Rooted in Thought

May 16, 2025

Another Housing Bubble?

> *"[T]he extreme brevity of the financial memory . . . [ensures] financial disaster is quickly forgotten. . . . [W]hen the same or closely similar circumstances occur again, sometimes in only a few years, they are hailed by a new, often youthful, and always supremely self-confident generation as a brilliantly innovative discovery in the financial and larger economic world."*[1] – John Kenneth Galbraith

A housing bubble brought the economy to its knees in 2008. Did we as a nation learn any lessons from that dreadful experience? It appears not. Less than 20 years later, the US seems near the peak of another, perhaps even bigger, housing bubble. The financial fallout should be less severe this time because losses will fall on taxpayers, not banks, but the economic impact could be material.

The Federal Reserve bought $1.3 trillion of mortgages between March 2020 and mid-2022.[2] This newly created money was, quite literally, pumped directly into the housing market, and the average price of homes rose 40.3% in the *two and a half* years from Q2 2020 to yearend 2022.[3] It took *five* years for home prices to rise by that much before the peak of the last housing bubble.[4]

Admittedly, home prices cannot alone tell us if there is a housing bubble. What matters is home prices *relative* to (1) people's income, which pays the mortgage, and (2) rental prices, which is the substitute for owning a home. Unfortunately, relative home prices are even more concerning:

(1) Home Price-to-Income Ratio | The average home cost 6.8 times the median household's pretax income in March 2006.[5] That was an all-time high since at least 1946, when the data series began. Then, in December 2021, the ratio set a new all-time high of 6.9 and kept rising. The last data point in the series was 7.4 in January 2025, yet another all-time high.

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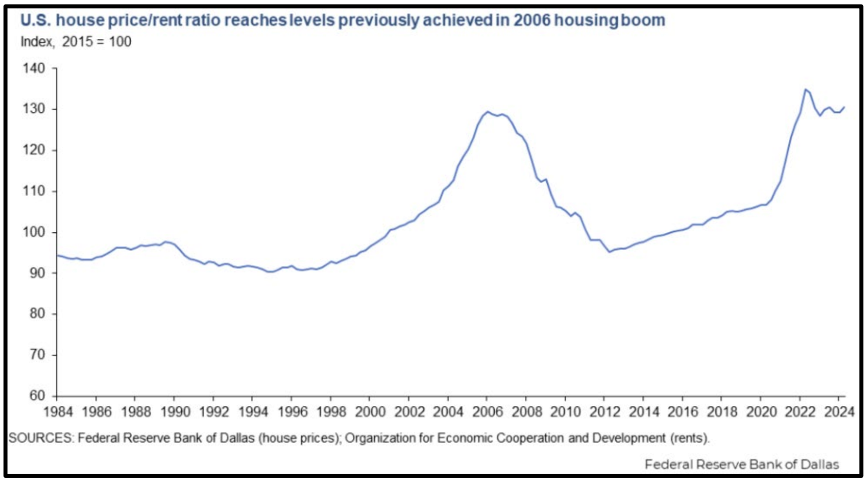
[1] John Kenneth Galbraith, *A Short History of Financial Euphoria*, Penguin Books, 1993 (13).
[2] Dava Na, et. al., *The Evolution of the Federal Reserve's Agency MBS Holdings*, Board of Governors of the Federal Reserve System, Sept. 20, 2024, *available at*: https://www.federalreserve.gov/econres/notes/feds-notes/the-evolution-of-the-federal-reserves-agency-mbs-holdings-20240920.html.
[3] *Average Sales Price of Houses Sold for the United States*, Federal Reserve Bank of St. Louis, *available at*: https://fred.stlouisfed.org/series/ASPUS.
[4] *Id.*
[5] *Home Price to Income Ratio*, Longtermtrends, *available at*: https://www.longtermtrends.net/home-price-median-annual-income-ratio/.

(2) Home Price-to-Rent Ratio | People can rent instead of buying, of course. Thus, the price-to-rent ratio is a key valuation metric for housing much like the price-to-earnings ratio is for stocks. The higher the ratio, the sillier the price. The home price-to-rent ratio hit what was an all-time high in 2006.[6] Then, in 2022, it hit a new high and remains near the high.



Clearly, this suggests we are in the midst of a housing bubble, but many say "this time is different" due to a housing shortage. We, however, do not see that in the data. There were 1.12 housing units, including apartments, for every household in 2010, which was the peak of the last housing bubble's construction glut.[7] Today the ratio is only moderately lower at 1.11.[8] There is no shortage.

There is, however, a shortage of existing homes for sale. Borrowers do not want to give up the 3% mortgage rates they have from the pandemic. This "Golden Handcuff" keeps them from selling their home. As a result, new homes cost *less* now than existing homes, which only happened once before in June 2006, and there are as many new homes for sale today as in December 2008.[9]

Others say "this time is different" because lending standards are better, but we disagree. The FHA, which guarantees mortgages with taxpayer backing, has become today's subprime lender instead of banks. Mortgage costs *exceed* 43% of the *pretax* income of almost two thirds of FHA borrowers today versus one third in 2007.[10] Unsurprisingly, 7.05% of FHA loans issued in 2024 were already at least 90 days delinquent *within 12 months* versus a peak of 7.02% in the last housing crash.[11]

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[6] J. Scott Davis, *Evidence Suggests U.S. House Price/Rent Ratio, Real Home Prices to Decline*, Federal Reserve Bank of Dallas, Feb. 25, 2025, *available at*: https://www.dallasfed.org/research/economics/2025/0225.
[7] *Housing Inventory Estimate: Total Housing Units in the United States/Total Households*, Federal Reserve Bank of St. Louis, *available at*: https://fred.stlouisfed.org/graph/fredgraph.png?g=1J5mP&height=490.
[8] *Id.*
[9] *See* Melody Wright, *Under the Hood*, M3_Melody Substack, Apr. 27, 2025, *available at*: https://m3melody.substack.com/p/under-the-hood, and *New One Family Homes for Sale in the United States*, Federal Reserve Bank of St. Louis, *available at*: https://fred.stlouisfed.org/graph/fredgraph.png?g=1J5oZ&height=490.
[10] Allysia Finley, *Biden's Mortgage 'Relief' Fuels Higher Housing Prices*, The Wall Street Journal, Feb. 23, 2025, *available at*: https://www.wsj.com/opinion/bidens-mortgage-relief-fuels-higher-housing-prices-policy-loans-risk-cb0a1974.
[11] *Id.*

Sadly, a *still ongoing* pandemic program is hiding the woes of the FHA's subprime lending. Rather than foreclose on FHA loans in default, *taxpayers are making mortgage payments* for borrowers, and the missed payments are added to the loan balance at no interest.[12] Abuse is rampant. Some borrowers still own their home *despite making virtually no mortgage payments* for years.[13]

The housing market therefore remains grossly distorted by pandemic-era policies:

(1) Bubble Catalyst | The Federal Reserve started the bubble by injecting newly printed money directly into the housing market via purchases of mortgage securities;

(2) Golden Handcuffs | Ironically, low mortgage rates reduced the supply of existing homes for sale since people are reluctant to give up their sub-3% mortgages;

(3) Subprime Lending | The FHA made matters worse by making reckless subprime loans to people who have little chance of ever making the payments; and

(4) Delayed Foreclosure | Taxpayers are making the mortgage payments for FHA borrowers in default so the FHA can avoid admitting to losses in its subprime lending book.

So, what will pop this housing bubble? It is hard to say. What cannot continue will not continue, however, and home prices are at unsustainable heights. Homes have never been less affordable.[14] At some point, people will shed their "golden handcuffs" due to life changes or to monetize their home equity. Moreover, the FHA's "extend and pretend" program largely ends later this year.[15]

In light of our views, your portfolio has little direct exposure to housing. We own no home builders or traditional banks. Do not, however, take this as advice on how to manage your real estate affairs. We simply want to share what we see and how we have adapted our portfolio to ***build permanent wealth*** for you and your family.

Sincerely,

Drew Estes, CFA, JD
Portfolio Manager

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[12] *Id.*
[13] Melody Wright, *Under the Hood*.
[14] Diana Olick, *Here's How Bad Housing Affordability is Now*, CNBC, June 25, 2024, *available at*: https://www.cnbc.com/2024/06/25/housing-affordability-price-mortgage-rates.html#:~:text=Housing%20supply%20was%20already%20low,market%20between%20buyer%20and%20seller
[15] Dana Gentry, *Trump Ends FHA COVID-Era Mortgage Assistance*, Utah News Dispatch, Apr. 19, 2025, *available at*: https://utahnewsdispatch.com/2025/04/19/trump-ends-fha-covid-era-mortgage-assistance/.