

Homebuilding

COMMENT

Research Analysts

Daniel Oppenheim, CFA
212 325 5726
dan.oppenheim@credit-suisse.com

Michael Dahl
212 325 5882
michael.dahl@credit-suisse.com

Russell W. Lane
212 538 3992
russell.lane@credit-suisse.com

No Hope for Recovery without Affordability, and Spike in Rates Doesn't Help

- **Blow-out in mortgage rates hurts affordability, further pressuring home prices and sales.** The 30-yr conforming mortgage rate spiked 37 bps yesterday to 5.34%, the highest level since February. This jump in rates has a significant impact on affordability, and absent a quick reversal of this will likely lead to lower home prices and lower home sales. All else equal, a 37 bps increase in rates has the same impact of about a 4% increase in home prices. We estimate this would increase the mortgage payment on a median-priced existing home by \$30-\$37 per month, and would increase the payment by \$37-\$44 per month on a median-priced new home. We expect lower prices in order to offset the impact of higher rates.
- **New home sales likely to suffer the most from higher mortgage rates.** We think the new home market will be the most impacted by the increase in mortgage rates given the already worse affordability relative to the existing home market. We think new home sales will suffer as buyers continue to focus on the most affordable homes (primarily foreclosures) and as banks are quicker to reduce pricing in response to higher rates, which will create even further pricing pressure as homebuilders must compete with lower foreclosure prices.
- **Existing home sales should fare better, but further price cuts necessary.** Higher mortgage rates will also pressure the re-sale market, but we'd expect sales activity in this market to perform above that of new homes, as more willing sellers (banks) are likely to drop prices faster to offset the impact from higher rates. We think banks will act quickly to reduce foreclosure pricing in order to spur sales and lower their elevated (and increasing) foreclosure inventory, further pressuring home price across the board.

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