BULL & BEAR BULLETIN

Volume 7, Issue 8 December 2016

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An on-line publication by The Investment Committee

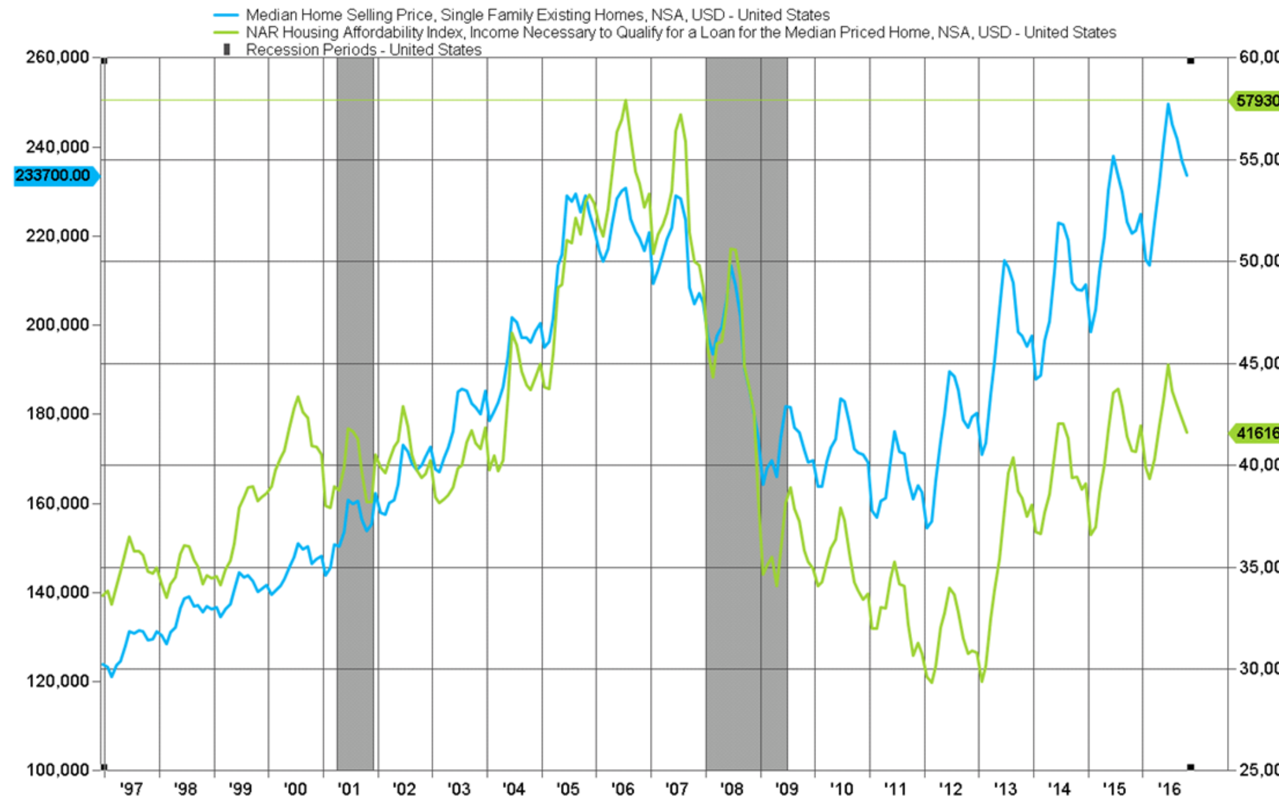
A Homebuyer Hangover

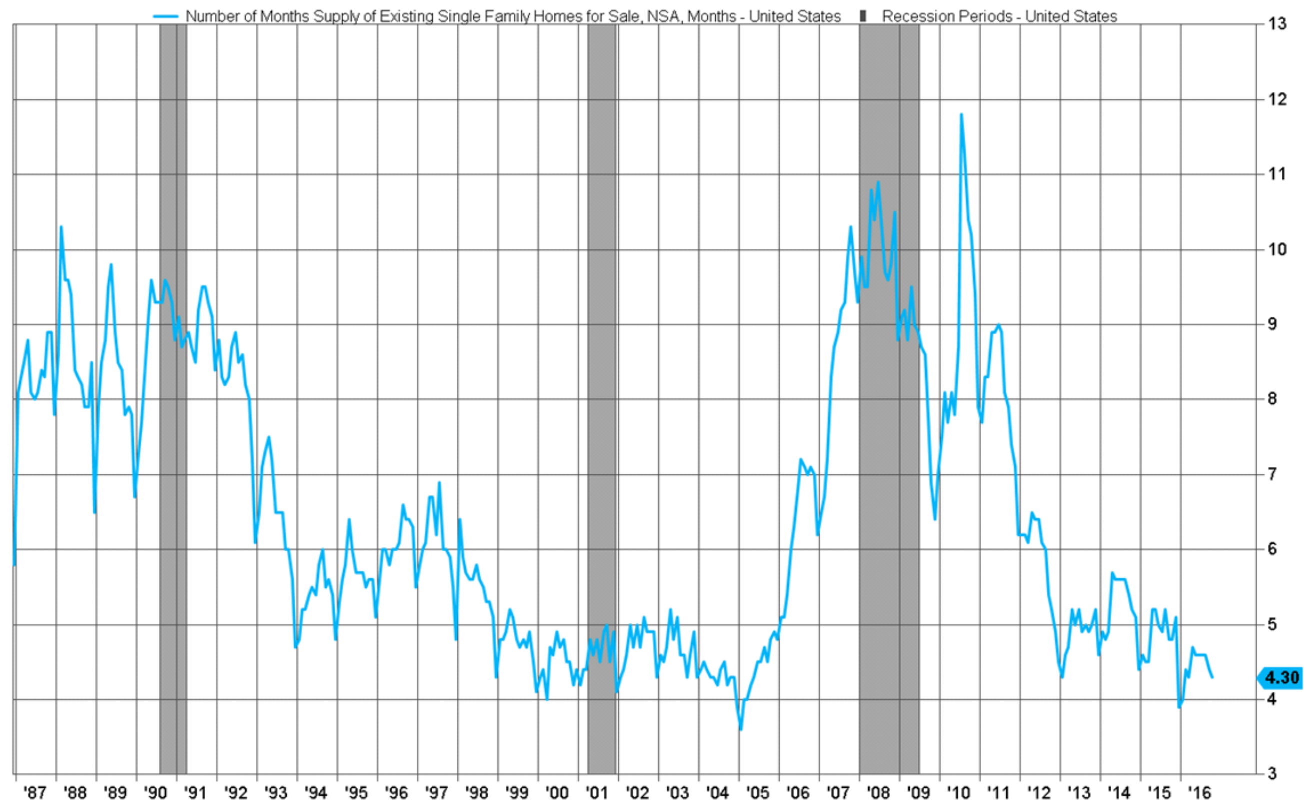
The subprime mortgage crisis of 2008 sent the value of most investors' largest asset, their homes, into a tailspin. Eight years later, the housing market is still a confusing place for buyers and sellers alike. The national median home price has recovered strongly. Rentals have been in high demand and borrowing rates have never been lower. Though it's a difficult, fairly opaque environment to wade through, housing and real estate demand investors' attention because of its large impact on consumers and their spending habits. Being a vast topic, we'll focus on two main points for the moment: affordability and inventory.

Affordability is a key issue for new homeowners. Along with the varying locations, taxes, preferences and closing costs, the biggest question for most people is: what will my monthly payment be? Across all mortgages and assuming the standard 30-year mortgage, the largest factors are interest rates and principal (home price). In 2015, the median home price broke above the pre-recession high of $231,000 and now sits at about $234,000. Interest rates, however, have fallen drastically, making affordability easier. The first graph helps depict this, as the green line displays income needed to afford the median price home (given a 25% debt-to-income ratio and a 20% down payment). With a 1% increase in home prices, required income has declined by 27% in the past ten years. This change in affordability is extremely positive for homebuyers, but there are headwinds to potential buyers, specifically in inventory.

Following a wild ride in home prices and interest rates, many homeowners refinanced their homes at lower rates, which pushed out their duration (creating a new 30-year mortgage vs. the previous payoff time horizon). Due to fees associated with refinancing and the lower principal payments, homeowners need to stay in their homes longer to rebuild equity, thus decreasing the number of sellers. Aside from the monetary standpoint, demographics and home ownership mentality has greatly shifted. Older Americans are staying in their homes longer and young professionals prefer rent/communal living over home buying commitments. Later in life family formation has had an impact as well. Without a need for bigger homes for bigger families, existing, smaller single-family homes for sale are becoming harder to find, especially at lower price points, and are picked up quickly when they come to market. These and other factors (such as many investor purchases) have inflated rent prices across the country and reduced homes for sale. As calculated by Months' Supply, the second graph helps depict this. Months' Supply is the number of existing homes available for sale divided by the number of homes sold that month. If no new homes were put up for sale and buying behavior continued, sales would be exhausted in that number of months. January 2016 saw the second lowest Month's Supply in thirty years and the trend is still very weak.

Most average investors do not have direct real estate stocks in their portfolio but housing expenses greatly impact spending habits. Housing payments account for 30% of most people's income but that estimate is very conservative. Will higher interest rates drag down home prices? If prices contract, will supply shrivel even further? What does affordability look like in five years? Due to the large impact housing has on consumers' incomes, swings in housing costs can drastically change discretionary consumer spending. Will Jimmy and Sally get a new games system for Christmas or does a lump of coal seem more likely? The housing Bull and Bear could help shape and provide insight into our future spending.





Source: FactSet