GSE Activity Report

Friday, July 8, 2022

Affordable Housing is Even Harder Than You Thought

Summary

A new Fed staff note contains startling statistics on how much the housing market has changed in just a few months at grave cost to lower income households. Although the study does not go on to draw policy conclusions, its findings make it clear that DTI underwriting tests are a significant barrier to home ownership clearly not ameliorated by the price-based QM standard.

Impact

As is well understood, an unprecedented 37% surge in home values in 2020 and 2021 was largely offset by record-low mortgage interest rates, buoying the purchasing power of home buyers. However, rising mortgage rates in early 2022 upset this balance, causing a dramatic 50% increase in average monthly payments on newly originated loans. Unsurprisingly, home-purchase lending to lower income borrowers then plummeted; buyers earning less than the median wage of $68,000 accounted for 35% of loans prior to the pandemic, but this dropped to 17% – a 51% drop – by May of 2022. As demand in the housing market continues to be high, the report predicts that prices will continue to rise, and lower-income buyers will be increasingly boxed out of the market.

Still, the report does indicate that the market shows signs of cooling. For example, the supply of existing homes for sale increased in April. The Fed staff thus predict that, as more and more households are priced out, the cooling trend may well become more pronounced. We would guess that this would surely be true in mid-price ranges where somewhat lower prices will sharply boost lower-income home affordability, but these forces do not apply at the higher-price ends of the spectrum that have always been out of reach to median-income borrowers. Here, demand is more likely to cool by virtue of recent purchases and resulting sunk costs combined with the shock of higher-cost mortgages for anything new.

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