



# THIS IS NO TIME TO PANIC

The era of super-low mortgage rates — rates not seen since the late 40s and early 50s — has come to an end. Should we panic?

BY DAN GREEN

**L**et's admit it. Mortgage rates in the three and low four percent range were very cool to experience, and not just for mortgage nerds and econ geeks. Yes, this period of uber-low rates pulled the US housing market out of a deep, dark recession. At the same time, these rates changed the nature of housing: Owners with low interest rate mortgages are loath to give them up since they can't be replaced, so they will likely stay in their homes much longer than they used to. Low rates were good. Now they are gone, and everyone is worried. Is it time to panic?

The short answer is no. There is no reason to panic. Rates have risen to their highest levels since April 2014, though at about 4 3/8% for a 30-year loan, rates are far from high. Rather, today's rates present a remarkable homeownership opportunity, one similar to the opportunity the grandparents of today's Millennials had when they bought their first homes in the late 1950s and 1960s.

Why the comparison? Rates were about the same in the era of Eisenhower and Kennedy as they are right now. Rates were rising, then, too, from the post-WWII lows that Millennials' great-grandparents enjoyed. Rising rates in the late 50s and 60s did not deter baby boomer homeownership; quite the contrary. Like the Millennials, Boomers were the biggest cohort of potential buyers the economy had ever seen. And buy they did, despite interest rates exceeding a whopping 5%.



Rates matter (although rates are but one variable in the housing equation). The trouble is, rates are getting all the attention despite the fact that they are not the most important variable at the moment. Affordability, not rates, is what mortgage lenders should be talking about.

#### **Affordability, Not Rates**

While mortgage rates cannot and should not be ignored, our focus should be on the broader measure of affordability. This is where rates, along with home prices and incomes, present a more accurate answer to the question, "Is now a good time to buy a home?" This is important because affordability right now is at one of its best levels in years, though potential homebuyers may believe now is not a good time to buy a home since rates have increased.

Fortunately, information on affordability in the form of the Housing Affordability Index (the HAI or the Index) is readily available from several sources including the National Association of Realtors, which publishes its affordability index monthly, as well as HUD, which publishes less frequently yet provides an important, long-term historical view on the subject.

Even though rates are rising to levels not seen for many years, they are, as mentioned above, on par with the low rate environment of the mid-1960s. Despite the alarmist news that rates are rising, rates are attractive and remain low. This is why it is important to look at affordability. According to data released by the National Association of Realtors, housing affordability in October 2016 was 170.2. According to HUD, the HAI for 2015 was 163.9. Since 170.2 is greater than 163.9, that would indicate that housing was more

wage earner.

Last October's index of 170.2 means the median wage earner has 1.7 times the income necessary to purchase the median priced home. During 2015, that same wage earner had 1.6 times the necessary income. Housing is, by this measure, affordable for today's buyers. But what about those grandparents back in the 1960s? Was housing affordable for them? The median home price in the mid- 1960s was \$13,600, with a median income of \$6,450. Assuming a mortgage rate of 5.50%, their affordability index would have been slightly above 200. Although better than 170.2, the environment in which they purchased their homes was roughly equivalent to what we are experiencing now. Those grandparents bought lots of homes; so should today's consumers.

Calculating the housing affordability index is easy. The formula for doing so is:

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affordable in the fall of 2016 than throughout all of 2015. It would also indicate that all the 'sky is falling' nature of the news about rising interest rates is wrong, or at least misdirected.

What do numbers such as 170.2 and 163.9 really mean in this context? How are they calculated? The housing affordability index is just that: an index. When the index measures 100, it means the homebuyer earning the median income has exactly enough income to purchase the median priced home. When the HAI is greater than 100, as it has been, according to HUD, since 1986, then housing, using this measure, is affordable. When the index reads less than 100, as it did in the early 1980s (more on this shortly), it means buying a home is not affordable and is out of reach for the median

$$\text{HAI} = (\text{Median Family Income} / \text{Qualifying Income}) * 100$$

Median Family Income data is readily available. Qualifying income is another calculation based on the monthly payment on the median priced home at then-prevailing interest rates. The Index also assumes the borrower makes a 20% down payment. There's no need to do the math, however, as the index is readily available.

With rates rising, shouldn't affordability be falling? The answer, as is true with so many things: It depends. It depends on the trend in median incomes, which is currently positive. So, while rates are up, so are incomes, offsetting higher rates and making housing slightly more affordable. There is one more variable in the equation in addition to median income and interest

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rates: The median home price. This has been rising, too, though not enough to negatively impact the Index.

The multi-variate nature of the Housing Affordability Index is exactly why affordability is a more important, more relevant story than rates, and the one everyone in our industry should be telling. Borrowers need to understand the whole picture, not just the view from the rate window.

Rates will probably continue to rise. The Mortgage Bankers Association predicts the 30-year rate will top 5.25% in 2019. That's a step up from the lows of the past several years, though still remarkably low by historical standards. When rates were 7% and 8% in the 1970s, affordability was slightly greater than 150. This is another indication that neither lenders nor borrowers should obsess about rates.

### When Do We Panic?

If you are going to panic, it's best to do so with full information. Panic, in this case, means all or most homebuyers sitting on the sidelines because affordability has tanked.

Parents of millennials, in contrast to grandparents of millennials, know about panic, at least when it comes to affordability (and rates). As the 1970s came to a close, so did the long, many-decade run of low, single-digit interest rates. From 1980 through 1985, mortgage affordability plummeted below 100, bottoming out at 68.9, meaning that the average wage earner purchasing the median priced home had only about two-thirds of the income necessary to purchase that home. Rates had a starring role in affordability's reversal, exceeding more than 15% in 1981 when the index hit its all-time low.

The early 1980s were a good time to panic, or at least to put the idea of homeownership on temporary hold. Having

just two-thirds of the income necessary to buy anything is a strong indication that it is best to skip or defer making the purchase. That is just what many people did throughout the 1980s.

Now, on the other hand, is no time to panic. It's time to seriously consider homeownership. Potential buyers have 1.7 times the income necessary to purchase a house. That's good. Even better, according to an article published by Zillow on November 16, 2016, buying is a better economic play than renting in that a mortgage today consumes just 14% of income whereas renting consumes 29%.

While an extreme example, the 1980s do illustrate that rising rates have a chilling effect on home buying sentiment as well as purchases themselves. But the 1980s were a long time ago. Mortgage rates are more than 1100 basis points lower than they were in 1981. Rather than fretting over rising rates there should be celebration about housing's continued affordability.

### What Do We Do?

The first step for lenders is to stop being our own worst enemy. The mortgage

business is about making loans, which depends on potential and repeat buyers entering the market. To enter the market, they have to believe their timing is right. Given current affordability levels, timing is excellent. Unfortunately the lead story is rates, a misleading and inaccurate picture of the housing market.

We should start educating the public, especially first-time homebuyers, on affordability. Rates are easy to understand: No math, no calculations, no deeper thought. Yet homeownership requires deep thought and even better understanding of all things it encompasses, especially the economic aspects. Rates are only relevant to the extent they affect affordability.

Rates are rising, but the sky is not falling. Housing is becoming more, rather than less affordable. The responsible approach, when talking about the housing market with buyers (and especially first-time buyers), is to talk about affordability in conjunction with rates. It is a good time to buy a house, and lenders should make sure that buyers understand why this is so. ❖

### ABOUT THE AUTHOR

Dan Green is EVP of Operations for Mortgage Cadence. He works with the team to create greater efficiencies in all areas and coordinating efforts that enhance service quality and teamwork. Formerly, Green served as Chief Operating Officer/Chief Marketing Officer of Prime Alliance Solutions followed by Marketing Lead for Mortgage Cadence. Prior to that, he had an eight-year career with CUNA Mutual Mortgage where he was responsible for origination, servicing, lending technologies, process reengineering and education. With over 30 years of financial services and mortgage experience, he's keenly interested in lending performance and performance benchmarking that helps lenders constantly increase efficiencies while enhancing the financing experience for borrowers.

