OBSERVATION

TD Economics

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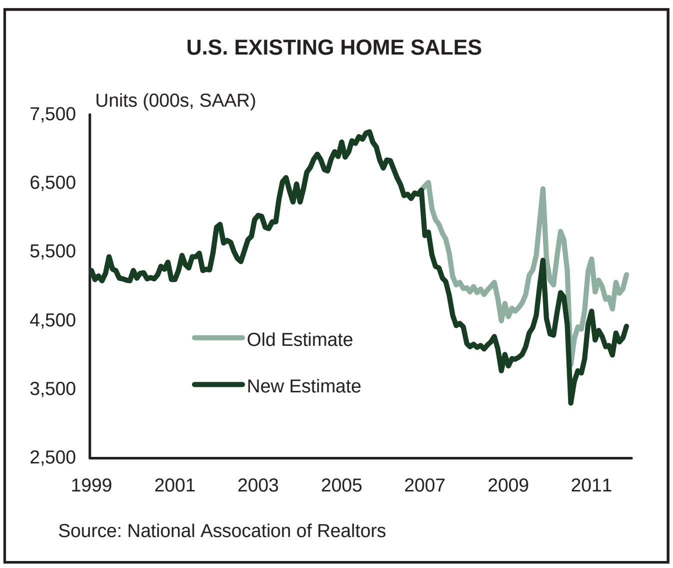
WHAT TO MAKE OF THE REVISIONS TO U.S. EXISTING HOME SALES

Highlights

- The National Association of Realtors made benchmark revisions to their estimates of U.S. existing home sales, reducing the level of sales by an average of 14.3% from 2007 to 2010. Revisions were especially large in the Northeast, where sales were revised down by 31.4% over the four years.
- The lower level of home sales will mean a longer time to clear the market of the shadow supply of distressed sales, currently estimated at around 1.9 million. However, a lower level of sales relative to demographics implies a larger degree of pent-up demand and therefore more upside potential for sales growth.
- For the Northeast where revisions were especially large, the lower level of sales offsets some of the advantage the region had in terms of smaller foreclosure inventories.

On December 21st, 2011, the National Association of Realtors (NAR) released benchmark revisions to their estimates of national existing home sales for the years 2007 to 2010. The revisions reduced the level of home sales and the inventory of homes for sale by an average of 14.3%. For 2011, the starting level was reduced to reflect the changes to growth rates in previous years, but the monthly growth in sales was left unchanged from previous estimates. In addition to revisions to total sales, the NAR also revised regional home sales for major Census regions. Revisions were particularly large for the Northeast (NE), where the level of sales was revised down by an average of 31.4% relative to previous estimates.

These revisions have important consequences for the housing outlook. In the near-term, the lower sales rate also means a longer time for the shadow supply of distressed sales to clear the market. However, the revisions also imply more pent-up demand for housing than previously estimated. A much lower rate of housing turnover relative to the stock of housing means more room for sales growth in order to get back to trend Finally, at the regional level, the disproportionate decline in sales in the NE has eroded some of the region's advantage in having fewer foreclosures than other regions. A more complete picture of the regional housing outlook will depend on revisions to state-level sales, which are scheduled to be released in February.



Source: National Assocation of Realtors

Why such large revisions?

As the NAR notes, there is no comprehensive national database of total existing home sales in the United States. The closest thing to one is the multiple-listing services (MLS) on which the majority of existing home sales are listed and sold. However, a

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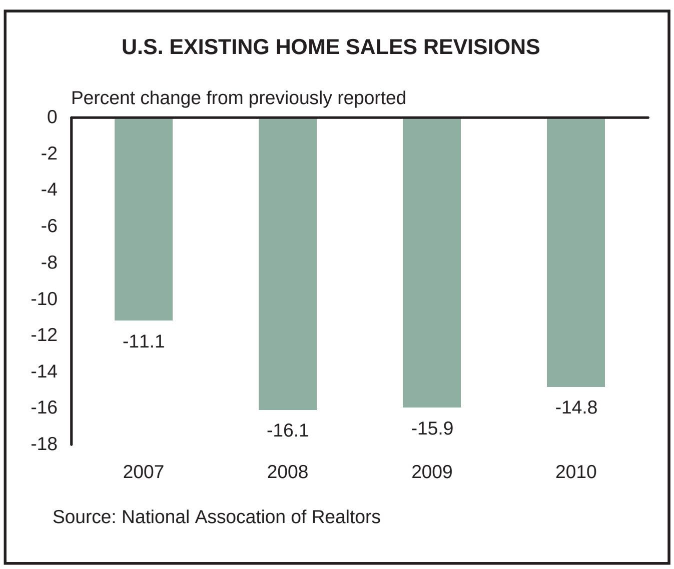
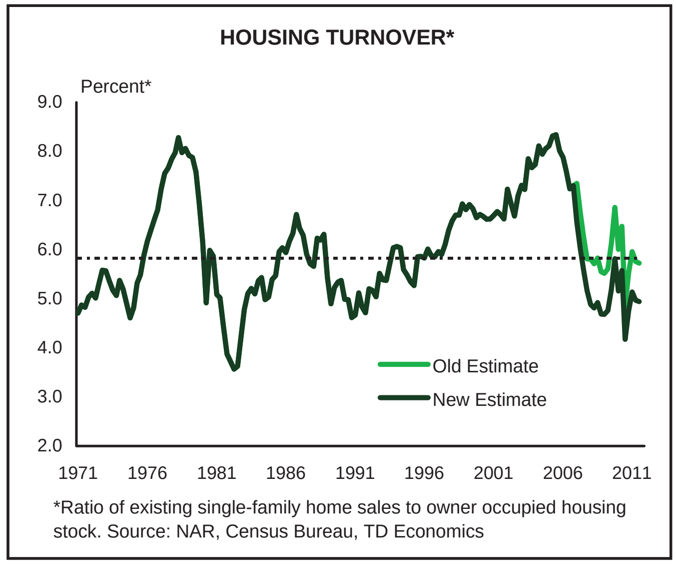
significant minority of homes sold in the U.S. are for-sale-by-owner (FSBO) for which information is less available.[1]

As long as the share of FSBO sales remains relatively constant over short periods of time, the growth rate of MLS sales should provide a relatively close estimate of the growth rate of total sales. However, as NAR notes in their revisions, the housing downturn appears to have resulted in a significant movement away from FSBO sales and towards MLS sales. According to NAR consumer survey data, the share of FSBO sales is estimated to have gone from 16% in 2000 to 9% in 2010. This change in share had the effect of inflating the estimate of total sales. The NAR estimates that over half of the previous overestimation in total sales came from the change in share from FSBO to MLS sales. The remainder of the revisions were attributed to an underestimation of the number of new homes listed on MLS services and double counting of sales that were listed on more than one local real estate board's MLS. Finally, because the NAR did not conduct benchmark revisions on an annual basis, past biases have compounded over the last several years.

Why do the revisions matter?

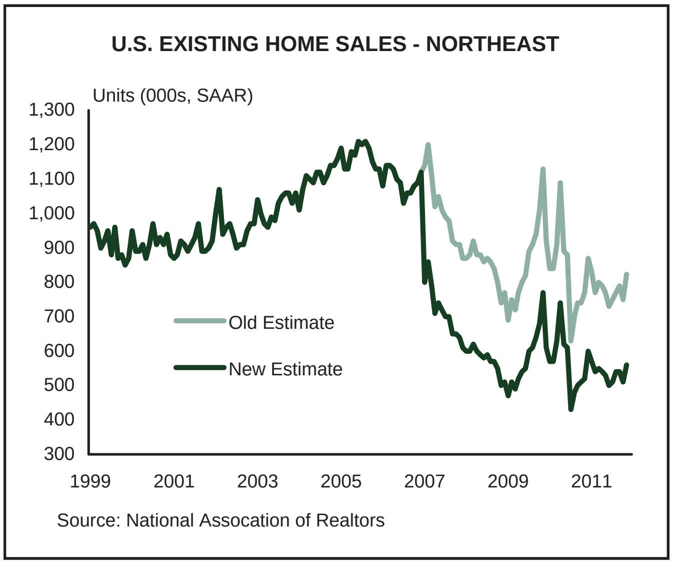
One reason that the revisions are significant is the impact on estimates of real GDP. Existing home sales are used to calculate brokers' commissions on sale of structures – basically the value added provided by realtors in the housing transaction. The downward revision to sales means that brokers' commissions will also have to be revised down in subsequent revisions to real GDP. Fortunately, these revisions are likely to be small. Brokers' commissions at their peak in 2005, accounted for 0.9% of GDP, but as the housing market went bust, this fell to less than 0.5% by 2010. As a result, the revisions will likely only change the growth rate of annual GDP by a few tenths of a percentage point at most.

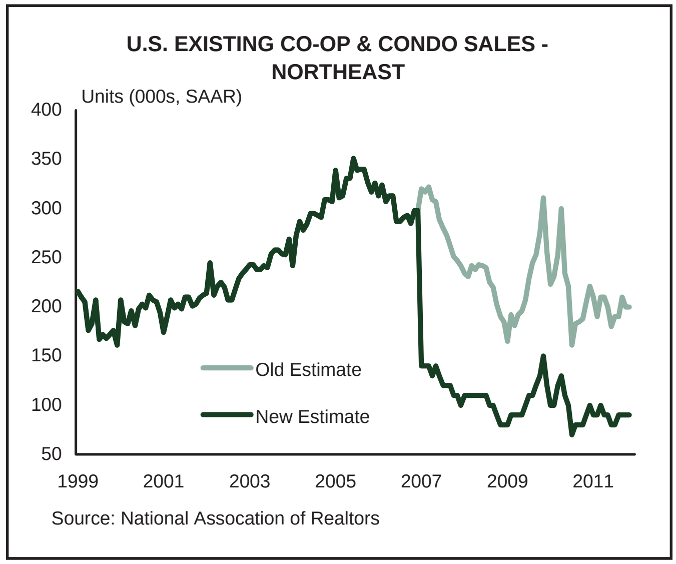




However, the revisions do have implications for future GDP. The immediate concern is that a lower level of home sales means a longer-time to clear the shadow supply of distressed sales that are set to enter the market over the next several years. According to Core Logic, as of October 2011 the shadow inventory of homes not yet put up for sale but that are seriously delinquent (90 days or more), in foreclosure or real estate owned (REO) stands at 1.9 million units. At the previous sales rate of around 5.0 million, this would have taken around 4.5 months to clear the market. With sales reduced by 15%, the month's supply of distressed sales is now 5.4 months.

Nonetheless, despite this lower starting point, a much lower level of existing home sales relative to the stock of owner-occupied homes in the country implies more pent-up demand for home sales than previously anticipated. Prior to the revision, housing turnover – measured as the level of single-family sales relative to the stock of single-family units – was right in line with the historical average (see chart above). With the revisions, it is now 15% below. The fact that housing turnover is 15% below its long-run level implies more upside to growth in home sales over the next few years, just to get back to the long-run trend. So, while the lower level of current sales increases the challenge posed by foreclosures, it also leaves scope for demand to rebound at a faster pace than previously thought.





Regional question marks

As important as the revisions at the national level are to the housing outlook, they are perhaps even more significant at the regional level. For the Northeast, the level of home sales was revised down by 31.4%. This compares to downward revisions of 14.3% in the Midwest, 12.2% in the South and just 5.4% in the West. The main reason for the disparity at the regional level appears to be differences in estimates of condo and co-op sales, which were revised down by 55% in the Northeast and 37% in the Midwest, but were revised up by 36% in the West and by 14% in the South.

The revisions at the regional level are important to forecasts for relative economic performance. While at the national level, inventories of home sales were revised down by the same level as sales, this data does not exist at the regional level. As a result, analysis of supply and demand balance must rely on data from the U.S. Census Bureau on the number of vacant homes for sale, which has not been revised. The disproportionately large decline in home sales in the NE reveals a considerably larger month's supply relative to other regions in the country. As a result, forecasts for how long it will take to clear the housing market regionally have changed considerably with the revisions.

Of course, the same logic with respect to pent-up demand that applies at the national level also applies regionally. A lower level of sales relative to the stock of housing implies more pent-up demand potential in the Northeast over the next several years. An additional redeeming factor in the NE may be that the revisions appear to be concentrated in the multi-family segment. Given the upward pressure on rents and the fact that many condo buildings can be more easily converted to rentals, this is likely a better starting point than had the revisions been to single-family dwellings.

An important caveat to this is that the NE faces a slower rate of population growth than the other regions in the U.S. So, while there may be more pent-up demand over the next several years, the longer-term growth in sales from increases in the population (and therefore stock of housing) is likely to be slower than other regions of the country.

Bottom Line

Revisions to existing home sales reveal a much lower level of home sales than previously estimated. Given the continued supply of shadow inventory, home prices will remain under pressure. As a result, the potential negative feedback from lower home prices to greater supply of distressed sales pulling more homeowners into negative equity positions remains a key risk to the outlook.

However, the lower level of demand relative to the stock of housing means more pent-up demand for home sales and a larger potential upside to sales growth over the next several years.

Finally, as important as these trends are at the national level, they are accentuated at the regional level, especially in the Northeast.

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Endnotes

1. NAR's methodology for producing monthly estimates of U.S. home sales is to apply the growth rates of sales on multiple-listing services (MLS) to a level of total sales derived from information contained in other sources. Prior to these revisions, the previous benchmark used was the level of total sales estimated from the 2000 Census. Henceforth, the NAR will use information from the annual American Community Survey (ACS) in order to re-benchmark sales on an annual basis.