Housing Watch

To buy or not to buy, that is the question

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Economics
United States

Jeseo Park
US Economist
BofAS
+1 646 855 8688
jeseo.park@bofa.com

Michael Gapen
US Economist
BofAS
+1 646 855 3270
michael.gapen@bofa.com

US Economics
BofAS

CPI: Consumer Price Index

Fed likely done- what about the housing market?

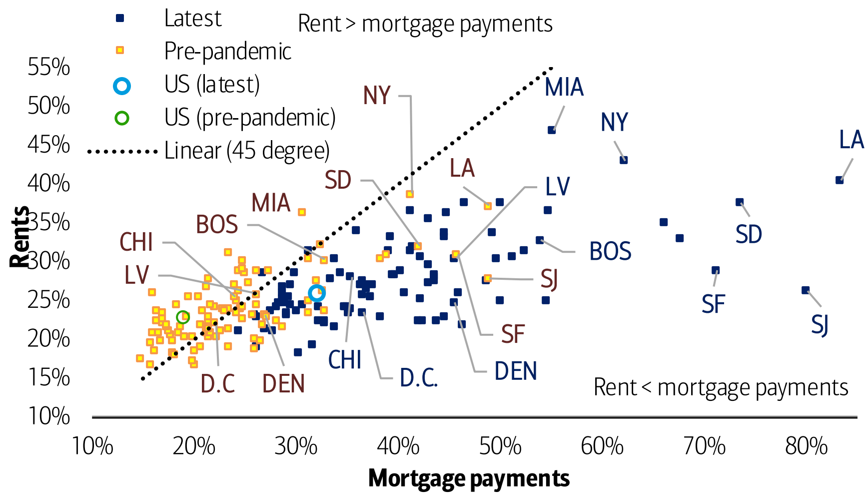
In our view, this week's softer-than-expected October CPI report signaled the end of the Fed hiking cycle. Markets seemed to agree, with rates staging a huge rally after the CPI release. Accordingly, the 30-year fixed mortgage rate has fallen by more than 30bp from its late-October peak of 8%, which was the highest level seen in over two decades.

To buy or to rent

With this welcome decline in mortgage rates, one key theme that arises is buying vs. renting. Both options have become noticeably more expensive post-pandemic (Exhibit 2): compared to Feb 2020, the S&P CoreLogic Home Price Index is up 34% while Zillow's Observed Rent measure has increased 30%. Furthermore, as of October, a stark 77% of consumers thought it was a bad time to buy a home according to the Univ. of Michigan's consumer sentiment survey, with 62% of them citing high interest rates and tight credit as the reason (Exhibit 3). It clearly has not been a buyers' market due to low affordability, but the situation has not been all that much better in the rental market.

So comes the question, do lower mortgage rates mean that we will soon see a more favorable buyers' market? Our analysis of the rent vs. mortgage payments data show that as of October, rent was still cheaper than mortgages in all but two of 97 major Metro Areas (Exhibit 1). Note that we included property taxes in our calculation of homeownership costs, but other excluded costs such as home insurance, utilities and maintenance costs would make the price of owning a home even higher. Although a small cooling in mortgage rates is good news, buyers should anticipate a higher-for-longer rate environment (Exhibit 4).

Exhibit 1: Rents vs. mortgage payments: now vs pre-pandemic (% of median HH income, annu.)
Post-pandemic, renting is noticeably cheaper than purchasing a home in most of the 97 MSAs



Source: BofA Global Research, Zillow, Tax foundation

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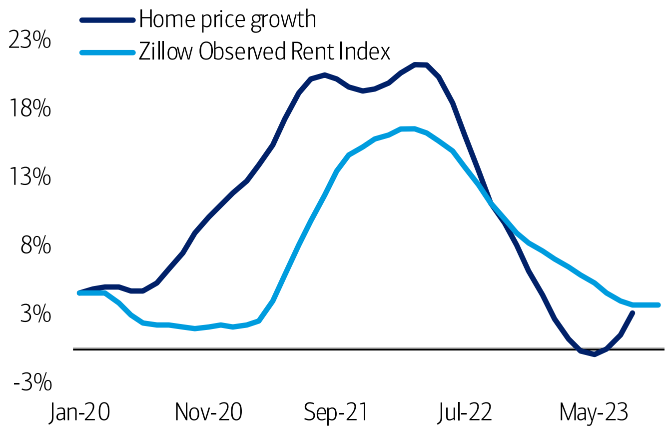
Exhibit 2: Year-over-year home price and rent growth
Home price growth outpaced rents for the first 2 years of the pandemic



Source: S&P, Zillow

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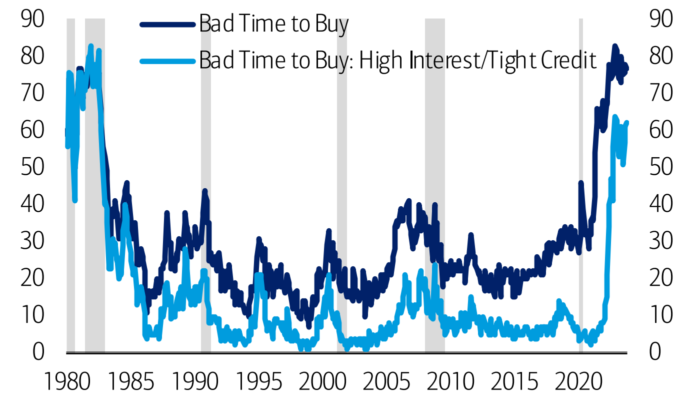
Exhibit 3: Current Conditions for Buying Houses: Good Time to Buy (% of respondents)
Only 21% of survey respondents thought it was a good time to buy a home



Source: University of Michigan

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Post-pandemic: rent and mortgage rates have shifted higher

One noticeable trend in Exhibit 1 is the post-pandemic shift. The yellow dots represent data pre-pandemic and the blue dots show the latest data. Broadly, the pandemic led to a shift rightwards and upwards, which indicates that both rents and mortgage payments have become more expensive relative to median household income. Furthermore, datapoints for some of the major cities in California have shifted significantly to the right to the 70% mark or above, highlighting the noticeable pickup in mortgage payments as a percentage of household income.

Regional data: buying is more expensive especially in the West

Regionally, we find that purchasing a home is significantly more expensive than renting in many of the major cities in the West. As a percentage of median income, mortgage payments and tax outpace rent in Los Angeles (83% vs 41%), San Jose (80% vs 26%), San Francisco (71% vs 29%), San Diego (74% vs 38%) and Seattle (55% vs 25%). Many other major cities such as New York (62% vs 43%), Portland (50% vs 25%), and Austin (45% vs 23%) are also seeing mortgage payments well in excess of rent.

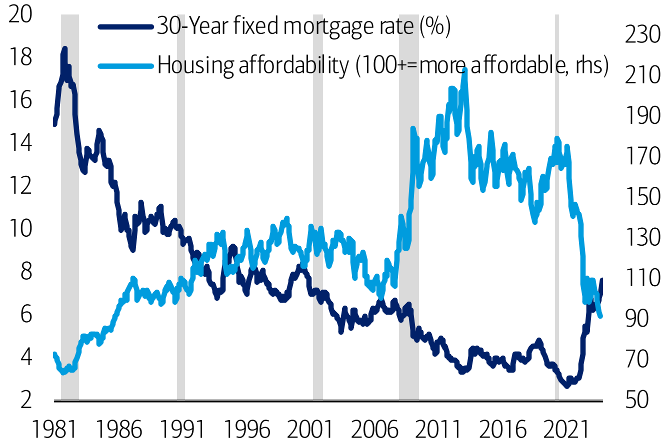
Meanwhile, cities such as El Paso, Salem, Syracuse, Pittsburgh, and Augusta are very close to the 45-degree line, and two cities- New Orleans and Jackson- are the only ones in which it is less expensive to buy than to rent.

A similar story applies to the United States as a whole. Despite the costs of renting and homeownership both increasing, renting is more affordable than owning. On a national basis, rents have increased from 23% to 26% of median US household income, while the ratio of mortgage payments to income has grown from 19% to 32%. Overall, the data clearly point to a housing market that has become more burdensome on the average buyer than pre-pandemic, and it may take some time to return to a new supply and demand equilibrium.

Looking ahead, a lengthy recovery

The Fed's rapid hiking cycle, which pushed up mortgage rates from 3% to 8%, has likely come to an end. In the near term, mortgage rates should remain higher for longer and keep home ownership challenging for many potential buyers. Nevertheless, once the Fed starts cutting in 2024, we should begin to see signs of housing activity gradually picking up due to improved demand and supply (Exhibit 5). We expect both existing and new home sales to warm up from 2H 2024 onwards, and greater active building to contribute to housing starts.

Exhibit 4: Mortgage rate and housing affordability
High mortgage rates have tanked affordability



Source: Federal Home Loan Mortgage Corporation, National Association of Realtors
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Exhibit 5: Summary of housing forecasts
Housing market expected to reach a new equilibrium as mortgage rates begin to cool in 2024

Summary of housing forecasts

	2021	2022	2023	2024	2025
Existing home sales (000s, saar)	6128	5081	4100	4200	4700
New home sales (000s, saar)	769	637	700	730	760
Housing starts (000s, saar)	1606	1551	1385	1365	1455

Source: BofA Global Research, Census Bureau, National Association of Realtors
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September housing data recap

The September housing data continued to show mixed signals between the existing and new homes markets (Exhibit 6). Existing home sales fell again by 2.0% m/m (-15.4% y/y) to 3.96mn saar, the fourth consecutive monthly decline. Inventories of existing homes remain limited due to the lock-in effect, with current homeowners unwilling to sell. This has contributed to a rebound in home prices after a brief period of weakness in 2H 2022. The median sales price of existing homes has climbed since April to $396k as of September, and Case-Shiller home prices were up 0.9% m/m (2.6% y/y) in August.

Meanwhile, the new homes market has benefitted from more breathing room in inventories- housing starts picked up 7% m/m and although building permits fell 4.5% m/m, single-family building permits were up 1.6%. New home inventory remains relatively more plentiful than existing homes at 6.9 months of supply. New home sales picked up 12.3% m/m to 759k saar in September. Ultimately, this trend highlights that demand for homes remain resilient despite high home prices and mortgage rates.

Looking ahead, limited inventories, high prices, and higher-for-longer rates may act as headwinds for sales, but the good news is that single-family permits have held up for the past several months. This should support residential investment in the meantime since single-family sector is a bigger driver of GDP growth than the multi-family sector, but downside risks remain in the higher-for-longer rate environment.

Exhibit 6: September housing data
Overall housing data came in mixed in September

Latest housing data (saar, thous)	Sep-'23	Aug-'23	Jul-'23	Jun-'23	May-'23	Apr-'23
Housing starts	1358	1269	1451	1418	1583	1348
% m/m	7.0%	-12.5%	2.3%	-10.4%	17.4%	-2.3%
Single-family	963	933	988	930	1012	847
Multifamily	395	336	463	488	571	501
Permits	1471	1541	1443	1441	1496	1417
% m/m	-4.5%	6.8%	0.1%	-3.7%	5.6%	-1.4%
Single-family	963	948	930	924	902	856
Multifamily	508	593	513	517	594	561
New home sales	759	676	736	683	710	679
% m/m	12.3%	-8.2%	7.8%	-3.8%	4.6%	6.1%
Existing home sales	3960	4040	4070	4160	4300	4290
% m/m	-2.0%	-0.7%	-2.2%	-3.3%	0.2%	-3.2%
Single-family	3530	3600	3650	3720	3850	3860
Condos/co-ops	430	440	420	440	450	430
Home price growth (% y/y)	N/A	2.59%	0.96%	-0.04%	-0.39%	-0.12%
30-yr mortgage rate (%)	7.20%	7.07%	6.84%	6.71%	6.43%	6.34%

Source: Haver Analytics, BofA Global Research

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