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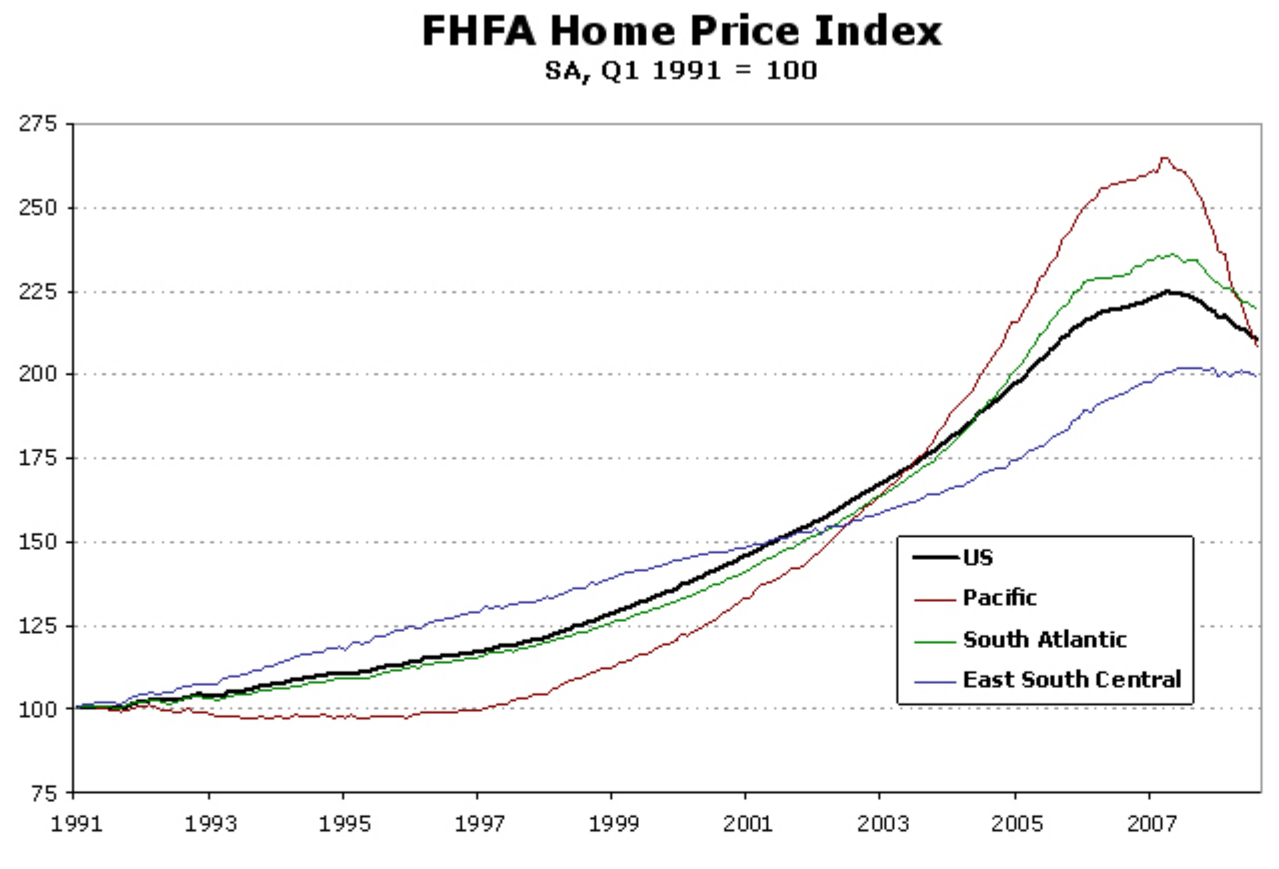
A home price index gets a new name (but it's telling the same story)

Yesterday we got a peek at the latest home price data provided by the Federal Housing Finance Agency (FHFA). Never heard of it before? It's the new agency that took conservatorship of Fannie Mae and Freddie Mac, the nation's giant housing GSEs (government-sponsored enterprises). FHFA has also absorbed the Office of Federal Housing Enterprise Oversight, or OFHEO. So the popular OFHEO home price index is now the FHFA home price index. (Let me weigh in here—I like the sound of OFHEO better.)

The FHFA price index posted another sizeable decline in August (0.6 percent) and is down 6.5 percent from its peak in April 2007. Here's what the home price index has done since 1991.



Source: Federal Housing Finance Agency

The national data mask some wide variations by region. While every part of the country has felt the decline in housing markets, the Pacific region has seen the largest price declines (off 21.5 percent since peaking in March 2007) and the East South Central (which includes Texas) has experienced the least slowing (off 1.7 percent since peaking in June of 2007). The South Atlantic Region, which includes much of the Atlanta Fed's Sixth Federal Reserve District, has also been hit with an above national average decline as home prices are off about 7 percent since their peak in May 2007.

I suppose these regional variations aren't too surprising. Stories of overbuilding and price speculation were most pronounced in areas such as California, Nevada, and Florida. These areas also rate tops among foreclosure rates according to data just released by RealtyTrac. Without getting into the thorny (albeit important) issue about what, exactly, constitutes a bubble, the "what goes up must come down" explanation may be a little overly simplistic.

Here's a perspective published in the Federal Reserve Bank of Cleveland's Commentary series a little more than a year ago. Davis, Ortalo-Magne, and Rupert say that home values, and especially relative home values, are really driven by fluctuations in the value of land. They argued that if you relax credit constraints, you unleash demand for housing, which because land is in fixed supply will produce a jump in home prices. And the subsequent declines we've seen to date? Well, constrain the credit, and the process works in reverse. The Davis et al. story works especially well if you think the housing boom and subsequent bust originated in the subprime market. Since these are exactly the homebuyers who were most credit constrained, the increased availability of credit significantly expanded the pool of potential home buyers.

Atlanta's recent housing experience may be a good example of the relationship between land, demand, and home prices. As my boss, Atlanta Fed President and CEO Dennis Lockhart, noted in a speech earlier this week, Atlanta had a large expansion of new home building in the first half of this decade. The expansion in home building wasn't impeded by natural barriers, like mountains and coastline. Atlanta has an abundance of low-cost land available for residential development, and in 2005 Atlanta's single-family new home market was the strongest in the nation with 61,000 single-family housing permits. However, Atlanta did not experience the extreme home price appreciation seen in some areas, and Atlanta's home price decline, while unpleasant, is much less than areas like Florida and the West Coast.

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