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Housing Boomlet: Is It Sustainable?

Special Housing Market Edition

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After coming to a screeching halt in April and May, housing market activity quickly resumed. Pent-up demand from would-be buyers, households leaving cities for the suburbs because of health concerns and the new work-from-home culture boosted buying and building. The gains were so strong, some predicted a V-shaped recovery. There are two problems with that argument.

First, a housing market boomlet cannot run on pent-up demand and wealthy buyers indefinitely, especially as credit conditions tighten. Home equity lines of credit have all but disappeared, while the hurdles to qualify for a mortgage have risen. That will dampen activity by first-time buyers, many of whom rushed to the market in the immediate aftermath of lockdowns.

Housing Outlook

	2018	2019	2020
Home Sales*†			
Total	5948	6015	6128
Existing	5334	5330	5325
New	614	685	803
Housing Starts*			
Total	1248	1295	1341
Single	872	893	906
Multifamily	376	403	435
Prices**			
Median Existing Single	3.3	7.8	5.5
S&P Core Logic Case Shiller	4.5	3.7	3.5
FHFA	5.9	5.7	4.7

†Includes condos, co-ops, and single-family homes.

*Thousands of units

**Annual percent change in home prices, EOP

Second, this is occurring at the same time that food insecurity and homelessness are rising. Many who deferred rent payments are now facing evictions.

This special edition of ***Economic Currents*** takes a deeper dive into the outlook for housing. We expect to see home buying and building recoup losses associated with lockdowns and drive the economy out of this recession. The forecast for housing assumes that we can avert a double-dip recession. (See table.)

Underlying Fundamentals

The most recent week shows mortgage applications running 33% above one year ago and about the same as the start of the year. (See chart.) Not all applications turn into purchases, but they suggest sales will remain strong for the next few months. The rebound in housing is being driven by:

- Record-low mortgage rates.
- Pent-up demand, especially among older millennials who had deferred home buying.
- The return of wealthy buyers seeking second homes, often in vacation communities.

The biggest constraint is supply, which was tight before demand started to grow. Bidding wars have resurfaced in the most attractive suburbs and vacation markets.

Hurdles for 2021 are higher. Credit conditions will tighten further, despite persistently low mortgage rates. Delinquencies and defaults will also rise. The pain could come sooner for the multifamily market where we are beginning to see a rise in nonpayment of rent since extended unemployment insurance (UI) was halted; evictions will inevitably follow unless Congress renews the supplemental UI benefits. The recent executive order is wholly insufficient to cover the losses.

New Home Sales Drive Gains

Our forecast shows home sales coming in at a seasonally adjusted annual rate of 6.1 million in 2020, slightly above 2019 levels. Strong gains at the start of the year and the boomlet in sales following initial lockdowns offset a sharp drop in sales during April and May. Realtors and moving companies are experiencing one of the busiest summers in recent memory.

New home sales in July surged to the highest rate in 14 years and are expected to drive gains through year-end, given the supply constraints on move-in ready homes in the market for existing homes. Many older millennials delayed buying their first homes and are now buying larger, higher priced homes instead of entry-level properties. This has created a window for builders who are facing soaring costs for materials.

Gains in sales have been broad-based, with the strongest recovery in the South, West and Midwest. The Northeast, the smallest market, has been a laggard. The South and the Midwest are the most affordable markets, with median sales prices below $300,000. The West has a much higher median sales price of $453,800; affordability is a major hurdle, particularly in California.

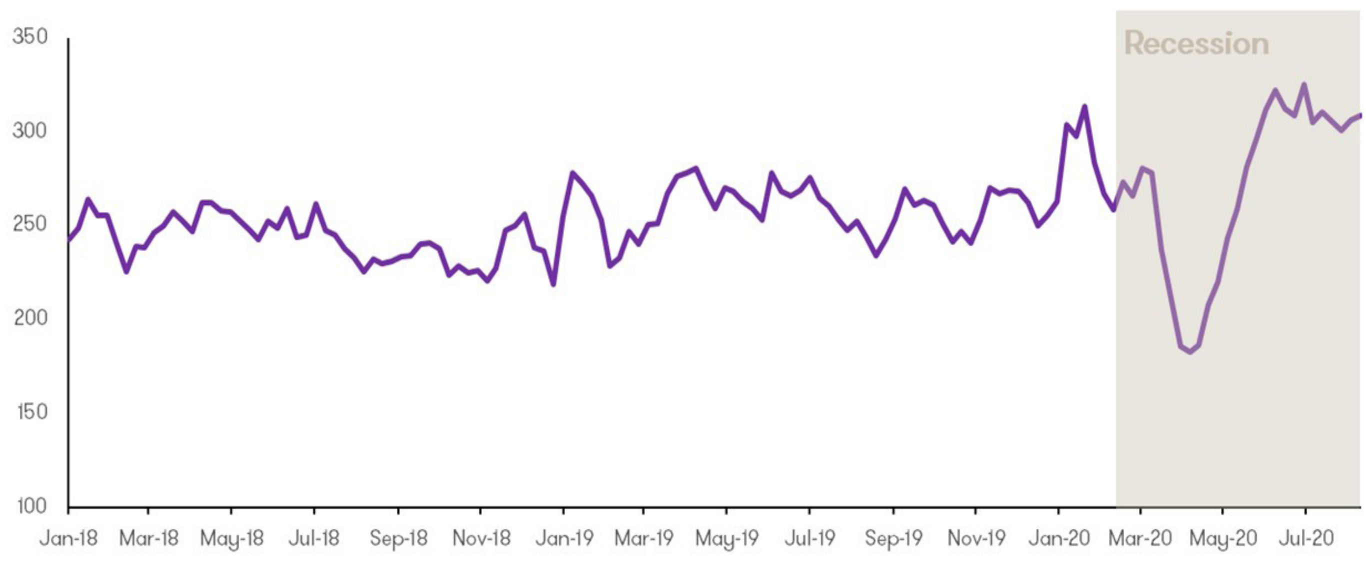
The move to second-tier urban markets and the suburbs from what were some of the hottest and least affordable coastal cities occurred before the onset of the pandemic. The shift to work-from-home, coupled with low mortgage rates, prompted a number of fence-sitters to act. It is too soon to call the shift a permanent move from urban cores.

A recent survey by the National Association of Realtors (NAR) suggests that the pandemic accelerated but did not create buyers' desires to move to the suburbs; it pulled sales forward. As a city dweller leaves his or her condominium for a suburban detached house, another city dweller is coming along right behind, ready to snap it up.

The only major exceptions we see are New York and San Francisco, which are experiencing an exodus tied to COVID-19. Even then, listings of homes for sale have dropped faster than actual home values in those two cities, suggesting that concerns about selling could be greater than the actual flight.

Mortgage Applications Hit Cyclical High

Mortgage Applications for Purchase Index, SA, 03/16/90 = 100



Source: Mortgage Bankers Association/Haver Analytics

Much will depend on the future of work and the role that work-from-home plays in a post-COVID world. The bet is that it will be greater than we saw pre-COVID but not as dominant as many expect. In-person interactions are still a large part of our DNA and critical to collaborative work. While some technology companies have extended their work-from-home policies during the pandemic, other large employers such as Amazon and Facebook have announced intentions to increase office space in cities including New York.

Housing Construction Plays Catch Up

Our forecast has housing starts rising to a 1.34 million-unit pace in 2020, only slightly above the level of 2019. That is well short of demand and more than one million shy of the 2.5 million new homes that Freddie Mac estimates is needed to keep up with household formation.

We expect to see strong gains in both single- and multifamily home construction for the rest of the year. A catch-up in activity following lockdowns, added to tight supply and strong demand for new single-family homes, will drive gains through year-end. The multifamily home market appears to be running on the fumes of development dollars. Longer term, we are cautious on multifamily given the surge in vacancies tied to evictions.

The end of supplemental UI benefits and moratoriums on evictions have left millions of people without the funds or protection to stay in their homes. As of the end of June, property managers surveyed by NAR said that less than half of rents, or 42%, were paid on time. Nationally, one in five renters has at least one household member who lost a job due to COVID-19; that is almost 9 million households. The effects are compounded for households with children or other dependants and seniors living on retirement income.

Repairs and remodeling are expected to hold up, at least in the near term. Funds once allocated for vacations and other types of spending are being reallocated to enhance home offices. A cessation of home equity lines of credit could take a toll on such projects when money saved during the pandemic is depleted.

Immigration curbs are a hurdle for the single- and multifamily markets. Wealthy Chinese played an outsize role in supporting sales in coastal cities and college towns prior to the crisis. Canada's housing market is ahead of us on this curve; the hardest hit market from the loss of immigration is the one for luxury condos in urban cores.

The South is the largest construction market in the country; land availability and affordability are the driving factors. Losses in the service industry from the pandemic, particularly in Florida, combined with hurricane risks and slow rebuilding, will have an immediate impact. FEMA funds could be depleted by the executive order to redirect them for supplements to UI. We are currently in the height of hurricane and wildfire season.

Home Prices Supported by Tight Supplies

Home prices are expected to rise between 3.5 and 5.5% in 2020, depending on the measure. That is close to what we saw in 2019, despite an uptick in bidding wars. House appreciation is reversing course and gaining speed after slowing down in the spring. Tight supplies, escalating materials costs and low mortgage rates have combined to keep prices elevated. A pick-up in sales of larger, more expensive homes and vacation properties is also pushing up median home prices, which hit the highest level on record (after adjusting for inflation) in July.

Suburban home prices are rising faster than in the urban areas. The shortfall in urban markets is mostly due to New York and San Francisco, according to a study by Zillow.

Bottom Line

Housing market activity is robust, but much of that is catch-up, which is expected to continue through year-end. First-time buyers have returned but are concentrated among higher-earning households. Tighter credit conditions and smaller job gains will keep middle-income households on the sidelines. Only those with pristine credit records and large down payments are being approved for mortgages. This, coupled with the pending surge in evictions, underscores how the housing market has come to embody the overall economy. Inequalities will widen unless Congress comes through.