

Shaping Up

Credit will influence the housing recovery in several ways.

HOME SALES APPARENTLY SCRATCHED OUT A CYCLICAL BOTTOM in the early months of this year, and the NAHB expects improvements in home sales and housing production to evolve over the balance of this year and in 2010.

A housing recovery cannot be put together, of course, unless financing for home buyers and home builders is available at rates and

terms that work. Recent surveys conducted by the Federal Reserve and by the NAHB document financing challenges still being faced by buyers and builders. These challenges need not prevent near-term housing recovery, but they will influence its shape as well as the types of homes produced and perhaps the types of companies doing the production.

FED SURVEY

The Federal Reserve's most recent "Senior Loan Officer Opinion Survey on Bank Lending Practices" contained some troublesome news for both home buyers and builders.

On the buyer side, there was no letup in the tightening of credit standards on home mortgages. Very few banks were offering subprime loans and nearly two-thirds continued to tighten standards on "nontraditional" loans. Half the banks continued to tighten standards on prime home mortgage loans and no banks eased their standards.

With respect to commercial real estate lending, a category that includes residential construction and land development loans, the Fed survey revealed serious tightening of lending standards for the 14th consecutive quarter. Indeed, two-thirds of banks tightened standards in this area during the first quarter of this year, and no banks eased their standards.

The Fed's survey contained special questions on the outlook for the quality of existing loans over the balance of the year, under the assumption that economic activity pro-

gresses in line with consensus forecasts. Overwhelming majorities of banks said that loan quality is likely to decline for all major loan types; 82 percent of banks expected further deterioration for prime residential mortgages, and 90 percent expected quality to continue to decline for commercial real estate loans. From this perspective, it's no wonder that banks are toughening standards on prospective new loans!

NAHB SURVEY

The NAHB's first-quarter survey of builders regarding conditions in the AD&C credit markets showed extensions of patterns identified in a series of similar surveys

conducted during the past two years.

Depository institutions (banks and thrifts) continue to be the dominant source of AD&C credit for the home building industry, particularly for smaller companies, and we continue to find progressive tightening of lending terms and standards for both outstanding credit and prospective new loans.

We asked builders about reasons given by lenders for clamping down on new or outstanding AD&C loans. We heard most about mandates from regulators, demands by boards of directors, regulatory or accounting rules, and lender concerns about loan performance. The downbeat expectations for loan quality revealed by the Fed's survey of bankers suggest that the tightening of AD&C credit conditions still has some distance to run.

IMPLICATIONS FOR 2009-2010

The evolution of housing credit conditions has a number of implications for the near-term outlook, including:

- The home mortgage market will be heavily dominated by Fannie Mae, Freddie Mac, and FHA.

- Mortgage finance constraints will compress affordable price ranges and encourage scaling back of new-home sizes and amenities.

- The early stages of recovery in housing production will favor builders that don't have to rely on depository institutions for AD&C credit.

- Tightness of supply at depository institutions will limit the strength of the recovery in housing production through 2010.



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