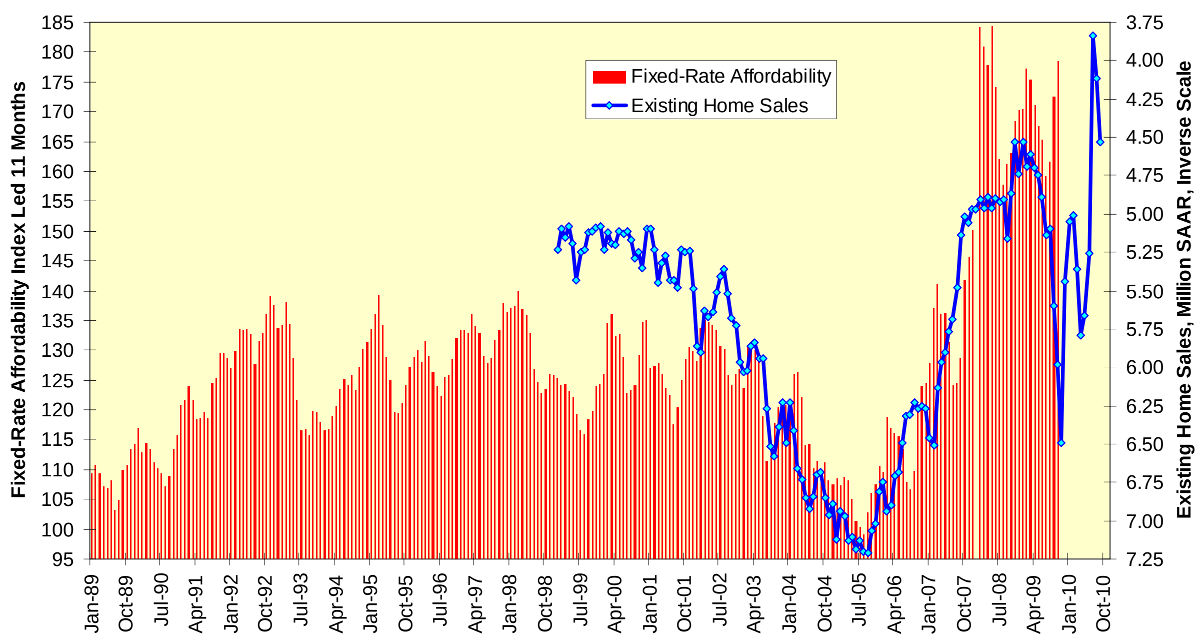
Home Affordability In A Bubbly Market

One of the great teeth-gritting phrases from socioeconomic engineering is "affordable housing." In reality, all housing must be affordable; if the price is too high, fewer and fewer potential buyers are going to show up to the auction. Every estate, every mansion, every showpiece in the glossy magazines was affordable to someone even if the seller had to price the merchandise to move it. It is called "clearing a market," and this seems to be somewhere below the last alternative tried in national housing policy since the market peaked in 2006.

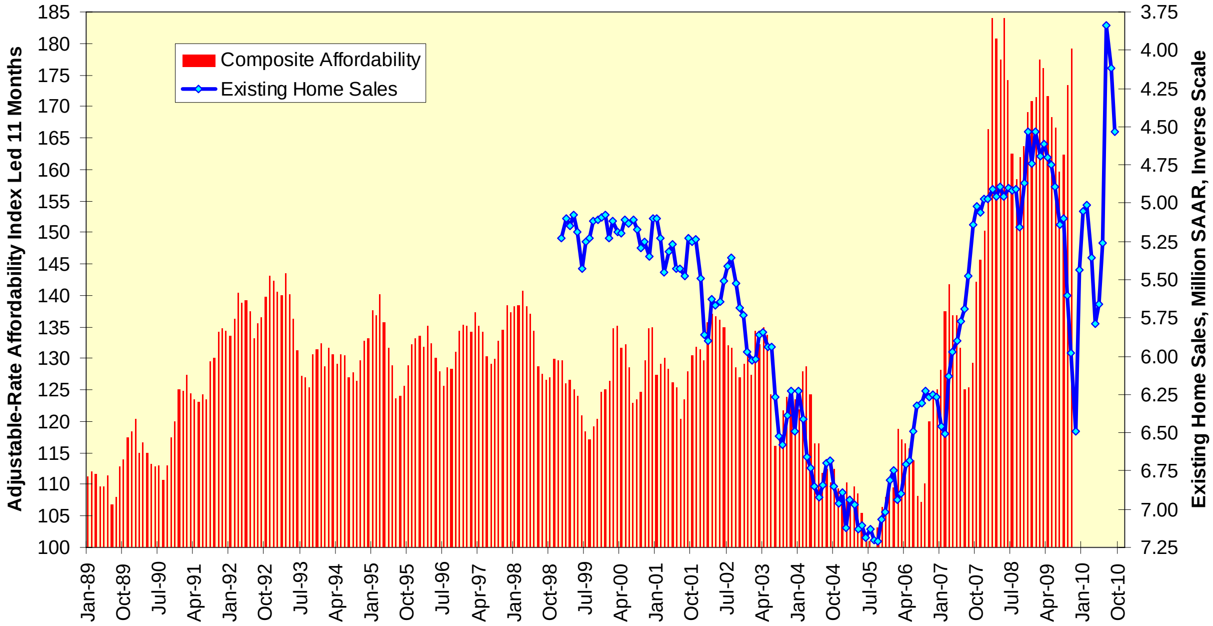
Housing affordability has three components, price, cost of capital and forward holding costs. The first two are in the National Association of Realtors' indices of home price affordability; neither realtors nor anyone else likes to contemplate the forward holding costs of being a homeowner such as taxes, utilities and maintenance. They can be considerable, and none of them tend to get smaller over time.

As mortgage rates, both fixed and a composite index of fixed and adjustable rates, have been declining and home prices have not been rising, affordability indices have been rising, with an interesting and unexpected lead/lag effect: Existing home sales lead affordability inversely by eleven months on average; affordability does not lead sales. As existing home sales have been weak following the end – for now – of the various mortgage subsidies and first-time homebuyers' tax credits, prices have remained under pressure and this has kept home affordability looking strong.

Existing Home Sales Lead Fixed-Rate Affordability



Existing Home Sales Lead Composite Affordability



If the eleven-month lead time holds, weak sales should keep affordability high well into the third quarter of 2011. The major risk here is money-printing or some other round of subsidies and tax credits will push home prices higher than they would be otherwise and discourage new buyers. After all, how smart do you need to be to stay away from buying something whose price is being supported by Uncle Sam, a list that includes just about everything these days?

Tellingly, the stocks of the homebuilders have struggled during the money-printing extravaganza. If we measure the total return since August 27, 2010, the date of Bernanke's declaration everyone would be a billionaire if we only had enough paper and ink, the S&P 1500 homebuilders index has returned 9.264%; the Supercomposite itself has returned 15.27%. As homebuilding and all of its related industries are major employers, how can we solve the unemployment problem by keeping these workers on the sidelines?

Three of the homebuilders, Skyline, Ryland Group and Pulte Group, have had negative returns since mid-August. Perhaps their fortunes will turn higher once investors start cashing in their portfolio gains from the money-printing and build new homes. Small detail: They have to sell their shares to build their new homes, and how can stocks rise when the winners start selling unless late entrants start buying aggressively? What are the stockholders supposed to do in this situation, borrow against their shares and overpay for houses, thereby combining the last two bubbles into one?

Let's add one more reason to the pile of why wealth cannot be created by counterfeiting your own currency.