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WRITTEN TESTIMONY OF

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CHIEF ECONOMIST

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

U.S. SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

HEARING TITLED

"PRICED OUT: THE STATE OF HOUSING IN AMERICA"

JULY 21, 2022

Executive Summary

Chairman Brown, Ranking Member Toomey, Members of the Committee: Thank you for inviting me to testify at this hearing.

I am Lawrence Yun, Chief Economist and Senior Vice President of Research at the National Association of REALTORS®. I lead the research team as we gather pertinent and timely housing data and oversee research pertaining to the real estate industry.

NAR Research produces monthly reports on pending and existing home sales data. Pending Home Sales Index captures the trend in ratified contracts to purchase a home, as a leading indicator for home sales. Existing Home Sales release provide information on closed transactions by region, the median home price, inventory listings, as well as survey results from our members about other important factors affecting the housing market, such as the number of first-time homebuyers, cash transactions, and distressed property sales. We also produce quarterly reports on metro home prices. NAR research also publishes annual and special reports that track data like Profile of Home Buyers and Sellers, The Impact of Student Loan Debt, Generational Trends, Housing Affordability Distribution Curve, Vacation Home Sales, and Veterans and Active Military Home Buyer Profile.

Making up a nearly 20 percent of the U.S. economy, the housing industry and specifically the REALTORS® that serve residential and commercial property buyers and sellers are vital to promoting homeownership that is the foundational bridge to financial security for consumers. With the current market challenges of low inventory and rising prices, as well as shifting trends in commercial real estate, those seeking to buy or sell a home or open or expand a business know that it is critical to have a REALTOR® aid in the transaction given their enhanced training, earned expertise, and subscription to NAR's Code of Ethics.

Most of America's 1.5 million REALTORS® are small business owners, and 87% are classified as independent contractors. The typical REALTOR® is 56 years old, female (66%), and has 8 years of experience. In 2021, the typical member had 12 transactions, which is up from 10 in 2020. REALTORS®, like many other workers report a fairly typical number of work hours and their incomes are generally up year over year. Key to our discussion today is the impact of the lack of inventory – which is by far their most pressing concern of members, with 57% believing it is the most important factor preventing their clients from completing a home purchase.

June Data

The housing market activity has been surprising and extraordinary since the onset of the pandemic. Home sales reached multi-year highs, and home prices set new records. Market conditions currently, however, are undergoing a dramatic shift. Home sales have fallen for the 5th straight month through June. The latest monthly existing-home sales on an annualized rate of 5.12 million is below the annual total of 5.34 million, last seen in 2019, before the onset of the pandemic. For comparison, in 2020, even accounting for several weeks of lockdown, the annual total sales reached 5.64 million, and in 2021, sales soared to 6.12 million, the highest level since 2006.

Even as home sales softened in recent months, the median home price set a new record in June, reaching $416,000—a rise of 13.4% from one year ago. Other home price measurements have shown an appreciation rate closer to 20%. Though still showing solid year-over-year gains, home prices are set to decelerate as weaker sales and a corresponding rise in unsold homes linger on the marketplace. I do not foresee a national home price decline, but some local markets may pull back somewhat from the record-high home prices. Any short-term price adjustments, if they occur, will be less consequential compared to the immense longer-term housing affordability challenges facing the country.

The COVID-19 Housing Market: Unexpected Demand Amid Uncertain Economic Conditions

When COVID-19 swept the nation in 2020, no one knew what that would mean for the housing economy. Housing market activity has been surprising and extraordinary since the onset of the pandemic. Home sales reached multi-year highs, and home prices set new records. In 2020, even accounting for several weeks of lockdown, the annual total sales reached 5.64 million, and in 2021, sales soared to 6.12 million, the highest level since 2006.

So, what is driving these changes in the housing market and what are the challenges and opportunities we face as a result?

Inventory and Supply

Historically low levels of inventory combined with strong demand continue to push prices to new highs. We profile this dual challenge in a joint report with REALTOR.com entitled "Double Trouble" explained in detail below. [1] By January and February of 2022, only 850,000 listings were on the market. In comparison, there were 1.5 million listed homes in the same months before the pandemic in 2020, which at that time was considered tight. The months' supply of inventory – a measure of the market's tightness capturing how many months it would take to exhaust the inventory at the current sales pace – hit an all-time low of 1.6 months at the beginning of 2022. A healthy market is considered to be about 4 to 5 months of supply because at that level, home prices and income generally rise by roughly the same percentage.

Affordability

At the same time, interest rate increases, price increases, and lack of supply have created an affordability crunch. While inventory has grown nominally since the early part of 2022, interest rates have increased about 2.5 percentage points, adding about $800 per month to a median-priced house payment. Our research also indicates that a buyer would need an income of about $125,000 to afford most of the homes on the market. [2] This affordability crunch is felt most acutely as we move down the income scale and by minority households given the current income distribution in America.

Implications Moving Forward

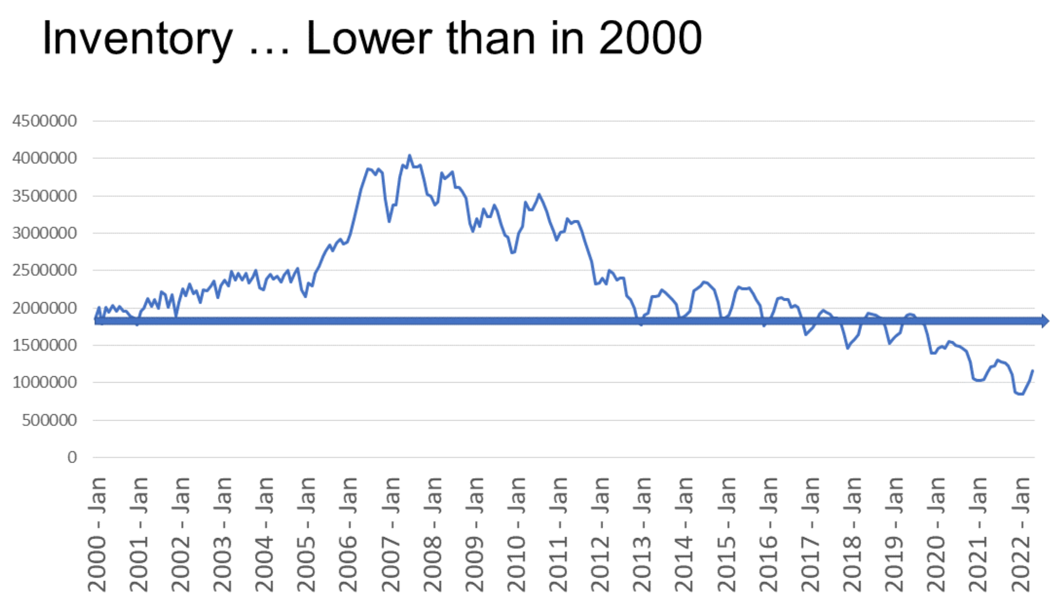
Though still showing solid year-over-year gains, home prices are set to decelerate as weaker sales and a corresponding rise in unsold homes linger on the marketplace. I do not foresee a national home price decline, but some local markets may pull back somewhat from the record-high home prices. Any short-term price adjustments, if they occur, will be less consequential compared to the immense longer-term housing affordability challenges facing the country.

Thank you for the opportunity to present my views today.

Housing Market Dynamics

Historic Undersupply

Lack of supply in the housing market is not a new phenomenon. While it is certainly more noticeable now, even before the pandemic, NAR estimated a nearly 5.5 to 6.8 million housing unit deficit in relation to population and job market conditions[1]



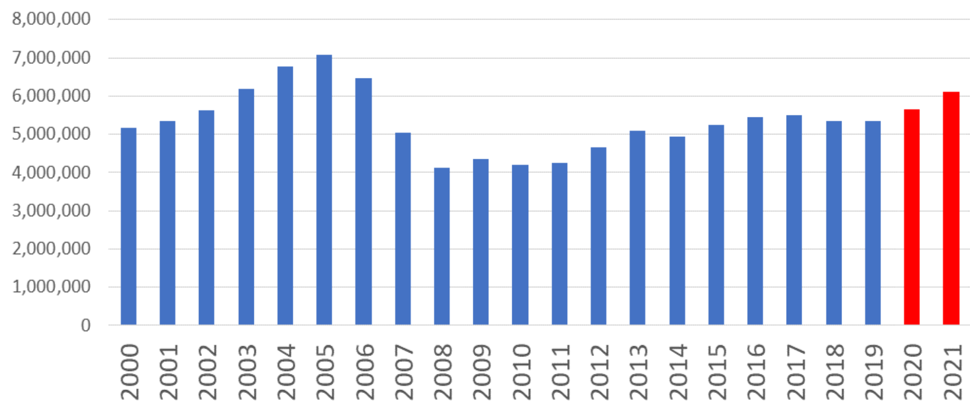
Historically, housing starts averaged about 1.5 million per year. Two factors typically drive this number; household formation and aging housing stock. About 1.2 million households are formed each year on average and over a business cycle. Another roughly 300,000 housing units become uninhabitable and require demolition. This estimate is quite conservative as it would correspond to a meager physical depreciation rate of less than 0.5% per year. In the ten years before the pandemic (2010 to 2019), total housing starts summed to only 9.9 million and not the usual 15 million to 16 million that would have been the case over a normal 10-year period. This slow-down in construction has left us in the current position of shortage.

Housing Market Boom of 2020 and 2021

The housing market always responds to changes in mortgage rates as an overwhelming number of buyers require financing for their home purchases. When the Federal Reserve essentially went all-in in the early months of the pandemic, at a time of a highly uncertain economic outlook, the 30-year fixed rate mortgage fell to its lowest in history, reaching 2.68% in December 2020. For most of 2020 and 2021, mortgage rates hovered near 3%. In the decade before, the mortgage rate moved consistently around the 4% to 5% level and averaged 4.4% in the months right before the pandemic.

[1] National Association of REALTORS® and Rosen Consulting Group, Housing Is Critical Infrastructure, June 2021, https://cdn.nar.realtor/sites/default/files/documents/Housing-is-Critical-Infrastructure-Social-and-Economic-Benefits-of-Building-More-Housing-6-15-2021.pdf

Existing Home Sales



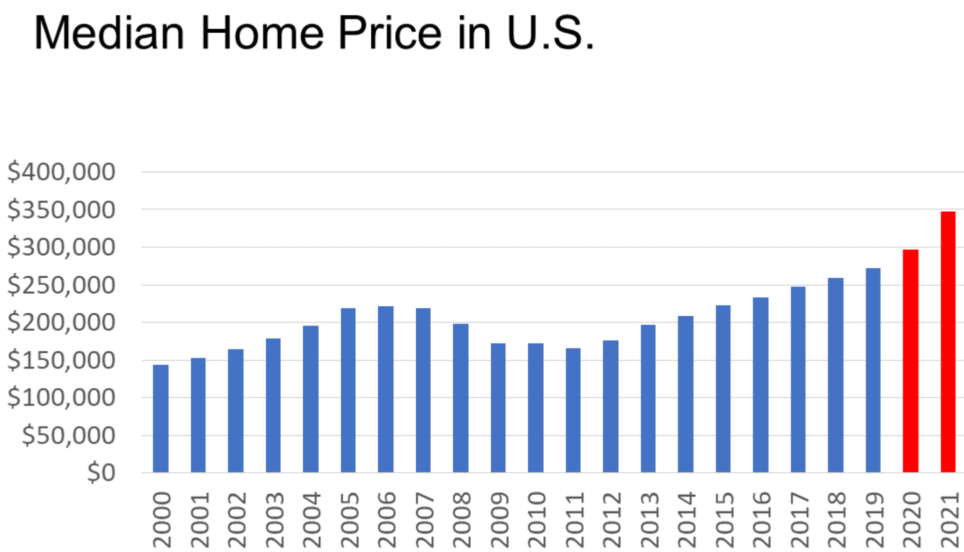
Source: NAR

The decline in mortgage rates and the cautious reopening of the economy after the lockdown boosted housing demand. The use of virtual office meetings and lower need to commute also increased the desire and demand for a larger home further away from downtown centers. Home sales increased to measurably higher levels by the second half of 2020 compared to the pre-pandemic days and continued throughout 2021. The inventory of homes for sale steadily declined. By January and February of 2022, only 850,000 listings were on the market. In comparison, there were 1.5 million listed homes in the same month in 2020 and 1.6 million in 2019, before the pandemic, which at that time was considered tight. The normal seasonal growth in inventory in spring and summer with weakening home sales have now yielded inventory count to 1.26 million in June. The months' supply of inventory – a measure of the market's tightness capturing how many months it would take to exhaust the inventory at the current sales pace – hit an all-time low of 1.6 months at the beginning of 2022. In June, it was 3.0 months' supply. We consider a healthy market to be about 4 to 5 months of supply because at that level, home prices and income generally rise by roughly the same percentage.

Paired with the already low supply before the pandemic, the steadily falling inventory throughout 2020 and 2021 brought about intense competition for available homes often resulting in multiple offer situations. In tracking our REALTOR® Confidence Index survey[2], a typical home attracted five offers. Due to the significant imbalance between those who wanted to buy a home and those offered for sale, multiple offers were occurring in a short period. A typical number of days on the market – the time from listing to a ratified contract signing – fell nearly in half from 34 days on market in 2019 to just to 18 days in 2021. This buyer frenzy boosted home prices to record highs. In our measurement, the median price of a transacted home sale was $407,600 in May of this year compared to $278,200 in the same month before the pandemic began in May of 2019. This phenomenon has been a boon for those who already own a home. A typical homeowner from 2019 accumulated $129,400 in housing wealth in three short years. In other measurements, such as by S&P CoreLogic Case-

[2] National Association of REALTORS®, REALTORS® Confidence Index, June 2021, https://www.nar.realtor/research-and-statistics/research-reports/realtors-confidence-index

Shiller Price Index and FHFA Home Price Index, which uses repeat transaction methodology, these increases were 45% and 35%, respectively.



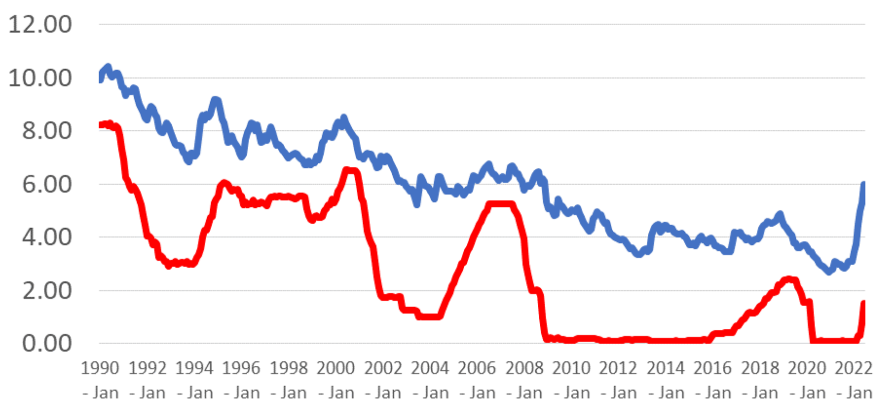
Source: NAR

Home prices rose more strongly in regions of the country that saw rapid job creation. Specifically, the Rocky Mountain states and mountain time zone states of Arizona, Nevada, Utah, Idaho, Montana, and Colorado, along with the southern states of North Carolina, South Carolina, Georgia, Florida, Tennessee, and Texas, have experienced spectacular home price appreciations. Home price growth was still relatively robust though less spectacular in regions with slower job growth.

The latest market shift to slowdown

With the consumer price inflation at a 40-year high, the latest reading at 9.1% in June, the Federal Reserve will almost certainly continue to raise interest rates. Though not directly controlled by the Federal Reserve, mortgage interest rates are influenced by the general direction and the magnitude of changes in the fed funds rate, which it does directly control. Based on expectations about future rate hikes, the mortgage market looks to have priced-in those future actions by the Federal Reserve. Last week, the average mortgage rate on a 30-year fixed rate mortgage was 5.51%. Throughout the past two years, the mortgage rate averaged around 3%.

Mortgage Rate and Fed Funds Rate



When thinking about what this means to a potential home buyer, I like to use the analogy of a mortgage calculator. A mortgage calculator is easy to use: punch in the loan amount and interest rate, and out comes the monthly mortgage payment. For example, on a $200,000 loan at 3%, the monthly payment would be $843 in principal and interest (and does not include property tax or maintenance savings). At today's higher mortgage rate of 5.5%, the monthly payment would balloon to $1136. So, the same loan amount for the same house would require an additional $293 each month. That is not all. Home prices are also increasing. Conservatively adding 10% to the loan amount needed to buy the same house, the monthly payment rises to $1249, which is 48% higher compared to just one year ago. This significant increase is not part of the consumer price inflation, even though many Americans are frustrated at the prospect of higher mortgage payments. Some would-be buyers simply no longer want to pay that amount or are no longer able.

Monthly Mortgage Payment on 200K loan one year ago at 3% rate

Mortgage Rate	Principal + interest
3%	$843
4%	$955
5%	$1074
6%	$1199
10%	$1755

Monthly Mortgage Payment on $220K loan at 5.5%

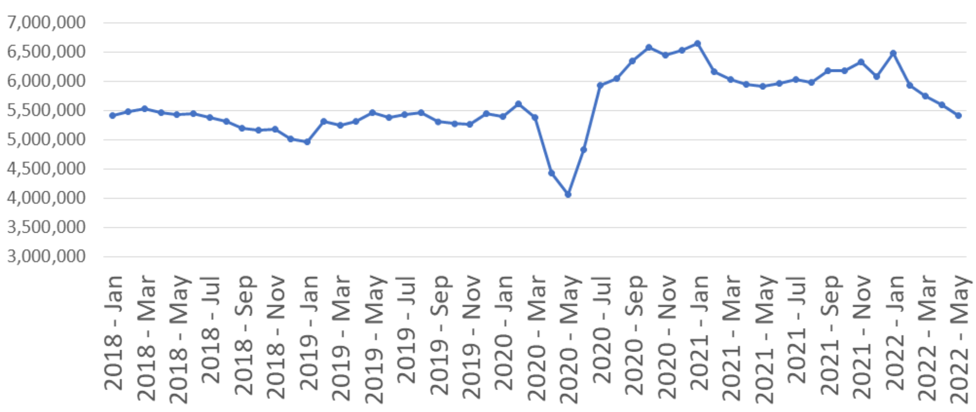
Mortgage Rate	Principal + interest
3%	$843
4%	$955
5%	$1074
6%	$1199
10%	$1755

Mortgage Rate	Principal + interest
5.5%	$1249

48% increase

As a result, home sales numbers have been trending down. As mentioned above, existing-home sales have been falling along with sales of newly constructed homes. Single-family housing starts in June fell to their lowest since the lockdown months in 2020.

Monthly Existing Home Sales



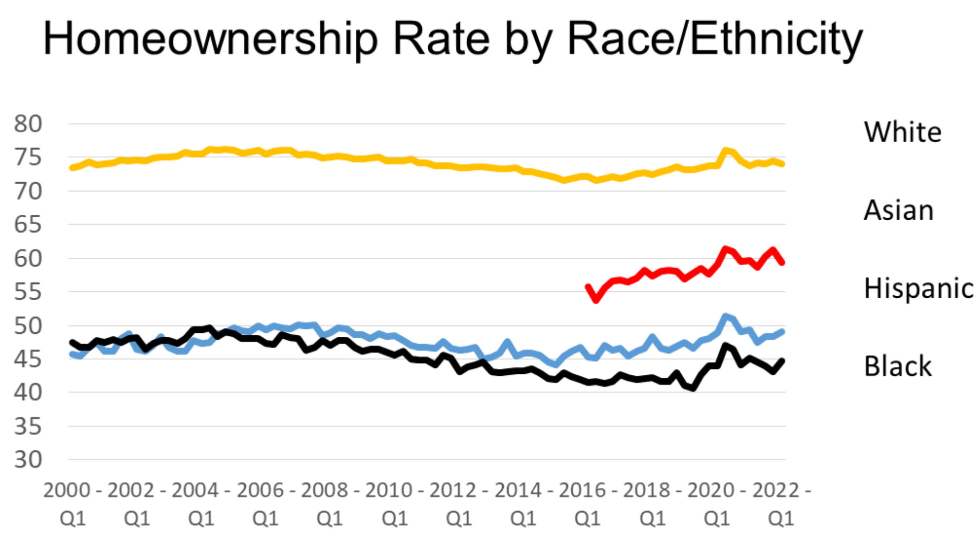
Source: NAR

The inventory of newly constructed homes jumped to 7.7 months of supply and is essentially at a decade high. There has been an increased number of cancellations in purchasing a newly constructed home since, at the original time of signing the contract, the mortgage rates were near 3%, while the current required mortgage is closer to 6%. But new homes that are fully completed and not amid construction are still selling at a fast clip. In May, the median days on market was 2.4 months, one of the swiftest paces to find a buyer of a newly completed home. There are contract cancellations primarily on those new homes not yet completed. Due to supply-chain disruptions during the COVID-19 environment, the time required to complete a home build after approved authorization rose to 8.5 months in 2021 from 8.1 months in 2019. Another measure of disruption can be seen by the difference between single-family housing starts and completion of single-family housing. In a typical year, the difference would be to the tune of 50,000 or less. The total completions lagged the total starts figure by 78,500 in 2020 and by 157,200 in 2021.

As to the rental market, the vacancy rate has been falling. According to HUD/Census, the rental vacancy rate reached 5.6% at the end of 2021, which is a near 40-year low. The number of rental households fell by 2.5 million during the lockdown and then steadily rebounded. There are essentially one million more renters now compared to pre-COVID-19 days (there are also two million more homeowners now compared to pre-COVID-19 days, which explains the similar homeownership rate over this period.) With the falling vacancy rate, rents naturally have risen. The rent component in the consumer price index was 5.8% higher in June compared to one year ago. More alarmingly, the annualized rent growth in June – a monthly change multiplied by 12 months – was much higher at 9.7%. Given that the rent measure is also feeder information for the homeowners' equivalence rent (what the homeowner would have hypothetically paid if the owner was renting the same house), which rose by 8.7% on an annualized basis, pressure on the consumer price index could intensify in the upcoming months. It is worth noting that private sector data on apartment and single-family rent have been rising measurably higher than the official consumer price inflation reported by the Bureau of Labor Statistics. The rise in rent and home prices is a direct consequence of the housing shortage that persisted even before the onset of the pandemic

Homeowners have, on paper, accumulated sizable housing wealth gains during the recent housing market boom. Specifically, I estimate that a typical homeowner's net worth is now estimated to be $320,000 compared to $5,000 to $10,000 for a typical renter. The high home prices have been extremely frustrating and deflating for renters and would-be homebuyers. Interestingly, during the boom over the past two years, the overall homeownership rate did not change in any noticeable way, going from 65.3% in the first quarter of 2020 to 65.4% in the first quarter of 2022. There is still a sizable homeownership rate gap amongst several racial and ethnic groups, as we are all aware, with White-American (non-Hispanic) households at 74.0% in the latest reports, Black-American households at 44.7%, Hispanic-American households at 49.1%, and Asian/Hawaiian/Pacific Islander households at 59.4%. Therefore, not all Americans have enjoyed the housing market boom. Instead, a good number are suffering under the current housing unaffordability.

They are priced out.



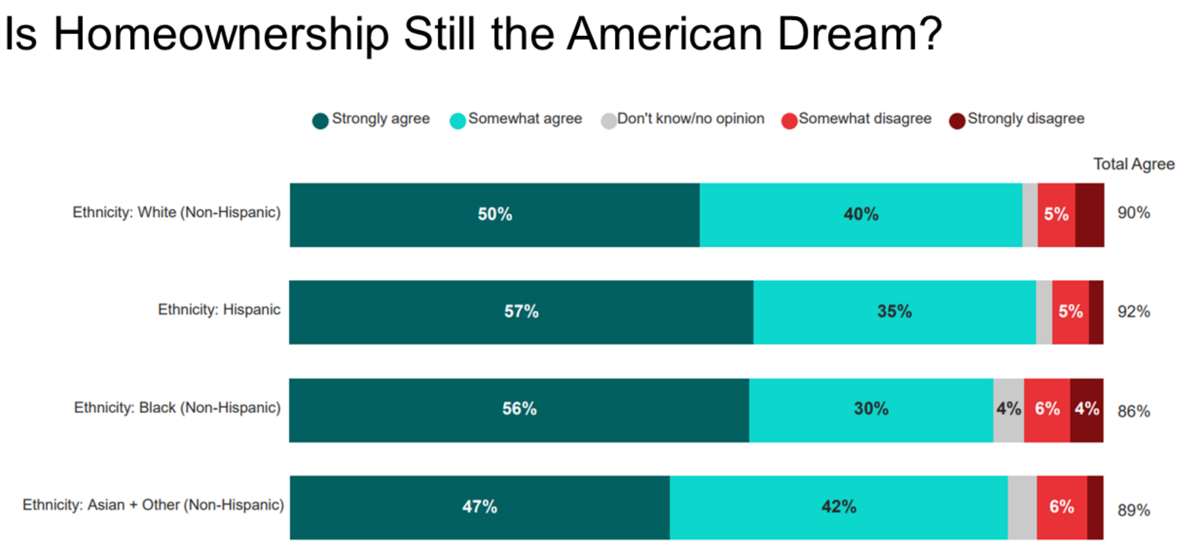
Source: Census

The biggest obstacle to homeownership has consistently been the ability to come up with a down payment. This issue is especially important among minority households as they are less likely to receive financial assistance from family members due to past legal discrimination, and hence less opportunity to have built generational wealth that could be passed down.

Who is Priced Out?

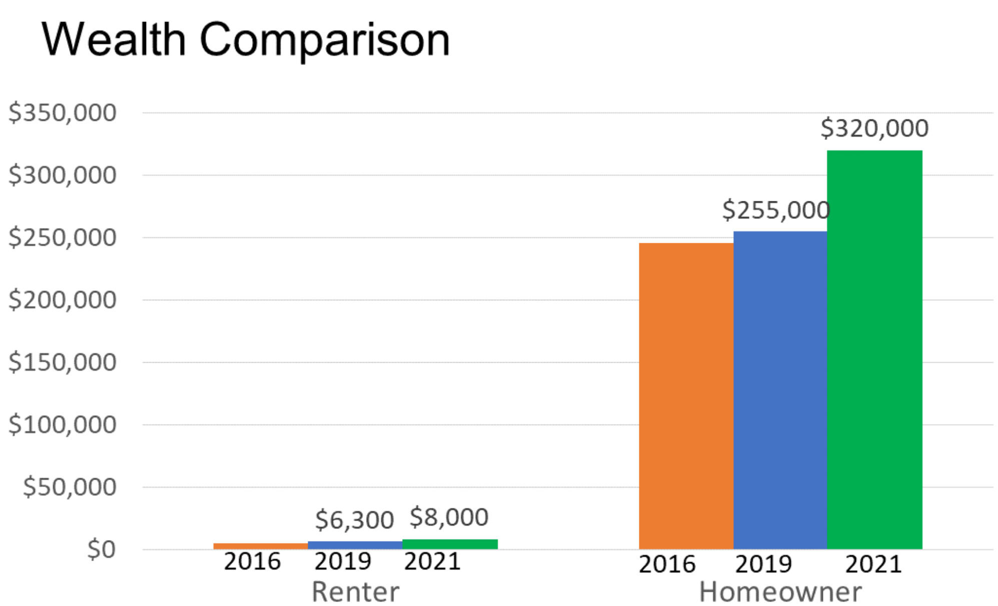
Home prices are high, and rents are rising. Housing costs are therefore much higher now than before. But what does it exactly mean to be priced out when a solid majority of households in America are homeowners? Homeowners are enjoying the wealth gains arising from home price growth. In fact, the last release of homeowners' wealth estimates by the Federal Reserve's Survey of Consumer Finances for 2019 shows $255,000 for a typical homeowner and $6,300 for a typical renter. This older data does not reflect the recent housing market boom. After reasonably accounting for the 30% home price rise of the past three years (along with very little cash-withdrawal via refinancing), my estimate puts the typical homeowner's wealth conservatively at $320,000. Homeowners, I would think, are quite content about recent market developments and have fewer financial worries than non-owners.

This is the crux of the current housing affordability crisis. Renters are paying ever higher rents with disappearing prospects of ever realizing the American Dream, which many associates with homeownership and owning part of America.



Homeownership Rate Gap

We have a significant division between owners and renters regarding wealth accumulation. The latest Fannie Mae survey of home buying sentiment is indeed low. Only 19% of the respondents indicated yes to the question, "is it a good time to buy a home?" The measure has been steadily falling from 60% before the pandemic to 45% in the spring months of 2021, lower still to 30% toward the year-end of 2021, and then to a historic low of 19% as of April of this year. Perhaps it is due to high home prices, with some potential buyers possibly wanting to wait it out to see if prices would buckle. In other words, the low sentiment could reflect market timing rather than the long-term desire to own a home or not.



In a different survey by the New York Federal Reserve, where the question was posed regarding home price expectations and rent growth forecast, consumers overwhelmingly replied that buying a home would be a good financial investment (74%) compared to those who said it would be a bad financial investment (7%). In this survey, the respondents generally believed that rents would be outpacing home price growth in the upcoming years. In a separate survey directly asking the question of whether or not "homeownership is still the American Dream," 90% of White-American (non-Hispanic) agreed, 92% of Hispanic Americans indicated yes, 86% of Black-American (non-Hispanic) indicated yes, and 89% of Asian-Americans agreed, according to Morning Consult.

The result should not be surprising. In addition to tangible financial benefits, our review of the literature found that homeownership brings substantial social benefits to families, communities, and the country as a whole. Because of these societal benefits, policymakers have promoted homeownership through several channels: from higher levels of children's educational achievement and adult civic participation to improved health benefits and reduced crime rates in neighborhoods. In general, research supports the view that homeownership brings substantial social benefits. Because of these extensive social benefits - what economists call positive externalities - policies that support sustainable homeownership are well justified.

Conclusion

Heading into the uncertainty of the COVID-19 pandemic, we knew of the historic undersupply of homes for sale—around 5.5 – 6.8 million units. Despite the initial slowdown in real estate activity due to lock downs and consumer apprehension, demand increased significantly and existing shortfalls in the market became more prominent. The ability for many to work from home led to a desire for more space and pushed up demand in areas outside major metropolitan areas nationwide. Supply chain issues that emerged over the past two years have only exacerbated shortages and slowdowns in construction of new homes. These shortages have also created significant challenges with the affordability, especially for first-time buyers looking to step up to ownership opportunities.

As noted earlier, homeownership is still viewed by many as part of the American Dream. If you owned a home before the pandemic, you have likely realized significant financial gains. On the other hand, ownership is becoming increasingly out of reach for many as the price to buy and interest rates increase and these same pressures are causing rents to increase and crowding out savings. In the near term, I do not expect the situation to change appreciably. While sales will likely slow down price growth is expected to continue, just at a slower rate. Historic undersupply in the market combined with continued demand will likely drive ongoing issues with affordability for many Americans.

Relevant Recent Research Studies

- **Impact of Institutional Buyers on Home Sales and Single-Family Rentals**
  https://www.nar.realtor/impact-of-institutional-buyers-on-home-sales-and-single-family-rentals

- **Housing Affordability Drops as Mortgage Payments Spike 51% From May 2021**
  https://www.nar.realtor/blogs/economists-outlook/housing-affordability-drops-as-mortgage-payments-spike-51-from-may-2021

- **Measuring Affordability and Availability of Homes as Mortgage Rates Continue to Rise**

https://www.nar.realtor/blogs/economists-outlook/measuring-affordability-and-availability-of-homes-as-mortgage-rates-continue-to-rise

- **NAR Forecast**
  https://cdn.nar.realtor/sites/default/files/documents/forecast-q2-2022-us-economic-outlook-04-27-2022.pdf

- **The Double Trouble of the Housing Market**
  https://www.nar.realtor/research-and-statistics/research-reports/the-double-trouble-of-the-housing-market

- **A Snapshot of Race and Home Buying in America**
  https://www.nar.realtor/research-and-statistics/research-reports/a-snapshot-of-race-and-home-buying-in-america

- **Obstacles to Home Buying**
  https://www.nar.realtor/research-and-statistics/research-reports/obstacles-to-home-buying