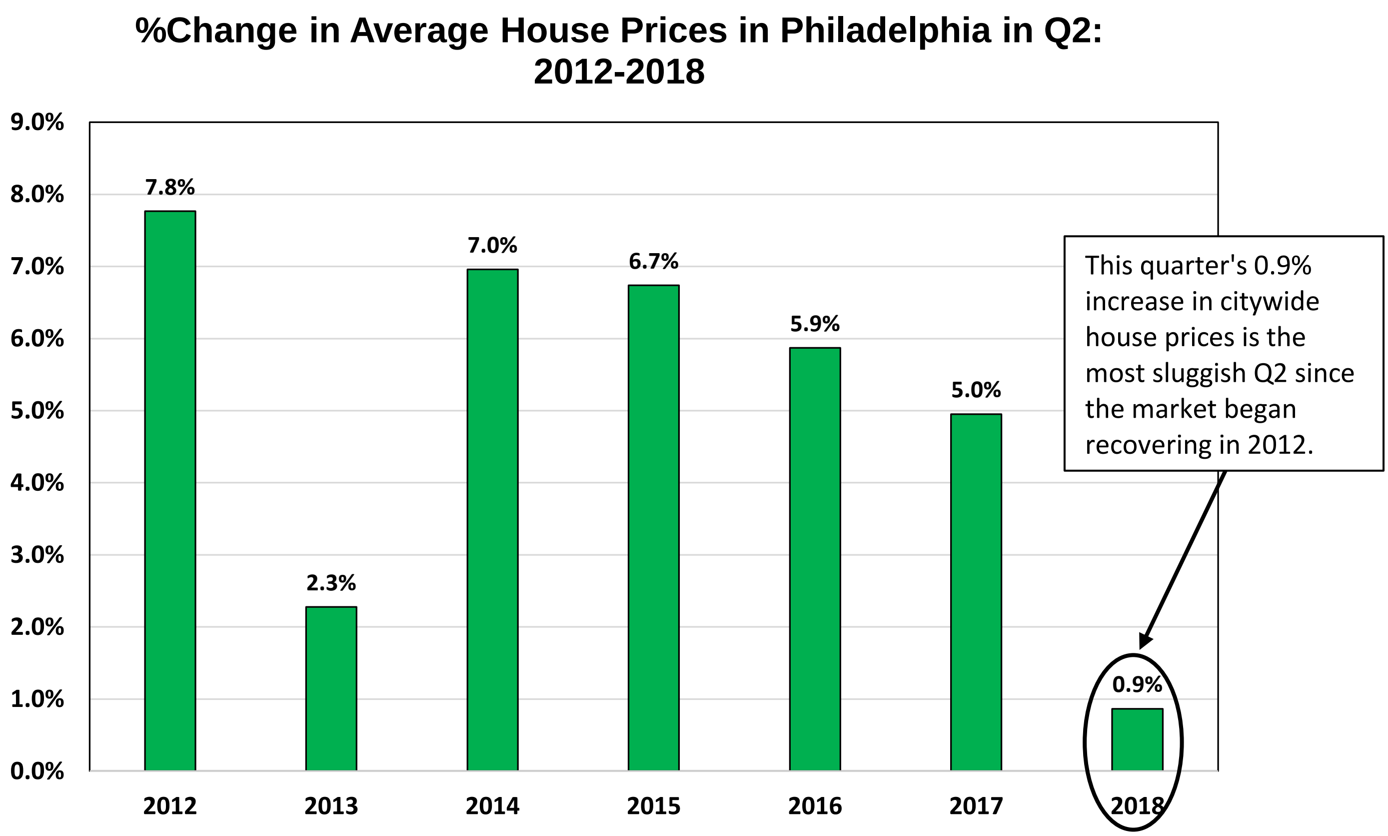
Is Philadelphia's Housing Market Hitting Its Peak?
Mixed signals continue into Q2, but are joined by some other pessimistic indicators as well.

August 2, 2018: Spring is usually the most robust time of year for Philadelphia's housing market. But, the city's housing market persisted in generating contradictory indicators for this period. Here's the latest numbers for 2018 Q2:

- **The average price of Philadelphia homes rose by 0.9% on a quality- and seasonally-adjusted basis in Q2.** Although this is an improvement over the 1.6% decline in the previous quarter, it is still a rather lethargic number for what is typically the hottest quarter of the year. In fact, this was the coolest Q2 for house price appreciation since the current bull market began in 2012:



- **After several consecutive quarters of flattening prices, the typical Philadelphia home is worth no more today than it was one year ago; i.e. YoY appreciation is 0%.** This is a consequence of the slowdown in house price appreciation over the course of the past year. Last quarter, house prices were 4.3% higher than in the same quarter one year ago. In the quarter before that, house prices were up 12.7% from the same quarter one year ago. On average, Philadelphia's house prices typically appreciate by 4-5% per year.

- **The median house price in Philadelphia in Q2 was $153,250, a 2.2% increase over $150,000 in the previous quarter**. However, the typical increase in the median house price in Q2 is 10%. So this 2.2% increase in nominal house prices is well below its historic average for this time of year. Note: the reason the increase in the house price index (+0.9%) is smaller than the increase in the median house price (+2.2%) is because the regression that computes the house price index adjusts for seasonal fluctuations in house prices. Thus, more than half of this quarter's increase in nominal house prices would seem to be attributable to temporary seasonal—as opposed to fundamental economic—factors.

- **Much like house prices citywide, house price changes in individual submarkets were generally positive but also relatively modest.** From smallest to largest, the average quarterly change in seasonally- and quality-adjusted house prices by submarket was: West Philadelphia (-1.5%), Northwest Philadelphia (+0.6%), North Philadelphia (+0.8%), Center City/Fairmount (+0.9%), Upper Northeast Philadelphia (+0.9%), Kensington/Frankford (+1.0%), University City (+1.7%), Lower Northeast Philadelphia (+2.3%) and South Philadelphia (+3.3%).

- **In contrast to cooling prices, home sales activity remains red hot.** There were 6,460 arms-length sales in Q2, up 15.7% from 5,585 home sales in the same quarter one year ago[1]. This is the highest volume of quarterly home sales since the current market began its post-recession recovery in 2012. The last time that quarterly home sales were so high was back in 2006, near the peak of the previous expansion.

- **Million-dollar home sales remain high, but are slowing.** There were 38 sales of houses at a price of one million dollars or more in Q2. This is down slightly from 41 in the same quarter one year ago. A similar pattern occurred in Q1. This is the first time during the current expansion that +$1m sales have declined YoY in consecutive quarters.

- **Housing inventories (the number of homes listed for sale) have fallen to an all-time low.** There are currently 3,460 houses listed for sale in Philadelphia, which is well below its historic average of approximately 6,000 units that typically prevails under more normal market conditions. At the current strong pace of sales, this inventory would be exhausted in just over 2 months. A 5-7 month's supply of inventory is typical of a balanced market. Current market conditions strongly favor sellers over buyers in Philadelphia.

The combination of extremely low supply (inventories) with very strong demand (sales) would normally place significant upward pressure on house prices. While this was the case up until a year ago, the recent cooling in prices needs to be explained by other factors. One of them is increasing mortgage rates, which limits the amount that buyers can afford to borrow, which in turn limits how high of a price they can afford to buy a house. Another complementary explanation is that, since the supply of homes available for sale has been very limited, shoppers have been increasingly experiencing what the business media has dubbed "buyer fatigue[2]": exhausted from searching for their ideal "dream" home, buyers are settling for their second- or third-best home, but are demanding—and obtaining—a relatively lower price in exchange for settling. A final explanation (albeit an anecdotal one) is that millennials are finally making the transition from renting to homeownership. However, their constrained incomes and generally high levels of pre-existing debt are skewing their purchases towards relatively lower-priced homes. The increase in the sales volume of lower-priced homes mathematically pulls down the average and median price of homes in the data sample.

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[1] Since sales volume of homes are highly seasonal, it is more common to compare quarterly sales numbers to the same quarter one year ago rather than the previous quarter.

[2] https://finance.yahoo.com/news/america-apos-housing-market-raising-145500807.html

Of larger concern is what these latest numbers imply for the market's outlook. Three other key indicators appear to have recently hit their turning points, which usually portends a shift in the market's direction:

- **Average Days-on-Market (the typical number of days it takes for a listed home to sell) declined to a new post-recession low in Q2.** It currently stands at 38 days. The last time that this number was below 40 days was all the way back in 2005 Q3, when it then began rising steadily before peaking at 95 days in 2011, during the depths of the downturn. Very low (or high) values of this number usually indicates that the housing market is near its peak (or trough).

- **The ratio of the average Philadelphia house price to the average Philadelphia rent (P/R ratio) has begun to decline from its recent post-recession peak.** It hit its post-recession high of 13.2 nearly one year ago and has been declining ever since. Its previous peak was 13.5 back in 2005, when it then began declining and continued doing so until hitting bottom at a value of 9.5 in 2012, just as local house prices (un-coincidentally) hit their bottom at the same time and began recovering. The P/R ratio is to real estate what the P/E ratio is to stocks: high values of the ratio often indicate that assets are over-valued relative to the cash flow they are currently generating.

- **The Philadelphia Stock Exchange's Housing Sector Index is currently declining from its post-recession high.** After hitting an all-time high of $365/share in January of this year, it has since declined by over 17% in less than six months to $302/share. During the previous expansion, the index hit a high of $288/share in 2005 before declining to a low of $55/share in 2009. This index is a composite index of publicly-traded firms whose primary revenues are directly related to the U.S. housing market: homebuilders, suppliers of building materials, mortgage lenders, etc. The recent decline in the index is the largest since the current housing expansion began in 2012. This would seem to indicate that investors are becoming bearish on housing, at both the local and national levels.

Philadelphia's housing cycle is currently in the 7th year of its expansion. While this is slightly less than the 8-10 year average duration of its previous expansions, it is still in its mature phase. This fact, along with the continuation of mixed signals in prices and sales combined with changes in other key market indicators increasingly points to the conclusion that the market is much closer to its next peak than it is from its previous trough.

However, if you would like a contrarian indicator, consider that Zillow recently upgraded its forecast of Philadelphia house prices from 3.7% to a whopping 13.4%: https://www.zillow.com/philadelphia-pa/home-values/). Although the most recent data would certainly not seem to substantiate such a bullish change in the forecast, this report will continue to monitor the market diligently and identify which predictions actually come to fruition.

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