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Freddie Mac sees Brightest Housing Year in Decade

Freddie Mac predicted in its monthly *Outlook* on Thursday that **2016 might be the best year for housing** in a decade with most sectors, sales, construction, and prices, set to reach new recent highs. They base this on several factors, mortgage rates, employment, household formation, rising home inventories and increasing prices.

Mortgage Rates

Rates so far this year have remained lower than the average for last year and Freddie Mac, while admitting that a rapid increase in rates would mean all bets would be off, remains convinced they will increase gradually and then only in the second half of the year, helping support homebuyer affordability in the face of rising house prices and stagnant income.

One factor that will probably serve to keep down interest rates in this country are the negative rates in many other countries. Japan's 10-year government bond, for example, reached a negative 0.1 percent this month and across Europe many countries' sovereign bond yields are also negative. These rates should keep the lid on long-term rates in this country although the outlook for global growth will improve or at least stabilize through the year lessening downward pressure. Further, Freddie Mac's economists say, "More good news on the domestic U.S. economy, and a return to tightening by the Federal Reserve, will push rates higher later this year. The Fed is likely to only raise rates twice this year, which will slow the pace of interest rate increases."

Resilient Labor Market

There has been an average of 205,000 net jobs created each month since 2011 and this has helped bring the unemployment rate to 5 percent. On the downside labor participation has fallen substantially with no signs of recovery and wage growth remains anemic.

Goldman Sachs says that only about 0.1 to 0.2 percentage points of the more than 3-point decline in participation is due to cyclical factors that can be expected to reverse. The rest is driven by long-term factors like the aging population meaning prospects for increased participation are dim. If that holds true and job gains maintain their recent pace, Freddie Mac says wages should start to rise and this ultimately will be a key factor for housing

Recent Housing Data

		Value	Change
Mortgage Apps	Aug 28	226.9	+0.49%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%
Builder Confidence	Mar	51	+6.25%

Housing News Update

markets. "If wages and incomes do not start rising, then rising interest rates, home prices and rents will squeeze households and ultimately slow housing markets," the company says.

Household Formations

Household formation rates dropped during the recession and while they have picked up it is not enough to match population growth. During the first half of last year the annual pace reached 2.2 million but that dropped by more than 50 percent in the second half, to a net of 800,000 households for the year.

Steady job growth should mean a pickup in formations. The drop-off last year could be an anomaly due to noisy data or it could be symptomatic of a housing shortage which means households can't be formed.

Housing Supply

There is hope, however for the housing supply. Multifamily housing starts have running above 300,000 for the past three years. In February single-family starts were at a seasonally-adjusted annual rate of 822,000, a substantial year-over-over percentage increase, but still well below what is needed to meet long-run demand.

Freddie Mac calls the single-family construction recovery long and tortured. The National Association of Home Builders' (NAHB's) Housing Market Index (HMI) which tracks builder sentiment regarding the market was above the benchmark of 50 in March for the 21st straight month but despite builder optimism, homebuilding activity has not followed suit. If the historic relationship between the HMI and housing starts that prevailed from 1985 to 2009 had held single-family starts would be nearly 50 percent higher than where they are today.

Part of the problem is a labor shortage; recent stats show unfilled openings for construction workers in January were the highest since July of 2007. Still starts are trending higher, and Freddie Mac forecasts that combined multifamily and single-family housing starts will increase by 200,000 units to 1.3 million in 2016.

House Prices

With demand picking up and supply lagging, house prices are moving higher, last year increasing 6 percent from 2014. Freddie Mac forecasts they will continue to rise but at a moderating pace, up 4.8 percent this year and 3.5 percent in 2017. This forecast "is consistent with a market where supply issues slowly abate." This will help drive up equity but drive down affordability.

Despite the challenges facing the housing market, low supply and declining affordability being key concerns, Freddie Mac's economists say they expect a banner year for housing with home sales, housing starts, and house prices reaching their highest level since 2006.