THE WALL STREET JOURNAL.

The Price Is Wrong for Housing

By Justin Lahart Nov. 28, 2023

The Price Is Wrong for Housing© Provided by The Wall Street Journal

Lower rates would make U.S. houses more affordable, just not affordable enough.

The pandemic set off a flurry of demand for housing. Americans' newfound desire for space, the padding of U.S. household finances from government relief checks, and sub-3% mortgage rates were a potent mix that sent home prices skyward. Now the buying frenzy has passed and, with mortgage rates at their highest levels in over 20 years, not many homes are getting sold at all.

Yet high home prices have proved more than sticky. On Tuesday, S&P Dow Jones Indices reported that the S&P CoreLogic Case-Shiller National Home Price Index hit a new record in September, putting it 3.9% above its year-earlier level.

The big reason why home prices have stayed so high is well known: Current homeowners, carrying mortgages that are far below today's rates, are unwilling to move, and that has placed severe constraints on the supply of homes.

Absent those unusual supply constraints, it seems likely that prices would be a lot lower than they are now. Or, to put it a bit differently, equilibrium prices for homes are probably a lot lower than spot prices.

How much lower? The National Association of Realtors produces a housing affordability index, based on single-family home prices, median family incomes and mortgage rates that has lately hit its lowest levels (signifying the lowest affordability) since 1985. What is striking is that even if mortgage rates declined significantly, this measure would still suggest houses are steep.

The same goes for a similarly constructed index from the Atlanta Fed. By its lights, the threshold for an affordable house is for mortgage and other housing payments to be 30% of household income. As of September, this measure showed that for the median household, the median-priced home was nearly 50% too costly to be considered affordable.

Take mortgage rates all the way down to 5%, versus September's 7.2%, and the Atlanta Fed's measure shows that housing costs are still nearly 25% beyond affordable. One way to make the numbers work at a 5% mortgage rate would, of course, be to boost household incomes by about 25%. The other would be to drop home prices by about 25%.

Nationally, home prices rarely decline by all that much—the housing bust that helped set off the 2008 financial crisis was an exception—in part because people would prefer to hang onto their home than sell it in a weak market. So it might be that home prices are destined to tread water for a number of years as some combination of higher incomes and lower rates brings the housing market to some semblance of health.

On the other hand, the speed with which home prices climbed, and the fact that so few homes are getting sold, might mean that prices might prove so sticky once supply starts to come back. Very few homeowners bought their homes for anything close to what they are fetching today, which means they would be unlikely to be selling at a loss. This includes many who bought after the Covid crisis hit: The peak month for existing-home sales in the pandemic period was June 2021; the National Home Price Index was 20% higher in September than it was then.

U.S. homes are worth a lot of money on paper. In a functioning market they would be worth less.