



Tennessee Housing Market

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Fourth Quarter Economic Overview

Economic conditions in Tennessee continued to deteriorate in the fourth quarter, with just about all major economic indicators shifting more negative in dramatic fashion. For example, total nonfarm employment fell 0.9% from the previous quarter,¹ the sharpest percentage decline since the first quarter of 1982. Most of the jobs lost (65%) occurred in the services-providing sectors, with losses spread throughout every major sector except education and health services. Although losses in manufacturing employment continue, the decline is not as large as experienced during the mild 2001 recession. By sector, seasonally adjusted job losses from the previous quarter include manufacturing (7,700), retail trade (6,000), professional and business services (5,000), transportation and warehousing (2,900), and local government educational services (1,600). These five sectors represent 90% of the net job loss for Tennessee.

1. A quarterly loss of 0.9% is equivalent to an annualized 3.6% rate of decline.

The unemployment rate rose during the fourth quarter to 7.3%, up from 6.9% in the previous quarter. A larger increase was expected; in fact, the fourth quarter increase of 0.4 percentage points was less than half the rise during the previous two quarters. Part of the reason is the fact that some unemployed workers are dropping out of the labor force because they either have become discouraged about finding work or are waiting for the job market to improve. In any event, fewer adults are working or pursuing work, causing the labor force to fall 19,000 from the peak in the second quarter of 2008.

Housing Construction

Single-family construction suffered a severe decline in the fourth quarter, falling to an annual rate of 9,800 permits issued, down 37% from the third quarter and 56% over the year. As shown in Table 2, the South and the U.S. also experienced large declines but not as large proportionally as Tennessee.

Permits issued for multi-family housing offer a modest degree of stability for Tennessee. Multi-family housing regained considerable ground in the third quarter and is down relatively

Table 1. Selected Tennessee employment indicators (in thousands, seasonally adjusted)

| | 2007.4 | 2008.1 | 2008.2 | 2008.3 | 2008.4 |
|---|--------|--------|--------|--------|--------|
| Employment by industry (nonfarm) | | | | | |
| Total nonfarm | 2,803 | 2,797 | 2,785 | 2,785 | 2,760 |
| Goods-producing sectors | 516 | 512 | 508 | 506 | 498 |
| Manufacturing | 377 | 374 | 371 | 369 | 361 |
| Services-providing sectors | 2,287 | 2,284 | 2,276 | 2,279 | 2,262 |
| Unemployed | 152 | 160 | 186 | 209 | 221 |
| Total employment | 2,901 | 2,896 | 2,873 | 2,831 | 2,817 |
| Labor force | 3,054 | 3,057 | 3,058 | 3,040 | 3,039 |
| Unemployment rate (%) | 5.0 | 5.2 | 6.1 | 6.9 | 7.3 |

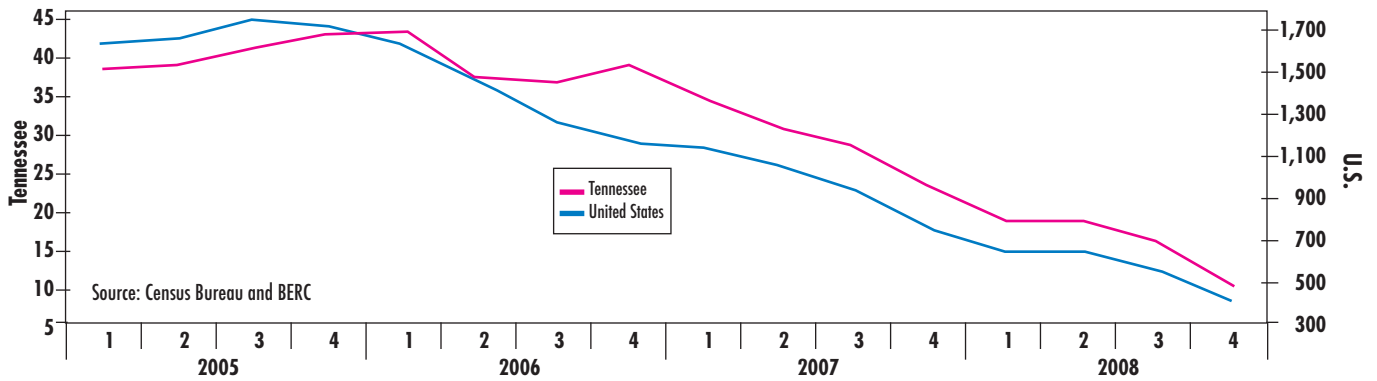
Source: Bureau of Labor Statistics

Table 2. Permits issued for privately owned new housing, seasonally adjusted annual rate (in thousands)

| Quarter | Single-Family Permits | | | Multi-Family Permits | | | Total Permits | | |
|------------------------------|-----------------------|--------|---------|----------------------|--------|--------|---------------|--------|---------|
| | Tennessee | South | U.S. | Tennessee | South | U.S. | Tennessee | South | U.S. |
| 2007.1 | 33.2 | 588.3 | 1,130.3 | 6.5 | 193.3 | 450.7 | 39.7 | 781.7 | 1,581.0 |
| 2007.2 | 29.6 | 540.7 | 1,052.3 | 7.0 | 202.0 | 429.0 | 36.6 | 742.7 | 1,481.3 |
| 2007.3 | 27.4 | 482.0 | 931.7 | 6.4 | 172.0 | 403.7 | 33.8 | 654.0 | 1,335.3 |
| 2007.4 | 22.2 | 399.7 | 764.0 | 9.1 | 169.7 | 396.0 | 31.3 | 569.3 | 1,160.0 |
| 2008.1 | 18.1 | 351.7 | 647.3 | 5.4 | 163.3 | 341.0 | 23.5 | 515.0 | 988.3 |
| 2008.2 | 17.6 | 331.7 | 633.3 | 3.3 | 141.0 | 399.3 | 20.9 | 472.7 | 1,032.7 |
| 2008.3 | 15.5 | 288.7 | 558.3 | 5.9 | 157.3 | 308.0 | 21.5 | 446.0 | 866.3 |
| 2008.4 | 9.8 | 213.7 | 416.0 | 5.5 | 100.7 | 214.7 | 15.2 | 314.3 | 630.7 |
| Change from previous quarter | -37.2% | -26.0% | -25.5% | -7.7% | -36.0% | -30.3% | -29.1% | -29.5% | -27.2% |
| Change from previous year | -56.1% | -46.5% | -45.5% | -39.9% | -40.7% | -45.8% | -51.4% | -44.8% | -45.6% |

Source: Census Bureau and BERCC

Figure 1. Single-family permits issued (thousands), Tennessee and U.S. (seasonally adjusted annual rate)



mildly (compared with single-family) in the fourth quarter. In fact, compared with the South and the U.S., multi-family construction in Tennessee seems rather stable.

Real Estate Transactions and Mortgages

Taxes collected from real estate transactions and mortgages fell again during the fourth quarter. As of yet, we see no bottom in sight for these indicators. In fact, the rate of decline actually accelerated during the fourth quarter, with mortgage tax down 16% and real estate tax down 13.3% from the previous quarter.

Home Sales and Prices

Sales of single-family homes showed no improvement in the fourth quarter; in fact, sales resumed a rather steep negative trajectory following rather modest declines in the third quarter. After seasonal adjustments, fourth-quarter closings are down 19.7% in the Nashville area, 10.3% in Memphis, and 11.1% in Knoxville.

The inventory of single-family homes continues to decline in the Nashville and Memphis areas and is flat in the Knoxville

Figure 2. Growth of repeat sales home price index, year to year

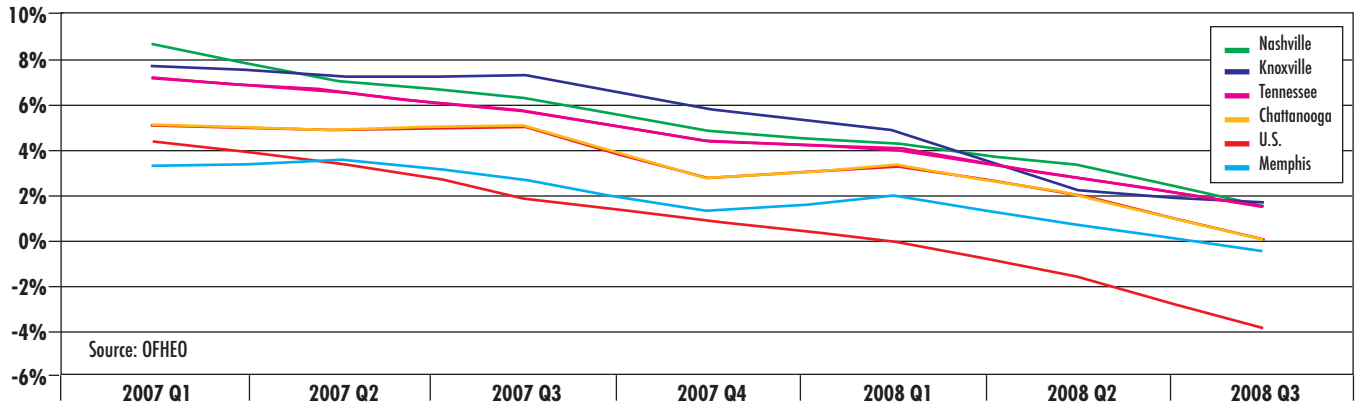


Figure 3. Mortgage tax collections (seasonally adjusted annual rate)

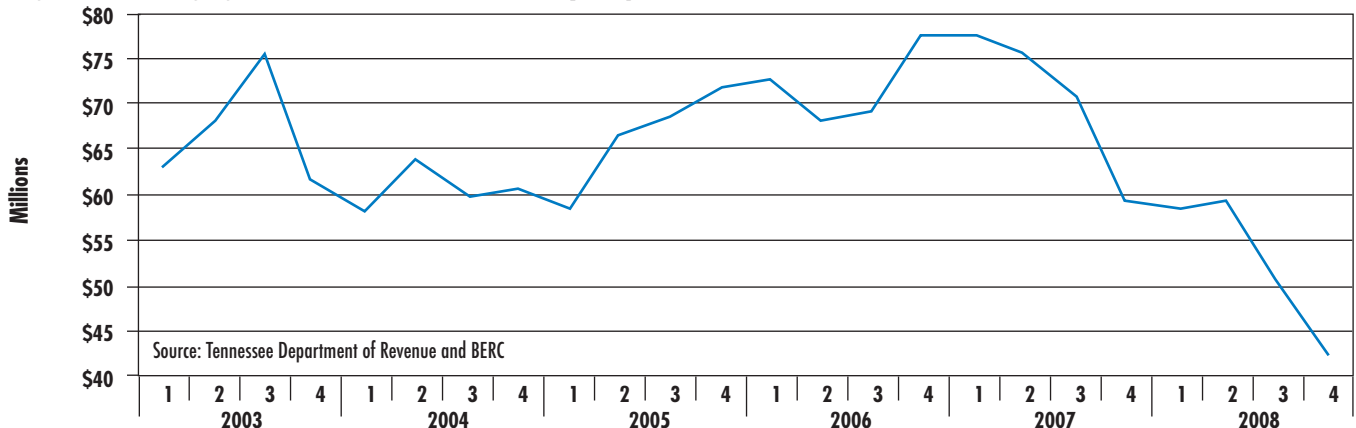
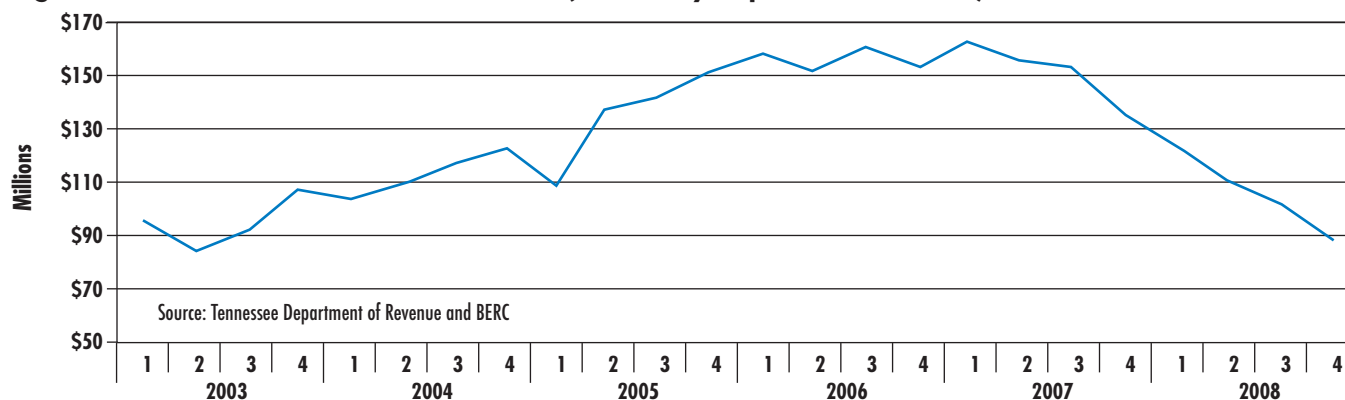


Figure 4. Real estate transfer tax collections (seasonally adjusted annual rate)



area. This trend is remarkable given the very large drop in demand we witnessed in the fourth quarter. Inventories rise when supply growth exceeds that of demand and fall when demand growth is greater than the increase in supply. If demand is falling yet inventories drop, supply must be falling faster than demand. Housing supply consists of new homes (construction) plus the number of existing homes placed on the market. We know that construction, as measured by building permits, seems to be falling faster than demand; hence, inventories fall. Falling inventories should eventually help restore balance between supply and demand and provide a floor to housing prices.

The most recent evidence for the third quarter 2008 shows home prices falling at a 4% rate for the U.S.; Tennessee continues to show modest price increases, but the appreciation rate is down to 1.4% in the third quarter, compared with a 2.6% gain in the second quarter. The Office of Federal Housing Enterprise Oversight same-sales index shows prices are now falling in Memphis (-0.7%) and Chattanooga (-0.1%) compared with a year earlier.

Mortgage Delinquencies and Foreclosures

The number of mortgages past due in Tennessee continues to rise, according to the latest Mortgage Bankers Association of America report for the third quarter of 2008. Past due rose to 8.3% of mortgages in place, up from 7.9% in the previous quarter.

Compared with other states, Tennessee has a below-average inventory of foreclosures (32nd highest) but an above-average rate of foreclosures initiated (20th highest). This means Tennessee’s foreclosure inventory likely will expand faster than some other states, causing the state’s foreclosure inventory ranking to rise in the coming quarters.

While rising, the foreclosure inventory for Tennessee is only about half as large as for the U.S., 1.59% for Tennessee compared with 3.02% for the nation. Also, the inventory of foreclosures is growing much more slowly than for the U.S. average. The national figures, however, are heavily weighted by large states including California, Florida, and Arizona.

Conclusion

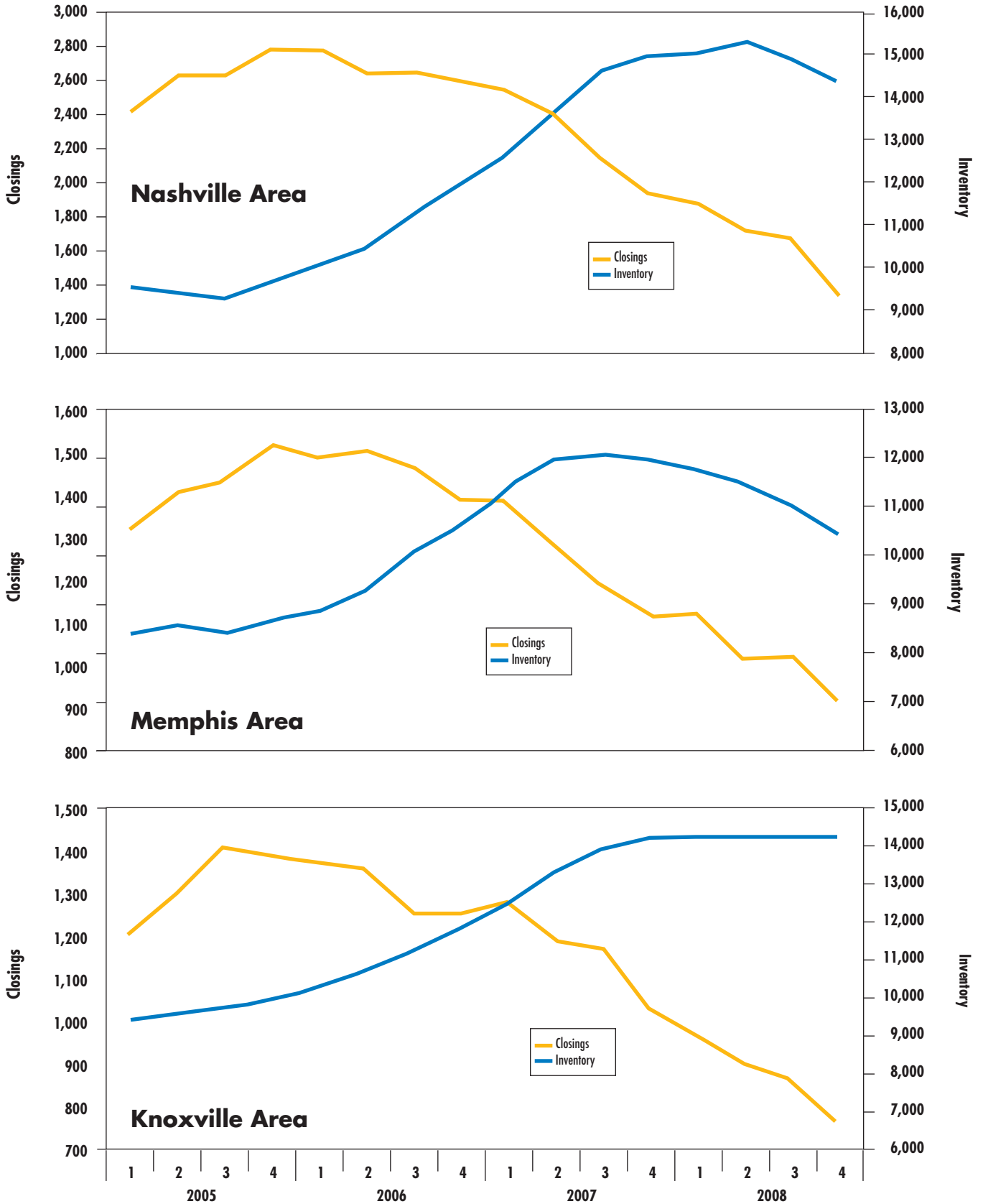
The fourth quarter was difficult for the Tennessee economy. The increase in job losses will create a substantial headwind for the housing market. Although mortgage rates are extremely low, a decline in household confidence along with falling housing prices will likely keep many home buyers on the sidelines. The inventory of foreclosures will continue to rise, as indicated by the rising number of new foreclosures. Home sales continue to fall, putting downward pressure on prices. Since supply is falling faster than demand, the inventory of homes on the market is declining. The scarce good news is the increase in multi-family permits. ■

Table 3. Mortgages past due, new foreclosures started, and foreclosure inventory (% of mortgages serviced, seasonally adjusted)

| Quarter | Tennessee | | | United States | | |
|---------|--------------------|-------------------------------------|---|--------------------|-------------------------------------|---|
| | Mortgages past due | Foreclosures started during quarter | Foreclosure inventory at end of quarter | Mortgages past due | Foreclosures started during quarter | Foreclosure inventory at end of quarter |
| 2007.1 | 6.5 | 0.59 | 1.24 | 4.89 | 0.58 | 1.26 |
| 2007.2 | 6.8 | 0.61 | 1.20 | 5.20 | 0.64 | 1.43 |
| 2007.3 | 7.3 | 0.70 | 1.28 | 5.54 | 0.78 | 1.72 |
| 2007.4 | 7.4 | 0.71 | 1.37 | 5.76 | 0.83 | 1.99 |
| 2008.1 | 7.8 | 0.72 | 1.49 | 6.38 | 0.99 | 2.44 |
| 2008.2 | 7.9 | 0.77 | 1.56 | 6.41 | 1.18 | 2.80 |
| 2008.3 | 8.3 | 0.79 | 1.59 | 6.95 | 1.07 | 3.02 |

Source: Mortgage Bankers Association of America and BERC

Figure 5. Single-family sales and inventory (seasonally adjusted quarterly average of monthly figures)



Source: Greater Nashville Association of Realtors, Memphis Area Association of Realtors, Knoxville Area Association of Realtors, and BEREC