



## Home Price Analysis for Tucson Region

By the Research Division of the National Association of REALTORS®

### Executive Summary

- Home prices in the region soared in the past three years. Prices rose 30% in 2005. There was no evident sign of major slowdown in the first quarter of 2006, as prices rose 25%.
- The slowdown in price growth was expected due primarily to higher mortgage rates, which have risen roughly one percentage point since last summer. Higher rates have dragged sales down in Arizona by almost 20%.
- Because of the strong increase in home prices over the past three years, mortgage debt servicing costs have risen significantly. In the first quarter of 2006 the debt service cost relative to household income stood at 26% -- well above the national average of 22%.
- A recent cut-back in new home building has reduced the risk of overbuilding in the region. Homebuilders evidently are responding to reduced housing demand. Low new supply better helps support home prices.
- A significantly higher percentage of mortgages was used to buy second/investor homes in the local area when compared to the nation as a whole. Thus, there is a higher chance of quick sales and dumping of properties onto the market.
- The percentage of homebuyers who utilized sub-prime mortgages (those with rates more than 3 percentage points above the average market rate) was much lower in the region than it was for the nation as a whole. Such conditions bode well for lowering risks associated with foreclosures and quick sales.
- Local job growth has been strong. The three-year job growth of 5.8% is more than two times as fast as the national pace. The local unemployment rate of 4.6% in the first quarter implies full employment in the region.
- Job growth attracts additional potential homebuyers to the market and limits the number of "forced-home sales" (as was the case in the early 1980s and 1990s). This suggests that any price decline will likely be short lived given the additional buyers ready to enter the market.
- However, the biggest risk is the drastic slowdown in home sales activity that could result from further measurable increases in interest rates. Should the 30-year average fixed rate approach 8% (from its current 6.8%) as a result of too much monetary tightening by the Federal Reserve, home prices in the region could well decline.

## Summary of Activity

	Tucson	National Average	Comment
<b>Price Activity</b>			
Latest Appreciation (2006 Q1 vs 2005 Q1)	24.9%	10.3%	Strong
Last Year Appreciation	29.5%	12.0%	Strong
3-year Appreciation	56.9%	31.0%	Strong
Historical Average Annual Appreciation*	5.5%	5.0%	Neutral
<b>Affordability</b>			
Mortgage Debt Servicing Cost to Income Ratio** (2006 Q1)	25.7%	22.0%	Unfavorable
Historical Mortgage Debt Servicing Cost*	22.5%	22.0%	Neutral
<b>Home Sales</b>			
State Existing Home Sales (2006 Q1 vs 2005 Q1)	-22.2%	-2.1%	Unfavorable
Single-family Housing Permits (2006 Q1 vs 2005 Q1)	-12.0%	-0.9%	Favorable
<b>Mortgages</b>			
Share of New Loans with ARMS	NA	28.0%	NA
Share of New Loans with LTV higher than 90%	NA	16.0%	NA
Percentage of Sub-Prime Mortgages	7.4%	10.1%	Favorable
Percentage of Mortgages for Second Home Purchase	19.7%	15.3%	Unfavorable
State Delinquency Rate (2006 Q1)	2.2%	4.0%	Favorable
<b>Local Fundamentals</b>			
3-year Job Growth	5.8%	2.4%	Favorable
Unemployment Rate (2006 Q1)	4.6%	4.7%	Favorable
Housing Permits to Total Employment (2005)	3.3%	1.6%	Unfavorable
Net Migration	12,800	0	Favorable
<b>Risk Factor</b>	The share of loans for second homes is uncomfortably large. Nonetheless, there is little risk of prolonged price declines given the low incidence of sub-prime loans. Positive job gains and positive net migration also help in supporting home prices.		

\* Average ratio from 1980 to 2005

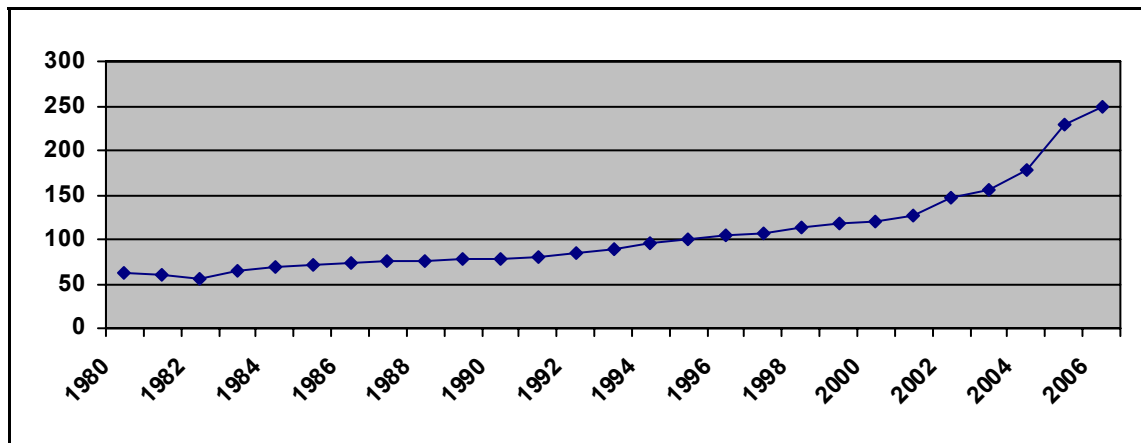
\*\* This ratio compares the monthly mortgage payment for a median-priced home financed at the prevailing mortgage rate to the median household income.

## Price Activity

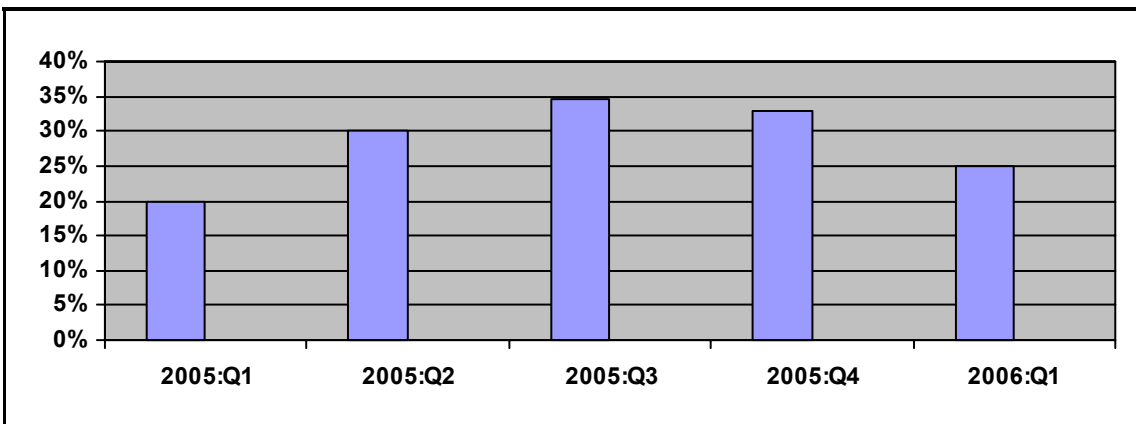
	Existing Home Price	Price Growth	Local to National Price	Per Capita Income	Mortgage Servicing Cost to Income	12 month Job Gain
2001	127,300	5.4%	0.8	24,833	16.0%	-2,500
2002	145,900	14.6%	0.9	24,994	18.0%	-1,600
2003	156,400	7.2%	0.9	25,777	17.0%	2,300
2004	176,800	13.0%	0.9	27,244	18.0%	11,900
2005	229,000	29.5%	1.0	28,470	23.0%	5,800

- 2005 was another strong year, with the median home price rising 29.5% to \$229,000.
- But in the first quarter of 2006, price appreciation slowed modestly to 25%. (See chart below.)
- If history is a guide, the robust job gains of 14,500 net new jobs in the past 12 months will keep home prices from falling.
- Home prices were relatively flat for most of the 1990s. So part of the recent years' increases are attributable to the "catch-up" effect.

**Local Home Price (in \$1,000)**



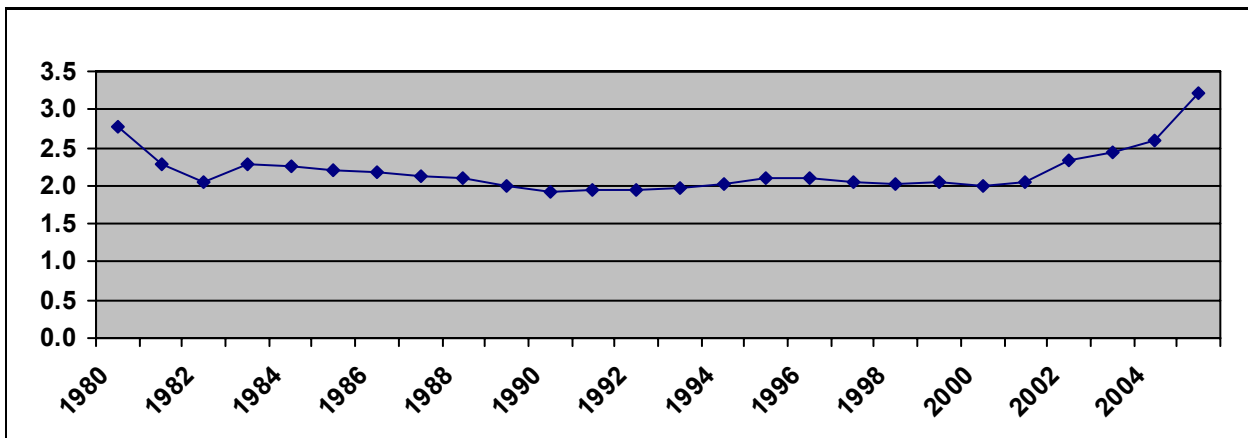
**Recent Price Appreciation**



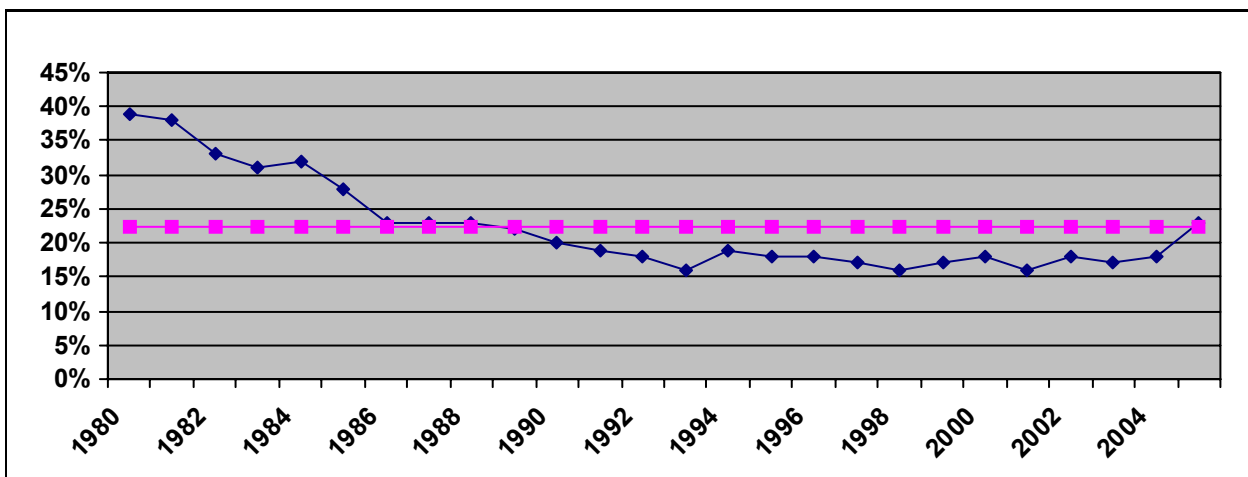
## Affordability

- Because home prices have risen faster than income, the ratio of price-to-income is currently above the historical norm. This measure is frequently cited to imply that there is a housing market bubble.
- However, mortgage rates declining to historic lows have been a major force in boosting home prices in recent years. Recent higher rates are still at historically favorable levels. Lower rates allow homebuyers to obtain a larger loan without necessarily increasing monthly mortgage payments.
- A more relevant measure for assessing the risk of a home price bubble is the median mortgage servicing cost relative to the median income. This ratio is at near the local historical average. It implies no widespread financial overstretching to purchase a home in the region.

### Price to Income Ratio



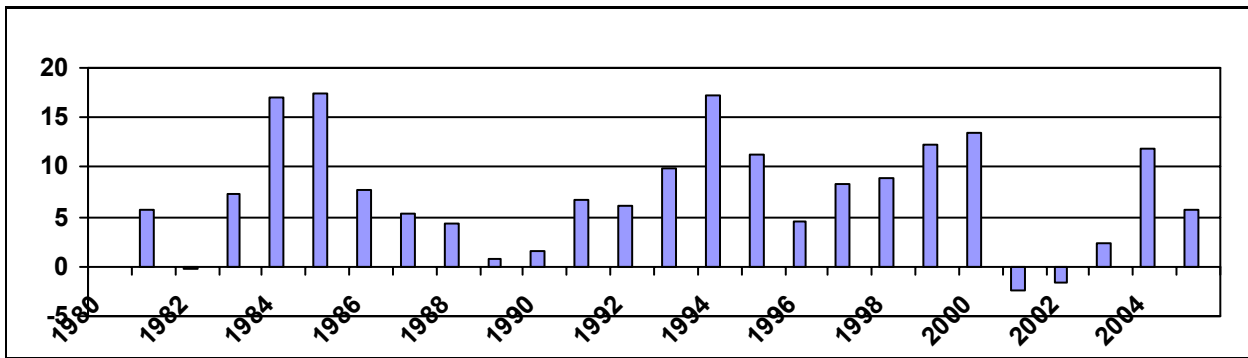
### Mortgage Servicing Cost to Income Ratio (Historical average shown as square boxes)



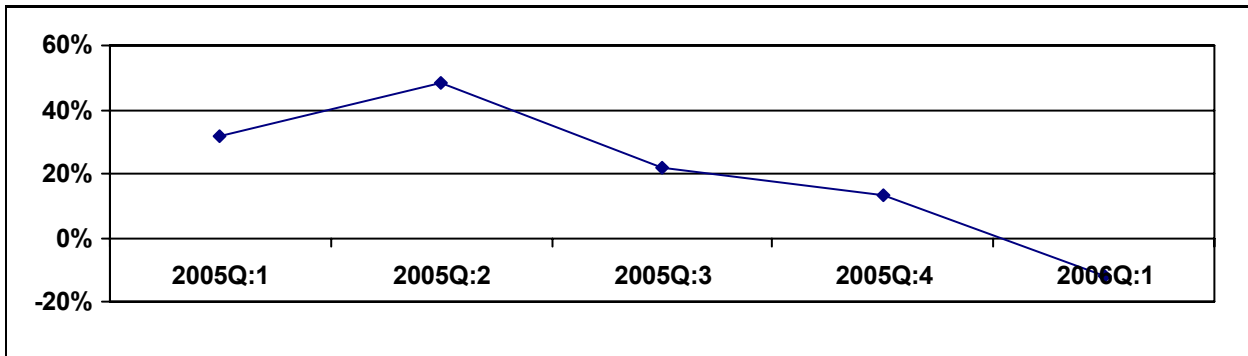
## Local Fundamentals

- Job gains have been robust in the last five years. A total of 16,000 jobs were added during that time. Many new job holders seek their own housing units.
- Over the same time period, the region added 40,300 new housing units, of which 36,600 were single-family units.
- New home construction declined in the latest quarter - a supply reduction, which helps support home prices.
- The ratio of five-year job gains to five-year new home construction shows the “hangover” impact of a housing shortage, or housing surplus. Based on this measure, there were fewer new job additions than new housing additions.

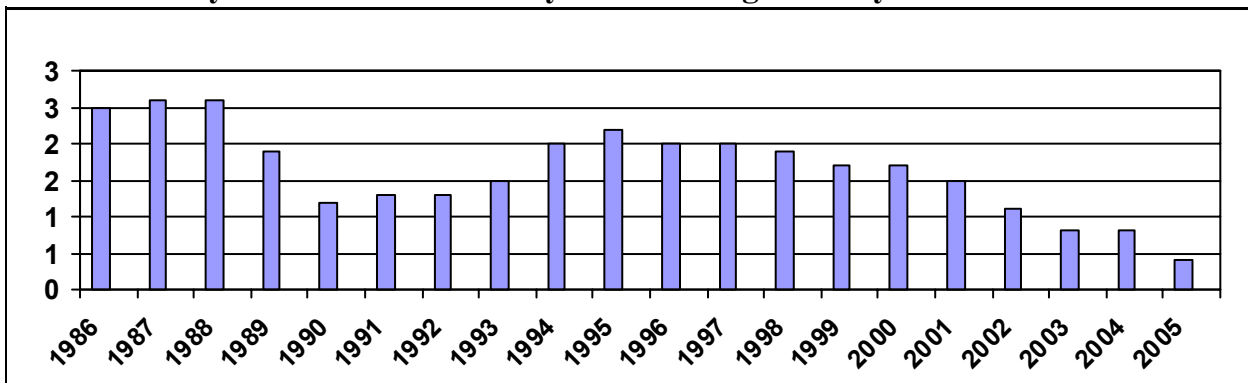
**Job Gains (in Thousands)**



**Recent new Single-family Home Construction**  
(% change from a year ago)



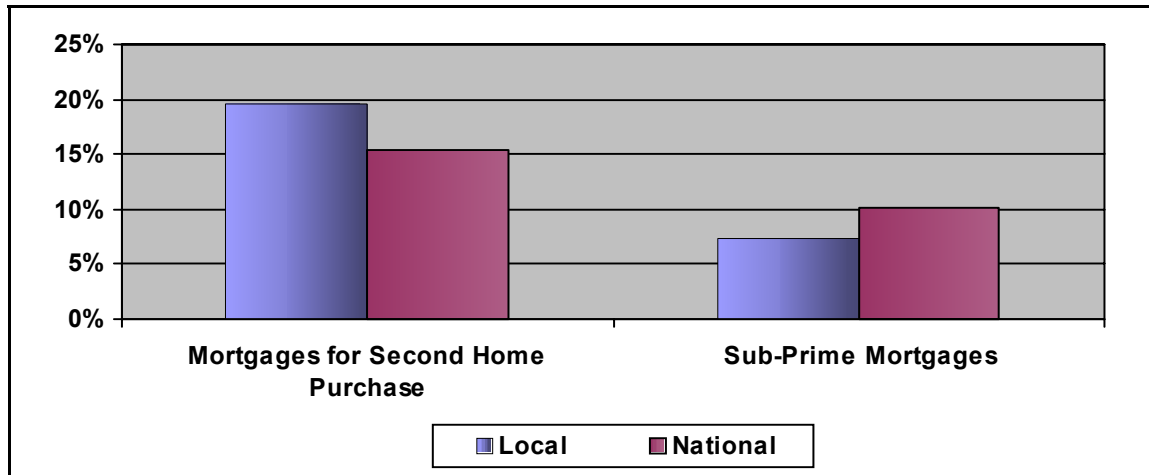
**Ratio of 5-year Job Gains over 5-year New Single-family Home Construction**



## Mortgage Activity

- Mortgage lending in the region has been primarily to owner-occupied, credit-worthy borrowers who are least likely to quickly “dump properties” onto the market. The percentage of sub-prime loans (those carrying interest rates at least 3 percentage points higher than market rates) was 7% versus the 10% national average.
- The share of loans for non-owner-occupied properties was 20%, well above the national average. Therefore, there is a risk of quick “dumping of properties” onto the market.
- Baby boomers are in their peak earning years and have been active in purchasing second homes, which many consider as their future retirement homes. The baby-boomer impact will continue for another 10 to 15 years and the southern and western markets generally tend to benefit from migration into these regions.

### Riskier Mortgages



## Price Scenarios

- Even in the unlikely event of prices declining by 5%, most homeowners will maintain sizable equity build-up in their homes. The table below shows the home equity gains if prices were to fall by 5% in 2006. A homebuyer who purchased in 2005 would suffer \$8,500 in home equity loss. But homebuyers who had purchased in prior years would still retain significant housing equity gains.

<b>Year of Purchase</b>	<b>Housing Equity after 5% Price Decline</b> (Home price appreciation + principal payments on mortgage)
1980	\$191,600
1985	\$169,100
1990	\$157,000
1995	\$131,800
2000	\$104,500
2001	\$98,000
2002	\$79,000
2003	\$67,600
2004	\$45,500
2005	(\$8,500)

- A likely scenario is for home prices to rise, though at a much lower rate than in recent past years. The equity gains under different though conservative price growth assumptions are presented below.

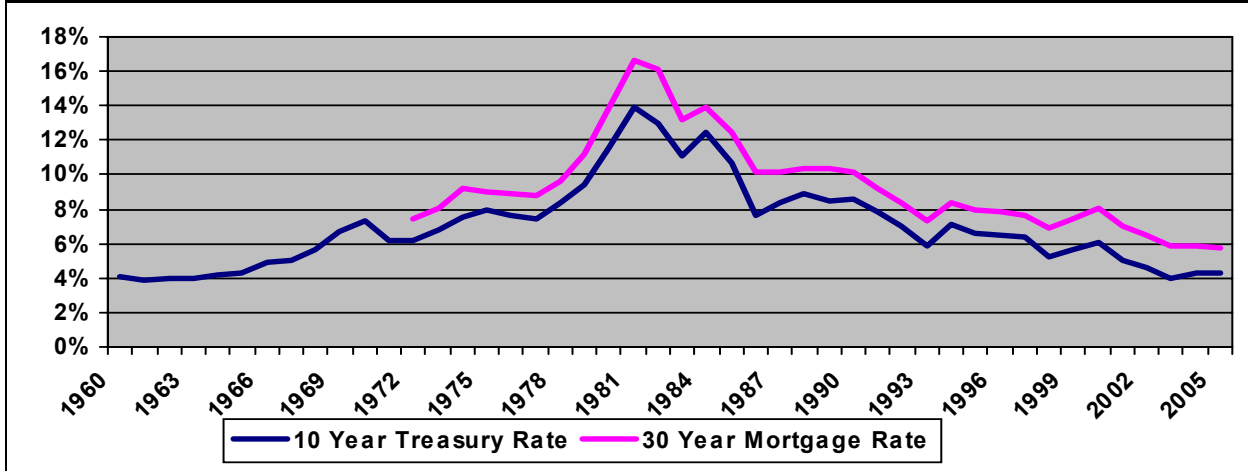
<b>Housing Equity Gain</b>				
<b>Appreciation Rate</b>	<b>1.5%</b>	<b>3.0%</b>	<b>4.5%</b>	<b>6.0%</b>
<b>Conservative Scenarios</b>	<b>Low</b>	<b>Middle</b>	<b>High</b>	<i>25-year average rate</i>
<b>2010</b>	\$34,200	\$53,000	\$72,900	\$94,400
<b>2015</b>	\$74,000	\$116,000	\$163,800	\$219,600
<b>2020</b>	\$123,400	\$193,900	\$280,300	\$388,500
<b>2030</b>	\$261,100	\$408,300	\$617,000	\$919,400
<b>2040</b>	\$385,600	\$644,400	\$1,068,800	\$1,779,600

## Additional Discussion Points

- Home price declines are very rare. In fact, the national median home price has not declined since the Great Depression of the 1930s. Stock market collapses, the OPEC oil crunch, economic recessions, and even wars have not negatively impacted national home prices since the 1930s.
- There have been few times when local prices declined. In nearly all these cases, the price declines were accompanied by sharp prolonged job losses. It is difficult to foresee a price decline in a job creating economy.
- Homes trade far less frequently than financial assets (about one home sale every 7 to 10 years for most homeowners). There are also larger transaction costs associated with selling a home due to the lengthy careful examination demanded by home buyers and sellers. Therefore, home prices are not prone to the fluctuations of the stock market. There are neither panic sells nor margin calls associated with homes.
- Many non-quantifiable factors could be important for this metro market in determining home prices. Access to cultural life, the quality of museums, nearby local and national parks, water views, exclusive neighborhoods, weather, the international airport, city vibrancy, restaurants, and a host of other non-quantifiable factors could have an important influence on the overall pricing.
- There are immense tax benefits to owning a home. These tax considerations were not considered in the analysis. For example, the 1997 law permitting primary owner occupants to trade down without having tax consequences. Also most home sales results in no capital gains tax. In addition, long-term capital gains tax rates were reduced in 2003, thereby providing higher returns for home investors. These positive benefits, if accounted for in the analysis, would have shown an even stronger case for housing fundamentals in supporting home prices.

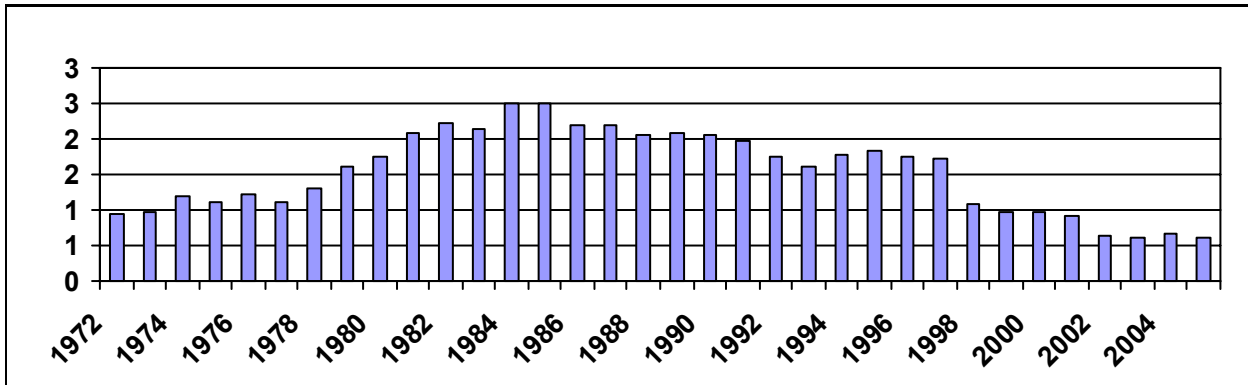
Additional Informative Charts

45-year Low Mortgage Rates



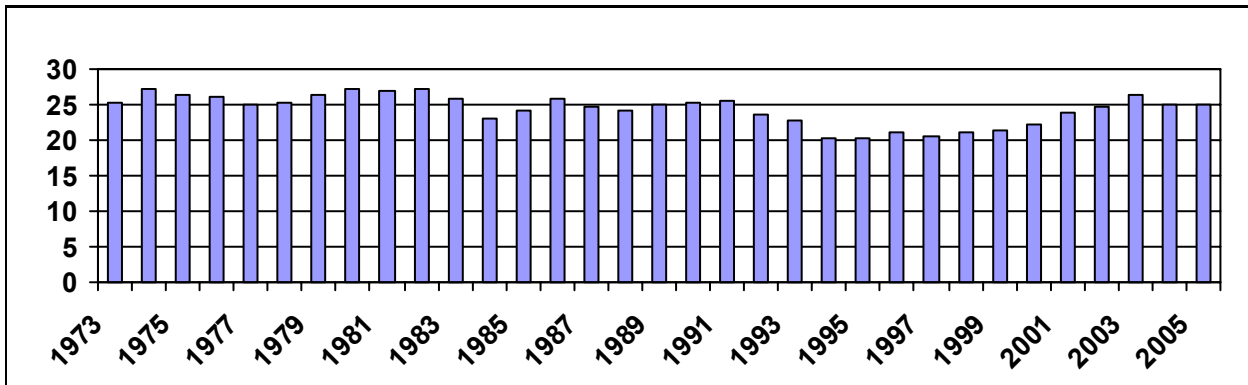
Source: Freddie Mac, Federal Reserve

Historic Low Fees and Points for Mortgage Origination



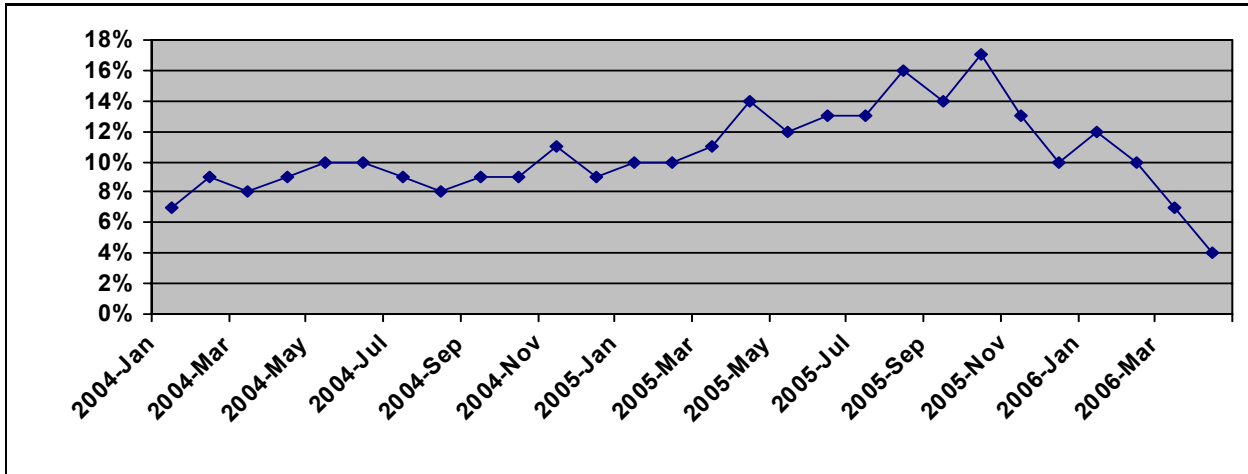
Source: Freddie Mac, Federal Reserve

Typical Down-payment Percentage Returning to Historic Norms



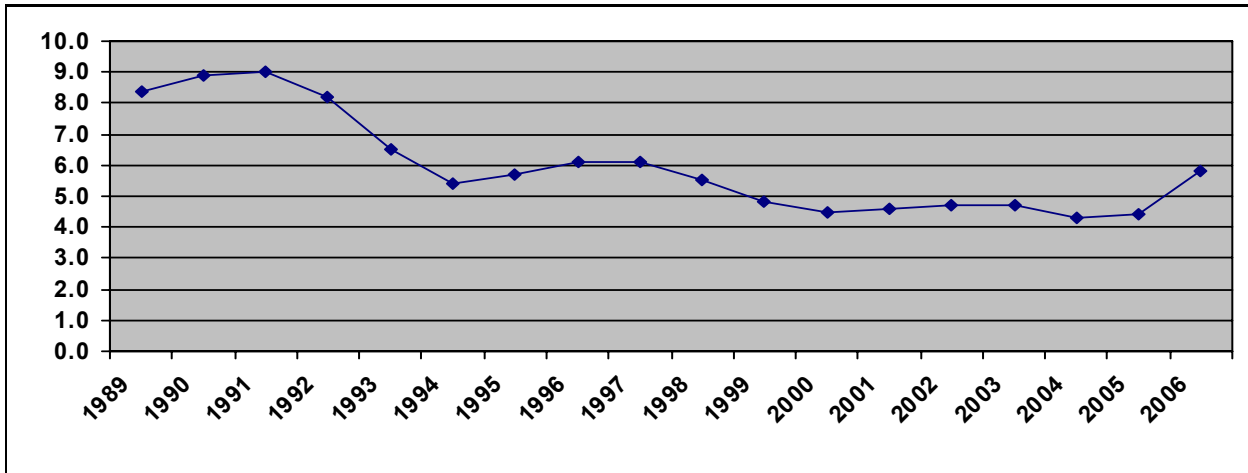
Source: Federal Housing Finance Board

**Recent National Price Deceleration**



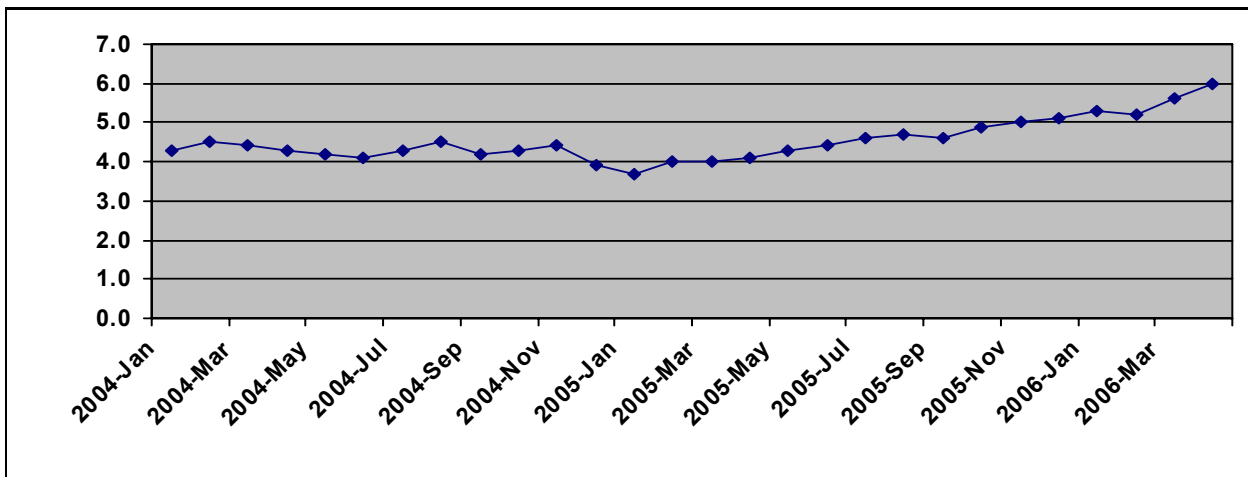
Source: NAR

**Historical National Months Supply of Homes on the Market**



Source: NAR

**Recent National Months Supply of Homes on the Market**



Source: NAR

## **NAR Research**

NAR Research produces the premier measurement of residential real estate activity – the existing-home sales series – and analyzes how changes in the U.S. and international economies can impact the real estate business. It also examines trends in real estate practices, and how NAR members are adapting technology in their business operations. NAR Research looks at regulatory and legislative policy proposals and how those policies could affect REALTORS® and their clients, America’s property owners.

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