The Daily Dish

Is Housing Affordability a Thing of the Past?

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As Eakinomics has previously noted, housing affordability has become a sleeper issue this election season. So it was with some interest that I read this Bloomberg article containing the following bombshell:

> *According to Fannie Mae calculations, it would take one of three things, or a combination of them, for affordability to return to 2016-2019 levels: The median price of a single-family home would need to fall 38% to $257,000 from September's $414,340; median household income would have to rise more than 60% to $134,500; or the mortgage rate would need to fall to 2.35% from roughly 6.5%.*

Yikes! Let's be clear: A 38-percent decline in home values is a housing crisis. A 60-percent rise in median household income will take nearly 17 years (at the average rate of increase of median income since 2000). And the 30-year fixed-rate mortgage simply has not been down to 2.35 percent in the past 50 years. Is it really that bad?

First, the calculations come from Fannie Mae and are derived using an affordability index published by the National Association of Realtors. The basic idea is that the homeowner should not have to use more than 25 percent of her monthly income to carry the cost of owning the home. So, take the current median sales price of homes as an indicator of home prices and the current average interest rate on a 30-year fixed-rate mortgage and use that to compute the monthly interest and principal. The target income, then, is one where the principal and interest is 25 percent. Compare this target income with the current median household income. If the median income is higher, then the principal and interest will be less than 25 percent and the house "affordable." The actual measure is the ratio of the median to the target, and will be above 100. If the median and target are the same, then the index is 100. If the median income is below, then the affordability index is below 100.

The Fannie Mae calculations are different ways to get the affordability index to 134.3 – the average over the 2016–2019 period – and none of them look particularly plausible in the near future.

There are, however, many caveats. The first, of course, is that the affordability index is completely arbitrary. Why 25 percent? Why a 30-year fixed-rate mortgage? The second is that there is no single housing market. There are hundreds of such markets across the country that come with very different house prices. And, finally, incomes are different across the country.