

Executive Summary

With Freddie Mac's weekly Primary Mortgage Market Survey showing the 30-year fixed mortgage rate at a 2-year high, and holding above 6% for six consecutive weeks, many housing industry analysts are expecting to see a fundamental shift in market conditions in coming months. Combined with a natural slow-down during the holiday season, which has been mostly absent in the past couple years due to excessively low inventories and high demand, the increased mortgage rates will likely cause a reduction in purchases and refinances, and cause real estate investors some concern. Unlike primary residences in which homeowners most often live for a number of years and are slow to pick up and move out, investment properties add volatility to the market, and are the first housing units to be "dumped" when signs of a market shift come about. As a result, the probable rise in inventories in coming months will in part be a result of investors trying to "cash in" their investment properties and move on to other opportunities. Some may even have to wait a month or two (which would have been considered expedient a few years back) instead of having a line of bids before the property even makes it to MLS (as has been the case in some areas during the past couple years). Suddenly in a panic, the edgier investors will fear they've missed the boat and drop their prices to ensure a sale. Will this sort of behavior cause a market-wide decline of prices? It's very unlikely, but we probably will see a few months of volatility in pricing sometime during the next year as the market finds a new equilibrium and deals with an outflow of some of the investment monies that the robust market has soaked up. In addition, homebuyers still looking for a primary residence may be able to get a decent value if they can find an investment property whose owner is anxious to get their money out.

The Economy

The Leading Economic Indicator Index increased more than a point in October to 137.9 after three consecutive months of decline. The Index has been fairly steady this year, but had deteriorated slightly in recent months in large part due to dropping consumer sentiment. October represented a small turn around, with seven of the ten indicators advancing month-over-month. While the economy has maintained moderate economic and job growth in the past year, continued risks such as volatile oil price fluctuations will likely linger and persist in causing concern over the health of the economy. Most economists expect continued moderate growth this year, and consequently, we expect the LEI index to stay relatively steady in coming months.

Financial markets also may have some good news on the horizon. With the popularity of real estate investing expected to wane as price appreciation begins to slow, there will likely be a return of investors to equity markets over the next year, which could exert a broad upward pressure on stock prices. The change would be welcome for current stock holders as most major indices have not made much positive ground so far in 2005.

Consumer Confidence has taken a beating in recent months, plummeting in September and edging down further in October to its current level of 85.0. The index was off two and a half points from the previous month, and more than 21 points lower than the recent peak of 106.2 in June. The Present Situation Index fell to 108.2 from 110.4, but has held above the 100 mark every month so far this year. The Expectations Index has not fared as well, falling to a dismal 69.5 from 72.3. Consumer psychology is often influenced by non-economic factors and can change relatively quickly. Should the holiday season go well for retailers and the economy in general, we could see a recovery in the index if consumers' perceptions of 2006 start to brighten.

The Housing Market

The NAHB Housing Market Index has been strong this year, although it took a bit of a dive in November to 60, about eight points off the current 12-month average of 68.25, likely in response to rising mortgage rates and an expected slowdown during the holiday season. Although home sales have likely peaked in most markets already, sales and construction activity should continue at an historically strong pace, and make 2005 a record year for the industry.

Single-family permit issuance decreased in October, falling 5% to a seasonally-adjusted level of 1,681,000 permits. While a decline from September, current levels of issuance are still near record levels in an historical sense. The number of single-family issuances was up 5% from October of 2004, and nearly 8% above the permit levels of two years ago. Total permit activity 1.1% lower than in October 2004 due a drop in multi-family activity, and amounted to 2,071,000 annualized issuances. Total housing starts were down 5.6% to 2,014,000, with both single-family and multi-family starts showing declines. Permit and housing start levels tend to fluctuate from month-to-month based on a variety of factors, but going forward we expect to see construction activity take on a trend of slow moderation as sales and construction activity come off peak levels.

For more detailed information on the indicators discussed in this key indicator alert, please visit the following links:

Leading Economic Indicators	136.8	D-	http://www.meyersgroup.com/analysisobjects/LeadingEconomicIndicator.asp?ProductCategory=HA
Inflation	4.3%	B-	http://www.meyersgroup.com/analysisobjects/Inflation.asp?ProductCategory=HA
Housing Market Index	60	B	http://www.meyersgroup.com/analysisobjects/HousingMarketIndex.asp?ProductCategory=HA
Housing Starts	2,014,000	B-	http://www.meyersgroup.com/analysisobjects/HousingStarts.asp?ProductCategory=NHMR
Single Family Building Permits	1,681,000	B+	http://www.meyersgroup.com/analysisobjects/SingleFamilyPermits.asp?ProductCategory=NHMR
Multifamily Building Permits	390,000	D-	http://www.meyersgroup.com/analysisobjects/MultiFamilyPermits.asp?ProductCategory=NHMR
Manufactured Housing Placements	116,000	D	http://www.meyersgroup.com/analysisobjects/manfhsgplacements.asp?ProductCategory=NHMR
Mortgage Rates	6.37%	A+	http://www.meyersgroup.com/analysisobjects/mortgagerates.asp?ProductCategory=HA
Purchase Mortgage Applications	477.9	C	http://www.meyersgroup.com/analysisobjects/NewMortgageApps.asp?ProductCategory=HA
Employment Growth / Building Permit Ratio	0.92	C-	http://www.meyersgroup.com/analysisobjects/epratio.asp?ProductCategory=NHMR
Demand / Supply Ratio	0.7	C-	http://www.meyersgroup.com/analysisobjects/demandsupplyratio.asp?ProductCategory=NHMR