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The St. Louis Housing Market: Steady as She Goes?

The long bull market in U.S. housing appears to be over. Housing price declines have contributed to a sub-prime mortgage crisis that has severely tightened credit conditions. Housing price declines and the sub-prime mortgage crisis in turn have significantly increased home foreclosures across the country, depressed the home construction industry, and weakened buyer sentiment. Most alarmingly, this may just be the tip of the iceberg, and there is widespread concern that housing prices are poised to drop precipitously in the U.S. What are the prospects for the St. Louis housing market?

In answering this question, it is important to gain a sense of perspective. According to Freddie Mac's Conventional Mortgage Home Price Index, average housing prices increased approximately 75% in the U.S. for the decade ending in the second quarter of 2007. This sharp increase in the average price of a home has raised concerns among many of a nation-wide housing price "bubble," which we are now beginning to see "burst." However, it can be quite misleading to think in terms of a single U.S. housing market, and the failure to make geographic distinctions in analyzing the U.S. housing market has the potential to create misplaced fears. Housing price increases have been very unevenly distributed across the U.S. over the last decade: prices more than doubled in many cities on the East and West coasts, while Midwestern cities like Cleveland, Detroit, Columbia, MO and Springfield, MO experienced much more modest gains of 40% or less. In the St. Louis area, housing prices have risen just under 60% over the past decade, more than in many Midwestern cities but substantially less than in many coastal cities. This suggests that St. Louis is in considerably less danger of a bursting housing price bubble than many other U.S. cities.

There are other issues to consider. There tends to be a link between housing prices and the local economy, particularly economic variables like income and employment. Indeed, these variables figure importantly in economists' efforts to build empirical models of housing price behavior. Many cities that experienced exceptionally strong economic growth over the last decade also experienced sharp increases in housing prices. Insofar as strong growth bids up housing prices but that growth is unevenly distributed, this puts a squeeze on the ability of many households to afford a house. For example, according to HSBC, the median housing price in San Francisco is over eleven times median income, so that housing would seem unaffordable to a large segment of the population. However, low interest rates and developments in the sub-prime mortgage market tempted many households to "buy beyond their means" by taking out adjustable-rate mortgages with initial "teaser" rates. But these interest rates are now rising, and many households find themselves unable to make their mortgage payments, leading to an increase in foreclosures which can place substantial additional downward pressure on housing prices. In summary, cities that have experienced especially high growth over the last decade are likely to be in more danger of sharp declines in housing prices.

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Supply-side considerations are also relevant. States such as Nevada, Arizona, and Florida with very strong price appreciations over the last decade attracted individuals who were apparently purchasing new homes primarily for speculative purposes. In Arizona, Florida, and Nevada, approximately 30% of all prime mortgage loans written in 2005 were for non-owner occupied home purchases or second homes. This helped to foster a building boom in these states. However, it also has the potential to create a supply of homes in these states that is beyond the capacity of the local population to support, and this can depress housing prices over time. Decreases in housing prices coupled with increases in interest rates create problems for borrowers, and, indeed, delinquencies on home mortgages in these three states are more than twice the national average. Furthermore, a perceived "over-supply" of housing has led to recent large declines in building permits in these states, which have helped to spur a nation-wide decrease in building permits of 25% over the last year.

For the most part, St. Louis has not experienced the types of events that significantly increase the likelihood of sharp declines in housing prices. For example, St. Louis experienced more modest growth over the last decade compared to cities like San Francisco, and the increases in growth have not been exceptionally highly concentrated. This has helped housing to largely remain affordable to households in the St. Louis region. The median housing price in St. Louis is approximately three times median income, significantly below the corresponding figure of eleven cited above for San Francisco. Delinquencies in St. Louis are near the national average and substantially below the levels in California and Nevada as well as Rust Belt cities such as Cleveland and Detroit, where declines in the auto industry have led to substantial increases in foreclosures in recent months. In addition, compared to a number of other regions, St. Louis did not experience a boom in housing construction. This makes it less likely that there is a significant surplus of housing in the St. Louis region. While housing construction is slowing in the St. Louis region, declines in building permits and residential construction over the past year are significantly less than the national average.

Of course, there are areas of concern. Home buyers and sellers at both the top and bottom ends of the income spectrum in St. Louis may experience difficulties over the next several years. The top end of the housing market faces a possible credit crunch as the market for jumbo loans is drying up. Lower-income households will find it more difficult to obtain loans due to the collapse of the sub-prime market. Jennings and the area near the Brewery are among the top 500 zip codes with significant problems with foreclosures. Laws safeguarding homeowners are also lacking in Missouri, as delinquency and foreclosures can occur in a period of 60 days, while homeowners in states such as Illinois, New York, and California have at least twice as long to sort out money problems.

Yale economist Robert Shiller recently opined at a Federal Reserve conference that real housing prices could fall as much as 50% in some places in the near future. However, it is unlikely that St. Louis is one of these places. In line with this view, according to PMI (a leading mortgage insurance company), St. Louis's affordable housing, moderate housing price increases over the last decade, and low historic housing price volatility implies relatively low housing risk. Of course, if the credit crunch continues (and perhaps worsens) and income and employment growth stagnate further, the St. Louis housing market will likely suffer like anywhere else; however, housing markets in many other U.S. cities are likely to suffer more. Overall, it looks to be (reasonably) "steady as she goes" for the St. Louis housing market.

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