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A Housing Market Hangover

In the year ahead, the housing market may be slow to start, with home prices, rents, inventory and interest rates not moving much at all, according to economists, analysts and real estate brokers.

At the beginning of the pandemic, office workers were liberated from their commutes but found themselves stuck at home and hungering for space. Many Americans went on a home buying frenzy, fueled by cheap debt and an insatiable urge to move. The result was a run up on home prices at a pace never seen before in U.S. history.

Then the party ended with a thud last spring when mortgage rates doubled in a matter of months. Buyers evaporated from the market, unable to pay the staggering cost of buying a home in this new reality. And those who had planned to dip into their stock portfolios to fund down payments saw their fortunes dwindle as stock prices tumbled. The housing market's anemic inventory did not recover, partly because sellers stayed put, realizing that they, too, would be at the mercy of high mortgage rates for whatever new home they purchased.

"The pandemic created a perfect storm for driving up housing prices," said Ruben Gonzalez, the chief economist for Keller Williams, and "2022 was the aftermath of that storm."

Get ready for one hell of a hangover.

The year ahead may continue to feel like the morning after an epic party: slow to start, with home prices, rents, inventory and interest rates not moving much at all, according to interviews with economists, analysts and real estate and mortgage brokers. Lingering economic uncertainty, including a rocky stock market, could translate to a housing market waiting for something to happen.

The housing market has "basically been in hibernation since late summer," said Daryl Fairweather, the chief economist for Redfin, which anticipates 16 percent fewer home sales in 2023 compared to 2022, dropping to the lowest level since 2011, around the time the last housing cycle bottomed out. "This is profound," she said. "It's like it ran out of gas."

Sales have fallen, yet prices are largely holding. In November 2022, home prices were up 2.6 percent from November 2021, while sales were down 35.1 percent during the same period, the largest drop in a decade, according to Redfin. A healthy housing market usually has four to five months supply; in November, the country had a 3.3 month supply of homes, according to the National Association of Realtors.

On Oct. 27, the 30-year fixed mortgage rate hit a high of 7.08 percent, according to Freddie Mac. On the week ending Dec. 22, the 30-year fixed mortgage rate was 6.27 percent, more than twice what it was the same week in 2021. Someone who locked in a 30-year mortgage on Dec. 22 for a $320,000 loan can expect to pay $1,974 a month in principal and interest, up 45 percent from the $1,357 a month they would have paid had they gotten a mortgage with the same terms a year earlier.

“We’re sitting right now at the worst housing affordability we’ve seen in several decades,” Mr. Gonzalez said.

For first-time home buyers, the current conditions are particularly bleak: Home prices skyrocketed 45 percent from December 2019 to June 2022, according to Standard & Poor’s CoreLogic Case-Shiller Home Price Index. First-time buyers, who overwhelmingly finance their homes, are now paying far higher borrowing costs as they compete against cash buyers, who, in October, accounted for a third of all purchases, the highest share since 2014, according to Redfin.

There has not been much relief for renters, either, who have endured stunning increases that gobbled up their savings, making it harder for them to pay basic expenses, let alone save to buy a home. In 2021, rents soared almost 18 percent, according to Apartment List. While landlords have pulled back on those dramatic increases, they haven’t offered much in the way of discounts. Rents rose 4.7 percent between January and November 2022, according to Apartment List.

‘No Risk of a Repeat of 2008’

For current homeowners, the end of the party is not so bad. Most have accrued enormous home equity simply by living there. Those who bought or refinanced are likely the beneficiaries of historically low interest rates, too.

Less than one percent of homes are in foreclosure, a fraction of the 4 percent of homes in foreclosure at the peak of the 2008 housing crisis, according to ATTOM, a real estate data company. Of the homes that are in foreclosure, 93 percent have equity, according to ATTOM. So an owner who is behind on mortgage payments could sell the house, potentially walking away with cash in hand.

Rick Sharga, an executive vice president of market intelligence at ATTOM, said there is “almost no risk of a repeat of 2008” when millions of Americans, many with subprime mortgages, defaulted on their loans, glutting the housing market with inventory and causing home values to crater as the country sank into a deep recession.

The housing boom of the early 2000s was defined by Wild West lending practices where banks doled out high risk loans to high risk borrowers until the market collapsed. In response to the crash, federal legislation was enacted to regulate the banking industry, and button down lending practices. At the start of the pandemic, with the economy’s prospects uncertain, banks further tightened their requirements, scrutinizing borrowers, demanding significant down payments, impeccable credit scores and more income documentation. The result is a generation of vetted, financially stable buyers, well positioned to pay their mortgages, even if the value of their home dips or the economy hits rougher waters.

The current market has advantages for buyers, too. It’s certainly more expensive to buy a home now than it was a year ago, but the shopping experience is less miserable. Buyers no longer have to overbid by enormous sums or sweeten deals with outrageous promises. Instead, they have time to think and negotiate repairs or a price reduction.

“It’s a much better time to buy now than it was six months ago,” said Greg McBride, the chief financial analyst at Bankrate.com. “You’re not competing with 44 other people in front of you on line at the open house. You’re not competing with people putting in offers sight unseen. That was not a good environment.”

Where Prices Dropped Most

The metropolitan areas in which home prices fell the most from June to September.

MARKET	SEPT. 2022 MEDIAN LIST PRICE	CHANGE SINCE JUNE 2022
Austin, Texas	$558,275	**−10%**
Phoenix	$493,500	**−10**
Palm Bay, Fla.	$379,995	**−9**
Charleston, S.C.	$500,000	**−9**
Ogden, Utah	$379,995	**−9**
Denver	$625,000	**−8**
Las Vegas	$460,000	**−8**
Stockton, Calif.	$581,725	**−8**
Durham, N.C.	$460,000	**−8**
Spokane, Wash.	$449,900	**−7**

Top Markets for 2023

Markets positioned for growth in price and sales, as predicted by Realtor.com.

MARKET	NOV. 2022 MEDIAN LIST PRICE
Hartford, Conn.	$372,400
El Paso	$290,500
Louisville, Ky.	$290,000
Worcester, Mass.	$447,500
Buffalo	$239,000
Augusta, Ga.	$318,900
Grand Rapids, Mich.	$358,300
Columbia, S.C.	$300,400
Chattanooga, Tenn.	$396,500
Toledo, Ohio	$161,100

Will Home Prices Budge?

Whether home prices will fall, and by how much, depends on who you ask. Redfin is predicting prices will fall by 4 percent in 2023. Mr. Gonzalez at Keller William is anticipating a peak-to-trough drop of 10 percent. The National Association of Realtors anticipates prices, overall, won’t move at all.

What will ultimately happen next year may have a lot to do with where you live. Markets like San Francisco, Phoenix and Las Vegas might see noticeable price drops, while other markets, like Chicago, Milwaukee and Pittsburgh, could see prices rise.

In Phoenix, a market that has attracted investors and cash buyers, home prices in October were down 4.5 percent from their peak in June, but still up 60 percent from where they were in February 2020, according to Zillow. “If you compare the market to last year, it’s horrible,” said Laura Coughanour, the owner of Century 21 Arizona West. “But if you go back a few years, this is what a more normal market looks like.”

But in Hartford, Conn., midway between Boston and New York, home sales have not slowed significantly. Realtor.com predicts prices will rise there by 8.5

percent in 2023. "We're a little bit odd," said Alison Malkin, the owner of Re/Max Essentia in Connecticut. "It's been a great year for us."

Sellers who price homes conservatively often get one or two offers, selling for around the price they would have commanded in early 2022, Ms. Malkin said. Some do even better. Ms. Malkin recently listed a small, dated ranch-style home in Farmington, Conn., for $219,900. It received 18 offers in two days, selling for $251,200.

But Ms. Malkin said she worries about affordability, particularly since the area is a draw for investors from New York City snapping up starter homes, "which freezes out the people who actually need a place to live."

What About Interest Rates?

Although mortgage rates aren't directly tied to the Federal Reserve's actions, they are influenced by them. In December, the Federal Reserve raised the federal funds rate at a slower pace than it had earlier in the year. While rates are expected to continue to rise in 2023, conditions could change.

Even the Fed chair, Jerome H. Powell, does not hold a crystal ball, saying at a December news conference, "I don't think anyone knows whether we're going to have a recession or not, and if we do, whether it's going to be a deep one or not."

Some real estate economists are projecting that mortgage rates will start to fall sometime in 2023, perhaps by the second half of the year. Lawrence Yun, the chief economist for the National Association of Realtors thinks mortgage rates already peaked in November, and will hover around 6 percent, or edge lower, in 2023. "That could open the gates for buyers who are priced out to re-enter the market," he said.

But interest rates don't rise and fall in a vacuum, and they are not the only factor home buyers consider. "Five percent mortgage rates don't solve the affordability issues," said Mr. McBride of Bankrate.com, adding that a weak economy could translate to a slow year for the housing market. "When people are worried about their job security, they don't buy houses."

Could New Homes Get Built?

America has not built enough housing for a decade. At the end of 2020, when the housing boom was just getting started, the country was short 3.8 million units of housing, according to Freddie Mac. While construction of single family homes started to pick up during the pandemic, builders pulled back in 2022, with housing starts down 16 percent in November 2022 from the same time a year ago, and building permits down 22 percent during the same period, according to U.S. census data.

“The pipeline is essentially shrinking,” said Robert Dietz, the chief economist for the National Association of Home Builders, which is expecting single family home starts to fall by another 15 to 20 percent in 2023 before beginning to rebound in 2024.

The repercussions could be widely felt, as inventory remains punishingly low and housing prices stay high. “My expectation is we’re going to see an increase in the share of young adults who live with family, which right now is one out of five 25 to 34 year olds,” Dr. Dietz said.

The Year Ahead for Renters

More Americans — almost 44 million households — rent than at any other time in the last half century, according to an October report by Rent Cafe. Through 2021 and the first half of 2022, they found themselves at the mercy of a relentless market, with packed open houses and, in some markets, bidding wars. In New York City, renters received lease renewals with eye popping rent increases, sometimes as high as 40 or 50 percent — a jarring change of fortune, particularly for those who had weathered the first year of the pandemic in the city as rents plummeted. By May 2022, the median rent in Manhattan reached $4,000 a month for the first time.

“Renters have been squeezed to their limits,” said Kenny Lee, a StreetEasy economist.

Nationwide, the picture was also grim, with the national asking rent crossing $2,000 a month for the first time in May 2022, according to Redfin.

Still, the market has been steadily cooling for months. From the beginning of September to the end of November 2022, rents saw the sharpest three-month drop since 2017, when Apartment List first started tracking such data.

The national median rent is now $1,356 a month, according to Apartment List. Heading into 2023, renters will have more options than they’ve had in a long time, with new housing units coming onto the market and less competition.

Rental construction was up almost 18 percent from January through November 2022 compared to the same period in 2021, according to Dr. Dietz of the National Association of Home Builders, adding that construction is expected to slow significantly in 2023. Currently, 932,000 apartments are under construction nationwide, the highest count since Dec. 1973.

“Over the next 12 months we’re going to see about as much construction in a year come on line as we’ve seen at any point in the last 40 years,” said Igor Popov, the chief economist at Apartment List.

The building boom could continue over the next few years in New York City, too. In the first half of 2022, the city issued almost 59,000 permits for new housing units, two and a half times the number issued in 2021, according to city data compiled by StreetEasy. The surge was attributed largely to developers rushing to get shovels in the ground before a program that provided tax breaks in exchange for building affordable housing expired.

“New Yorkers will start noticing more cranes up in the sky as these projects break ground,” Mr. Lee of StreetEasy said.

How many of those apartments actually get built as rentals remains to be seen, given high interest rates, expensive construction costs, and a looming 2026 deadline for the developments to be completed to benefit from the tax break.

With rents leveling off and new apartments hitting the market, “renters are going to be back in the driver’s seat,” Mr. Popov said. “Whether or not they will then press the gas and drive really depends on this broad conversation of where the economy is headed and whether or not renters are feeling good about it.”