On The Mark

CAPSTAR FINANCIAL

Is there a bubble in the real estate market?

August 20, 2021

Key Takeaways

- Rising home prices have many worried about a real estate bubble like 2007.
- While rising home prices may look a lot like 2007 on the surface, the circumstances driving home prices higher today are different and don't resemble a bubble many are worried about.

If you know anyone who is in the market for a home, then you have likely heard anecdotes on how they were outbid multiple times with offers higher than the asking price. Home prices across the nation have soared over the past year. This rapid increase has unsurprisingly raised concerns of another housing bubble. In 2007, a housing bubble propped up by low-quality mortgages burst and led to a financial crisis and a global recession. So, are we in for a repeat?

The circumstances driving prices higher today are different than 2007. A closer look may help understand the fundamentals of today's real estate boom.

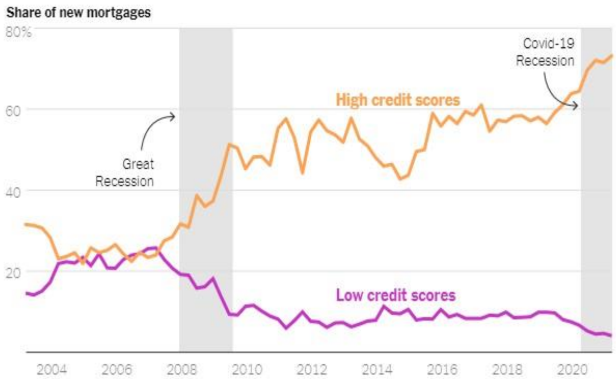
Low mortgage and high savings rates have improved home affordability: While this may be shocking, despite higher home prices, housing affordability has risen with record low mortgage rates. The trend in the 30-year mortgage rate is remarkable from a record high rate of 18.6% in 1981, to roughly 6.5% in 2007, to below 3% in 2021.[1] Lower mortgage rates reduce the percent of one's income being spent on a mortgage payment and can improve affordability.

In addition to low interest rates, consumers benefited from an increase in savings. In the previous publication, I highlighted this very point. Some U.S. consumers are flush with cash right now because they were unable to spend on typical purchases during the shutdown. In addition, Congress supplied the economy with trillions of dollars in fiscal support. While the pandemic did lead to financial devastation for many and fiscal support partially or fully replaced lost income, not everyone was impacted. Many consumers remained employed and collected additional financial support during a turbulent time for all. This historic environment contributed to an excess savings buffer of $2.5 trillion.[2] Add to that the incredible rise in the stock market driving investment accounts higher, as well.

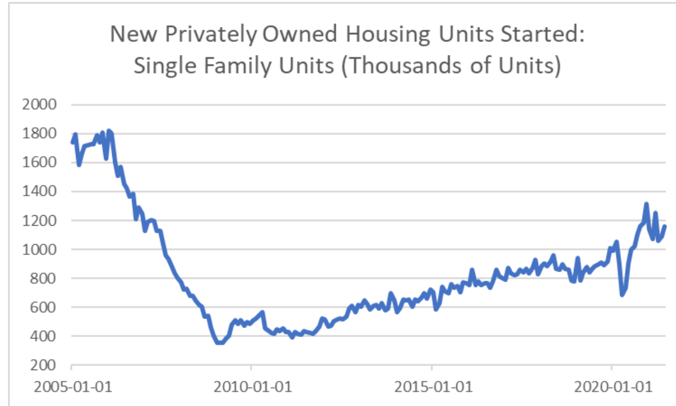
Source: Forbes, Freddy Mac, US Census Bureau

With historic low mortgage rates, higher savings and larger investment accounts, consumers have more to spend on mortgage payments. The chart above shows, despite a sharp increase in median home prices, mortgage payments as a percent of household income has become more affordable.[3] This remains in sharp contrast to 2007.

Homebuyers are in better financial health: In 2007, stories of no-income, no-down payment, no-verification mortgages were common. Today, banks have adopted higher lending standards. A simple way to see this is in the percent of mortgages issued today to consumers with high credit scores (greater than 760). Unlike 2007, where people with low credit scores (below 660) were granted more new mortgages than people with high credit scores, today 73% of mortgages issued in the first quarter of 2021 went to consumers with high credit scores.[4]



Source: New York Fed Consumer Credit Panel/Equifax • Reflects share of dollar amounts of new mortgages. High credit scores are defined as scores 760 and above, and low scores defined as those below 660. • By The New York Times



Source: FRED, US Census Bureau

Housing supply remains constrained: The inventory of homes for sale fell dramatically after 2007[5] and has not kept up with demand. A few of the most common reasons for low inventory are the lack of property developers, shortages in construction labor, increased cost for raw materials and increased regulations. High demand and low supply have driven prices even higher.

While rising home prices may look a lot like 2007 on the surface, the underlying fundamentals are different from back then. Despite this, many will still be frusterated as high home prices have priced out many buyers. Home prices have risen due to a confluence of record low mortgage rates, increased savings, improved affordability, and low housing inventory. Pair that with healthier lending standards and these fundamentals don't resemble a bubble many are worried about.

[1] https://fred.stlouisfed.org/series/MORTGAGE30US
[2] https://www.blackrock.com/us/individual/literature/whitepaper/systematic-fixed-income-outlook-summer-2021.pdf
[3] https://www.forbes.com/sites/raulelizalde/2021/06/23/home-prices-are-soaring-but-also-most-affordable-in-generations/?sh=462e91866c39
[4] https://awealthofcommonsense.com/2021/07/the-biggest-differences-between-now-the-housing-bubble/
[5] https://fred.stlouisfed.org/series/HOUST1F

AssetMark, Inc.

1655 Grant Street
10th Floor
Concord, CA 94520-2445
800-664-5345

IMPORTANT INFORMATION

This is for informational purposes only, is not a solicitation, and should not be considered investment, legal or tax advice. The information in this report has been drawn from sources believed to be reliable, but its accuracy is not guaranteed, and is subject to change. Investors seeking more information should contact their financial advisor. Financial advisors may seek more information by contacting AssetMark at 800-664-5345.

Investing involves risk, including the possible loss of principal. Past performance does not guarantee future results. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio. No investment strategy, such as asset allocation, can guarantee a profit or protect against loss. Actual client results will vary based on investment selection, timing, market conditions, and tax situation. It is not possible to invest directly in an index.

Investments in equities, bonds, options, and other securities, whether held individually or through mutual funds and exchange traded funds, can decline significantly in response to adverse market conditions, company-specific events, changes in exchange rates, and domestic, international, economic, and political developments.

AssetMark, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission. AssetMark and third-party service providers are separate and unaffiliated companies. Each party is responsible for their own content and services.

102814 | C21-17951 | 08/2021 | EXP 08/31/2022