona and Florida which had more generous building policies. He puts it this way: "In the years leading up to the financial crisis, the shortage of housing in Closed Access Cities had become so severe that each year hundreds of thousands of households moved away in search of an affordable home." So, the event that burst the bubble was a demand driven shock, not a supply driven one!

We have seen some of this sort of migration particularly to Kent and Sussex counties because Delaware is surrounded by high-cost, high-tax states with Closed Access Cities as well. The conventional view of a bursting housing bubble driven recession is, according to Mr. Erdman, not sufficiently borne out by the facts. It was not caused by Americans over investing in housing in a misappropriated speculative effort. To use former Federal Reserve Chairman Ben Bernanke's explanation that too many houses had been built and during the Great Recession that oversupply was being worked off, misses the point according to Mr. Erdman. He says there never was such a "supply overhang" except perhaps in the Contagion Cities which migrating households vacated after witnessing unsustainable price increases there as well. American households spend a consistently stable percentage of their income on housing. However, he says, they continue to also get less house for it. The relative unchanged level of household income means that they have had to reduce their consumption of housing or move in order to keep their housing expense at a stable level.

The relative number of new housing units increased marginally from 2000 to 2005 but remained below previous peak levels. From 1959 to 2005 the number of homes built annually averaged 1,669,000 units. According to Mr. Erdman, at the peak of the boom years the number of housing units added was only slightly above this long term average and single family home construction actually took market share from other types of housing units. That developed because of continuing barriers to the construction of higher density dwellings.

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Closed access areas show household income levels that are much higher than incomes in other areas but, as you might expect, that extra income there is going into housing expense.

From 1979 to 1999 median household income rose from $52,000 to $60,000. It barely moved from 2000 to 2016. The following year, 2017, is the first year the median household income level exceeded 1999 at $61,400. So, to keep their housing expenditure stable, households have had to put more people to work or occupy less space. The Federal Reserve has raised its Fed funds rate for the third time this year and is signaling another increase for December. Undoubtedly the cost of borrowing to purchase a home, now just below 5% on a fixed- rate thirty- year loan, will rise in tandem.

According to Zillow, there is a 6.3 million unit deficit in the nation's housing stock that will need to be made up to balance supply and demand. Over the last ten years there have been 1.9 approved single family building permits per 1,000 people whereas historically that ratio has been 3.9 per 1,000. Had construction continued at this 3.9 level those 6.3 million units would be here today. Perhaps this is a fitting statistic for 2018 as this is the 71st birthday of Levittown, New York where at one point former Seabee William Levitt and his company were able to finish a house every 16 minutes.

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