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Connecticut Home Prices Now More Affordable

By Steven P Lanza

A state's demographic profile may change with time. Its numbers may grow larger, its average resident may grow older, and its ethnic composition may grow more diverse. But one constant remains—a population needs a roof over its head. And for Connecticut at least, that requirement has grown easier to afford.

Years of falling home prices, rising incomes and tumbling interest rates have combined to make Connecticut homes their most affordable in decades…and more affordable than the typical U.S. home for the first time in nearly twenty years. Even the recent rebound in the state's real estate market and tighter monetary policy at the Fed have failed to dull the luster of housing affordability in Connecticut.

Measuring Affordability

An affordability index measures the ability of a typical family to buy a typical single-family home. The National Association of Realtors (NAR) produces one such affordability index for the U.S. as a whole and for four broad geographic regions of the country. The NAR index shows what percentage of the mortgage payment on the median-priced home the median family can afford. The "median", represents the home price or family income that is exactly in the middle of a top-to-bottom ranking for the area in question. In calculating the index, the NAR assumes a down payment of 20% and a qualifying ratio of 25%, which is to say the monthly mortgage payment cannot exceed 25% of gross income.

Consider a Connecticut example. In 1998, the median family of four earned a monthly income of $6,300, so it could afford a maximum mortgage payment of $1,575. But the actual mortgage payment on the median home, priced at $149,000, was just $789. Thus the 1998 Connecticut affordability index was 199 (= $1575/$789 x 100). If the index is above 100 housing is "affordable" at the median, and "unaffordable" if the index is below 100.

NAR does not publish state-specific indices, but the same methodology can be used to produce home-made indices for Connecticut and the other 49 states. All we need are three pieces of data for each state: 1) the median price of an existing single-family home (Economy.com, Inc. based on NAR data); 2) the median income of a 4-person family (U.S. Census Bureau); and 3) the average 30-year fixed mortgage rate (Federal Home Mortgage Corporation).

The Connecticut Experience

As the chart illustrates, Connecticut's housing affordability index has swung between extremes over the past quarter century, ranging from relatively affordable in 1974, to unaffordable in 1981, and back to affordable in 1998 (the last year of Census income data). Over the same period, the U.S. index followed a similar, though not parallel, course.

In the 1970s, sharply rising interest rates and fitful income growth caused the Connecticut and U.S. indices to drop sharply. Then during the 1980s, a widening affordability gap opened up between Connecticut and the U.S. Nationwide, interest rates fell and incomes kept pace with rising home prices, so the U.S. index improved. In Connecticut, though, a 228% jump in median home prices kept the affordability index fairly flat. By 1986 and 1987, Connecticut ranked 48th in affordability out of 50 states, ahead only of Hawaii and Massachusetts. In 1988 and 1989, Connecticut also became more affordable than Connecticut, but we were still just 47th on the affordability list. For the decade then, the median U.S. family could afford the median-priced home or better, but the median Connecticut family decidedly could not.

But the decade of the 1990s was a completely different story for the state. Steady improvement in home affordability for the nation as a whole became, for Connecticut, dramatic progress. Nationally, vigorous economic expansion kept incomes and home prices growing apace, while interest rates fell. The difference in Connecticut was that real estate prices took a dive. Hence, as early as 1991—when Connecticut was still knee-deep in recession—its affordability index had passed 100, and in 1995 (as incomes in the state finally began to grow) the index jumped ahead of the nation's. In 1998, the median Connecticut family earned twice the income needed to finance the median-priced home, making Connecticut housing 13% more affordable than in the U.S as a whole.

What has happened since 1998, when interest rates nationally, and home prices statewide began to rise?. Census data on median family income is unavailable beyond 1998, but substitute data for average incomes is, and it suggests that for an average-sized household in Connecticut, housing affordability by 2000-Q1 had dropped 16% from its 1998 peak but still remains 12% above comparable U.S. figures.

Whose Cloud, Whose Silver Lining?

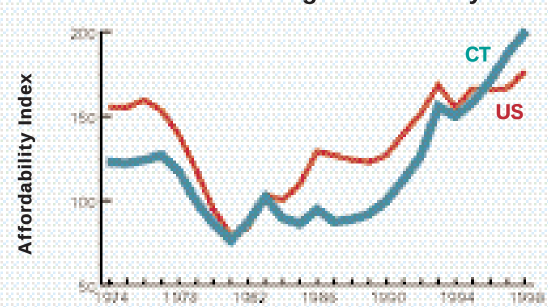
Homeowners who bought at the peak of the market in 1989 and sold at the trough in 1995 suffered a 16.5% drop in the value of their homes … and that's using data at the median. Fortunately, three-quarters of the gain in affordability over that period came not as a result of falling prices, but as a consequence of rising incomes and cheaper financing costs.

Still, for those forced to sell into a sinking market, Connecticut's impressive gain in housing affordability likely seemed little more than a silver lining in a cloud that rained buckets. Some were over-leveraged real estate speculators who had voluntarily assumed such risk. But others were young workers forced to leave the state for more promising opportunities in the south and west. Those of "Steady Habits" who stayed put, ate their paper losses and went about their business.

Among the likely beneficiaries of Connecticut's more affordable housing: younger population cohorts and other new entrants into the state's real estate market. Connecticut is apt to appear a relatively attractive place for first-time homebuyers and potential migrants from regions with less affordable housing. The attraction should not only help to draw workers from out-of-state, it should also help to keep more workers here—something Connecticut employers, desperate for workers to help grow their businesses, would welcome.

And for those who do call Connecticut home, the exhibit at the bottom of the next page shows how their prices changed in 2000-Q3.

Connecticut's Housing Affordability Soars



Developed by *The Connecticut Economy* based on data from Economy.com, the Census. Bureau, and Federal Home Mortgage Corporation.

GDI Acrophobia

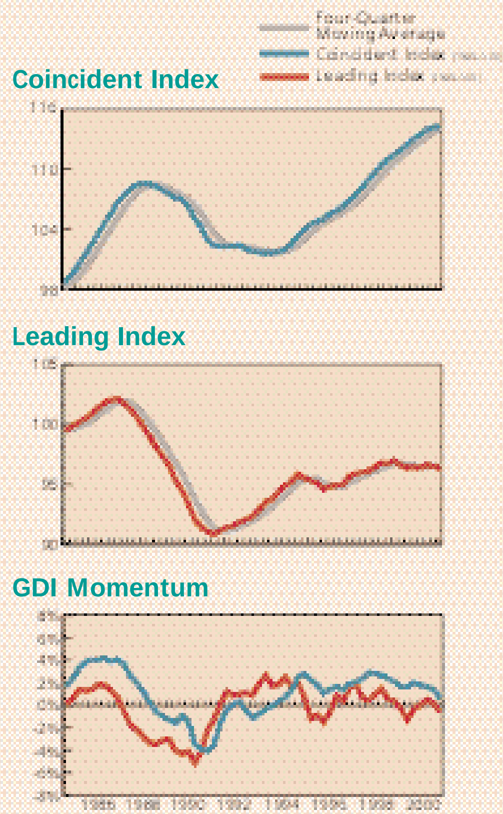
By Steven P. Lanza

After a dizzying climb, the GDI appears to have developed a fear of heights. Mounting evidence suggests the GDI may have reached a plateau and is now struggling for some solid footing. The coincident index grew at its slowest rate in six and a half half years, and the leading index hit the skids once again. The GDI is a composite measure of the four-quarter change in three coincident and four leading economic variables, and is indexed so 1986 = 100.

The coincident GDI inched up one tenth of a point, from a revised 114.2 in 2000-Q2 to 114.3 in 2000-Q3, for a four-quarter growth rate of just 0.4%. Though the coincident GDI has experienced slowing momentum since early 1998, this quarter's increase was the smallest since 1994, a period soon after the economy had pulled itself out of a prolonged recession. The Connecticut Manufacturing Production Index declined for the second straight quarter, dropping 2.2% in the four quarters ending 2000-Q3. Employment growth held steady, as the economy added jobs at the same 1.4% rate in 2000-Q3, as in 2000-Q2. Higher prices, however, cut into income gains. Real income made a four-quarter gain of 1.6% in 2000-Q3, compared to a 2.0% advance in 2000-Q2.

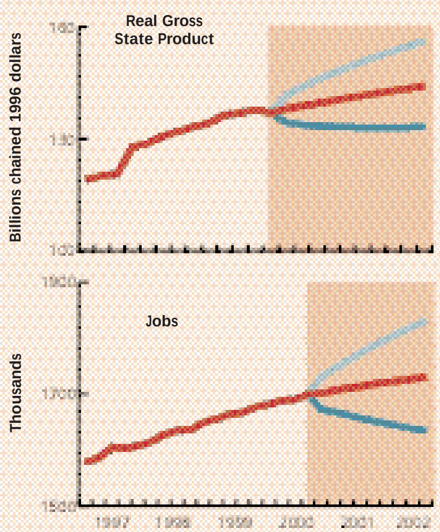
Though hardly in a free-fall, the leading index again lost ground, slipping from 96.5 in 2000-Q2, to 96.4 in 2000-Q3. The same three variables that contributed to a weak second quarter also produced a third quarter loss, although the damage was a bit less severe. Housing permits suffered a 15.2% four-quarter drop—a disappointment, for sure, but better than the second quarter decline of 21.1%. Average weekly hours dropped 0.4%, and help-wanted advertising was down 5.4%. Only initial unemployment claims made any headway, with 9.5% fewer new claims in 2000-Q3 than in 1999-Q3. The improvement, however, was not enough to catch the fall of the leading GDI.

GDI Components



A Chill Runs Through the Connecticut Forecast

By Kathryn Parr

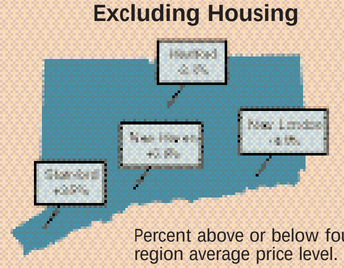


Where the lines branch out, the red line shows the predicted values for RGSP and jobs, and the green lines show a one-standard deviation margin-of-error around the forecast.

Weaker than expected growth in real U.S. Gross Domestic Product (GDP) sent a chill through Connecticut this quarter. Connecticut's real Gross State Product (GSP) grew by a lower-than-expected 2.9% annualized growth rate in 2000-Q3. And with national figures showing an economy that's continuing to cool, GSP growth is likely to moderate further, falling to a lower, though still respectable, 2.0% rate by this time next year.

Connecticut added a healthy 22,600 jobs between 1999-Q3 and 2000-Q3. Our forecast suggests that jobs will continue growing through the coming year, though at a diminishing rate. By 2001-Q1, we expect a four-quarter growth in jobs of just 14,500. Labor supply pressures and a slowing national economy are the major obstacles to job growth. Other economic indicators performed modestly, with an especially noticeable slowdown in the growth of real state personal income.

Cost of Living by Region, Excluding Housing



Percent above or below four-region average price level.

Connecticut Price Changes

Percent Change 1999-Q3 to 2000-Q3

Food	H	6.9%
Housing	H	7.5%
Apparel	P	1.4%
Transportation	H	5.5%
Medical	H	15.7%
Entertainment	H	1.2%
Miscellaneous	H	6.9%
Overall	H	6.7%