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Weakness in Grand Rapids Housing Prices

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The weak housing market has been one of the most important business stories of 2007. A weak housing market decreases the value of a house. As a result, the wealth of the individual consumer drops, decreasing their financial security. There are many ways to measure the weakness in the housing market such as the number of house sales, foreclosure rates, and median house prices. However, for the homeowner the most important value should be the quality adjusted price index for housing in their area. A price index gives an idea of how prices are changing for houses with the same size, building materials, location, and many other characteristics.

A change in the number of house transactions can give an idea of the strength or weakness in an overall housing market. Using data from the Grand Rapids and East Grand Rapids assessors' offices, it is easy to see on the following graph a drop in the number of housing transactions (City of Grand Rapids, City of East Grand Rapids). However, the number of transactions dropped sooner and faster in East Grand Rapids.

Year-over-year, the number of houses sold has dropped every year since 2003 in East Grand Rapids and since 2005 in Grand Rapids. Possible reasons could be that owners in East Grand Rapids are trying to wait out the housing slowdown before they sell, alternatively it might be more difficult for buyers to afford the more expensive homes in East Grand Rapids.

Foreclosures can put downward pressure on housing prices because they put a greater supply of houses on the market. Michigan has had some of the worst foreclosure rates in the nation. Michigan's foreclosure rate has increased from 1 foreclosure in 538 households in September 2006 to 1 foreclosure in 314 households in September 2007 (RealtyTrac). However, West Michigan has not been as bad, with Kent County having only 1 foreclosure in 429 households in September 2007.

The median price of a house is reported by the National Association of Realtors for metropolitan areas. This is found by arranging the prices of houses sold for an area in a list and then reporting the price of the house in the middle. The NAR reports a 3% drop in the median price of a house in Grand Rapids between July of 2006 and July of 2007 (National Association of Realtors). Unfortunately, the median price of houses in a region can change either due to a change in the value of individual houses or because people are choosing to buy a house that is less expensive. The result is that an individual house owner does not know what is happening to the value of their house.

The previous data confirm what many already know: there is weakness in the housing market in the Grand Rapids area. However, it does not really tell what has happened to the price of individual houses. Economists use a quality adjusted price index to better define how prices have changed in an area. The best known example of a price index is the Consumer Price Index issued by the Bureau of Labor Statistics. Stylistically, a price index tries to compare prices between two identical items sold at different times. This idea can be used to compare prices in the Grand Rapids housing markets.

There are many statistical ways to try to determine how a price for a house of the same quality changes over time. One way to do this is to use a technique called a fixed effect regression. This technique basically compares the price change over time for individual houses. Using data from the Grand Rapids and East Grand Rapids assessors' offices, the sale prices for every house sold more than once between 1987 and 2007 are compared (City of Grand Rapids, City of East Grand Rapids). Although there might be things such as renovations or an owner that does not keep up maintenance that affect the change in the price for a particular house, this technique will find the cumulative effect of all houses across the entire city.

The index indicates for every 100 dollars spent on a particular house in 1987 how many dollars would need to be spent in another year to buy the same house. Looking at the graph of the price index, it can be seen that for both Grand Rapids and East Grand Rapids an average house price would have doubled between 1987 and 1998. After the year 2000, a typical house in Grand Rapids appreciated more than a typical house in East Grand Rapids. However, since the start of 2007 the Grand Rapids housing market has given up much of this additional appreciation with the price index dropping approximately 10%
in Grand Rapids, but only dropping 3.5% in East Grand Rapids.

Looking at the last two years in greater detail, the quarterly price index is calculated. The price index shows generally no change in the price of a house between the beginning of 2005 and the third quarter of 2006. However, the price index shows a drop in the price of a typical house every quarter since the third quarter of 2006. In fact, between the third quarter of 2006 and third quarter of 2007 the value of a house has fallen almost 15%. This means that a typical house sold today would sell for the same price it would have sold for in 2003 or 2004. Initial data for the fourth quarter of 2007 shows a continuation of the downward trend in prices.

This has not been a forward looking analysis and one bad year does not mean that the weakness in the market will continue into the future. There are many things that affect housing prices, but for West Michigan the job market is one of the primary concerns. As can be seen in the following graph, there is a strong correlation between employment and the moving average of housing sales. Unfortunately, the employment level in the Grand Rapids area has not improved over 2007 (U. S. Bureau of Labor Statistics).

Overall, 2007 was a bad year for the real estate market in Grand Rapids and East Grand Rapids. There were decreases in the value of individual houses, and decreases in the number of houses sold. Until the job market improves drawing people who will buy houses to Kent County, these measures of the housing market will continue to show weakness for the near future.

References