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Drop Foreseen in Median Price of U.S. Homes

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The median price of American homes is expected to fall this year for the first time since federal housing agencies began keeping statistics in 1950.

Economists say the decline, which could be foreshadowed in a widely followed government price index to be released this week, will probably be modest — from 1 percent to 2 percent — but could continue in 2008 and 2009. Rather than being limited to the once-booming Northeast and California, price declines are also occurring in cities like Chicago, Minneapolis and Houston, where the increases of the last decade were modest by comparison.

The reversal is particularly striking because many government officials and housing-industry executives had said that a nationwide decline would never happen, even though prices had fallen in some coastal areas as recently as the early 1990s.

While the housing slump has already rattled financial markets, it has so far had only a modest effect on consumer spending and economic growth. But forecasters now believe that its impact will lead to a slowdown over the next year or two.

"For most people, this is not a disaster," said Nigel Gault, an economist with Global Insight, a research firm in Waltham, Mass. "But it's enough to cause them to pull back."

In recent years, many families used their homes as a kind of piggy bank, borrowing against their equity and increasing their spending more rapidly than their income was rising. A recent research paper co-written by the vice chairman of the Federal Reserve said that the rise in home prices was the primary reason that consumer borrowing has soared since 2001.

Now, however, that financial cushion is disappearing for many families. "We are having to start from scratch and rebuild for a down payment," said Kenneth Schauf, who expects to lose money on a condominium in Chicago he and his wife bought in 2004 and have been trying to sell since last summer. "We figured that a home is the place to build your wealth, and now it's going on three years and we are back to square one."

On an inflation-adjusted basis, the national median price — the level at which half of all homes are more expensive and half are less — is not likely to return to its 2007 peak for more than a decade, according to Moody's Economy.com, a research firm.

Unless the real estate downturn is much worse than economists are expecting, the declines will not come close to erasing the increases of the last decade. And for many families who do not plan to move, the year-to-year value of their house matters little. The drop is, of course, good news for home buyers.

It does, however, contradict the widely held notion that there is no such thing as a nationwide housing slump. A 2004 report jointly written by the top economists at five organizations — the industry groups for real estate agents, home builders and community bankers, as well as Fannie Mae and Freddie Mac, the large government-sponsored backers of home mortgages — was typical. It said that "there is little possibility of a widespread national decline since there is no national housing market."

Top government officials were more circumspect but still doubted that the prices would decline nationally. Alan Greenspan, the former Fed chairman, said the housing market was not susceptible to bubbles, in part because every local market is different.

In 2005, Ben S. Bernanke, then an adviser to President Bush and now the Fed chairman, said "strong fundamentals" were the main force behind the rise in prices. "We've never had a decline in housing prices on a nationwide basis," he added.

But Global Insight, the research firm, estimates that the home-price index to be released Thursday by the Office of Federal Housing Enterprise Oversight, a regulatory agency, will show a decline of about 1 percent between the first and second quarter of this year. Other forecasters predict that the index will rise slightly in the second quarter before falling later this year.

In all, Global Insight expects a decline of 4 percent, or roughly 10 percent in inflation-adjusted terms, between the peak earlier this year and the projected low point in 2009. In California, prices are expected to decline 16 percent — or about 20 percent after taking inflation into account.

The government's index, which compares the sales price of individual homes over time, is intended to describe the actual value of a typical house. Since the index began in 1975, it has slipped from one quarter to the next on a few occasions, but it has never fallen over a full year.

Another index dating back to 1950, calculated by Freddie Mac, has also never shown an annual decline. Price data published by the National Association of Realtors, based on the prices of houses sold in a given year, have also never declined. According to the association, the median home price is now about $220,000.

Mr. Schauf and his wife, Leslie Suarez, put their condo in the Sheridan Park neighborhood of Chicago up for sale shortly before moving to Texas last year so he could take a new job. They bought the two-bedroom unit in September 2004 for $255,000, with a 5 percent down payment. They redid the floors, installed new window treatments and repainted the walls.

They said they expected the condo to sell quickly. Instead, they have cut the price several times and have yet to receive an offer. The current list price is $279,000, though they expect to settle for less.

Without the money for a new down payment, they are renting an apartment in Austin. They also expect the monthly payment on their adjustable-rate mortgage to go up $200 in October.

Ms. Suarez, who grew up in the Dallas-Fort Worth area, says she is not as surprised because she remembers home prices falling after the oil bust in the late 1980s. "Growing up in Texas, real estate has never been a windfall," she said. "For me, I always just wanted to break even."

Housing prices have previously declined for long stretches in various regions. Most recently, prices fell in California and in the Northeast during the recession of the early 1990s.

The current slump is different from that one, though, in both depth and breadth. In fact, the national median price rose only slightly faster than inflation from 1950 to the mid-1990s.

But as interest rates fell and lending standards became looser, prices started rising rapidly in the late 1990s, even in places like Chicago, which had rarely seen a real estate boom. The result was a "euphoric popular delusion" that real estate was a can't-miss investment, said Edward W. Gjertsen II, president of the Financial Planners Association of Illinois. "That's just human nature."

Many families are clearly richer because of the boom. In the Old Town neighborhood of Chicago, the town house that Ian R. Perschke, a technology consultant, and Jennifer Worstell, a lawyer, bought in late 2004 has appreciated more than 30 percent, they estimated. The gain was big enough to allow them to take out a larger mortgage and renovate two rental units in the house. But Mr. Perschke said he understood that he was "not going to see that appreciation over the next three years."

Prices in Chicago peaked in September 2006 and have since dipped 1.7 percent, according to the Case-Shiller home-price index, which is tabulated by MacroMarkets, a research firm.

For all the attention that the uninterrupted growth in national house prices received, some economists argue that it was misplaced. The Case-Shiller index, which many experts consider more accurate than the government measure, did show a drop in prices in the early 1990s. (Unlike the government's measure, it includes mortgages of more than $417,000, which are not held by Fannie Mae or Freddie Mac.)

After adjusting for inflation — the most meaningful way to look at any price, economists say — even the government's index fell in the early 1990s.

Dean Baker, an economist in Washington who has been arguing for the last five years that houses were overvalued, said the idea that house prices could go only up had fed the bubble.

"It was very misleading," said Mr. Baker, co-director of the Center for Economic and Policy Research, a liberal research group. There are a lot of people, he said, who bought "homes at hugely inflated prices who are going to take a hit. You also have a lot of people who borrowed against those inflated prices."

Perhaps the most prominent housing booster was David Lereah, the chief economist at the National Association of Realtors until April. In 2005, he published a book titled, "Are You Missing the Real Estate Boom?" In 2006, it was updated and rereleased as "Why the Real Estate Boom Will Not Bust." This year, Mr. Lereah published a new book, "All Real Estate Is Local."

In an interview, Mr. Lereah, now an executive at Move Inc., which operates a real estate Web site, acknowledged he had gotten it wrong, saying he did not fully realize how loose lending standards had become and how quickly they would tighten up again this summer. But he argued that many of his critics have also been proved wrong, because they were bearish as early as 2002.

"The bears were bears way too early, and the bulls were bulls too late," he said. "You need to know when you are straying from fundamentals. It's hard, when you are in the middle of the storm, to know."