

Home Prices Remain The Housing Market's Biggest Mixed Blessing

Blessings, curses, enigmas, paradoxes, etc... The state of home price appreciation in the U.S. is all of the above. The positive case for home prices is as simple as glancing at the most recent update on the two major home price indices (HPIs) released this week by FHFA and Case Shiller. Both agree that homes continue to appreciate at a historically elevated pace.



David Wiest

MLO, US Bank

P: (916) 955-7664

M: (916) 955-7664

1400 Rocky Ridge Dr
Roseville CA 95661
561109

Note the extreme difference between the price correction seen in early 2023 and the outright price depression associated with the Great Recession more than a decade earlier. It goes without saying that if appreciation is going to decline (or even briefly turn negative, in the case of Case Shiller), this is what we'd want things to look like if we're interested in maintaining healthy levels of demand among buyers.

The counterpoint is that 4-7% annual growth in home prices significantly outpaces growth in income. In other words, it's not sustainable. Combine that with mortgage rates over 7% and it's an easy recipe for extremely poor affordability.

What can help affordability? Here's a list:

- Home prices could fall
- Rates could fall
- Homes could get smaller (this would effectively make prices lower, but not in a way that would show up in the home price indices due to what's known as "repeat sales" methodology)
- Builders could build more homes/apartments/etc, and at a faster pace
- Multiple roommates/families under one roof sharing expenses
- The balance of other expenses could go lower

If we look at that list and ask what's actually been happening and what could feasibly happen, we're right back to the most basic hope for affordability which is for mortgage rates to move lower. Why focus on rates?

We don't really want prices to fall, per se, although it would be OK if they rose at a gentler pace. The risk is that the perception of poor price appreciation could cause an undue drop in already constrained housing activity.

Increasing inventory seems like a good way to address affordability, and it is, but not at a faster pace than we're currently seeing. If new units are added too quickly, it risks tipping the scales in favor of depreciation, and that could cause a snowball effect where buyers wait for prices to fall and purchase demand takes a huge hit.

Homes are already getting smaller, because they have to in order for builders to build homes that people can afford in this environment. There's a limit to how much smaller they can get. The roommate/family "solution" suffers from the same sustainability problem.

Last but not least, while inflation has certainly fallen, that is only the rate at which prices are rising. Prices themselves, in most cases, continue inching up or holding steady.