~ INTERN EDITION ~

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Dynamics of the Housing Market

INTRODUCTION

The continuous rise in home prices has become a critical issue for prospective buyers and the broader economy. Many factors have contributed to the drastic increase in home prices throughout recent years. Using historical data and expert opinions we will analyze the current market, identify the factors contributing to price increases, and analyze the impact of AI on the market.

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HISTORICAL CONTEXT

In the past, it was common to find homes priced at approximately three times the annual household income. This ratio provided a sustainable and affordable path to homeownership for many families. However, since 2020, home prices have surged by 47%, while average earnings have only increased by 22.3%. As of the report from the National Association of Realtors, the average home price sits at $419,300, significantly outpacing the average household income of $74,580. This disparity means that the average home price is now 5.62 times the average household income and 7.06 times the average annual salary of $59,384.

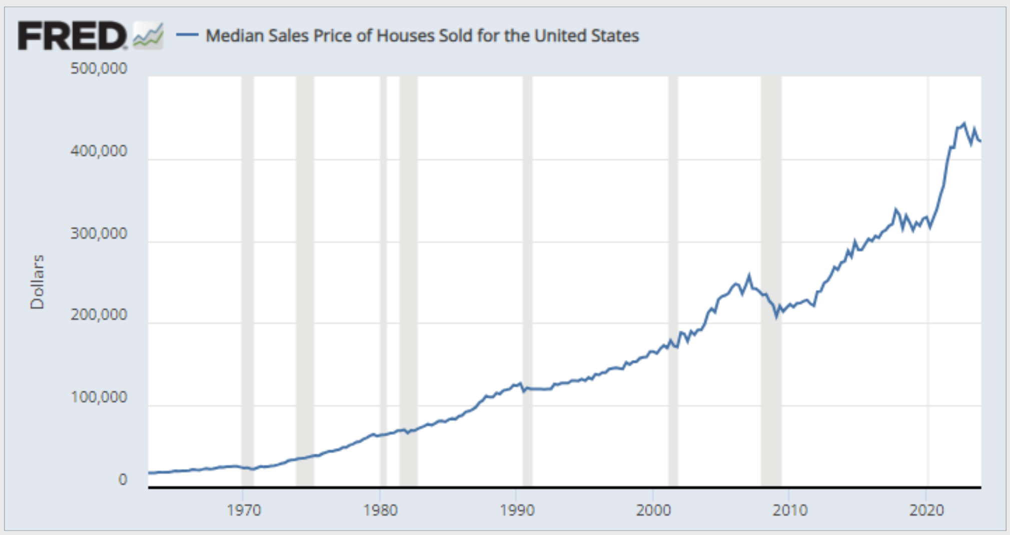

Figure 1: Depicts the rise in median home prices sold in the United States from 1963-2021

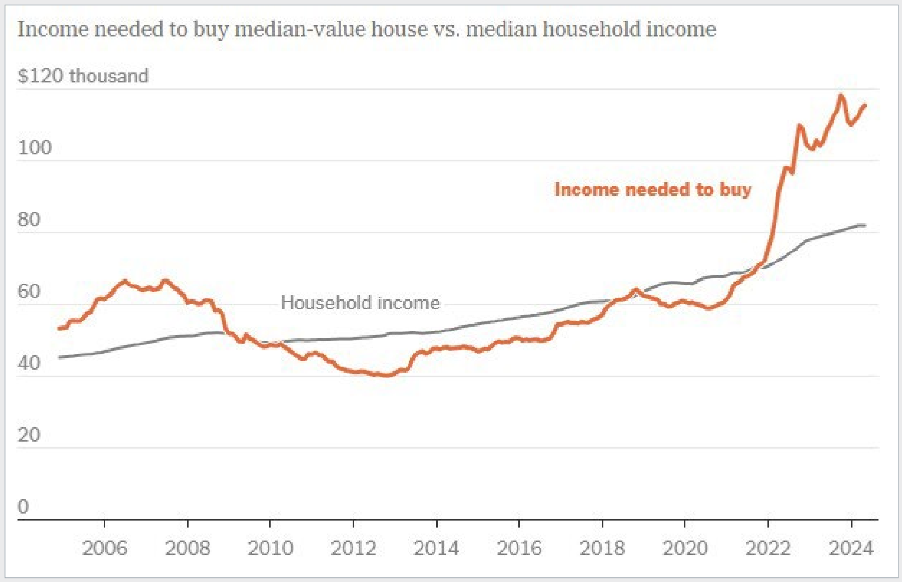

Figure 2: The graph, provided by NY Times represents the median home cost compared to the median household income

ROOT CAUSES OF RISING HOME PRICES

Several factors contribute to the rapid rise in home prices:

- **Exploding Demand and Low Supply:** With 65% of homes being occupied, many Americans are shut out of the housing market. Millennials are currently facing difficulty with home purchases, as at age 35, 52% of Millennials own a home compared to 72% of Boomers at that same age.
- **Elevated Mortgage Rates:** High mortgage rates have kept many buyers and sellers on the sidelines, reducing the number of homes available for sale and driving prices up for those who are on the market.
- **Lock-In Effect:** Homeowners who locked in low mortgage rates before 2022 are reluctant to sell, as doing so would mean losing their favorable rates.
- **Construction and Supply Chain Issues:** Higher borrowing costs have slowed new construction, yet the demand for new homes remains strong due to the scarcity of existing homes for sale.

FUTURE TRENDS FOR THE HOUSING MARKET

Additionally, the future of home prices will be influenced by economic conditions, policy changes, and demographic shifts. According to NBC, a traditional fixed-rate 30-year mortgage rate is expected to fall below 6% by the end of year 2024. In sought-after towns and cities, anticipate a moderate increase in median home price as well as continued demand for homes. However, some regions may experience slower growth or even slight declines due to varying local market conditions. On the other hand, building costs are expected to continue to rise due to ongoing supply chain disruptions, laborshortages, and increased material costs.

CURRENT MARKET AND UPCOMING CHANGES

The NAR (National Association of Realtor's) agreed to pay a $418 million settlement to compensate home sellers across the U.S. The settlement comes after multiple parties went after the association for driving up selling costs by requiring selling agents to make a commission offer to buyer's agents. The requirement, which affected all 1.5 million members of the association, caused homeowners to have to pay excessive fees when they sold their properties. The settlement further includes a requirement for the NAR to take away their MLS requirements. The group governs over its affiliated MLS by unfairly propping up agent commissions and incentivizing buyer's agents to avoid showing their clients listings where commissions were lower for the buyer's agent. The full changes will likely go into effect by September 16th with final court approval occurring on November 22nd.

Current sale commissions average around 5%-6% and will likely drop due to more impetus from home sellers to negotiate lower commissions. A lower average rate will likely streamline the process of negotiation between buyers and sellers agents. The process will also make the buyers/sellers' market more efficient as all properties will have level commission rates. The changes have the possibility to increase home prices as the liquidity premium will no longer be at high rates.

HOME INSURANCE CHANGES

The rising costs and availability of homeowner's insurance are becoming increasingly influential in the housing market, particularly in regions susceptible to severe weather events. States like California and Florida have seen significant impacts, with insurance companies pulling out due to escalating risks and costs. In March 2024, State Farm General announced it would not renew over 72,000 policies in California, citing increased construction costs and growing wildfire risks. According to the LA Times, climate change has increased wildfire risk by 25%, and Redfin reports that counties with the highest wildfire risk have seen a recent increase of risk by 51%. This escalation, along with a 28% rise in building costs since 2020, has driven up the cost of insurance.

HOME INSURANCE CHANGES *(continued)*

These changes in insurance availability and cost directly affect home prices and market dynamics. Higher insurance premiums add to the overall cost of homeownership, making homes less affordable for prospective buyers. In high-risk areas, the difficulty in obtaining insurance can also depress home prices, as buyers are wary of the additional financial burden.

Despite these challenges, the housing market remains resilient. The industry is adapting to new risk factors with innovative solutions. For instance, in high-risk fire areas in California, new regulations now require homes to incorporate fire-safe features such as noncombustible siding, double-sided tempered windows, and fine mesh screened vents. These measures aim to mitigate risks and could help stabilize insurance costs over time, making homes in these areas more attractive to buyers.

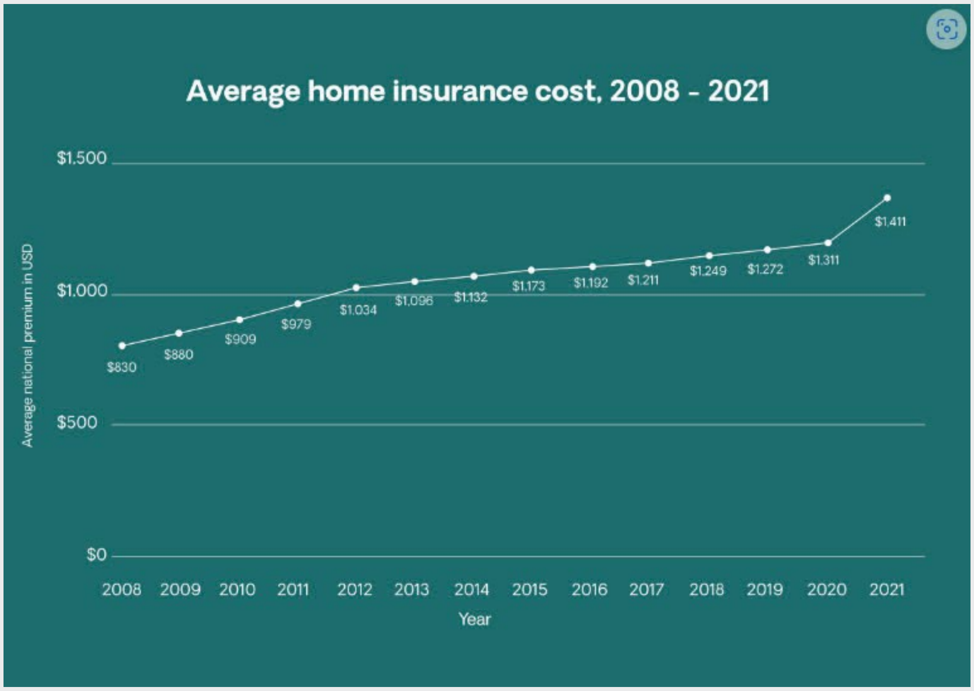

Figure 3: Shows the average home insurance premium cost from 2008-2021.

Source: Insurance Information Institute, Fact + statistics: Homeowners and renters insurance. Accessed 5/20/2024

IMPACT OF AI ON THE HOUSING MARKET

The advent of AI is set to transform the housing market in several ways. AI technologies are expected to introduce new homebuilding methods such as 3D printing and factory-built components, which will reduce costs and construction times. The concept of 3D printing houses is not new as in the past companies have experimented with the idea, but it has not been effective enough to use on a large scale. With the addition of AI to the process, 3D printing homes become more feasible. AI will also enhance real estate transactions by matching buyers with suitable mortgage products and predicting market trends more accurately.

Moreover, AI will impact the broader economy and the housing market by influencing the nature of work. As hybrid work models become more prevalent, with employees working remotely part-time, the demand for homes in suburban and rural areas is likely to increase, affecting overall home values and market dynamics.

PAST AND PRESENT MORTGAGE RATES

Today's average mortgage rate stands at just under 7%, up from the Pre-Covid average of 3.5%. The long-term average mortgage rate since 1971 is just under 8%, indicating that current rates, while high, are not unprecedented.

Historically, the highest interest rates were between 1980-1989 where rates averaged 12.82% and reached a high of 18.63% in 1981. According to the data from Department of Housing and Urban Development, The median home price in 1981 was $68,900 which is roughly $248,800 adjusted for inflation, well below today's average home price of $419,300. According to our mortgage and inflation calculator, for homeowners buying today, they would average a monthly payment of roughly $2,200 for a 30-year fixed rate mortgage on a $419,300 home with 20% down and 7% interest rate. Home buyers in 1981 paying an 18% interest rate on a 30-year fixed loan would have had mortgage payments of $831 after putting their 20% down on a $68,900 home. Adjusted for inflation their $831 payment would now cost around $3,000 a month. While home prices have far outpaced inflation, when factoring in interest rates, amortgage is now cheaper than it was in 1981.

While rates are at highs of the last 10-15 years, they are still below historical averages. Those concerned with the high rates are most likely being affected by recency bias and should not show concern. For those who are waiting for rates to drop, hoping to save money, even from 1980-1989 when rates were at record highs home prices still increased 8.3%. There may not be a benefit to hold out and wait for rates to drop as Bank of America predicts home prices will grow by 4.5% in 2024, 5% in 2025, and then another 4.5% in 2026.

Figure 4:Represents mortgage rates from 1971-2024.

Source: Freddie Mac PMMS. (c) The MortgageReports.com

CONCLUSION

The surge in home prices is a multifaceted issue influenced by a combination of high demand, limited supply, elevated mortgage rates, and various market dynamics. Historical data illustrates a significant shift from affordable homeownership ratios to the current challenging landscape where prices vastly outstrip average incomes. While policy changes, such as the recent NAR settlement, may offer some relief by lowering transaction costs, the market's future will also be shaped by economic conditions, technological advancements, and demographic trends. Despite current challenges, the housing market's resilience, coupled with innovative solutions and adaptive strategies, suggests a cautiously optimistic outlook for prospective homeowners. Everyone has a unique set of circumstances that help determine one's optimal price range for home ownership. Sitting down with your financial advisor to better understand your affordability and comfort level is the first step in making an informed and unemotional decision.

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