

The U.S. Housing Market Becomes a More Local Story

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As bond yields have risen, mortgage rates are again facing upward pressure, extending the U.S. housing market's post-pandemic affordability challenges. Beyond mortgage rates, trends in wage growth, taxes, and insurance costs also continue to shape the affordability outlook. In addition, the national housing market is increasingly becoming a more local story, with regional divergence often driven by differences in new housing supply.

For four years, the defining feature of U.S. housing has been paralysis. Homeowners with fixed-rate mortgages that originated well below today's rates have had little reason to move. The resulting scarcity of listings has upheld prices, and affordability has deteriorated to its worst level since the 1980s. Activity remains slow, but the deep freeze in housing markets may show signs of thawing.

National inventories, while still low by historical standards, have been rising steadily and – measured in months of supply – are back to pre-COVID levels. The lock-in effect is eroding too: The share of homeowners carrying very low mortgage rates is steadily shrinking as newer loans enter the stock. Meanwhile, several years of negative real (inflation-adjusted) home price appreciation at a national level has aided affordability at the margin.

We remain generally constructive on mortgage credit. U.S. homeowners currently hold approximately \$35 trillion of equity and collectively carry one of the least levered balance sheets across the credit landscape. The national shortage of homes persists, and we think a substantial pool of pent-up demand is waiting for affordability to improve.

Two other levers are important. First, nominal income growth erodes the affordability gap every year that it outpaces home price growth. A stagnant nominal home price level could potentially create a credible route back to 1990s and 2000s affordability levels if it's combined with steady wage gains (for more on the path of wages, see the 2 September Macro Signposts, "If Inflation Is the Problem, Why Aren't Wages?").

Second, carrying costs cut the other way: Taxes and insurance typically run 2% to 3% of the loan balance, so a 50% increase in escrow-related items is worth roughly a full point on the mortgage rate. Unlike a rate move, this hits every borrower rather than only the marginal buyer. These costs are also diverging at the state level: Since 2019, average monthly escrow has risen roughly 80% in Florida, which faces elevated hurricane-related exposure, versus about 50% nationally (see Figure 4). A stabilization or decline in taxes and insurance could potentially help close the affordability gap even if mortgage rates remain elevated, since these costs directly affect the monthly payment households must carry.

As the housing market has become more segmented, such local trends and granular data may offer greater insight than broader national averages. Geographically, pockets of inventory have emerged in areas that have accommodated more construction. For example, some areas in Texas and Florida have seen outright price declines, compounded by fast-rising insurance costs and property taxes in those

same markets.^{Footnoteii}

The West Coast, starting from a far more stretched affordability position, has been potentially the most rate-sensitive. Prices fell in Southern California and the Bay Area after the 2022 rate shock, though limited supply and difficulty adding units have since helped stabilize prices, and Bay Area prices are now picking up benefits of the AI boom. The Northeast, chronically undersupplied, has seen limited deceleration in home price appreciation.^{Footnoteiii}

A similar dispersion shows up across borrowers. The K-shaped U.S. economy is visible in the mortgage market: Most homeowners sit on the upper arm of the K, but delinquencies are rising in the weakest segments, primarily Federal Housing Administration (FHA) loans (for more, see our 2 September Economic and Market Commentary, “How a K-Shaped Economy Affects Opportunities in Asset-Based Finance”). The scale is manageable and, with post-crisis underwriting remaining robust, in our view, we do not see a path to 2008-style contagion.

Markets that built more housing tend to have lower prices and cheaper rents. Across metro areas that added the most market-rate apartments over the past three years, rents on the most affordable Class C units fell roughly 8%. In the metro areas that built the least, those same Class C rents rose about 12% (see Figure 5). In the process, the higher-supply markets absorbed materially more demand.

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