

# Stellar House-Price Gains Break New Economic Ground

MUCH IS MADE OF the stamina shown by the current economic boom, now in its record-setting ninth year. But as of mid-1999 three other little-noticed yet important characteristics likewise distinguish this expansion from those of the past quarter century:

- Disparities in regional home-price growth have collapsed to a 25-year low. As a result, the best-worst annual performance gap among the country's nine regions has narrowed dramatically from 1975's unrivaled 37.6 percentage points to the current 3.4 percentage points.
- For the third consecutive year, regional home prices from north to south and east to west are solidly beating inflation.
- For only the third time in recorded annual house-price history, home values in every state are climbing.

In short, this economy has developed broad shoulders upon which every region and state is riding high. Yet, these three unique markers of the post-1992 economic boom do not appear in



sharp relief until viewed through the lens of Freddie Mac's [Conventional Mortgage Home Price Index \(CMHPI\)](#).

## Splitting the Difference Between Boom and Bust

As depicted by the purple-shaded areas in *Exhibit 1* on the next page, the country has moved through three major periods of economic growth since 1975. In between, the economy persevered through three short-lived downturns—namely, the back-to-back [recessions](#) (separated by two quarters of economic growth) of 1980 and 1981-1982 and the 1990-1991 recession.

The center line in Exhibit 1

demonstrates the impact of economic cycles on home values by plotting the national average rate at which regional home prices change each year. The chart data are presented in [real terms](#) to eliminate the effects of inflation. Thus, a positive value signifies house-price growth that exceeds inflation.

In the past, average regional house-price performance has surged forward with a growing national economy and

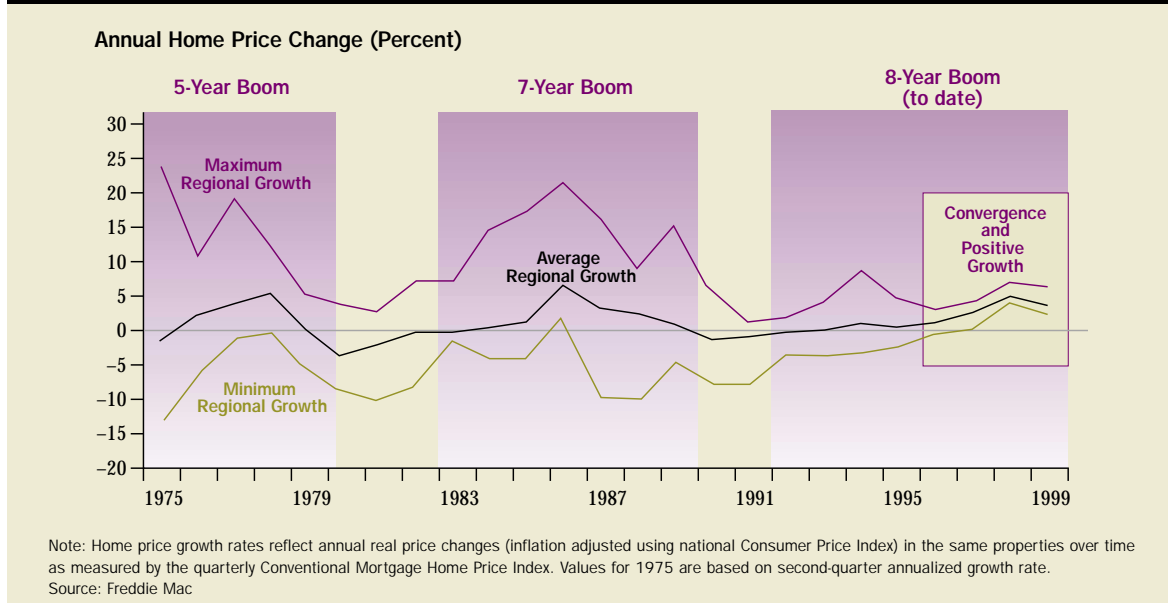
slid backward with the onset of recession. When the ongoing expansion took off in 1992, the average rate of regional house-price growth trailed inflation by one-half of a percentage point. Just two years later, the house-price rate pushed past inflation and has continued to pick up ground ever since. By mid-1999, the annual regional house-price rate reflected an average 3.1-percentage-point gain over inflation.

As with any normed number, however, the average [appreciation](#)

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## EXHIBIT 1: Inflation-Adjusted Home Price Trends



The spread between the Home Price performances of the strongest and weakest regions has expanded and contracted over time. An imposing 38-percentage-point gap separated the top and bottom performers in 1975. The distance narrowed to 9 percentage points in 1983, only to nearly triple to 26 percentage points by 1987. After that, the spread tightened steadily—the two extremes are now fewer than 4 percentage points apart. Since 1997, every region—even the worst performer—has enjoyed real gains in home values.

figure does not tell the whole story. During earlier periods of prosperity, some areas of the country grew at a furious pace relative to the regional average, while others stagnated or declined. Thus, strong economic growth in a few regions pulled the regional average performance indicator into the positive column, masking the struggles of the remaining regions. The distance separating the best and worst annual house-price performances of the nine U.S. census divisions illustrates that point, which is conveyed by the upper and lower lines in Exhibit 1.

In 1975, as a five-year economic expansion got under way, a gaping 37.6 percentage points separated the two extremes in regional performance. The same economic

engine that propelled the South Atlantic states—stretching from Delaware to Florida—to a whopping 23.7-percent appreciation rate that year simultaneously slugged the Mid-Atlantic states of New Jersey, New York and Pennsylvania with a 13.9-percent loss in housing-stock value.

Due solely to geographic happenstance, then, a family in Athens, GA, theoretically could have gone into 1975 with a home valued at \$100,000, yet have ended the year with the property worth \$123,700—thus enriching the household by \$23,700 in new **equity**. Meanwhile, a hypothetical family living in Rome, NY, could have started out with a residence worth \$100,000 but watched helplessly as the property's value sank

to \$86,000 during the same 12-month period.

**All for One and One for All** Pliancy within the regional economies, coupled with technological advances, has connected the nation's states and regions—indeed, the world—in ways previously unimagined. Change elements like these have helped eliminate trade barriers while providing round-the-clock access to goods, services and information. Out of that convergence has grown today's nationwide service economy with its far-reaching powers. Consequently, the industrial specialties that until recently defined the country's regional economies—the oil belt and the farm belt, for example—

are individually less important now. Regardless of whether the current state of affairs is temporary or signals a permanent sea change, the absence of any regional recession for the time being is surely a novelty worth noting.

The growing convergence among economic forces shows up clearly in regional house-price performance. As the disparities among regional economies generally have narrowed, so, too, have the geographic differences in house-price changes. The 38-percentage-point chasm that in 1975 divided the most steeply **depreciating** region from the most steeply appreciating region underwent several contractions and expansions of varying degrees over the next 15 years. As the 1980s drew to a close, the gap began to narrow more or less steadily—and markedly so in the late 1990s. As highlighted in Exhibit 1 by the box labeled “Convergence and Positive Growth,” a mere 3.4-percentage-point difference now separates the top-performing New England states from the underdog states of the East South Central region.

### Keeping a Good Thing Going

Another striking feature of the changing house-price landscape lies in the experiences of the weakest performers. During the past 25 years, every region has taken at least one turn as the worst house-price performer, while most have enjoyed the distinction of best performer. Apparently, one area of the country can beat all of the regions some of the time but not every

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region all the time.

Until two years ago, the poorest annual performer endured a decline in house values, achieving a slightly positive reading only once, in 1986. In sharp contrast, the regional winner in each of the past 25 years (upper line, Exhibit 1) always experienced house-price appreciation. In 1997, however, the trend line for the weakest region went positive for only the second time in 25 years. Since then, the trend line has not crossed back to the negative side, giving the weakest performers their first sustainable victory over inflation.

Thus, for the third year running, the weakest regions have joined the top performers and every other region, for that matter, in neutralizing inflation. Today, even the worst regional house-price performance—turned in by the East South Central states of Alabama, Kentucky, Mississippi and Tennessee—is beating

inflation by more than 2 percentage points.

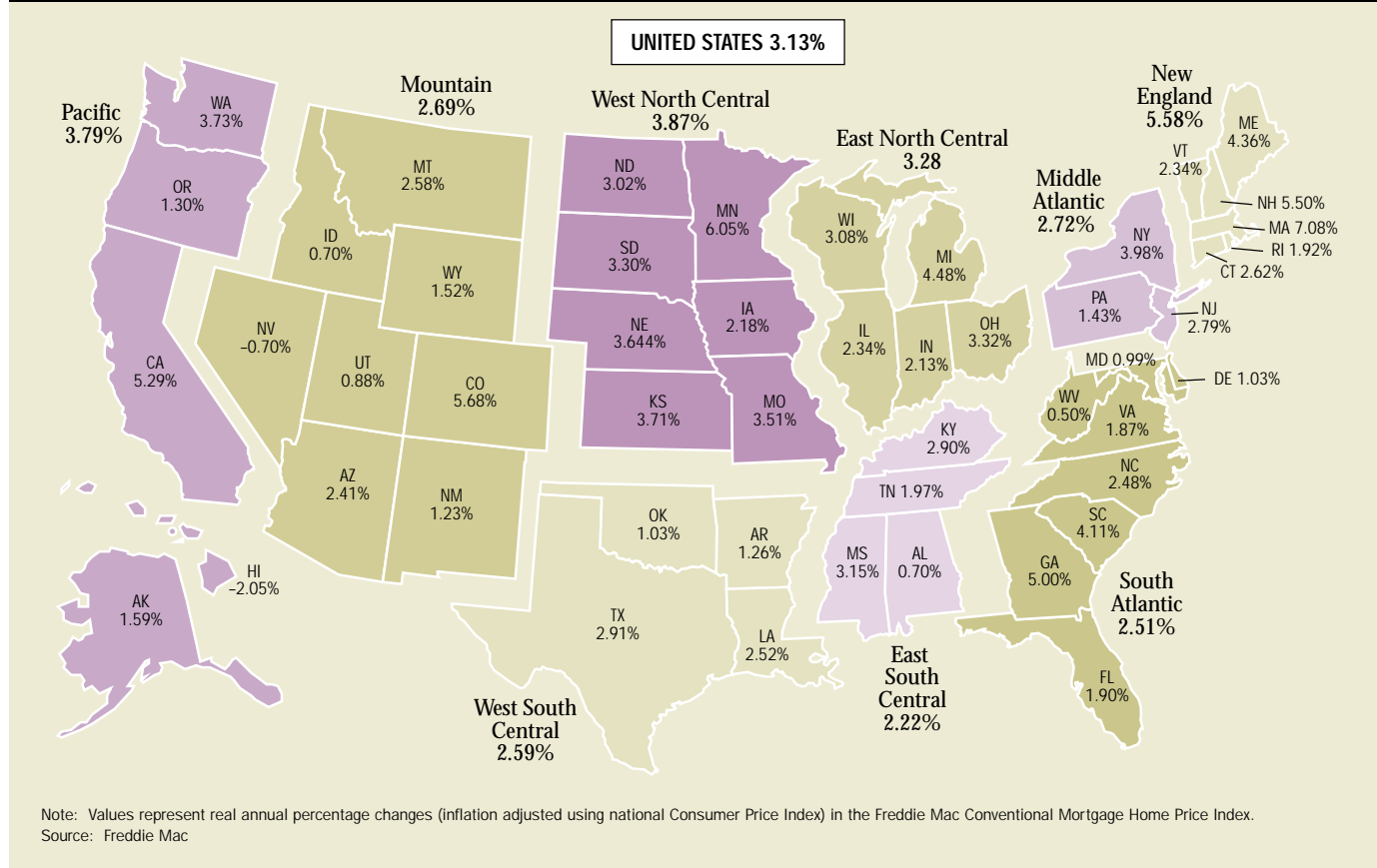
The improved fortunes of the poorest regional performers are coming at a time of diminished appreciation levels among the best regional showings. Back in the 1970s and 1980s, the high-flyers frequently booked annual appreciation gains in the heady 15-percent to 25-percent range. More recently, though, the highest achieving regions have not broken free of house-price appreciation in the 5-percent range.

### Base Industry Bounds Blur

As it turns out, the conditions enabling the low gainers to participate in the nation's economic rally are the same ones evening out the appreciation spikes among the highest annual advancers. One reason this may be happening is because fewer industries these days confine their business operations to traditional geographic boundaries. The Silicon Valley, for instance, has become much more than a California phenomenon. High-tech centers have sprung up in Texas, northern Virginia, Boston and Atlanta, to name but a few.

A 5-percentage-point rate of real price growth may sound pretty low for the best regional performance in a year. But keep in mind that the current after-tax mortgage interest rate works out to around 3.5 percent in real terms [(7.5-percent note rate - 2.2-percent inflation rate) x 67-percent after-tax rate]. Consequently, a 5-percent run-up in value covers not only the mortgage costs—thus, many homeowners are getting

**EXHIBIT 2: Inflation-Adjusted Changes in Freddie Mac Home Price Index by Region and State, Q2 1998–Q2 1999**



their mortgages essentially for free—but also is enough to provide a 1.5-percentage-point boost in real homeowner equity (5-percent appreciation - 3.5-percent effective mortgage rate = 1.5-percent net equity). Moreover, a homeowner receives the benefit of living in this investment—the same cannot be said of an investor in stocks or other financial instruments.

The compression among home-price appreciation rates means that homeowners in every region of the country are enjoying roughly the same proportionate increase in their home values. That, too, is a much more optimistic outlook than in the past

when it took a national recession for regional house-price trends to move closely together and in unison. Of course, that feat previously was achieved only when the regions simultaneously tanked together.

### Break Out the Champagne

The latest house-price index data for each state likewise reinforce what is arguably the third of the overlooked hallmarks of this economy. Specifically, the boom now in progress has generated the most even and broadest dispersion of economic well-being in 25 years. *Exhibit 2* captures the current house-price trends, expressed in

real terms to eliminate inflationary impacts, over the 12 months ending in the second quarter of 1999. With all regions sharing in the wealth, the house-price appreciation rate for the nation as a whole (the average of the nine regional rates) works out to 3.3 percent. That's not too shabby considering the national average skirted zero for many of the past 25 years.

In terms of equitability, the same pattern of convergence exhibited by the regions shows up at the state levels as well. In other words, the poorer states generally are getting richer and the richer states are getting richer. At the same time, the differences in

home-price growth rates among the states are growing smaller. Take, for example, the most rapidly appreciating state, Massachusetts, located in the most rapidly appreciating region, New England. The gap is not all that great between Massachusetts' 7.1-percent annual growth rate and the 5.6-percent average among the six New England states.

Minnesota turned in the second-best performance of the year ending in the second quarter with a 6.1-percent hike in values. Coincidentally, Minnesota is located in the second-best performing region. This seven-state region, the Great Plains section of the country, chalked up a 3.9-percent increase for the period.

Less predictable is the case of Hawaii, where property values actually sank by 2.1 percent in real terms. The island state shares little geography with the slowest-appreciating region, the four East South Central states, where prices for the 12-month period rose by 2.2 percent. One reason behind Hawaii's lackluster performance is the state's inability to shake off last year's bout with the Asian economic flu. Even at that, Hawaii was not able to exert enough drag on the four other Pacific states to arrest overall house-price growth for the region. That area ranked third in regional performance with a 3.8-percent improvement in house prices.

Nevada was the only other state where house values lost ground to inflation. Nevada is located in the fifth-ranked Mountain region, where home prices in the eight-

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state area rose by 2.7 percent. The state, however, lacks the economic vitality radiated by the manufacturing, financial, intellectual-capital and technology sectors enjoyed by its neighbors. Apparently, Nevada's existing economic underpinnings—agriculture, ranching, mining, military and gaming—could not muster enough energy to prevent the recent 0.7-percent erosion in real house values there.

Then again, the disappointing performances of Hawaii and Nevada are not as dismal as they may seem. When state house-price data are recast in **nominal terms**, all 50 states turn up winners for a second time during this economic expansion, echoing last year's positive performance. That's a big switch from when at least one state has depreciated in each of the past 25 years, with the exceptions of 1999, 1998 and 1978. Even Hawaii and Nevada have realized positive annual growth of 0.2 percent and

1.5 percent earlier in the year, when their performances are translated into nominal terms. Nominal growth rates in housing prices are obtained by adding the annualized six-month inflation rate of 2.2 percent to each state's real appreciation rate.

### **Catching the Wave**

The past nine years of economic expansion have delivered employment opportunities unequaled outside of wartime. A decade of lofty stock market gains has created new riches for many. As a result, a number of American families have experienced a significant improvement in household finances. One way some of these families are celebrating their good fortune is through the real estate market, thereby increasing demand for more and better housing. That, in turn, moves more capital into the housing market and creates greater value for homeowners.

Today's housing advisory, then, is simply this: Not every rising economic tide lifts all boats, but for homeowners swept along by today's growing appreciation and narrowing regional house-price spreads, this is one time when it has paid to go with the flow. SMM