Lower housing costs? Yes, but hard to take advantage - by Daniel Calano

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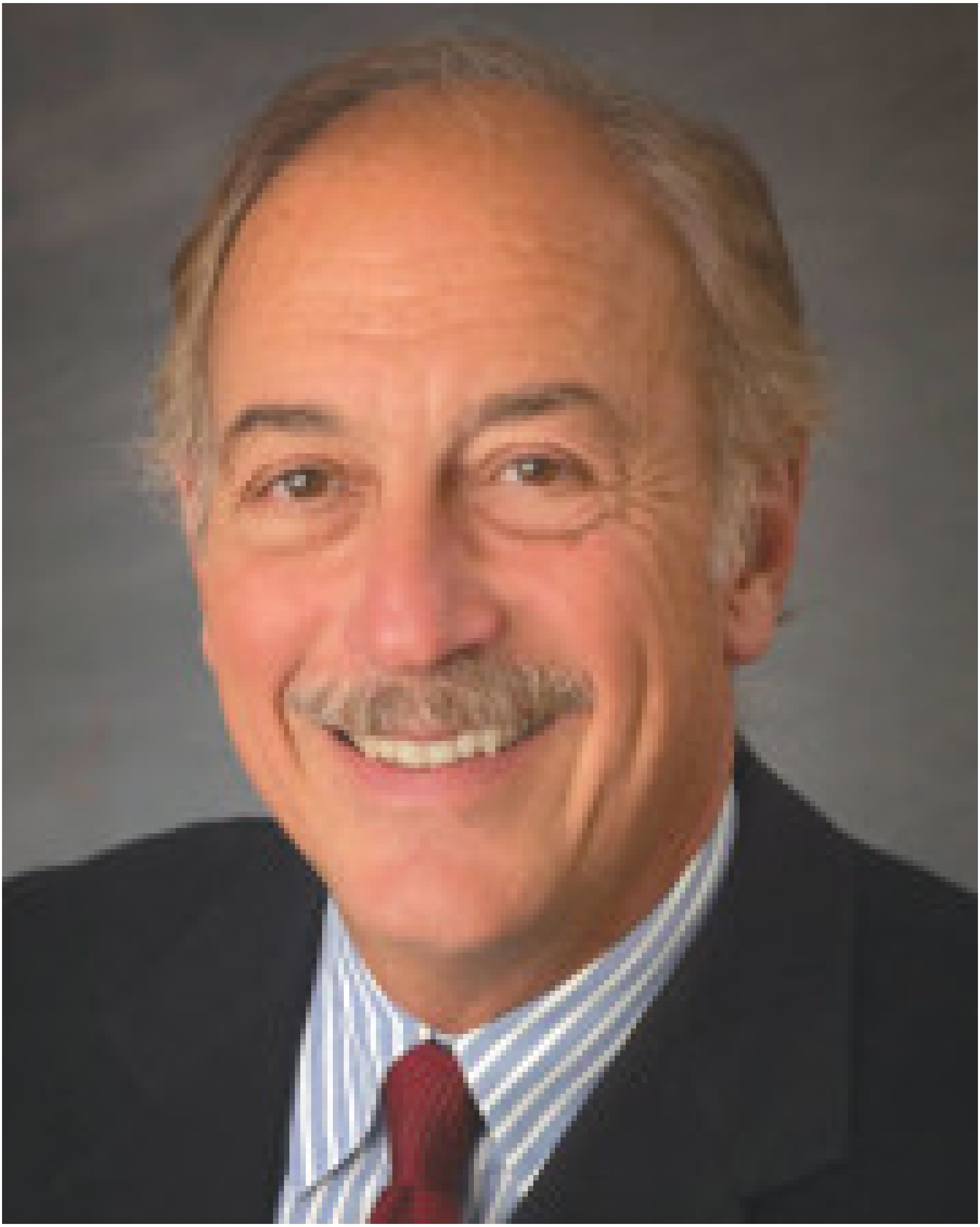

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Not again! What? Another inflation story? Fed raising interest rates? This saga is slowly evolving, perhaps to a close, but not at all over. It's worth keeping up with, since the Fed is dead serious about crushing inflation and is having some real success.

The Federal Reserve is bringing inflation down by raising interest rates, first by doubling borrowing rates, but also by accelerating the process. It is definitely working by lowering demand for goods, and thus lowering prices in the process. The new buzz-word is called "demand destruction," because people who now borrow more expensive money will be less inclined to purchase, thus reducing demand, thus lowering asking prices of goods. It all makes sense, and works well when talking about food, transportation, energy…. the basic living requirements… and yes, some construction materials for basic shelter.

But, housing or shelter is a conundrum, an outlier. The Fed is not making housing affordable because it is making the two things we need most to buy or build housing, that is, a loan and down payment, more costly. Rates have moved from around 3% to over 7%, at a pace faster than any in recent times. High rates are driving down costs in some areas, but ironically raising key ones for housing. Housing values are starting to slow, but the average buyer can't afford to pay the borrowing costs . We can't have it both ways, at least for now.

Other, more subtle effects are also at work in this interest rate increase: For first home buyers, 7% borrowing rates simply make first home buying unobtainable. For others, the incentive to move or build is also dampened by reticence to give up one's 3% loan on their existing housing. It is just the difficulty of letting a good deal go. It used to be bragging rights to say how inexpensive your loan or refi was, but nothing to brag about now. Additionally, tapping home equity loans or refinancing existing homes will also be higher, as variable rates kick in. Home equity loans may also already be simply maxed out. Basically, lending has come to a halt, with very little financing from banks and only some from Freddie Mac.

As stated, the Fed means business, and clearly does not intend to step down until it lowers the inflation rate to 3 to 4%. While quality of life in some areas of purchases is improving, it is hurting housing purchases. The bottom line is that properties are staying on the market longer, not reaching asking prices, and backing out of deals is common, leaving sellers with a less certain process.

It will take some time for this to all shake out, perhaps two to three years. During those years, housing prices will definitely come down. But, people will still be less able to buy homes because of illiquidity and cost of money. Builders are standing by, not producing housing supply, because of the evidence of buyer's reticence, backing out of deals, inability to pay. It is a vicious cycle, with everyone trying to solve it, but very little success. Theoretically, when housing prices decrease enough to accommodate increased borrowing costs, there should be something like equilibrium. Let's hope.

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