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Philadelphia's Housing Market Continues to Push Forward in Q3

Multiple records are broken, but some issues persist in becoming increasingly worrisome.

October 21, 2020: The latest quarter's numbers indicate a lot of demand, but also some real concerns. Here they are:

- **The average price of Philadelphia homes rose by 0.7% in Q3 on a quality- and seasonally-adjusted basis.** This is a deceleration from the previous quarter's increase of 2.4%, but is still within the bounds of what is a historically typical quarterly house price appreciation rate for Philadelphia.

- **Philadelphia's house prices are currently up an average of 8.4% from one year ago (YoY).** This increase is well above the city's historic annual average appreciation rate of 4.5%, and is also above the YoY increases in recent quarters from previous years.

- **After breaking the $200,000 barrier for the first time in Q2, the median house price in Philadelphia remained at $200,000 in Q3.** Although this is a very slight decline from the Q2 median price of $200,750, it is not only the first time that the median price has exceeded $200,000, but it is also a nearly 18% increase over the median price of $169,900 in the same quarter last year[1]. However, it should be emphasized that this number represents the median price of homes that **sold**, and **not** the median value of all Philadelphia homes. Since sales activity has become skewed towards higher-priced segments of the market in 2020, so too has the median price become skewed (some may say "biased") upwards.

- **Annualized (YoY) house price changes in individual submarkets continue to be uniformly positive—and also well above their historic averages.** From smallest to largest, the average annual change in seasonally- and quality-adjusted house prices by submarket was: Center City/Fairmount (+1.4%), South Philadelphia (+5.4%), Upper Northeast Philadelphia (+5.7%), Lower Northeast Philadelphia (+5.9%), Kensington/Frankford (+8.1%), University City (+8.9%), Northwest Philadelphia (+9.4%), North Philadelphia (+14.6%) and West/SW Philadelphia (+18.7%).

- **After a debilitating spring, home sales activity rebounded this past summer.** After plunging to an 8-year low in Q2 (due to both COVID and government-imposed restrictions on showing homes), sales activity have since risen sharply. The number of arms-length transactions in Q3 was 5,339, up a whopping 71% from just 3,127 transactions in Q2. However, even with such a strong rally, this level of sales volume is still 14% below the 6,229 transactions that occurred in the same quarter one year ago[2].

[1] Since raw house prices exhibit substantial seasonal fluctuations that are independent of the market's or economy's cycle, it is a standard industry practice to compare these numbers to the same time period one year ago, rather than to recent months or quarters.

[2] Like raw house prices, the seasonality of home sales volume make it a standard industry practice to compare these numbers to the same time period one year ago rather, than to recent months or quarters.

- **Philadelphia's housing market also set multiple new records (or at least came very close) this past summer:**

    - **Listed homes are moving faster than ever.** The average time it takes for a home in Philadelphia to sell (DOM) is currently 38 days, which is well below the 65 days that the housing industry considers typical of a "balanced" market. This is just 4 days shy of the previous record of 34 days, set way back in July 2005.

    - **Inventories continue to break through to new lows.** As of the end of September, there were only 3,208 houses currently listed for sale in Philadelphia, which is the lowest number recorded since this number began being tracked back in 2001. This is also well below Philadelphia's historic average of ~7,400 houses listed for sale in any given month.

    - **Record-high turnover plus record-low supply equals unprecedented upward pressure on house prices.** At the current pace of sales and the current inventory level, Philadelphia would sell off its current supply of homes available for sale in just 2.1 months. This is also an all-time low since this number began being recorded back in 2001, and is well below the 5-7 month average that the industry considers to be typical of a "balanced" market.

    - **The mood of homebuilders—both nationally and locally—has switched from crushing pessimism to an all-time optimistic high…in just 5 months!** The NAHB[3] index of homebuilder sentiment (which measures the sentiment of both national and northeast homebuilders on a scale of 0 to 100) swung from a score of 19 back in April to a score of 81 this September. The recent low of 19 is close to the index's historic low of 8 back in 2009, and its current value of 81 broke the index's previous all-time high of 78, which occurred all the way back in 1998.

    - **After rebounding from record lows, housing-related stocks are setting new highs.** The Philadelphia Stock Exchange Housing Sector Index (Nasdaq Symbol: HGX), which is composed of several dozen stocks of housing-related companies (homebuilders, mortgage lenders, building materials suppliers, etc.) closed at over $400 a share for the first time ever this October. In March of this year, the index plunged to an all-time historic low of $180 per share. For context: when the HGX was first offered in 2002, its initial value was $250 per share.

- **Zillow has revised its forecast for Philadelphia house prices dramatically upwards.** Following several quarters in which the national housing analytics firm was predicting negative house price appreciation (i.e. falling house prices) for Philadelphia County, Zillow is now predicting that the general level of the city's house prices will rise by 8.3% over the next 12 months. This is close to double the city's historic average annual appreciation rate of 4.5%.

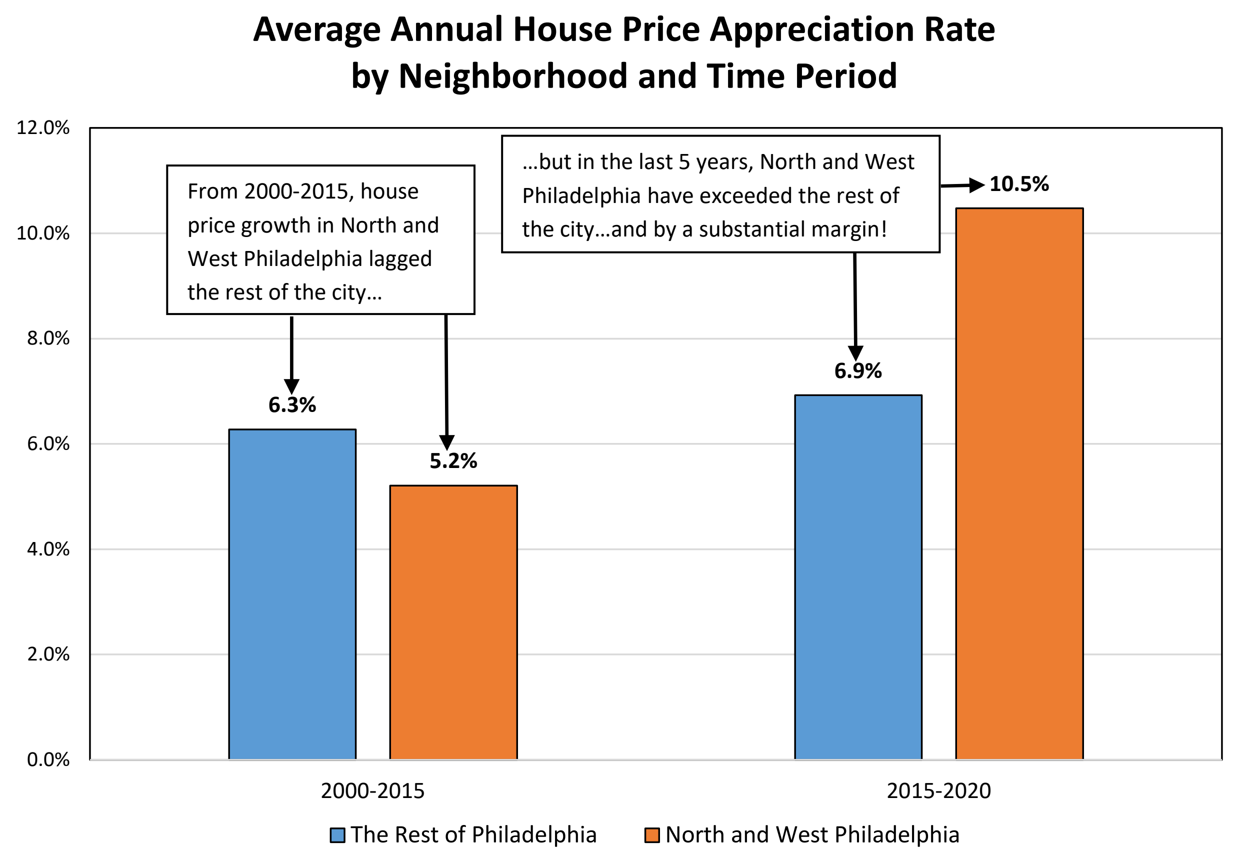
The relatively active performance of the housing market—both locally and nationally—continues to exceed many expectations, especially in light of the fact that we are currently living in especially challenging and uncertain times. However, most market-watchers point to several key explanatory factors for this. First, historically low interest rates make real estate both affordable and attractive, thus increasing both its desirability and its market value. Second, historically low (and still dropping) inventories are putting significant upward pressure on house prices due to restricted supply during a

[3] National Association of Homebuilders. They survey their members monthly to ask them to rate the near-term outlook for their business on a scale of 0 to 100. A value of the index in excess of 50 indicates that more homebuilders are optimistic than pessimistic, and vice-versa if the value of the index is less than 50.

period of very high demand. Third, the COVID-driven shift from working in traditional commercial office space to working from home has increased both the demand for housing as well as its price inelasticity (since there are fewer options of where to work from). The result has been to effectively 'upzone' much of the nation's housing stock to a more intensive commercial mixed use, thereby increasing the market value of many homes. As a senior officer with NAR said at a recent industry conference[4]:

"The home is no longer just a residence, or even a combination residence and office. It's now also a gym, a school, a restaurant, a spa, a library, a theater and [if you have a yard] a private park. So, all of the money in the economy that would have been spent outside the home on those things is now [being] spent within and on the home!" -Marc Gould, SVP National Association of Realtors

Lastly—but less commented on—is that recent years have seen a deceleration in price appreciation in formerly "hot" high-priced neighborhoods while there has been a simultaneous increase in price appreciation in many traditionally lower-income areas of Philadelphia. But, because these lower-income areas are starting from a lower price point, even a modest shift in demand for these homes can result in mathematically large percent increases in price, since their denominator is both relatively and absolutely small. As evidence, consider the following chart, which compares the annual level of price appreciation in the traditionally lower-income neighborhoods of North and West Philadelphia (combined) to that of the rest of Philadelphia:



As the chart indicates, from 2000 through 2015, annual house price appreciation in North and West Philadelphia averaged 5.2% per year, which is less than the rest of the city's average annual appreciation rate of 6.3% per year. This may not seem like a large difference, but when the effects of compounding

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[4] RISCEO Media Exchange, September 2020. The quote is transcribed from notes I took during the conference.

are taken into account over this 15 year period, it can be quite meaningful[5]. However, in the last 5 years, homes in North and West Philadelphia have appreciated at an average annual rate of 10.5% per year, compared to 6.9% in the rest of the city. Not only is overall house price growth in these two submarkets outpacing the rest of the city, it is doing so by a much larger margin that what was previously occurring when the situation was reversed[6]. And, it is also doing so on a more consistent basis: <u>in every quarter from 2015-2020, YoY house price growth in North and West Philadelphia exceeded the rest of Philadelphia in 20 out of 23 quarters.</u>

Whether one views this disparate outcome as a positive indicator of long-overdue investment in these historically underserved areas, or as a negative signal of both increased gentrification and housing unaffordability, ultimately depends upon one's own personal values, views and predispositions. As such, these same statistical measures of disparate house price appreciation could serve as talking points between traditionally opposed groups that argue for more housing development and investment versus less housing development and investment in these communities. But, it would be more constructive to interpret these numbers as a reason for both sides to make common cause on this issue: those who claim Philadelphia needs more market-rate affordable housing and those who cite developers and investors as the primary source of increased gentrification and housing unaffordability could essentially agree to play for the same team by uniting to advocate for a lowered and streamlined cost of development in Philadelphia that would increase the affordability of housing, while also decreasing the displacement that current conditions encourage.

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If you would like Dr. Gillen to address your organization, business or community group with a presentation on recent trends in the local economy and real estate market, he would be happy to do so…and it's absolutely free! Just contact him at the email address above.

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[5] As an example, consider two different homes that were purchased for $100,000 in 2000. If that house appreciates at the average rate of homes outside of North and West Philadelphia, it would be worth nearly $250,000 by 2015. By contrast, if the same home appreciated at the average rate of homes in North and West Philadelphia during that period, it would only be worth only $214,000 in 2015; a nearly $36,000 loss in foregone housing wealth.

[6] Again using the previous example, a home purchased for $100,000 in 2015 would be worth nearly $165,000 after 5 years if it appreciated at the North/West Philadelphia average annual rate, but only $140,000 if it appreciated at the same rate as the rest of the city. So, between these two scenarios, the typical homeowner in North or West Philadelphia would have gone from a $36,000 loss during 2000-2015 to a nearly $25,000 gain from 2015-2020.