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What the 'Foreclosure Fade' Means for Housing

By Nick Timiraos, The Wall Street Journal

The U.S. housing market appears to be finding its footing after a sharp rise in mortgage rates last summer, on top of some big price gains, deflated sales.

The National Association of Realtors reported on Tuesday that sales of previously owned homes rose 2.6% in June to a seasonally adjusted annual rate of 5.04 million units. That's the third straight monthly gain and the highest level since last October.

Housing became less affordable last summer after rates jumped from around 3.5% in May 2013 to 4.5% by July 2013. Since then, rates have drifted a little lower, and buyers and sellers have had time to readjust their expectations.

This has kept supply and demand fairly balanced, and it's one reason why prices have continued to rise. The Federal Housing Finance Agency said on Tuesday that home prices in May rose 0.4% from the prior month and were 5.5% above their level of May 2013. At June's pace of sales, there was a 5.5-month supply of homes for sale. The Realtors' group considers a 6-month supply to be a balanced market. Higher supplies favor buyers and lower supplies favor sellers.

But there's another important factor that explains the housing market dynamic right now: the foreclosure crisis has faded. This isn't to say foreclosures are over, but so-called "distressed" sales accounted for just 11% of sales in June, down from 15% last year, 25% in 2012, and 30% in 2011.

Foreclosures tend to sell at lower prices than comparable homes because they're not as well maintained, they're often vacant and not staged, and banks are motivated to sell quickly. Prices plunged from 2008 to '11 as the supply of foreclosures rose, but prices rebounded in late 2011 as the share of foreclosed-property sales fell.

While total home sales stood 2.3% below the June 2013 level, most of that can be attributed to the falling share of foreclosures and other distressed sales. Distressed home sales fell by nearly 40% in June from last year, while non-distressed property sales rose 2.3%.

The foreclosure fade is great news for the housing market, as it means homeowners don't have to compete with banks to sell homes — and eventually, builders will have to ramp up construction to satisfy new demand if job growth continues. (Even if young households aren't ready to buy, they'll have to live somewhere — paying rent, and driving new construction.)

But the foreclosure fade also helps explain the eye-popping gains in sales volumes and prices that we witnessed in 2013. These bargains generated frenzied bidding wars,

(continued next column)

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both from investors and owner-occupant buyers, and they're largely history.

Through the first half of the year, home sales are running around 5% below last year's level, though they're still running ahead of 2009 - 2012's levels.

Now, the housing market is going to rely more heavily on traditional drivers of growth, including job and wage gains and demographics. Tighter credit standards, higher levels of student debt, and lower incomes for young adults will keep pressure on homeownership, and they could make the housing recovery far bumpier than the steady gains of 2012 to '13 would have suggested.

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