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# Gem *insight*



April 2010

Property Management - Leasing/Sales - Appraisal/Consulting - Public Sector

## Well...

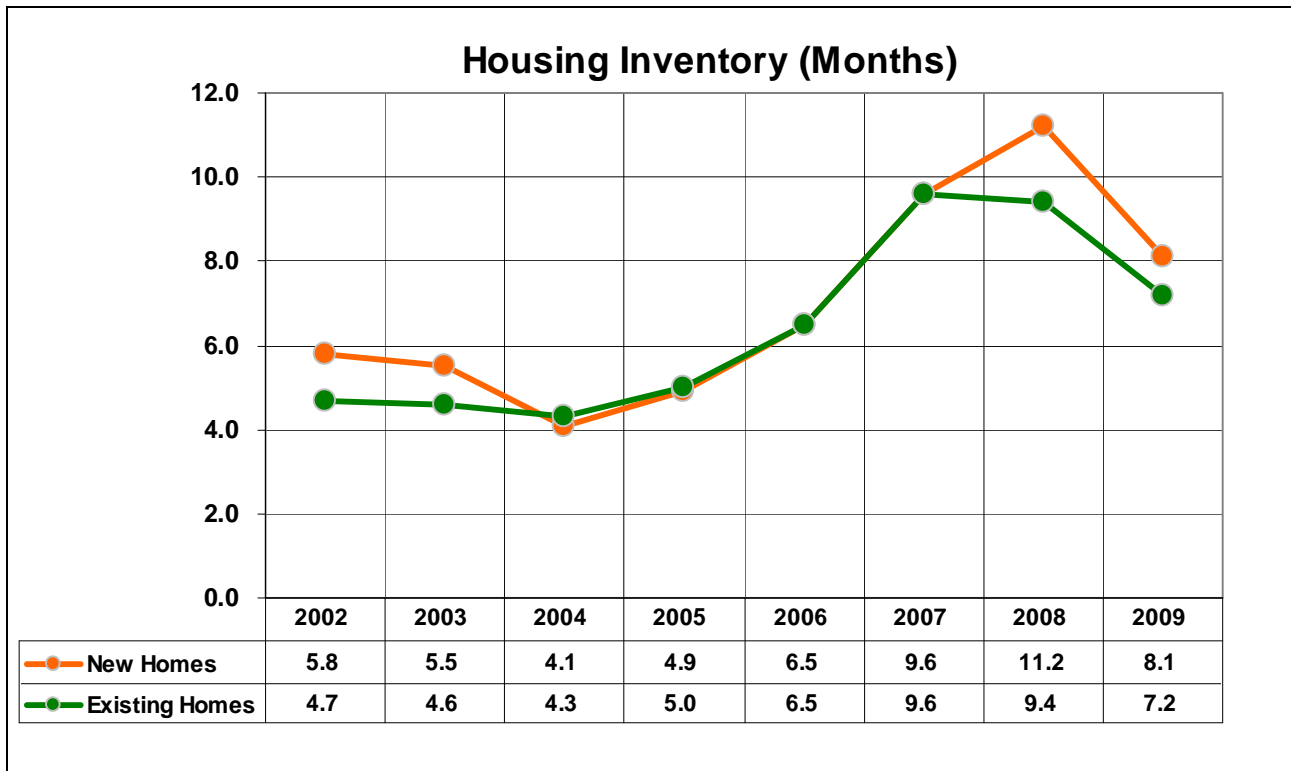
By Tom Sherick, MAI, Senior Vice President Gem Real Estate Group

12-Months ago, my viewpoint on the housing market was one of guarded optimism. That article was titled **Maybe, Just Maybe...** – the premise being, maybe the market had moved beyond the “bottom of the curve”. I had a few data points and an article or two to support my position, and felt pretty confident that while the worst was over, the pending recovery would be slow and arduous. With that said, the “proof” would be reduced inventories, lower price points, and accelerating absorption. So, now the \$64,000-Question is pretty obvious – is there some hard data to show any sign of market improvement? Yes, I think so.

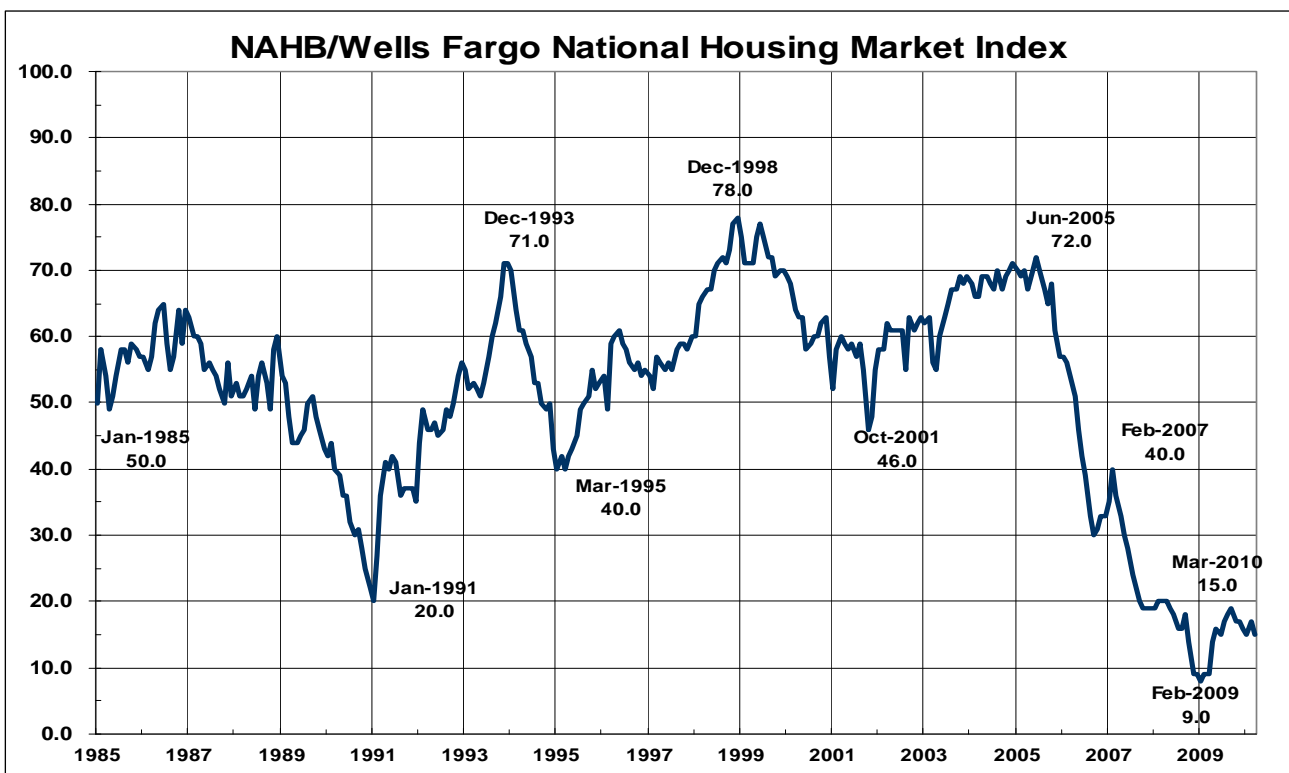
It is important to note current inventory levels. This can be done two (2) different ways. First, it is apparent that the market has effectively reduced the number of unsold housing units, returning to “normal” levels in 2008. This is done by subtracting the number of **New Homes Sold** from the number of **Housing Completions**. The annual data is summarized below:



Second, we consider the amount of inventory in terms of the number of month's worth of supply. This measure gauges the number of new housing units available compared to the running pace of absorption.



This data can also be considered on a more macro level by analyzing data obtained from the **National Association of Home Builders (NAHB)**. The **NAHB/Wells Fargo National Housing Market Index (HMI)**, which is based on a monthly survey of **NAHB** members designed to take the pulse of the housing industry, especially the single-family industry. With this in mind, the **HMI** has been published monthly since January 1985.



For context, the **NAHB** provides the following description of the *HMI*:

- The *HMI* is a weighted average of separate diffusion indices, calculated for three (3) key single-family series in the survey: Present Sales of New Homes, Sale of New Homes Expected in the Next 6-Months and Traffic of Prospective Buyers in New Homes.
- The first two (2) items are rated on a scale of Good, Fair, and Poor and the last is rated on a scale of Very High to High, Average, and Low to Very Low. Each diffusion index is calculated by first applying a multiplicative seasonal adjustment procedure to the Good/High and Poor/Low series. Then the formula  $(\text{Good/High} - \text{Poor/Low} + 100)/2$  is applied to the seasonally adjusted numbers.
- This formula puts each diffusion index on a convenient scale. If all respondents answer “Good/High” then the index is 100. If all respondents answer “Poor/Low” then the index is 0. If equal numbers of respondents answer “Good/High” and “Poor/Low” then the index is 50.
- The weights for the *HMI* are 0.5920 for Single Family Detached Sales at Present Time; 0.1358 for Single Family Detached Starts in Next 6 Months; and 0.2722 for Traffic of Prospective Buyers. The weights are chosen by applying a simple 8-equation model to the data. One of the equations defined the *HMI* as a latent (unobserved) variable that is a linear combination of the 3 diffusion indices with coefficients constrained to sum to 1. The other 7 equations regress current and future single family starts on the latent variable. Thus, correlation with current and future starts determine the weights for the *HMI*.

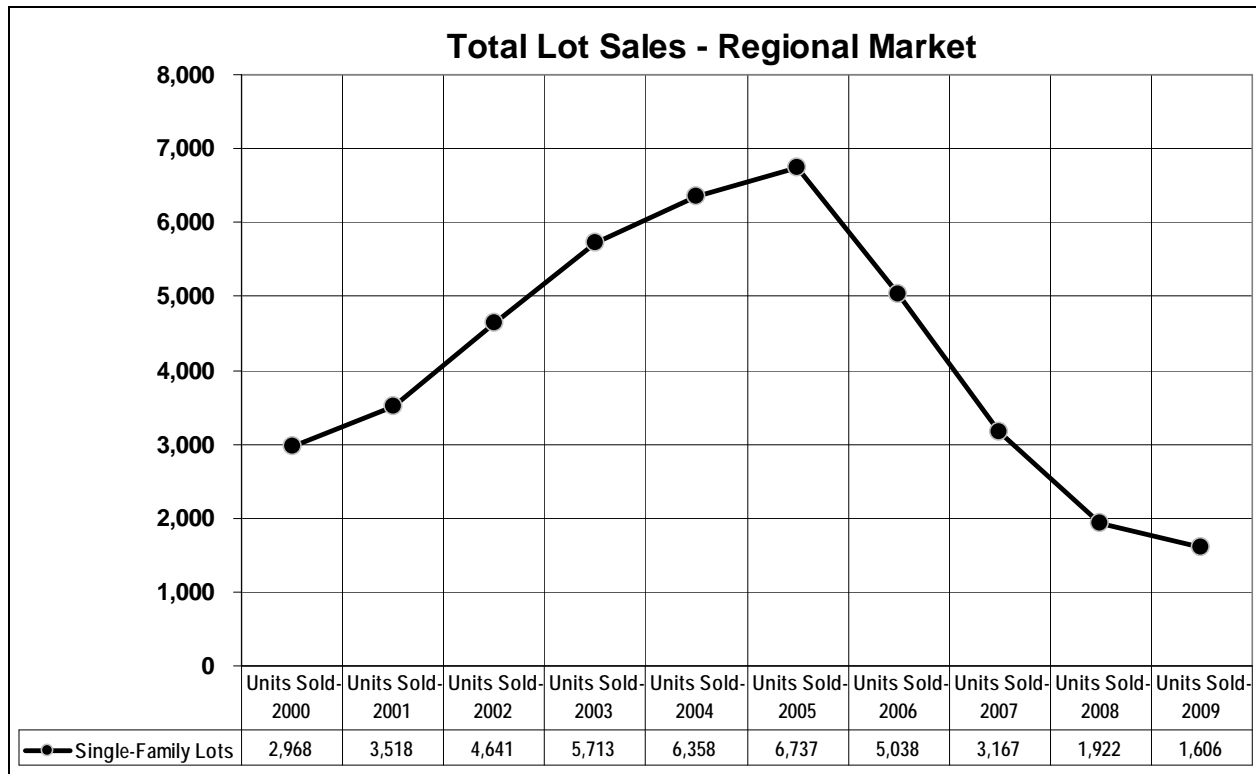
The recent downward trend is apparent (beginning July 2005), and has led to the *HMI* being at its lowest levels since 1991. However, in April 2009, builder confidence in the market for newly built, single-family homes rose five points to the highest level since October 2008. This gain was the largest monthly increase since May 2003. Since April 2009, the index has fluctuated between 15 and 19, suggesting market stability.

Finally, unemployment and inflation are the primary concerns, and with the expiration of the Federal Housing Tax Credits for home buyers, there are plenty of reasons to anticipate a “double dip” within the housing market. So, does this all lead to an optimistic viewpoint going forward? No, but the quantitative seems to support the qualitative. More specifically, I think it points to sustainability. The optimism of 2003-2005 has been proven to be unsustainable, but it appears that the pessimism of 2006-2009 was just as unsustainable.

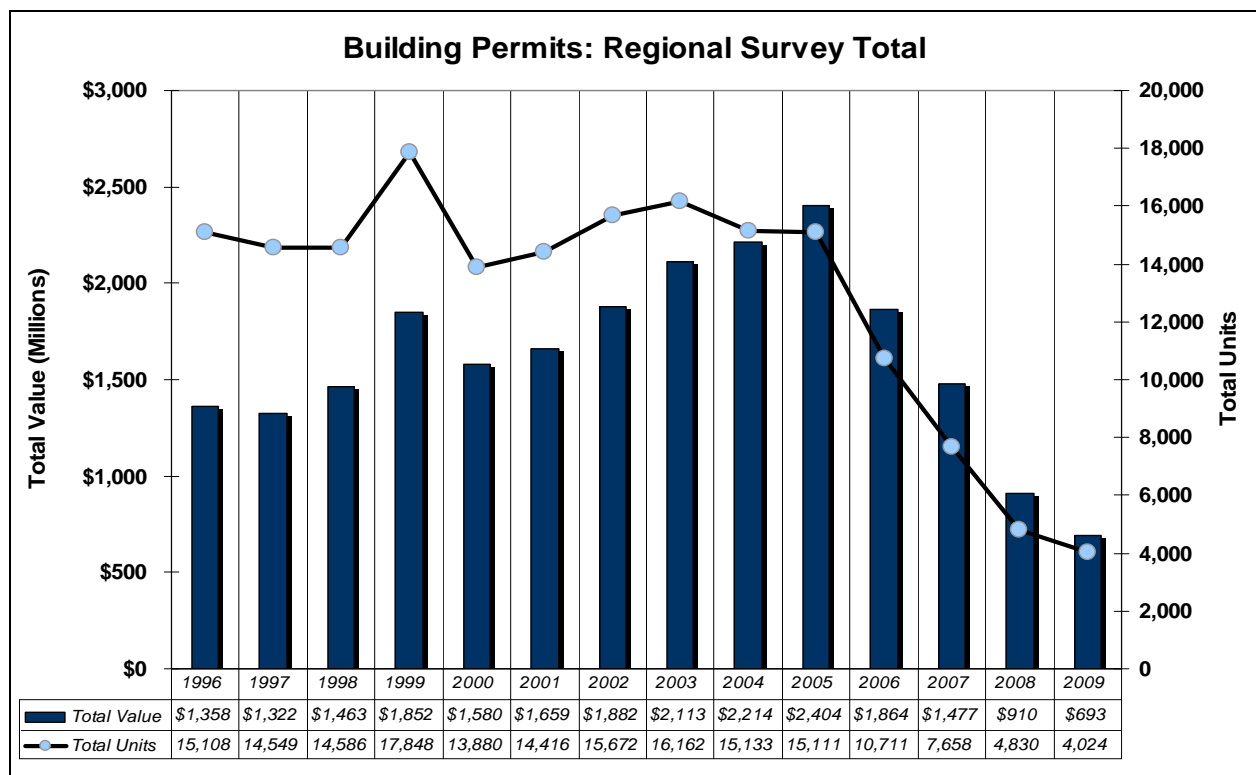
This National perspective might be useful, but applying it to the regional market can be tricky. Local markets can be even more difficult to assess. With this in mind, we have built a comprehensive database of residential developments that we track in an effort to understand pricing and absorption trends throughout the regional market. The data has been compiled by geography – first by County, and then by School District – and it can be disaggregated in any number of ways. The cumulative results are summarized below:

School District	Developments Surveyed	Total Units	Units Sold	Current Inventory (Units Remaining)	Average Annual Lots Sales	Inventory (Months)
<b>Butler County</b>	129	15,894	11,763	4,131	970.3	51.091
<b>Clermont County</b>	72	6,055	3,716	2,339	323.2	86.849
<b>Greene County</b>	88	8,045	5,801	2,244	400.9	67.167
<b>Hamilton County</b>	65	3,199	2,038	1,161	171.7	81.129
<b>Miami County</b>	20	1,472	1,337	135	101.7	15.934
<b>Montgomery County</b>	127	11,863	7,787	4,076	541.7	90.289
<b>Northern Kentucky</b>	45	4,909	3,182	1,727	200.1	103.577
<b>Warren County</b>	192	20,289	13,503	6,786	1,065.8	76.403
<b>Total Survey</b>	<b>738</b>	<b>71,726</b>	<b>49,127</b>	<b>22,599</b>	<b>3,485.9</b>	<b>77.795</b>

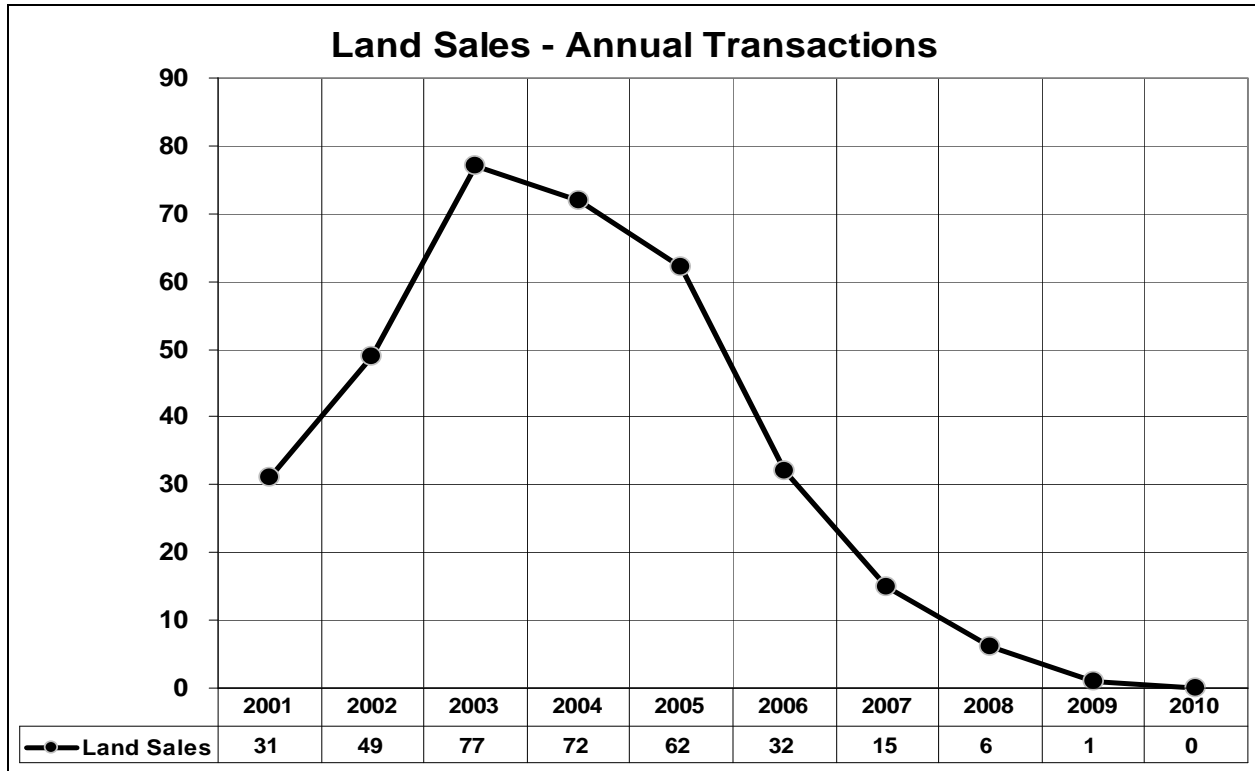
The **Total Units** include total planned lots (if available), not just actual lots in place. Therefore, the **Inventory (Months)** may be misleading at first. This aggregate data takes on more significance when historic context is provided. The most fundamental way of determining current market conditions is to consider historic absorption, as follows:



This trend parallels the same trend indicated by building permits:



It is important to note that there has been very little development activity since 2006. This is evident when the number of development land sales is considered, as follows:



So what does it all mean? Well... as you might conclude, last year's guarded optimism has led to this year's continued caution.