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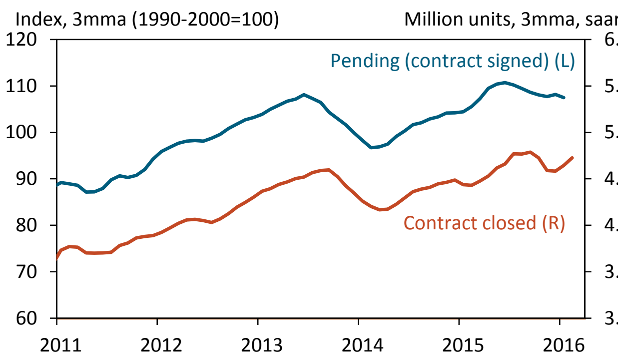
The Limited Supply of Homes

By Jordan Rappaport

A limited supply of single-family homes available for purchase will continue to constrain sales growth and put upward pressure on home prices over the next few years.

Although the labor market has improved significantly over the past three years, sales of existing single-family homes have not risen in kind. In February, sales of single-family homes were approximately the same as they were in mid-2013 (Chart 1).

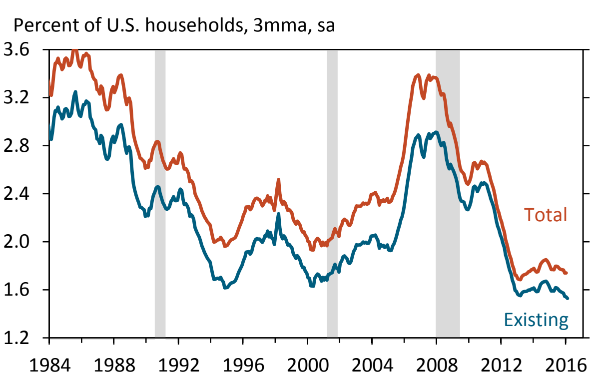
Chart 1: Sales of existing single-family homes



Sources: National Association of Realtors and Haver Analytics.

One factor constraining sales is the limited supply of homes available for purchase. Most measures of supply relate the number of homes listed for sale to monthly sales. But when sales are already constrained, this approach understates tightness. To better gauge the housing market's tightness, I measure the supply of homes relative to the number of U.S. households. The number of existing single-family homes listed for sale has remained at about 1.6 percent of U.S. households since early 2013, slightly below brief lows in 1995 and 2000 (Chart 2, blue line). The number of both new and existing single-family homes for sale has remained at about 1.7 percent of U.S. households since early 2013, more significantly below previous brief lows (Chart 2, orange line). Moreover, the current lows understate tightness, as the number of U.S. households remains well below trend (Rappaport 2013).

Chart 2: Single-family homes listed for sale

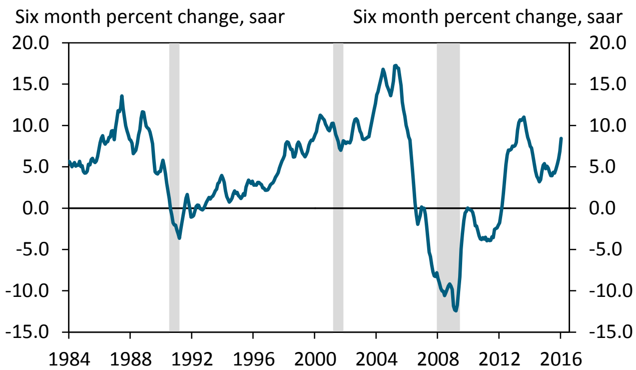


Sources: Census Bureau, National Association of Realtors, and Haver Analytics.

Total homes available for sale is an important component of housing market liquidity. As most sellers purchase another single-family home to move into, owners who are considering selling their home must also consider their purchase options. When options are limited—as they are currently—many owners may decide to delay moving, thereby reinforcing the tight supply by not putting their own home up for sale.

Because the supply of homes is limited, the improving labor market and strengthening consumer confidence have placed upward pressure on purchase prices. The annualized rate of price growth accelerated from just below 4 percent during the first half of 2015 to above 8 percent over the six months through January (Chart 3).

Chart 3: House price growth

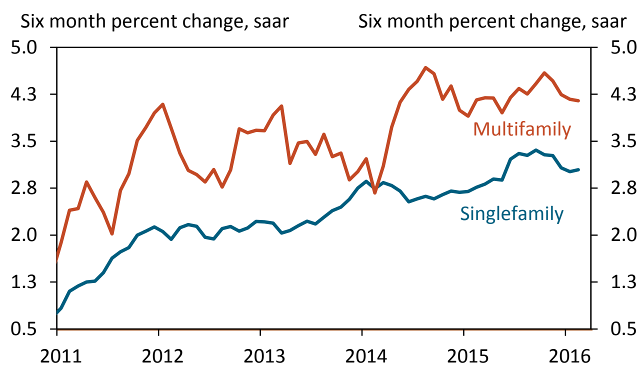


Sources: Core Logic (ex-distressed) and Haver Analytics.

In the short term, rising prices may not significantly increase the number of existing homes for sale. Potential sellers will face the rising prices if they wish to purchase a single-family home to move into. And rental homes and apartments may not be an attractive alternative. Their supply is also tight, placing upward pressure on rents. Since mid-2015, rent on single-family homes has increased at more than a 3 percent annualized rate (Chart 4, blue line); rent on multifamily homes has increased at more than a 4 percent annualized rate (Chart 4, orange line). The recent pace of price increases for co-ops and condos appears to be similarly elevated.

In the medium term, rising purchase prices for single-family homes will encourage developers to build new ones, improving the liquidity of the purchase market and moderating further price increases. However, construction is likely to be less responsive now than in the past. Single-family construction remains unprecedentedly low. In February, annualized home starts equaled just 6.4 percent of U.S. households, about half its average during the 1980s and 1990s (Chart 5). Ramping up to higher rates of construction will take time.

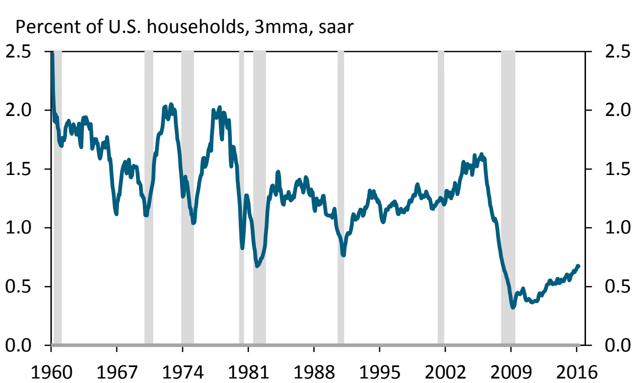
Chart 4: Rent growth



Note: Single-family rent is measured by Owners' Equivalent Rent (OER); multifamily rent is inferred from OER and Rent of Primary Residence.
Sources: Bureau of Labor Statistics and Haver Analytics.

In addition, changing consumer tastes may dampen home construction in the future. In many metro areas, suburbanization appears to have reached its limit. Increased traffic congestion and a possible decreased tolerance for commuting appear to have shifted demand toward living closer to workplaces, which remain concentrated in the center of metro areas. And tastes, especially by millennials, appear to have shifted toward living in more dense urban areas. Consistent with this, many firms have moved from suburbs to central business districts, finding it easier to attract and retain employees there.

Chart 5: Single-family housing starts



Sources: Census Bureau and Haver Analytics.

In the past, single-family homes were primarily constructed in new suburban subdivisions at the periphery of metro areas. Going forward, a much larger share of homes are likely to be constructed closer to the center of metro areas—but this infill will be constrained by limited undeveloped land and regulations on land use.

Over the longer term, the supply of homes for purchase should considerably improve as baby boomers increasingly downsize from single-family to multifamily homes. But recent experience suggests that downsizing typically begins when people are in their late seventies, a milestone the leading edge of the baby boom will not reach for another five years (Rappaport 2015). Until then, the supply of single-family homes for purchase is likely to remain tight, putting continuing upward pressure on home prices.

References

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