Home market continues to cool

In 2023, housing hit its least affordable level since 2006

By ROB KREIGER

Home sales prices edged higher in 2022 and 2023 and interest rates continued to rise, pushing housing to its least affordable level since 2006. That's unlikely to change any time soon.

According to data from Multiple Listings Services and our Quarterly Survey of Lending Activity, sales in Alaska's major markets settled back below their pre-pandemic levels last year and in many cases hit decade or record lows. Homes are still selling, and the market is by no means stalling, but limited inventory — a common theme in recent years — and dwindling affordability pushed some prospective homebuyers out of the market.

Why a quick return to historically average affordability is unlikely

While affordability is probably keeping many buyers on the sidelines as they wait for conditions to change, a major market shift is unlikely in the near future because none of the factors that can move the affordability needle are expected to change dramatically in the next few years.

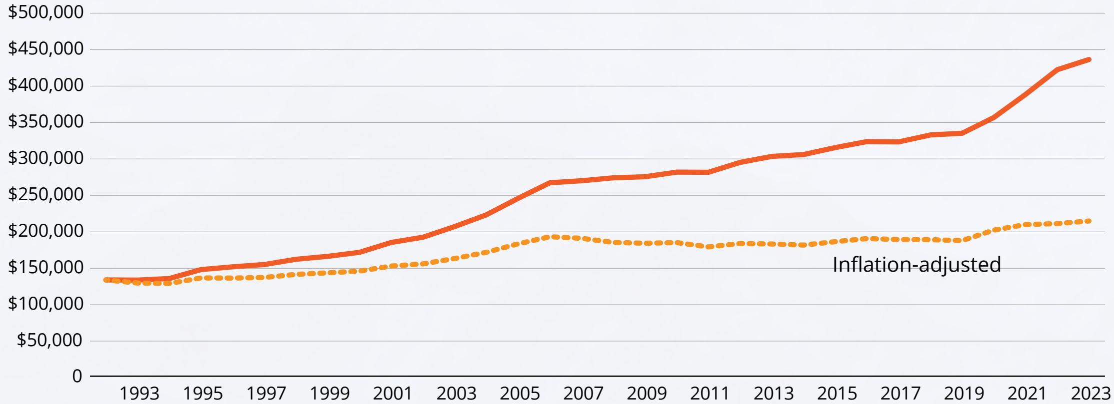
For example, interest rates, which have climbed in recent months, will not fall back to record lows absent a major economic shock. It's important to remember that rates dropped that low during the pandemic, 2020 and 2021, partly because policymakers took drastic measures to stabilize the economy. Low interest rates combined with higher wages and a limited supply of homes for sale created a frenzied buying market as housing reached its most affordable level on record.

If inflation continues to cool and market expectations about the future of inflation shift, rates for 30-year fixed-rate mortgages could decrease in the coming months or years. However, mortgage rates would need to fall about 170 basis points (a basis point is one-hundredth of a percentage point) to reach affordability in line with the historical average, which is unlikely in the short term.

Absent that type of rate drop, the other two components of housing affordability — sales prices and monthly wages — would have to move significantly, which is equally unlikely in the near future.

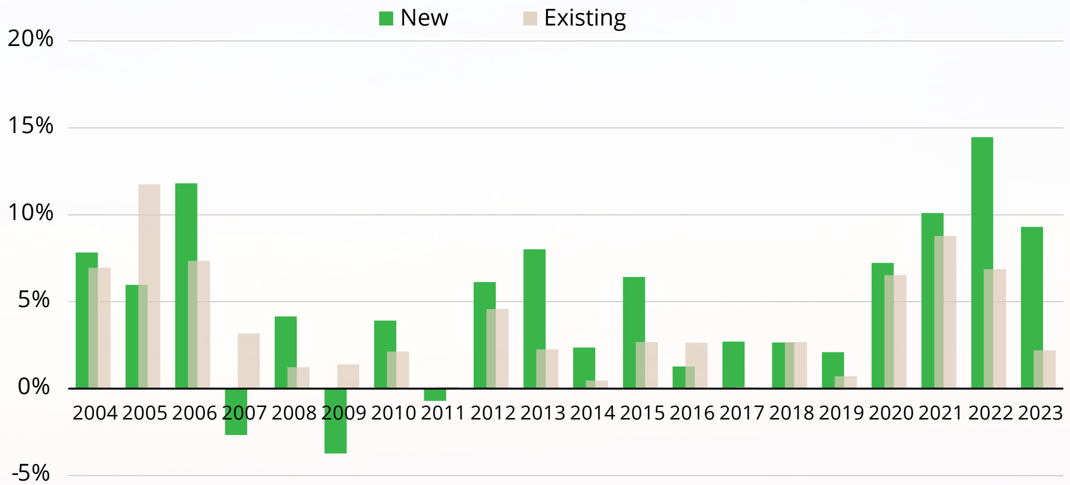
Sales prices may come down as affordability weighs on demand, but history shows that a price drop large enough to affect affordability is not likely. The last time prices soared, in both nominal and

Average sales price for a single-family Alaska home, 1992 to 2023



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, and Alaska Housing Finance Corporation

Prices for new home construction continue to outpace existing



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, and Alaska Housing Finance Corporation

inflation-adjusted terms, was 2003 to 2006. After that, prices leveled off and then rose much slower for many years after, even losing ground to inflation some years. In other words, prices can fall, but it usually happens gradually over many years.

Average wages have risen nearly 20 percent since 2019 and will continue to go up, but affordability returning to average would require another 20 percent wage increase. Pay will rise that much but over a longer period.

While we won't soon return to the super-affordability of the pandemic years, it is possible to return to average affordability with some combination of a drop in interest rates, a decline in prices, or a wage increase. Interest rates are the most likely of the three to move in an affordable direction in the coming months.

Rising rates and prices weighing on affordability

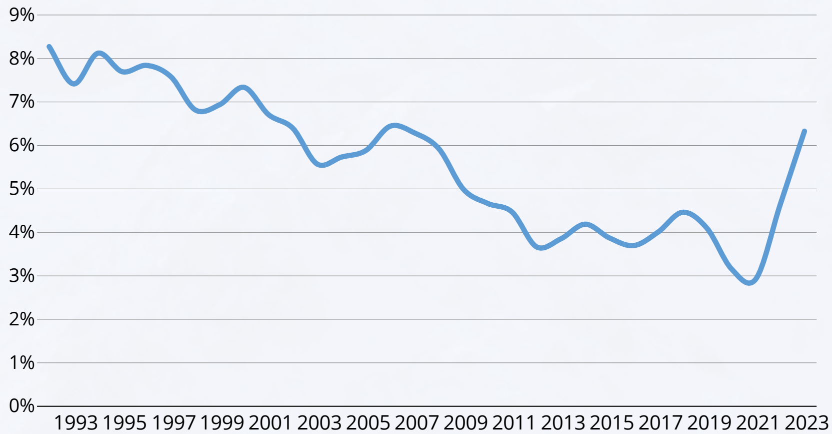
The average sales price for a single-family home in Alaska rose 3.3 percent in 2023, to $436,407.

As was the case in 2022, the largest cost increase came in new construction, where buyers appear to be using larger amounts of cash and would therefore be less sensitive to interest rates. New home prices rose 9.3 percent from the previous year while existing construction rose 2.2 percent, putting the averages at $612,745 and $414,728, respectively.

At the same time, interest rates for 30-year fixed-rate mortgages moved up to an average of 6.33 percent, the highest since 2006. Since 2021, the average rate has risen an unprecedented 340 basis points.

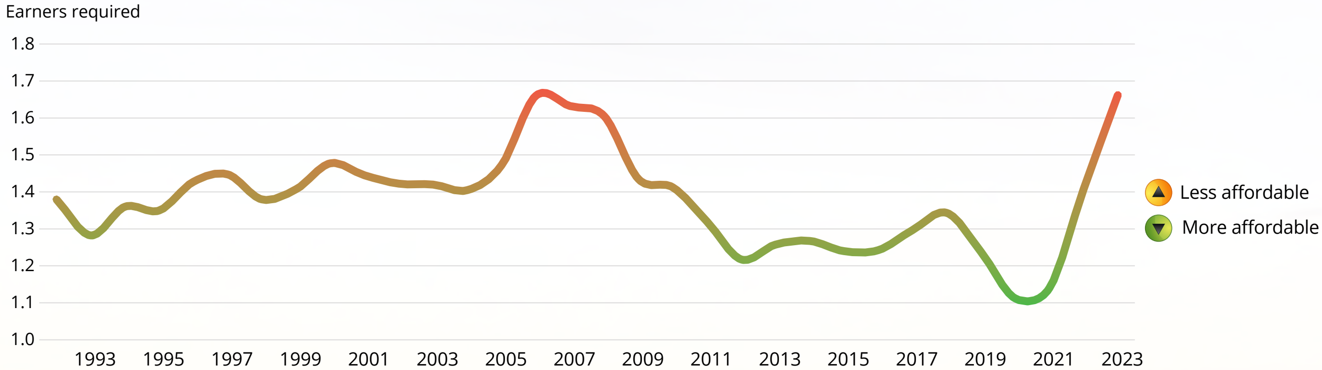
The Alaska Affordability Index, a measure we've produced since 1992, shows how many people earning the average wage it takes to make the payment on a 30-year fixed-rate mortgage. (See the sidebar on the next page for how the index is calculated).

Mortgage interest rates continue steep climb



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, and Alaska Housing Finance Corporation

In 2023, housing hit its least affordable level in Alaska since 2006



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, and Alaska Housing Finance Corporation

About the Alaska Affordability Index

The Alaska Affordability Index is calculated by determining the monthly principal and interest payment for a 30-year fixed rate mortgage to buy the average priced single-family home, with a down payment using the average loan-to-value ratio — which comes out to about 20 percent.

The required monthly income for the mortgage is determined by dividing the monthly principal and interest payment by 24 percent, where 24 percent is the maximum amount of income a home buyer should spend on monthly mortgage payments. Using 24 percent is more conservative than the 30 percent commonly used in other home-ownership calculations.

The index values are then determined by dividing the required monthly income by the average monthly wage from our own data. When required monthly income and average monthly wages are the same, the value is 1.0. As the gap between required monthly income and average wages increases, the index value increases, showing housing is less affordable as higher wages are needed to meet the monthly income requirement. As the gap narrows, housing requires less in wages and is more affordable.

The average wage is based on wages employers report to the Alaska Department of Labor and Workforce Development when they submit their unemployment insurance tax reports each quarter.

The estimated average monthly mortgage payment is based on the loan amount needed to purchase the average-priced single-family home and the fixed interest rate Alaska mortgage lenders report to us each quarter in the Alaska Quarterly Survey of Lending Activity. We conduct this survey with Alaska Housing Finance Corporation.

The Alaska Affordability Index is available on our website.

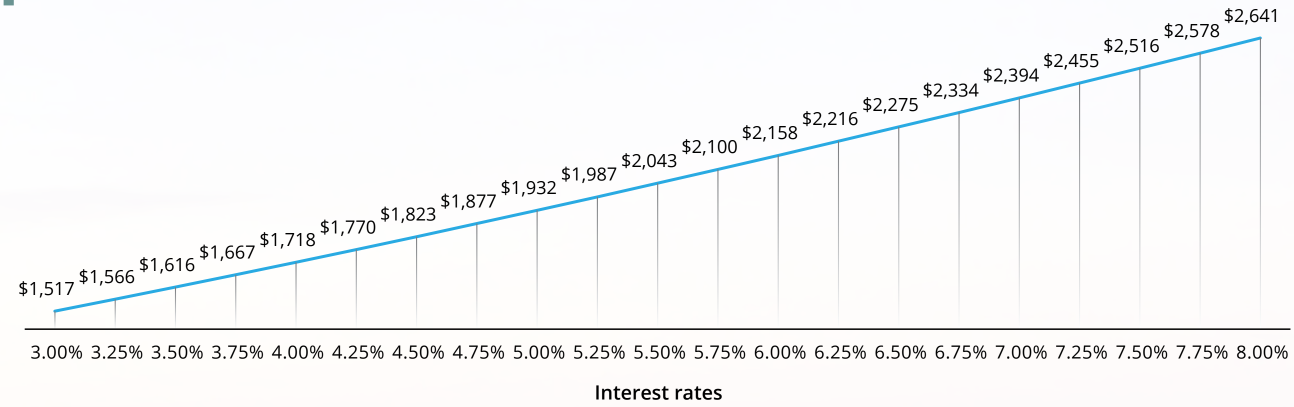
An index value of 1.0 means that one person's average monthly wages are sufficient. As the index value rises, it shows housing is becoming less affordable. Various market conditions can cause this number to change from year to year, and areas around Alaska have varying levels of affordability.

The index's strengths are that it shows how affordability differs across major housing markets and the direction it's moving. However, it considers only the mortgage payment, and the real costs of owning a home are much higher — property taxes, utilities, and insurance can easily add hundreds of dollars each month.

The index also doesn't consider any buyer-specific factors that can make housing more affordable than the index would suggest. For example, a larger down payment means a lower monthly mortgage payment. Buyers can also qualify for lower rates than the index uses depending on their credit history, and even a few basis points could make the difference in being able to afford a home.

In 2023, the average affordability for the year was 1.66 average earners, the same as in 2006. For historical context, average affordability going back to 1992 has been 1.38, and the record low, when housing was most affordable, was 1.11 in 2020.

What the payment would be at various interest rates for a $436,407 home



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, and Alaska Housing Finance Corporation

The effects on different types of Alaska buyers and owners

There's no ideal level of affordability nor a consensus definition of "unaffordable" housing, and the fact that homes have become less affordable recently is a problem for some, but not all.

For example, first-time homebuyers are having a harder time in the current market, and many may defer purchasing in the hope that something changes soon. Even if buyers have enough cash for the down payment, higher rates are making it harder for some to buy the homes they want, and what falls into their price range may not be desirable.

For some existing homeowners, especially those who have owned their homes outright for many years, there has never been a better market. After a long period of modest price growth from 2007 to 2019, existing homeowners saw the value of one of their largest assets jump 30 percent in just a few years, from an average of $335,362 in 2019 to $436,407 in 2022.

Affordability also matters to this group of long-term owners in the sense that they want prices to continue rising, but they need enough buyers in the market who can afford those prices when they're ready to sell.

Another category of existing homeowner — one who bought in recent years and has less equity in their home — cares about affordability from the perspective that they might feel stuck in their current home. What they could afford a year or two ago when rates were much lower may be unaffordable now, so these homeowners do not want to give up their current mortgage payment with a low rate because they would have a hard time upgrading to their next home.

If this type of owner does sell, depending on the equity they built up in the short time they owned the home, what they can afford next might be less of a house than the one they just sold.

The chart above shows the relationship between interest rates and monthly payments for a loan on the average-priced house in 2023, which was $436,407. When rates were at 3 percent in 2021, the monthly principal and interest payment would have been $1,517. In 2023, interest rates at 6.33 percent pushed the monthly payment above $2,200.

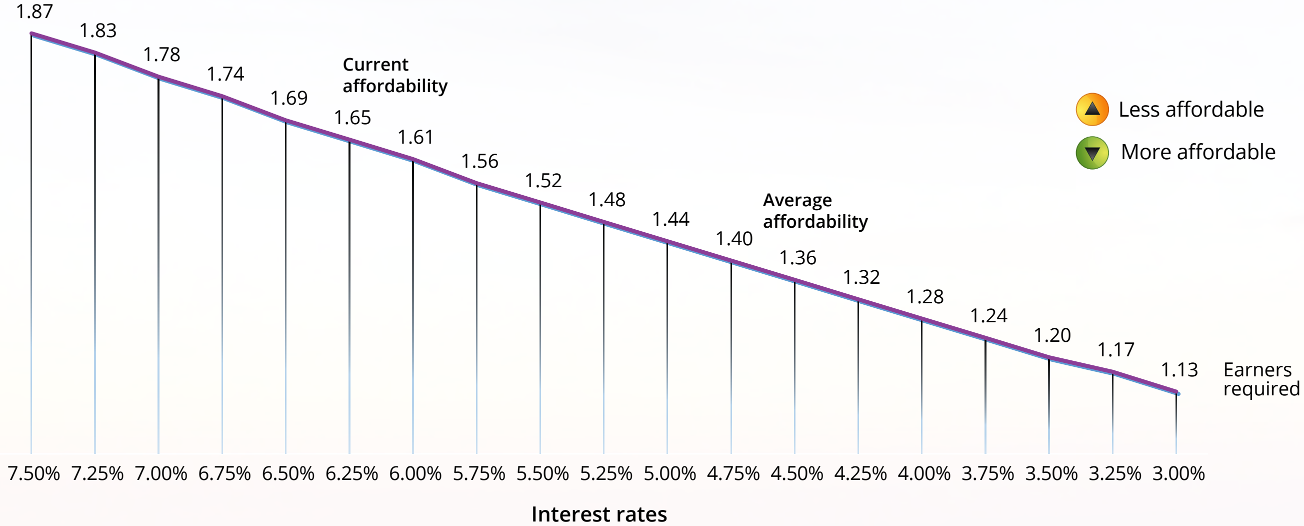
How movement in prices, rates, or wages would shift affordability

To the extent affordability is contributing to the current state of the market, as explained earlier, nothing big will change unless interest rates fall, sales prices fall, or wages rise.

While housing could realistically become more affordable from some combination of these factors, the following scenarios look at each individually to give a sense of how much they would need to move on their own to get housing back to average affordability (1.38).

Of all these scenarios, falling interest rates are the most likely to have an immediate effect on affordability while keeping the market stable.

How interest rate changes would shift home-buying affordability



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, and Alaska Housing Finance Corporation

What would it take to get back to average affordability if only one factor changed?

If only rates fell, they would have to drop to 4.6%

If prices and wages remained unchanged, rates would need to drop from the current rate of 6.3 percent to around 4.6 percent for housing to reach average historical affordability. This would be a big drop by historical standards and could happen over months or years, but not quickly.

If rates do trend downward while prices and wages remain stable, more buyers will return to the market, although not to the degree they did during the pandemic. This could push prices higher, but less than they've risen in the last few years.

If only prices fell, they would have to decrease by 17%

A prospective homebuyer may root for a decline in prices, but it's the last thing most homeowners would want. For housing to return to average affordability with stable wages and interest rates over the next few years, prices would have to drop about 17 percent.

Not since the housing crash of the 1980s have prices fallen that hard; it would likely take a massive increase in home inventory amid a collapse in demand. However, inventory could increase less dramatically in two major ways: overbuilding or people leaving the state in large numbers.

Overbuilding is less likely because the level of construction has been fairly consistent since 2008 with no indication of too many homes being built. People leaving the state, on the other hand, is a risk and will be important to watch in the coming years.

Alaska has seen 11 straight years of negative net migration, or more people leaving the state than moving in. The biggest change has been fewer people moving to Alaska rather than more people leaving.

The working-age population is shrinking, and they are an important home-buying demographic. If the decrease continues, demand could slump even without more construction. The net out-migration trend continuing or accelerating could destabilize the housing market, so it will be critical to understand not just who is leaving Alaska or not coming in, but why.

If only wages rose, it would take a 20% increase

Affordability is determined in part by what percentage of monthly wages are used for mortgage payments. Since 2019, the average monthly wage has risen about 18 percent, not adjusted for inflation, and that wage growth combined with record low interest rates had kept housing at the most affordable level on record.

Wages will continue to grow, but in the short term, an increase that big tends to take years. Given that housing in 2023 was the least affordable since 2006 (at an average monthly wage of $5,600), wages would need to rise 20 percent to reach average affordability if rates and prices remained where they are.

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