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Examining the Housing Crisis by Home Price Tier

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The current housing crisis has been long and severe. Some areas of the country—particularly California, Florida, and Arizona—have been hit much harder than other areas, such as the Midwest. A less-discussed issue is that home price tiers—high-priced, mid-priced, and lower-priced homes—each responded differently to the mortgage boom and subsequent implosion.

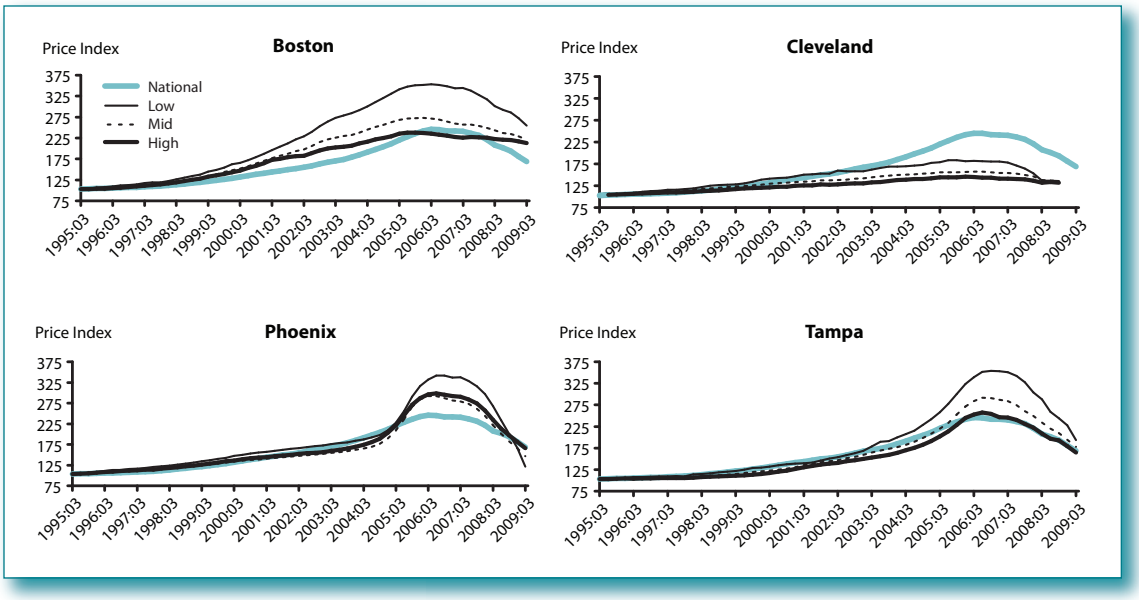
Many factors caused the run-up in home prices. Interest rates were at unprecedented lows. Mortgage market innovations, including products such as interest-only loans and negative amortization loans, attracted many additional borrowers. Many first-time buyers rushed to buy a home, hoping to "get in" before it was too late and homes became even more unaffordable. Also, the ability to finance all, or nearly all, of the purchase price artificially buoyed home prices, as individuals could "afford" more because a lower down payment was required.

Middle- and upper-tier homebuyers were more insulated from many of these factors. They had less need for the newer mortgage products, as most of these consumers were not first-time buyers. As homeowners, they had equity to put toward their purchase, in contrast to most lower-tier first-time homebuyers.

The pattern individual cities display is the same across the country. Before the boom, house prices in all tiers grew at roughly the same rate. Sharp appreciation of home prices in all tiers followed, but prices for the lower tier increased at a much steeper rate. As home prices fell, the tiers also fell disproportionately. The chart tells the story vividly for four metropolitan areas: Boston, Cleveland, Tampa, and Phoenix. These communities are representative of the country's 17 largest metropolitan statistical areas. Each plot shows four lines: lower-tier, middle-tier, and upper-tier home price indices and a national home price average. The data are quarterly and each line is normalized to 100 beginning in 1993.

When broken down by price level—high-priced, mid-priced, and lower-priced homes—the housing boom and subsequent implosion affected each tier differently.

Each city paints a different picture about the current state of the housing crisis. If we consider the picture of price stability to be the three lines reconverging to move in tandem again, many still have far to go. Cleveland, which had less of a spike than the other areas, appears to have leveled off and may be near the end of the downslide. Phoenix, on the other hand, may have overcorrected, with



the lower-tier home price index plunging well below middle- and upper-tier home price indices. Interestingly, Phoenix's middle- and upper-tier home prices spiked nearly as sharply as those in the lower tier, and it is the only city in which upper-tier prices peaked above middle-tier prices.

The chart implies hopeful recovery for some but continued hemorrhaging for others. In most cases, though, the declines in house prices have moved toward convergence and recent home price data do suggest that prices have stopped falling as dramatically. Current governmental policy offers an $8,000 tax credit to all first-time homebuyers, and the Fed continues to keep the federal funds rate low. Whether these actions, and the correction that has already taken place thus far, will stabilize home prices remains to be seen. ■

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