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LONG ISLAND'S CURRENT HOUSING MARKET SLUMP: A SYMPTOM OF DEEPER LONGER-TERM HOUSING PROBLEMS

The nation is in the midst of its worst housing slump in recent memory. The National Association of Realtors expects home prices to decline this year for the first time since the Great Depression. Few analysts expect the housing market to stabilize before 2009. The Long Island economy is particularly vulnerable to the housing downturn because housing and housing-related industries accounted for much of its economic growth during the first half of this decade. Yet, even as Long Island home prices flatten and begin to decline, affordable housing remains out of reach for most households. This article discusses the immediate economic impact of the current housing slump and the longer-term problems that confront Long Island's housing market.

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Origins of the Current Housing Recession

Much has been written about the causes of the current housing crisis. Most analysts agree that the immediate cause was the unraveling of the market for mortgage-backed securities, specifically securities backed by subprime mortgage loans. Subprime loans, which were given to homebuyers with less than perfect credit, are often characterized by high loan-to-value ratios, a lack of income documentation and/or low initial "teaser" interest rates that subsequently reset to much higher rates.

The widespread use of mortgage-backed securities is a relatively recent phenomenon. Whereas mortgage-backed securities accounted for only 12 percent of all outstanding mortgages in 1980, they currently account for 56 percent of all mortgage loans outstanding. In absolute terms, $5.7 trillion in outstanding mortgage loans have been pooled into securities backed by home mortgages, including subprime mortgages. Approximately $370 billion in adjustable-rate mortgages will reset this year and 2.5 million homeowners will see their mortgages reset to higher interest rates in the next two years. Subprime borrowers face an average increase of $400 in their monthly mortgage payments. However, those with low teaser interest rates could face a jump of as much as $1,500 monthly. Resets have already caused a growing wave of mortgage defaults and foreclosures. At the same time, tighter loan standards have limited the number of potential homebuyers who qualify for a mortgage. Recently, even creditworthy borrowers who apply for jumbo loans, loans above $417,000, have been turned down or forced to pay higher interest rates. This exacerbated the housing downturn in areas like Long Island, where home prices are unusually high and jumbo loans are often needed to purchase a home. The housing decline has already had a negative impact on the U.S. job market. Between January and September, 17 percent of U.S. job losses were directly related to the current housing market downturn.

Long Island's housing bubble began to deflate during the second half of last year. After five consecutive years of double-digit home price increases, few potential buyers could afford a Long Island home without resorting to innovative mortgage loans, the so-called subprime loans. Some recent homebuyers may have hoped that their economic circumstances would improve enough to allow them to meet their mortgage obligations when their interest rates reset. Others may not have fully understood the financial implications of these resets. The widespread

Table 1

Owner Costs as a Percent of Household Income, Nassau-Suffolk, 2006

Owner Costs/ Household Income	Owners With A Mortgage (No.)	% Of Total	Owners Without A Mortgage (No.)	% Of Total
Less than 20%	116,251	22.4	113,976	49.5
20.0% to 24.9%	64,789	12.5	25,328	11.0
25.0% to 29.9%	68,496	13.2	19,337	8.4
30.0% to 34.9%	52,940	10.2	11,710	5.1
35.0% or More	213,789	41.3	59,232	25.7
Not Computed	1,804	0.3	1,041	0.5
All Owners	**518,069**	**100.0**	**230,624**	**100.0**

Source: U.S. Census Bureau, American Community Survey, 2006

Table 2

Gross Rents as a Percent of Household Income, Nassau-Suffolk, 2006

Rent/Household Income	Number of Renters	% Of Total
Less than 20%	30,759	18.3
20.0% to 24.9%	17,700	10.5
25.0% to 29.9%	16,507	9.8
30.0% to 34.9%	14,278	8.5
35.0% or More	76,481	45.4
Not Computed	12,623	7.5
All Owners	**168,348**	**100.0**

Source: U.S. Census Bureau, American Community Survey, 2006

use of subprime loans set the stage for a financial meltdown among recent purchasers. As the subprime loans issued to Long Island homebuyers in 2004, 2005 and 2006 began to reset, foreclosure filings on Long Island escalated sharply. The bulk of these foreclosures occurred in Suffolk County, which has proportionately more first-time homebuyers than Nassau. First-time buyers are more likely to extend themselves financially in order to buy a home. In the first half of this year, there were 2,993 foreclosure notices in Suffolk and 1,822 in Nassau. Foreclosures continued to increase in the third quarter. There were 1,241 foreclosure notices in Nassau and 1,080 in Suffolk in the third quarter of this year according to RealtyTrac.

Foreclosures are costly. According to the Joint Economic Committee of Congress, the average foreclosure results in $7,200 in administrative charges to the borrower. Lenders can lose as much as $50,000 per foreclosure. Local governments lose property taxes when houses are foreclosed. Foreclosures also hurt neighboring property owners. One foreclosure can cut the price of nearby homes by 1.4 percent. As a result, the typical foreclosure can cost up to $80,000. Because foreclosures are so costly, many lenders are attempting to help subprime borrowers who have fallen behind in their payments by renegotiating or refinancing their mortgage loans. Some lenders have set up payment plans under which they temporarily forgive missed payments. This strategy works best when the homeowner has fallen behind because of temporary circumstances such as illness or job loss. Some lenders have modified the terms of the mortgage loan by permanently lowering the interest rate, extending the life of the loan or switching borrowers from an adjustable rate to a fixed rate mortgage. Lenders are sometimes allowing homeowners to sell the home for less than the amount of the loan, a so-called "short sale". The lender then forgives the difference between the selling price and the amount of the outstanding mortgage. This avoids foreclosure proceedings and limits the damage to the borrower's credit. However, it does have tax consequences because the seller must pay income taxes on the amount forgiven.

Despite the use of such strategies, the fact is that many recent homebuyers are living in houses that they cannot afford and should never have bought. For some of them, renegotiating or refinancing their loan is not a viable option. This suggests that foreclosure filings on Long Island will continue to increase for the foreseeable future. Foreclosed homes will be put up for sale, augmenting the inventory of unsold homes on Long Island. A growing inventory of homes for sale coupled with fewer potential homebuyers will put downward pressure on home prices. Money Magazine projects that home prices on Long Island will decline by 6 percent between April 2007 and April 2008. (1) This would be one of the steepest price declines in the Northeast but not as steep as the 6.6 percent home price decline that occurred on Long Island between 1989 and 1990, when Long Island lost much of its defense industry base. The general expectation is that Long Island home prices will decline by an average of 10 percent before the housing market begins to stabilize in 2009. However, steeper price declines are likely at the high end of the market, where sellers have more leeway to lower prices and buyers must often obtain "jumbo" mortgage loans in order to close the deal. Fortune Magazine projects that the value of upscale homes on Long Island, defined as homes that sell for double the local median price, will decline by more than 23 percent in the next five years. (2) Declining home prices make it less likely that Long Islanders can continue to tap the equity in their homes to finance their current purchases. This is likely to cause a drop in consumer spending on Long Island, a drop that has already become evident over the past several months.

Long Island's Longer-Term Housing Problems

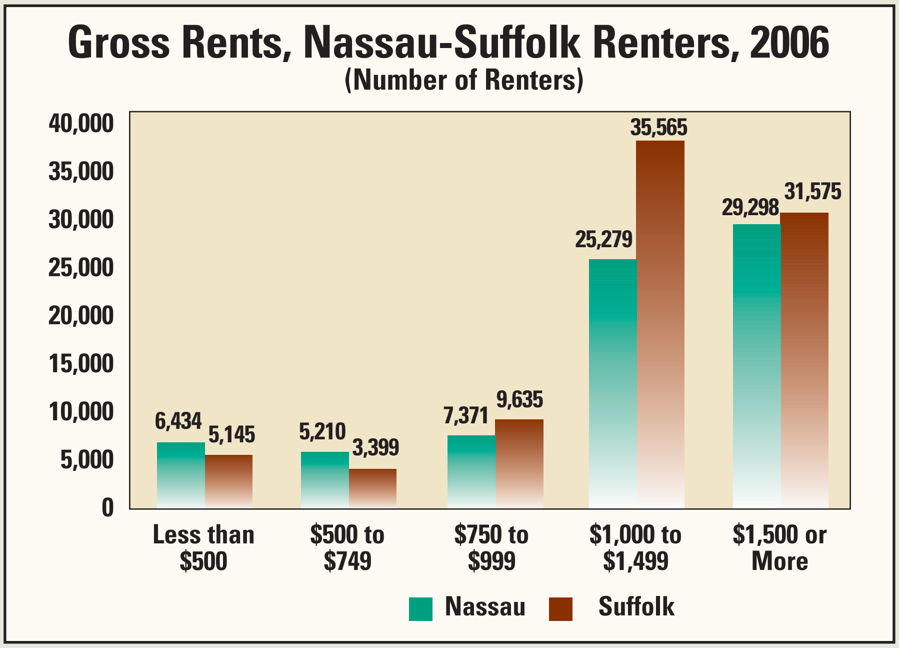
Projected declines in Long Island home prices are unlikely to make Long Island homes significantly more affordable for most potential homebuyers. Nor will these price declines change Long Island's mix of housing types, which is heavily skewed toward single-family, owner-occupied units. This housing mix no longer meets the housing needs of much of Long Island's population, which contains proportionately more singles, young couples without children and senior "empty nesters" than during the early post-World War II period. Recently released Census Bureau statistics provide a snapshot of Long Island's current housing market and underscore just how

Table 3

Owner vs. Renter Occupied Housing in Selected Suburban Counties, 2006

County	Owner Occupied Units (No.)	Renter Occupied Units (No.)	Total Occupied Units (No.)	Renter Units as a % of Total
Nassau, NY	356,561	78,897	435,458	18.1
Suffolk, NY	392,132	89,451	481,583	18.6
Westchester, NY	213,214	119,900	333,114	36.0
Rockland, NY	67,952	24,163	92,115	26.2
Bergen, NJ	226,828	106,641	333,469	32.0

Source: U.S. Census Bureau, American Community Survey, 2006



Gross Rents, Nassau-Suffolk Renters, 2006
(Number of Renters)

unaffordable Long Island housing has become.

Housing Affordability. According to the U.S. Department of Housing and Urban Development (HUD), households should pay no more than 30 percent of their household income for shelter. Those who do are considered to be living in unaffordable housing. In 2006, more than half of all Nassau-Suffolk homeowners whose homes were mortgaged paid 30 percent or more of their income for shelter. These payments include mortgage principal, interest, taxes and insurance (PITI). (See Table 1) Almost one-third of homeowners whose mortgage was satisfied also paid at least 30 percent of their household incomes for shelter. Presumably, this group of homeowners includes seniors living on fixed incomes. Renters were equally stressed. Almost 54 percent of Nassau-Suffolk renters paid 30 percent or more of their household income for shelter in 2006. Anecdotal evidence suggests that many paid 50 percent or more, leaving little left over for other necessities such as food and medical care. (See Table 2)

Much of the financial stress associated with homeownership reflects the rapid escalation of home prices on Long Island since 2000. According to the Census Bureau, 2006 median home prices were $506,800 in Nassau and $445,700 in Suffolk. A long-held standard in the real estate industry is that buyers should spend no more than 2.5 times their annual household income for a home. Using this standard, Nassau buyers would have needed an annual household income of about $200,000 and Suffolk buyers would have needed an annual income of $178,000 to purchase a median priced home in their respective counties in 2006. Only 50,000 Nassau households, 11 percent of all households, had annual household incomes of $200,000 or more in 2006. Only 72,000 Suffolk households, 15 percent of the total, had annual household incomes of $178,000 or more. It is no wonder that homebuyers currently pay three, four or even five times their annual income to gain a foothold in Long Island's housing market. As a result, shelter costs have become a major source of financial stress among Long Islanders.

The Housing Mix. Long Island's housing mix is highly skewed toward single-family, owner-occupied housing. Rental housing accounted for fewer than 19 percent of all occupied housing units in both Nassau and Suffolk Counties in 2006. By comparison, the ratio of rental housing to all occupied housing units was 36 percent in Westchester County, 26 percent in Rockland County and 32 percent in nearby Bergen County, New Jersey. (See Table 3) The bias against multi-family rental housing on Long Island is reflected in the fact that fewer than 8 percent of Nassau's housing units and only 3 percent of Suffolk's are in structures containing 20 or more residential units. (See Table 4)

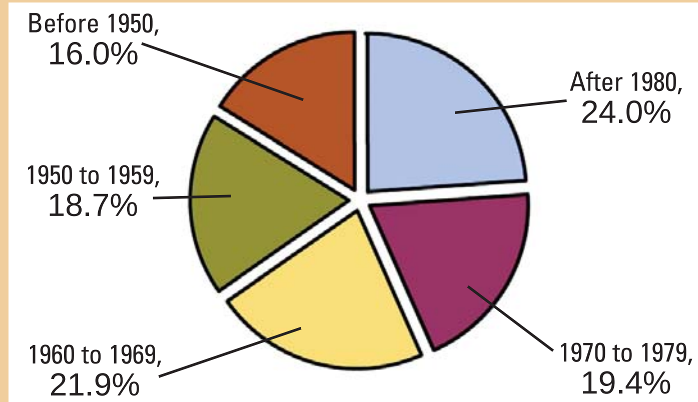
Table 4

Number of Long Island Housing Units by Type of Structure, 2006

Type of Structure	Nassau	% Of Total	Suffolk	% Of Total
One-Family, Detached	352,573	76.9	436,419	80.4
One-Family, Attached	12,548	2.7	23,363	4.3
Two Unit Structure	34,572	7.5	21,375	3.9
Three or Four Unit Structure	8,483	1.9	10,520	1.9
Five to Nine Unit Structure	7,803	1.7	12,474	2.3
Ten to Nineteen Unit Structure	7,049	1.5	16,088	3.0
Twenty or More Unit Structure	34,582	7.5	17,101	3.1
Mobile Home	739	0.2	5,616	1.0
Total	**458,349**	**100.0**	**542,956**	**100.0**

Source: U.S. Census Bureau, American Community Survey, 2006

Suffolk's Housing Stock, by Year Built (percents)



Some Possible Solutions. Much of Long Island's residential development occurred in the 1950's, 1960s and 1970s. Almost three-quarters of Nassau's housing stock was built prior to 1960. Three-quarters of Suffolk's housing stock was built before 1980. Both counties are now nearing "buildout" under existing zoning regulations. Some analysts believe that buildout could occur as early as 2015. Residential construction has virtually ground to a halt in both counties. Only 1,645 residential units were built in Nassau and another 4,732 were built in Suffolk during 2005 and 2006 according to the U.S. Census Bureau.

By changing existing zoning regulations to accommodate higher residential densities in communities that can reasonably support such densities, it would be possible to jumpstart bi-county residential construction and develop a more diverse housing mix, as well. A housing mix containing smaller rental units, condominiums and townhouses would more adequately meet the needs of a growing segment of Long Island's population, including its young people and seniors. Long Island can accommodate higher density residential housing as part of mixed-use developments in some of its older downtowns. Many of these downtowns have lost their traditional retail function but still contain valuable infrastructure. Such mixed-use developments, incorporating housing, commercial and recreational activities, could be built around Long Island Railroad stations as part of "transit friendly" villages. They would also be suitable for the large tracts of land in both counties that become available for redevelopment.

Several forward-thinking communities are already moving in this direction. Others are poised to do so but have been deterred by community opposition or by the lack of necessary infrastructure such as sewers. Community opposition is often based on the fear that higher-density residential housing will generate significantly more school-age children than traditional single-family homes, leading to higher property taxes for everyone. Although many credible research studies have demonstrated that higher density residential housing, including rental housing, is actually tax-positive, this fear nevertheless persists. State government could be helpful in blunting community opposition to higher-density housing by offering to hold local school districts harmless in the event that such housing does in fact generate more children per household than traditional single-family homes, an unlikely possibility. State loan guarantees for needed infrastructure improvements would also be a positive step for communities facing large infrastructure investments to accommodate higher density housing. Given the magnitude of the affordable housing problem on Long Island, such "carrots" may not be sufficient to do the job. A carrot and stick approach, the stick being inclusionary zoning legislation, is also needed. Such legislation, which has already been introduced in Albany, would mandate that a certain proportion of the units in new housing developments be priced at levels that are affordable to most purchasers.

Long Island's current land use patterns and housing mix reflect an era of virtually unlimited land availability. That era is over. Unless attitudes concerning higher-density housing in appropriate locations begin to change, Long Island will continue to lose some of its most productive residents and the Long Island economy will be denied the labor force it needs to flourish.

1. See Money Magazine, "The 100 Biggest U.S. Markets, May 2007, P. 81.

2. See Fortune Magazine, "Where the Nation's Housing Markets are Headed", November 12, 2007, p. 88.

Nassau's Housing Stock, by Year Built (percents)