# 2017 Mortgage Market Outlook: Executive Housing Report

January 2017

| Source | 2016 Estimate | | | 2017 Forecast | | | 2017 |
|---|---|---|---|---|---|---|---|
| | Purchase ($B) | Refinance ($B) | Total ($B) | Purchase ($B) | Refinance ($B) | Total ($B) | Purch/Refi Ratio |
| iEmergent | $947 | $903 | $1,850 | $1,025 | $532 | $1,557 | 66%/34% |
| Fannie Mae | $1,013 | $890 | $1,903 | $1,053 | $520 | $1,573 | 67%/33% |
| MBA | $990 | $901 | $1,891 | $1,092 | $479 | $1,571 | 70%/30% |
| Freddie Mac | $1,060 | $940 | $2,000 | $1,084 | $421 | $1,505 | 72%/28% |

Note: All forecasts are as of December 2016

For the 2017 housing market, the outlook is generally positive. The long recovery from the elevated delinquency and foreclosure rates of the Housing Bust is nearly complete, and home values nationally have returned to their pre-Boom peak. For the 2017 mortgage industry, a sharply shifting change is in order as refinance volumes fall significantly and purchase becomes a much bigger part of the market.

Forecasters, including Fannie Mae, Freddie Mac, iEmergent and the MBA, anticipate that total mortgage opportunity in 2017 will decrease from 2016, because of a drop in refinance activity, but the purchase market will again see healthy growth.

Comparing the outlooks from these forecasts, we note that they are about as closely aligned as they have been for years. This is largely due to the fact the disruptive forces in the mortgage market for the last decade – elevated delinquency & foreclosure rates, number of households underwater on loans, volume of homes at distressed prices – are dissipating. But there are fundamental differences in forecast methodology here. Most mortgage forecasts are generated at the national level. At iEmergent, we work from the bottom up. Our methodology for forecasting purchase opportunity begins at the census tract level with quantifying the homebuyer pool – or *the number of households that are ready, willing and able to buy a home*. The size of that pool is determined by demographic shifts (i.e. household growth) and by the relationship between the financial health of US households (demand) and housing-market issues (supply).
In addition, driving both the demand and supply-sides of the equation are macroeconomic trends, regulatory and legislative actions in lending, and – as always – the individual behaviors of households across the nation.

This market-based approach gives our clients the critical information necessary to make successful tactical and strategic decisions in managing their businesses.

# Housing Market Conditions Overview

- With the continuing improvement of homeowner **delinquency and foreclosure** levels, one of the biggest impediments to housing market health is fading away.

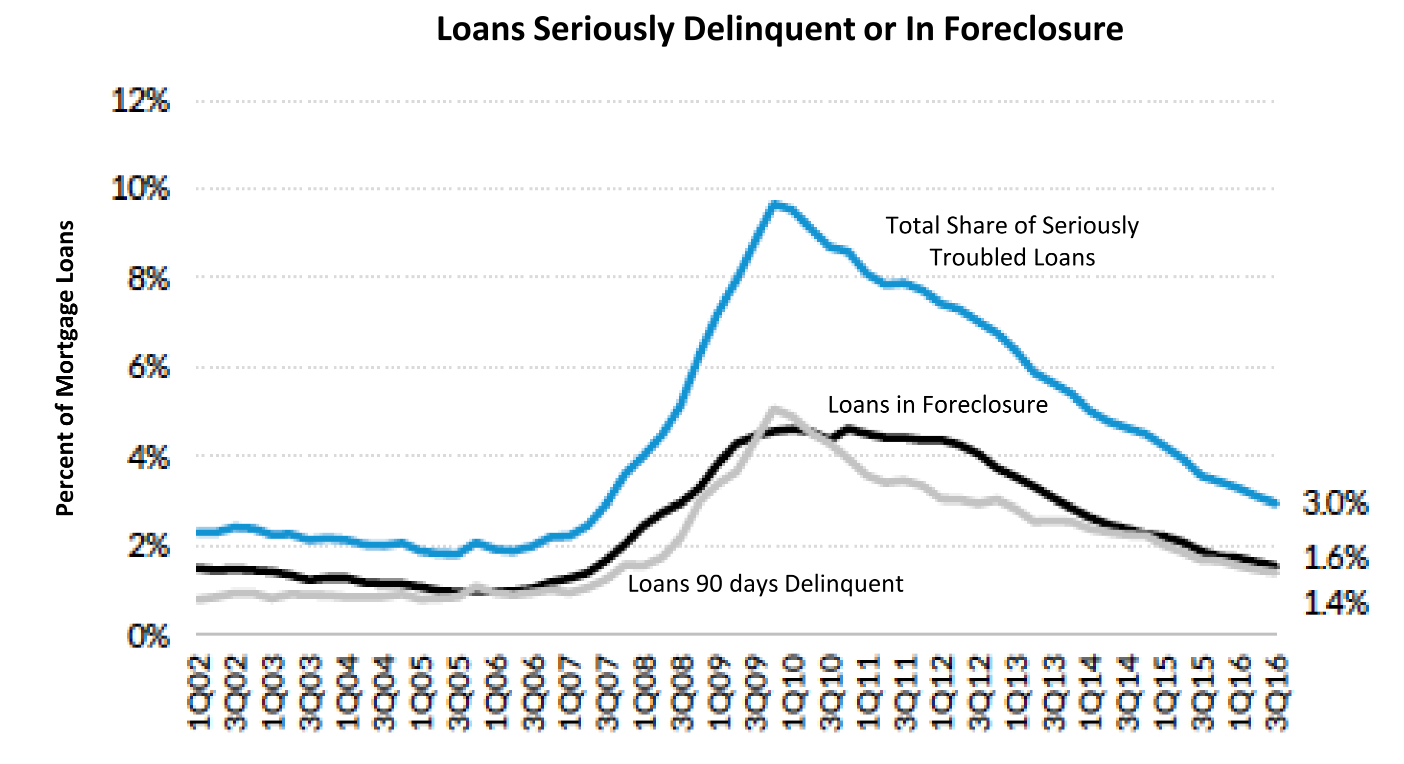
- **Building** – Housing construction crashed during the Great Recession and was extremely weak early in the current expansion.  **Multi-family building** led the way out of the recession and for the past seven years has been very strong, recently surpassing previous peak levels.  Now, however, it is starting to moderate. In contrast, the **single-family construction** recovery started slow but is showing increasing momentum recently, although it is still far below pre-recession levels. Expect robust single-family construction growth in 2017, which will significantly exceed multi-family growth.

- **Home Sales** – **New** home sales growth has been slowly accelerating as new construction has grown.  But the lion's share of home sales is **Existing** Home Sales (now 90% of sales), and it has been flattening, largely due to tightening inventory of available homes.  Moreover, that inventory pressure is generally tightest for *less* expensive homes.  Nevertheless, expect solid home sales growth in 2017, especially for new homes, but perhaps with periodic setbacks due to inventory constraints.

- **Prices** – Nationally, the latest Case-Shiller HPI (for October) is increasing at 5.6% year-over-year and just regained its pre-Bust peak.  Regionally, four of the five hottest markets for price appreciation are west of the Mississippi (Seattle, Portland, Denver & Dallas).  However, most of the 20 major markets still have yet to match their pre-Bust peak.  Expect continued strong gains in most home prices as sales inventories remain tight.

- **Affordability** – Despite significant home price appreciation in the last 3-4 years, mortgage-financed housing remains more affordable now than at any time from the late 90s through 2009.  This is because mortgage interest rates have declined for most of this period.  Unfortunately, with rises expected for both home prices and interest rates in 2017, affordability will worsen.

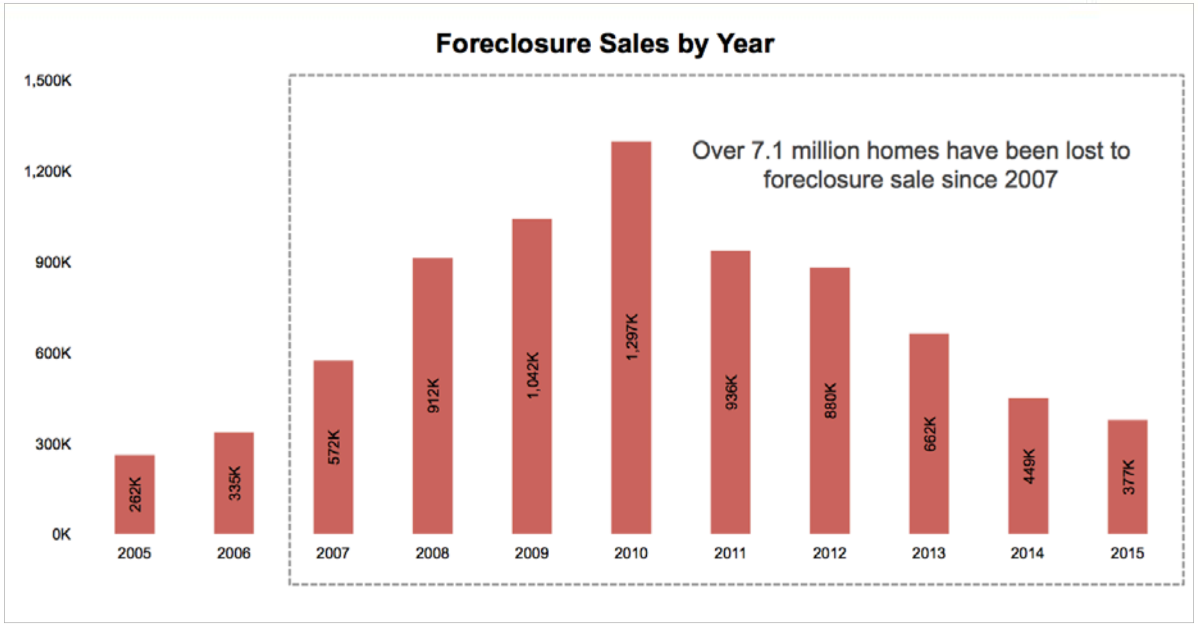
It has taken a decade, but delinquency and foreclosure rates are finally returning to "normal" market levels. This is a marvelous thing for for all homeowners, even those who were never in danger of losing their homes during the Great Recession. That's because the homes that went into foreclosure resulted in a massive oversupply of homes for sale, reducing prices and thus the values of all homes.

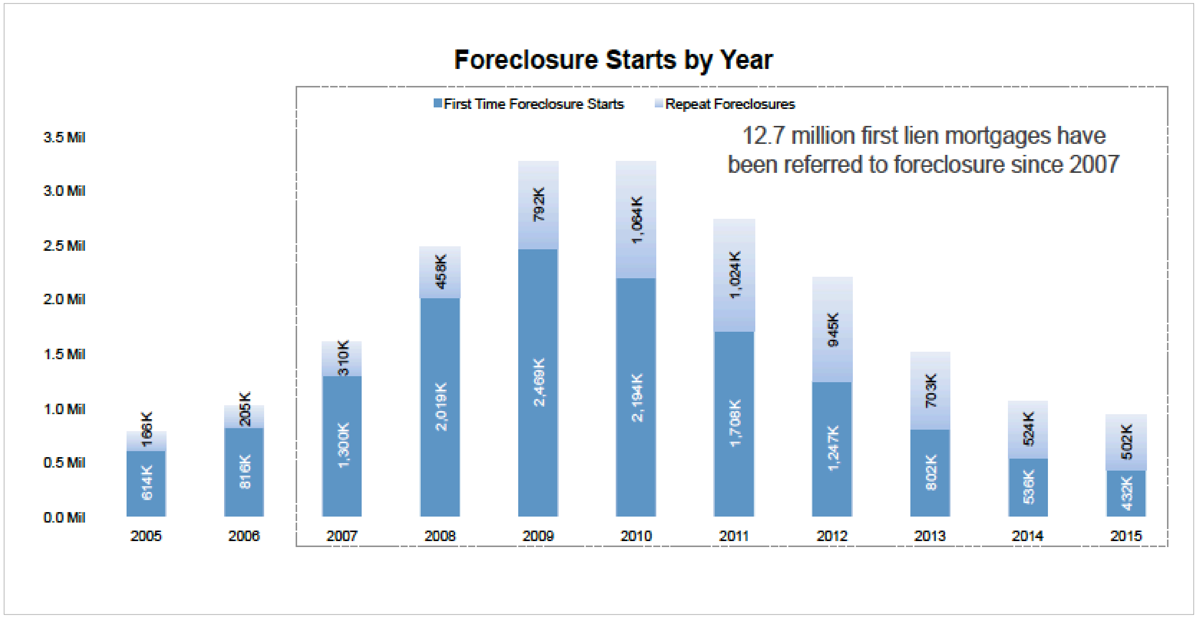



Source: Mortgage Bankers Association, Urban Institute

The Housing Bust took millions of homes away from households and destroyed billions of dollars of home equity, not to mention crippling the home construction industry for years.

But with the return to a more normal level of delinquency and foreclosure, the housing market recovery is nearing completion.

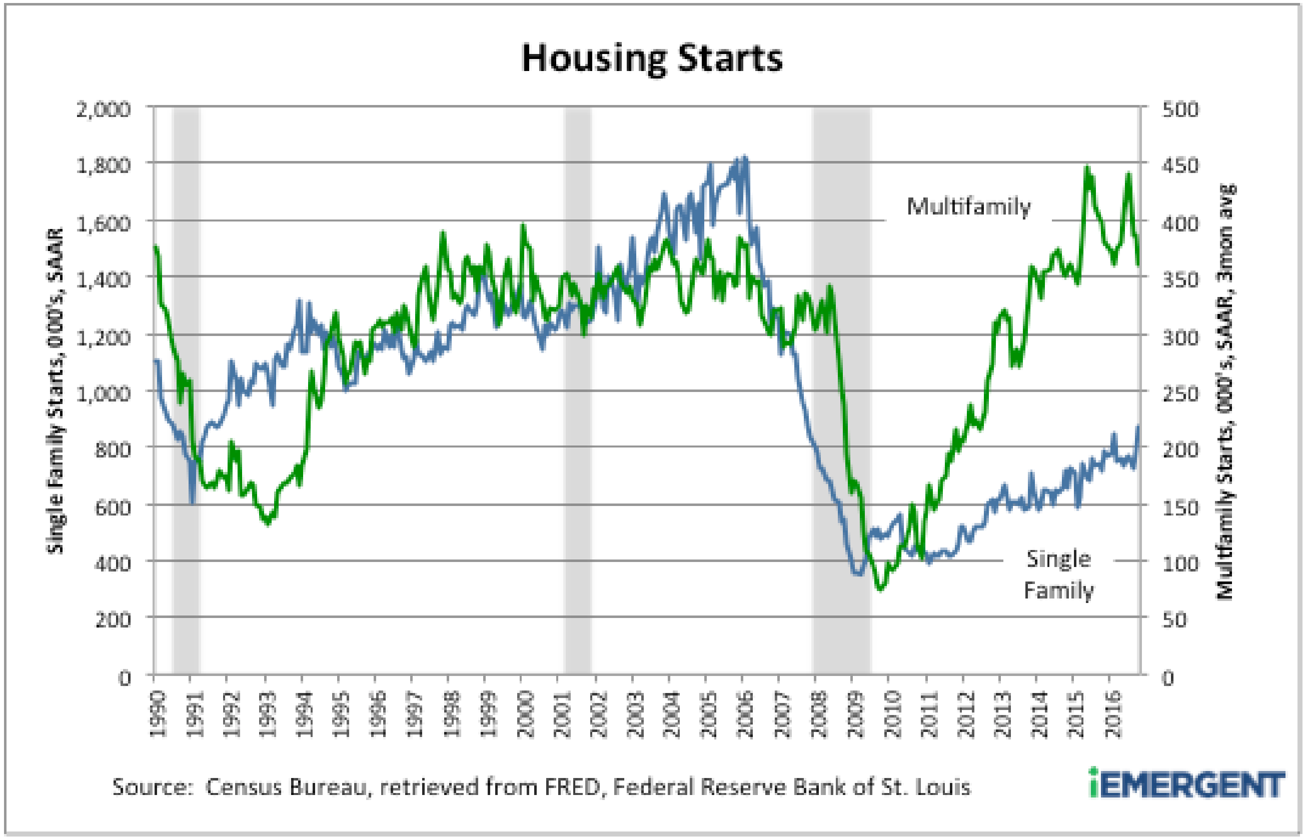



*Graphs source: 2015 Mortgage Monitor Report, Black Knight Financial Services.*

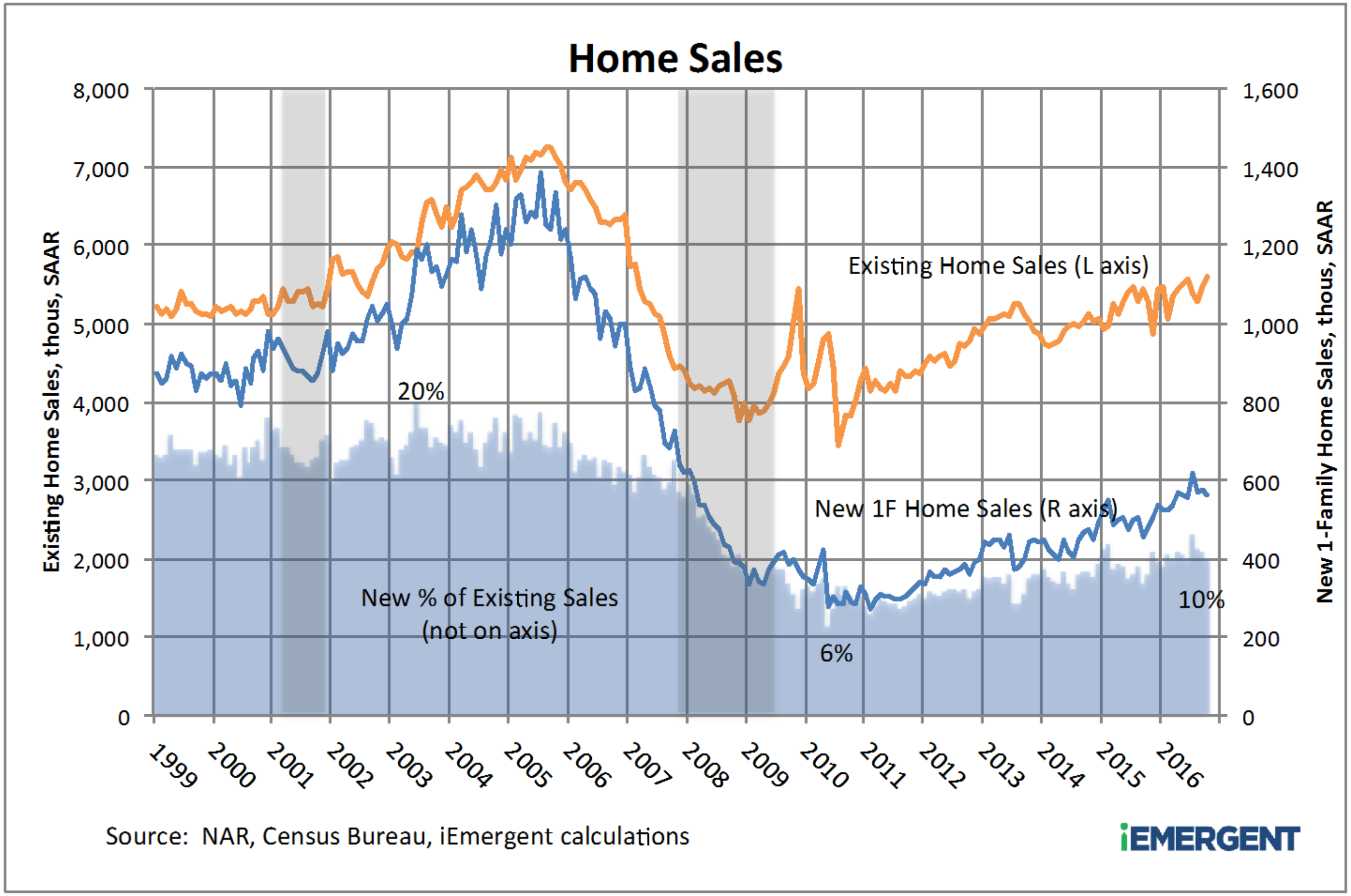
Housing construction in the current expansion has been uneven, with robust multifamily construction but weak single family home building. In the last few months, however, multifamily starts have shown signs of cooling off, though they are still at historically high levels.

Single family starts took more than two years to begin moving after the recession ended, largely because the market was working through its backlog of distressed properties and prices were still falling. But since late 2011, they have been trending upward. Nevertheless, current single family home building is still far below the levels of the 90s and 00s.



Home sales continue to increase steadily. Existing home sales have now reached pre-Boom levels and continue to rise despite tight inventory.

New homes have always been a smaller segment of total home sales. Before the Great Recession, they ranged between 15-20% of existing home sales, but they declined sharply during the Housing Bust, not just in levels but also in relation to existing home sales. After bottoming out at 6% early in the recovery, new home sales have since grown at a slightly faster pace than existing homes. They are back up to 10% of existing home sales, but still well below pre-Boom levels.



Most industry experts expect that home building will grow in 2017, with single-family construction outpacing multi-family construction.  Home sales should also increase, with the growth of new home sales increasing faster than existing home sales.

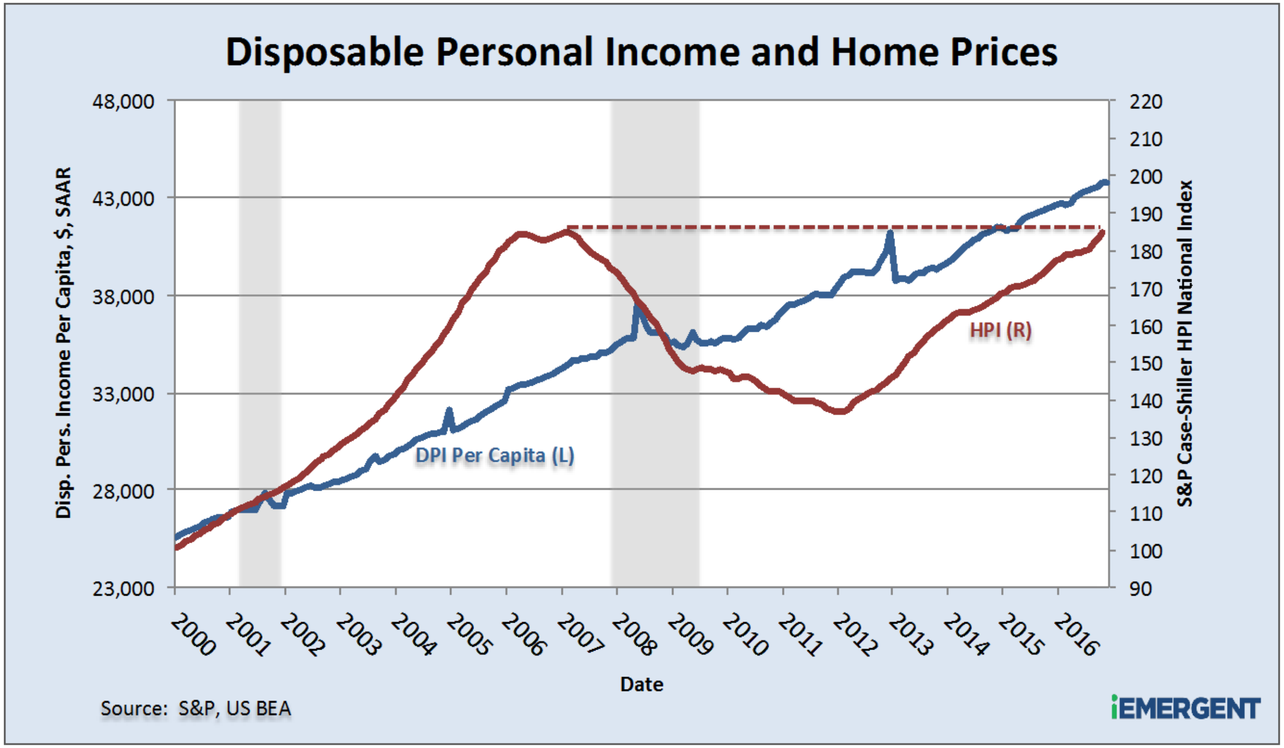
## 2017 Outlooks for Housing Construction & Home Sales

| | Housing Starts | | Home Sales | |
|---|---|---|---|---|
| | Single Family | Multifamily (2 or more) | Existing | New |
| | (% Change, '16-'17) | | (% Change, '16-'17) | |
| **Fannie** | 13.3% | 7.6% | 1.2% | 19.0% |
| **Freddie** | n.a. | n.a. | n.a. | n.a. |
| **MBA** | 10.4% | 3.1% | 5.0% | 13.2% |

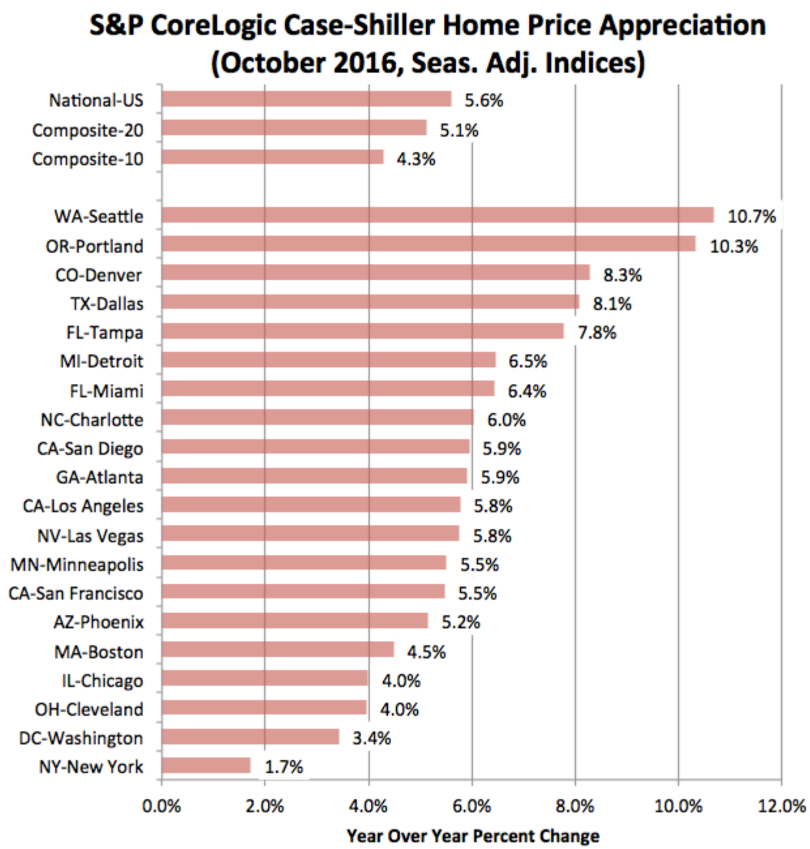
Source:  December 2016 housing forecasts from Fannie and MBA

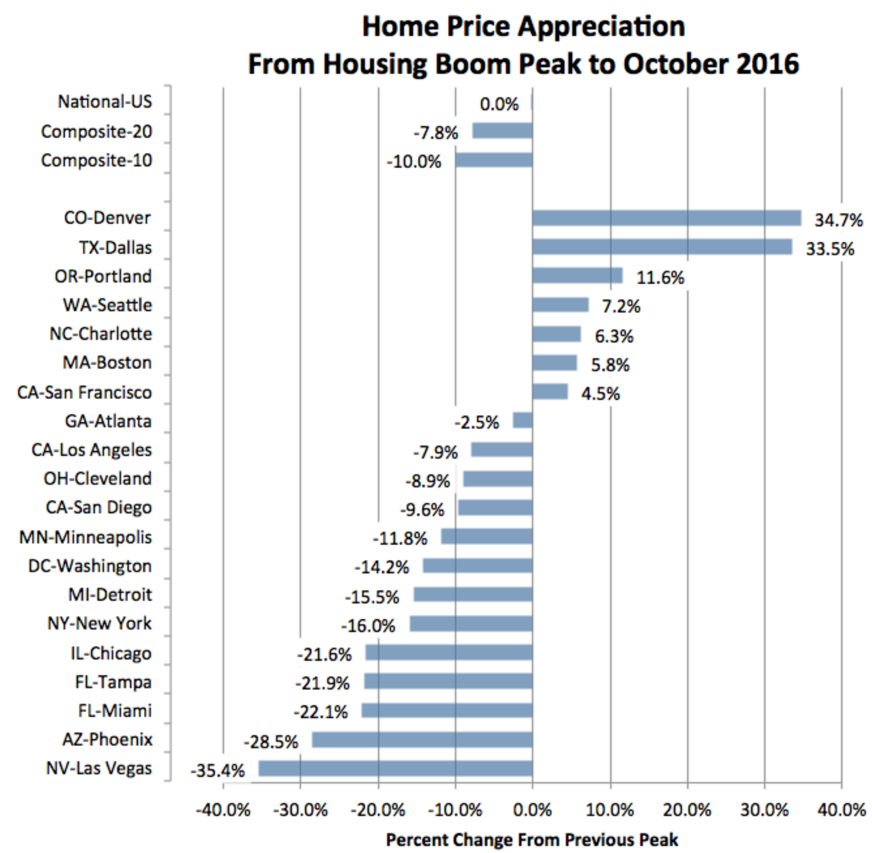
In the most recent report on the S&P Case-Shiller Home Price Index (October data, released in December), home prices reached an important milestone:  After just less than a decade, the HPI finally regained its peak level from the Housing Boom.

The housing bubble occurred because home prices increased faster than incomes could support; households just couldn't afford homes at such elevated prices.  Overheated home prices began falling before the official start of the Great Recession and continued to fall well into the current expansion.  They didn't begin rising again until early 2012.  Since that time, home prices have increased faster than household incomes, but they haven't yet closed the gap on income increases since the expansion began.  This is why new bubble worries continue to be premature, at least at the national level.



From market to market, home price behavior varies significantly. Home price appreciation rates for 12 of the 20 major markets are now exceeding the national average of 5.6% (left chart), and most of these are western markets. However, while the national index has regained its pre-Bust peak, only 7 of the top 20 markets have matched that feat. Las Vegas, Phoenix and the major Florida markets have the furthest yet to go; but markets including Chicago, New York, Detroit and the major California markets (except San Francisco) are still below their previous peak levels as well (right chart).




Source: S&P, iEmergent calculations

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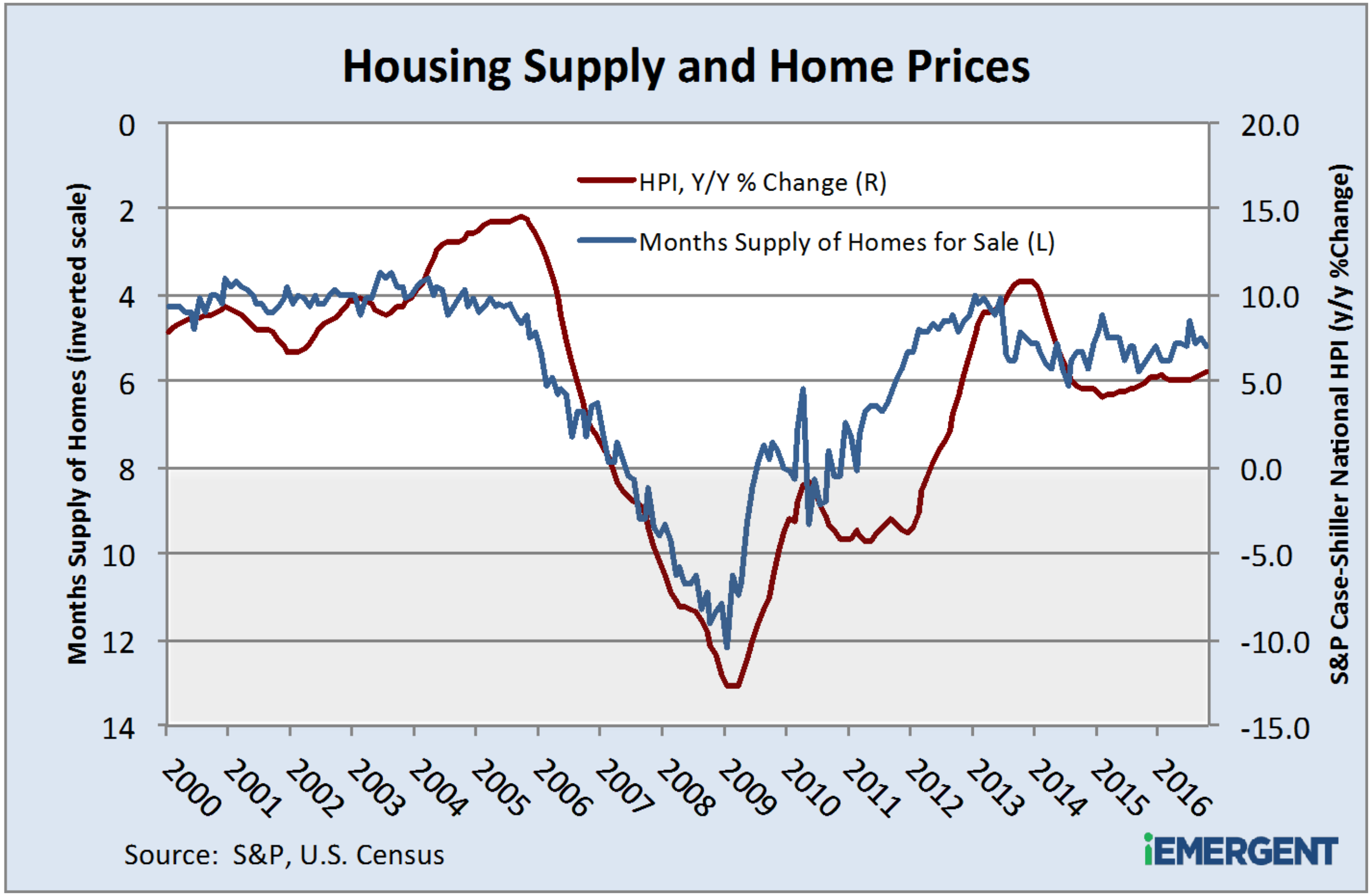
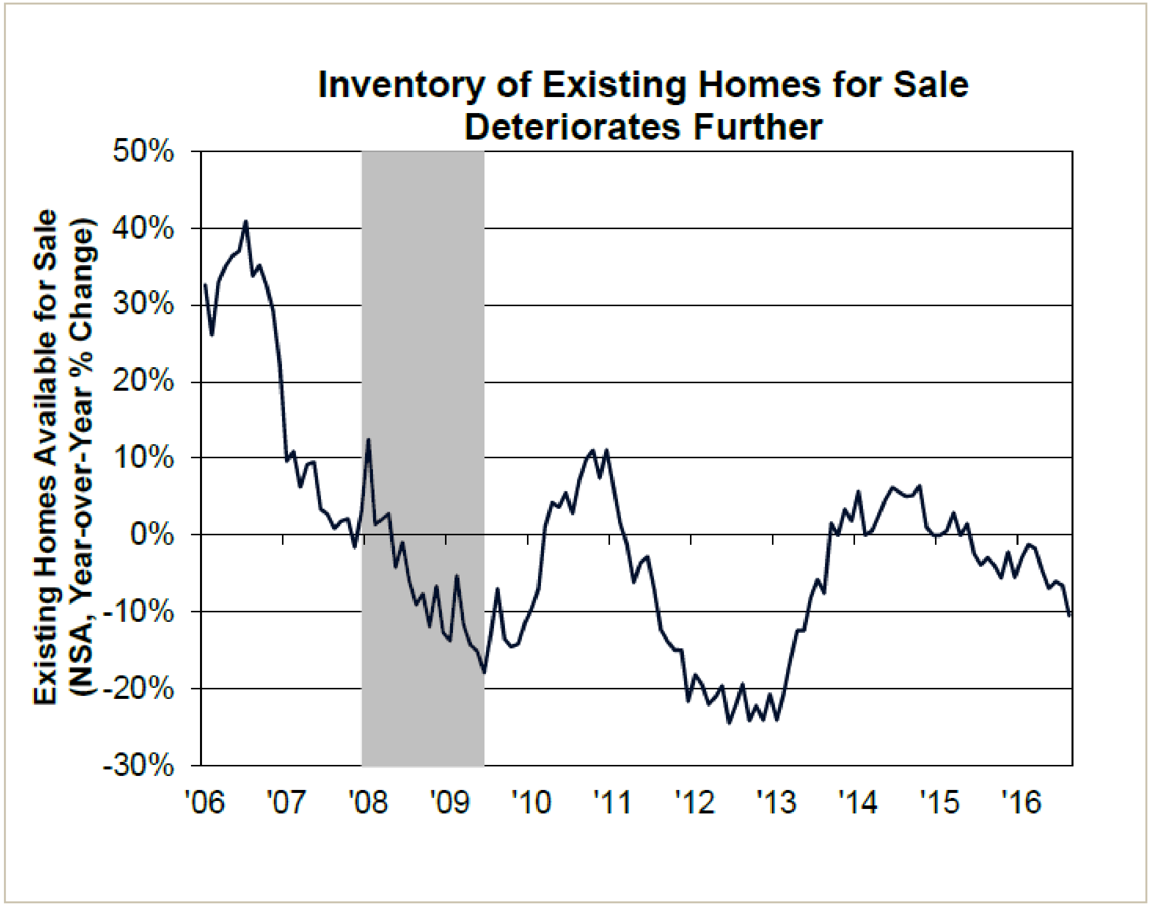
Housing supply, as measured by the months of supply statistic (the ratio of housing inventory to home sales), has remained within the four to six months range for some time now, so home price appreciation has been relatively stable for the last three years at around 5%.



An emerging housing market concern is the size of the housing inventory. Years of depressed building activity and steadily increasing sales demand have depleted the supply of homes available for sale. A tight housing market will constrain future sales volumes and result in upward pressure on home prices.



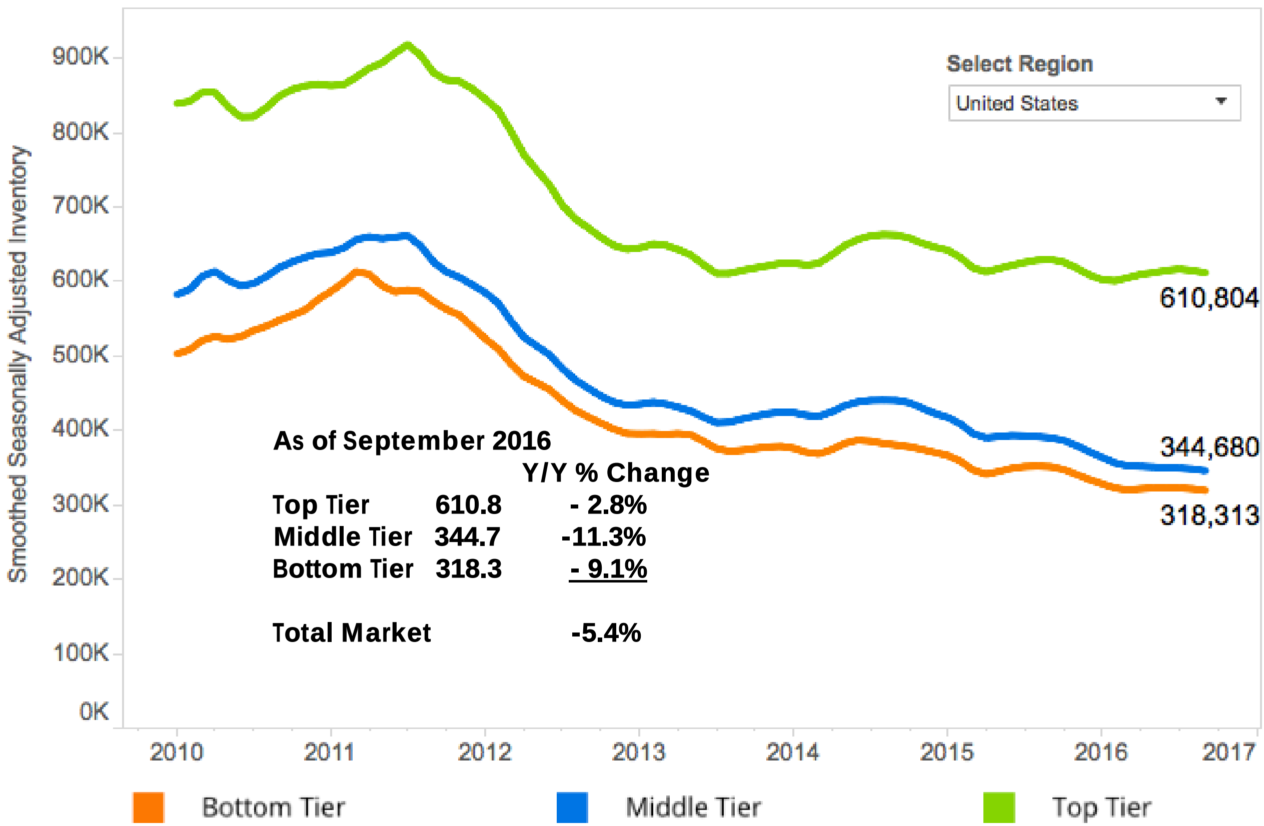

Source: Fannie Economic Developments, October 2016.

# HOUSING MARKET CONDITIONS - INVENTORY

Several market sources have observed that low housing inventories, particularly among lower priced homes, are affecting home values and prices. Zillow reports that inventories of all homes for sale are down 5.4% from a year ago, but inventories for homes in the bottom and middle price tiers are down 9.1 and 11.3% respectively – far more than the 2.8% decline in the top price tier.

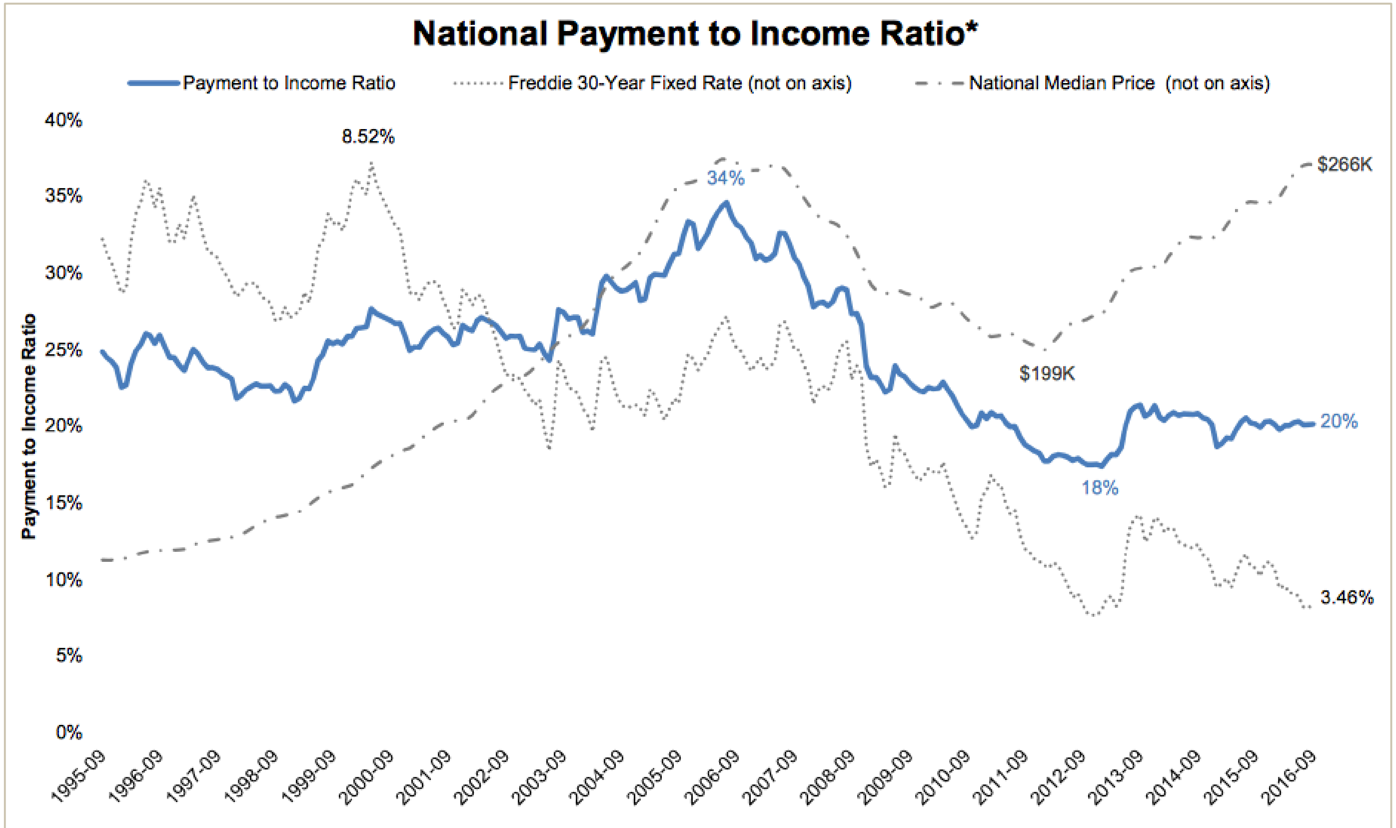
Not surprisingly, price pressure is higher in the lower priced tiers as well. In the top 35 metros in the country, bottom tier home prices are growing fastest in 18 markets, middle tier price growth is fastest in 11 markets, and top tier is fastest in only 6 markets.

## Homes for Sale – By Price Tier




Zillow.com "Q3 2016 Market Report", http://www.zillow.com/research/september-2016-market-report-13641/

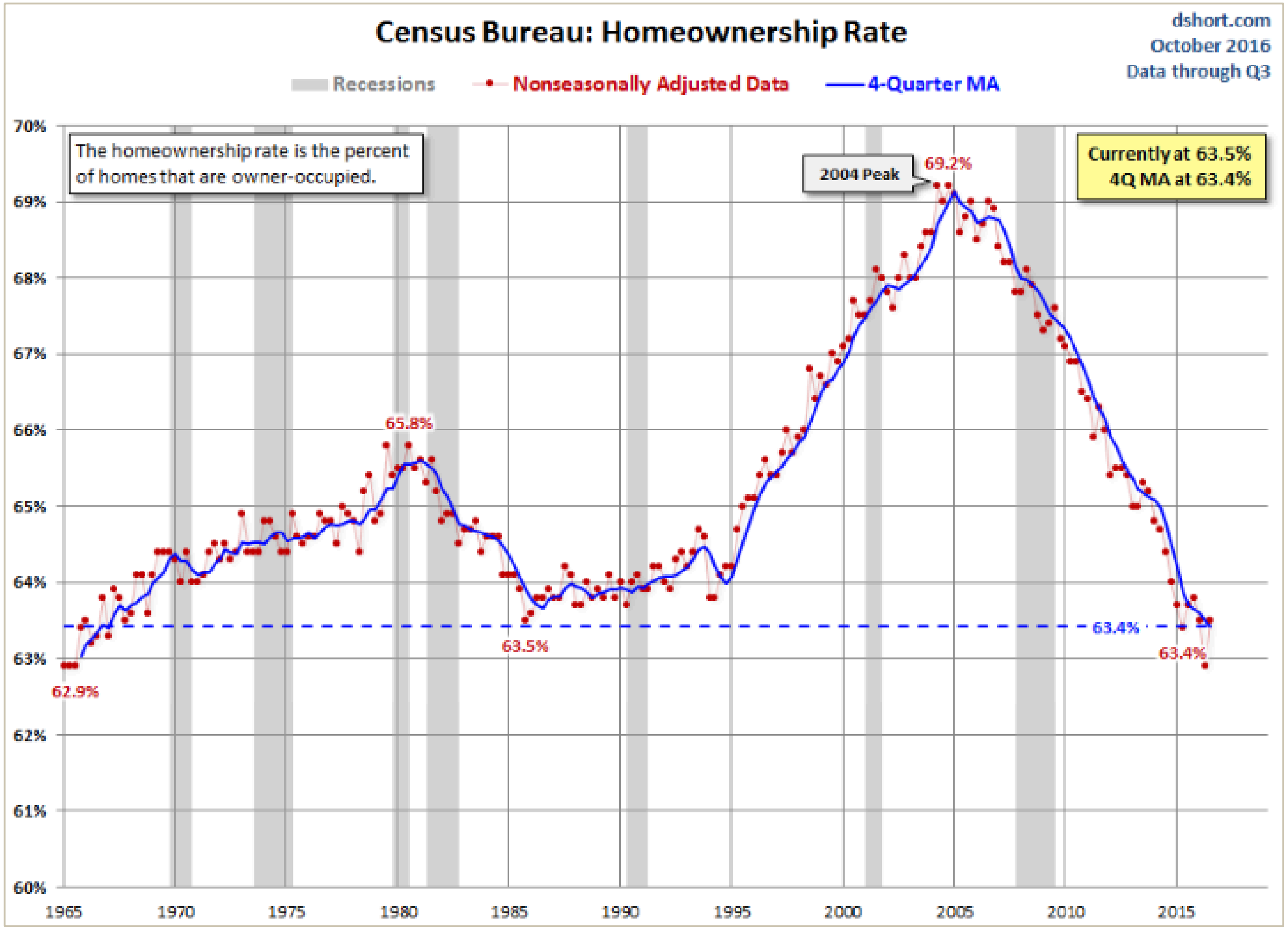
Even though home prices have risen steadily since 2012, housing affordability, as measured by the mortgage payment-to-income ratio, has stayed relatively constant over the last three years because mortgage interest rates have declined. In fact, housing continues to be more affordable now than at any point from the late 90s through 2009. But with *both* home prices and mortgage rates on the rise, affordability will get worse, increasing the challenges of buying homes, particularly for FTHBs.




****Payment to Income Ratio* is the percent of the median household income required to purchase the median priced home based using an 80% LTV 30-year fixed rate mortgage at the FHLMC 30-year rate.*

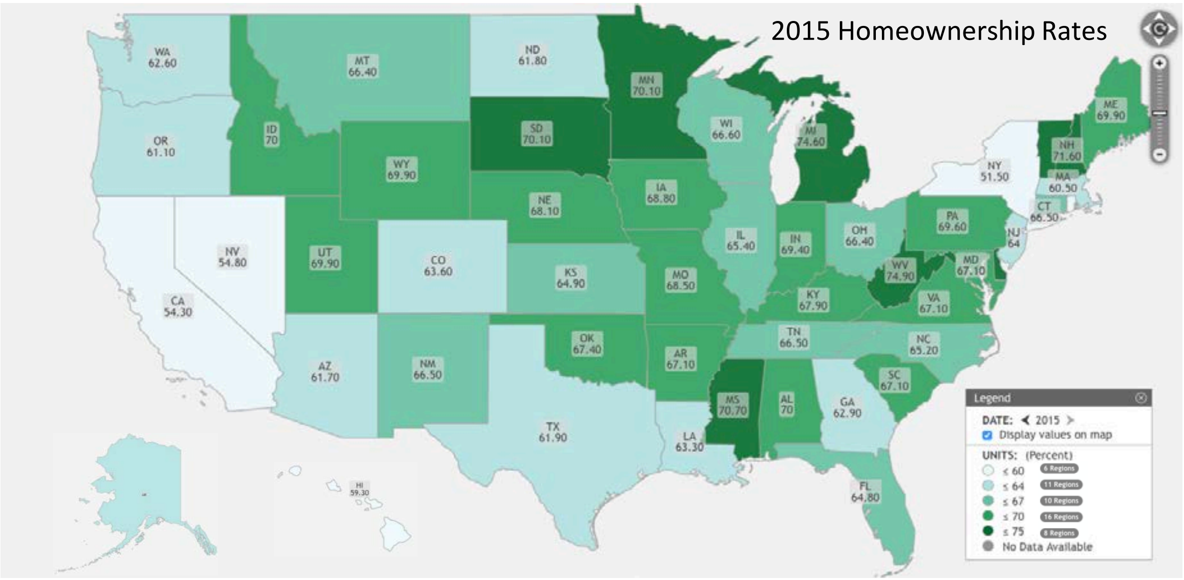
Source: Black Knight Financial Services Mortgage Monitor

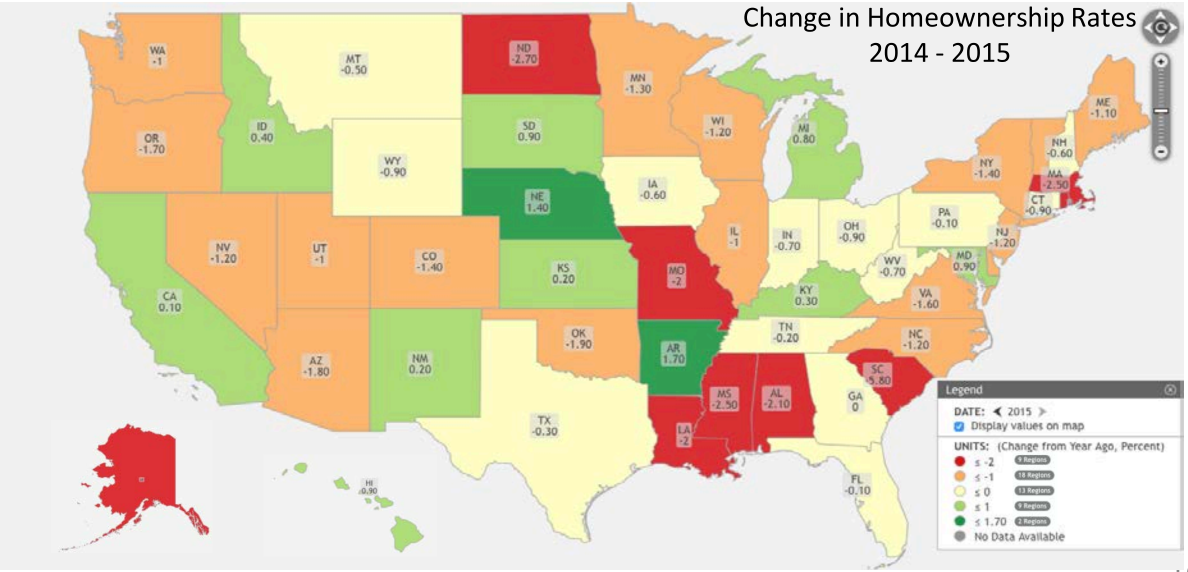
The homeownership rate in the U.S. has been declining steadily for over a decade now and has reached lows not seen since the mid-1960s. While some experts see the homeownership rate leveling off at current levels, we at iEmergent believe the homeownership rate will continue to fall for at least another few years. This is because in order for it to rise, first-time homeowners must enter the market at a faster pace than income demographic analysis suggests is possible.



Homeownership across the country varies due to housing supply and demand factors and regional economic conditions. At any point in time, some areas may be improving while others may be on the decline.

In 2015, the U.S. homeownership rate fell to 64.65% from 65.48%. On the state level, the homeownership rate declined in 39 states and the District of Columbia. Only 11 states had gains (the green states in the lower chart).




Source: Data from Census Bureau, maps from GeoFRED, Federal Reserve Bank of St. Louis. (2016 state level data not yet available.)

## OUR COMPANY

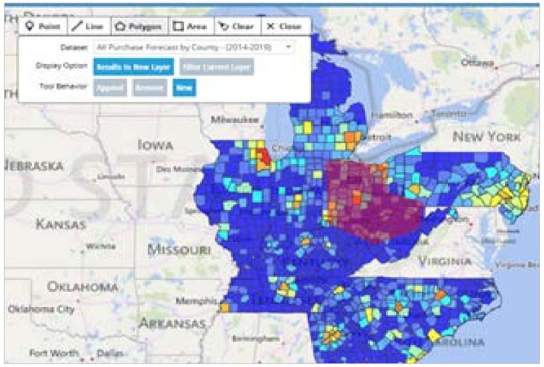
iEmergent is a forecasting and advisory firm for the lending industry. Since 2000, we have been focused on delivering a forward-looking approach to helping organizations navigate the industry's changing landscape. After nearly 20 years as an executive at two national lenders, our founder leveraged his background in mathematics and predictive modeling to develop a groundbreaking method for forecasting mortgage opportunity. In addition to our forecasts, we provide strategic advisory services to lenders of all sizes and types, as well as mortgage insurance, title, and investment companies. Viewed as industry leaders, we have been featured in Mortgage Banking magazine, HousingWire, National Mortgage News, Origination News, Inman News, and the Credit Union Journal.

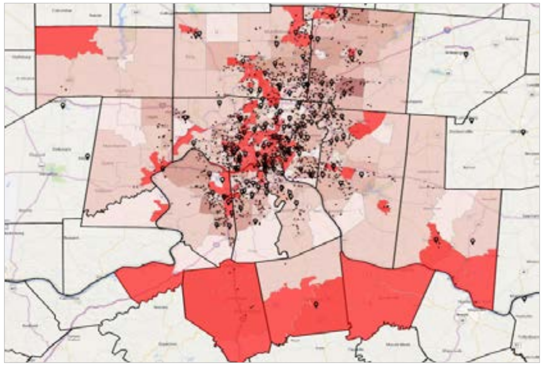
## OUR PRODUCTS

iEmergent provides accurate, forward-looking data that quantifies what's next in mortgage markets across the nation. As housing and lending sputter and stutter toward recovery, our forecasts drill down into states, metro areas, counties, and neighborhoods to quantify where and how mortgage opportunity will grow, slow, or stay the same.

Most clients access our data through Mortgage MarketSmart, a web application with dynamic maps. This powerful visualization tool brings HMDA and detailed forecast data to life, helping organizations easily make decisions about high-level strategic opportunities and tactical, market-level challenges:

- Expand and grow responsibly
- Improve sales strategies at all levels
- Optimize resources, brand, and locations
- Recruit, hire, train, and retain sales resources
- Minimize distribution risk and meet CRA/Fair Lending regulations



### FORECAST SEGMENTS

**Market Geography**
- State
- MSA
- County
- Census Tract

**Market Segments**
- Occupancy Types
- Custom Loan Sizes
- Conventional Loan Type
- FHA,VA, FSA Loan Types
- Jumbo, Conforming
- Borrower Income Levels
- Borrower Race/Ethnicity
- First Time Homebuyer
- CRA Eligible
- New Construction Sales
- Custom Loan Sizes
- Refinance Ranges

For more information about Mortgage MarketSmart, our forecasts, or advisory services, call Fenn Meents at 515-327-0070 (x101).