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Rates have dropped, but homeowners are not moving

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On an earnings call last month, the CEO of online real estate brokerage Redfin was asked whether he had a contingency plan if interest rates did not come down. His answer was maybe a bit too frank.

"Great question," Glenn Kelman, the CEO, began on the Aug. 6 call, "Plan B is to drink our own urine or our competitors' blood."

A little more than a minute later, he corrected himself, saying that he shouldn't have used those exact words. But to the analysts on the call, his point was clear: The housing economy is in trouble, and a major reason has been soaring interest rates, which hit a high-water mark of 7.79% last fall.

Since then, the 30-year mortgage rate has dipped into the low 7s, then the high 6s, and as of last week, it fell to 6.35%. The drop — coupled with a "likely" rate cut by the Federal Reserve at its upcoming meeting in September — should spell good news for the housing economy, but a major structural problem remains. Close to 60% of homeowners have outstanding mortgages that are locked in at rates below 4%, according to recently released data from Redfin.

If a homeowner sold and bought a new home in a comparable neighborhood, they would forego a low rate for another that is at least 2.5 percentage points higher. For many homeowners, that simply doesn't make sense — a phenomenon that economists call the "golden handcuffs."

Although the recent dip in the mortgage rate has been significant — over 1 point in less than a year — I interviewed seven economists, as well as finance and real estate experts, who say it's not enough.

"It's a drop in the bucket," said Sam Khater, chief economist of Freddie Mac.

A Sisyphean battle

The recent decrease in rates is equivalent to a 2% reduction in the price of the home, according to Daniel McCue, a senior research associate at the Harvard Joint Center for Housing Studies.

The math is as follows: Take a house priced at the national median, which is around $430,000. The recent drop in interest rates would have shaved $66 off the monthly payment of around $3,435, McCue estimates. Had the interest rate not dropped, that $66 in savings is equivalent to buying the same house for around $424,000.

Although that may sound significant, McCue points out that this year alone, the price of homes has inched up over 4.5%, according to the Case-Shiller index. McCue estimates that rates would need to drop almost another half-point — down to around 6.09% — for homeowners to get back to the payments they would have had in the first month of this year.

He paints a picture of a Sisyphean battle: Rates have come down, reducing the cost of a monthly mortgage, but even as they fall, prices continue to rise, negating any savings.

"The bottom line," said McCue, "It's not enough to kind of make up for these rising prices."

Sidelines

Growing families have postponed moving to more spacious homes. Households hoping to trade up have held off. And a lot of people have been sitting on the sidelines, waiting and watching.

Yet, people are itching to pack their bags, according to a survey of more than 1,000 homeowners published Wednesday by Point, a home equity startup. About 72% of homeowners have a desire to move, up from 35% last year, the startup found.

Sean Adu-Gyamfi, 33, an associate broker with Coldwell Banker Warburg, sets aside an hour each day to send out text messages to the list of contacts and fence-sitters he has amassed in the months since interest rates hit a two-decade high.

His messages mostly went out into the ether. "Very little engagement," he said.

Then, as rates tumbled to 6.49% from 6.73% in the first half of August, he began hearing back.

Among the people who responded was 31-year-old Christina Branche: "I was waiting for rates to drop for sure," she said, describing how she was at work at Citigroup, where she is an in-house counsel, when she received an alert on her phone about the fall in rates.

When Adu-Gyamfi's message popped up sometime after, she decided to resume her search — she had been looking for more than a year and had given up, frustrated at the double whammy of high interest rates and high home prices.

At her broker's urging, she began looking in the upper reaches of the New York City borough of Manhattan, including a neighborhood not far from the Cloisters, an outpost of the Met, where a listing caught her eye: a two-bedroom co-op in the low $700,000s.

But Branche fits into a unique category: a first-time homebuyer. She has no former mortgage to give up, hence no "golden handcuffs."

The part of the housing economy that has been hit the hardest is the so-called "resale" sector — homes that were previously owned and are sold again.

"That segment of the market is what has really evaporated," said Lance Lambert, co-founder of news-and-research platform ResiClub and one of the analysts on the Redfin earnings call last month, who previously reported on Kelman's colorful comments.

Existing home sales remain at the lowest they have been since 1995, but the country has almost 70 more million people today, according to data from the National Association of Realtors.

The five Ds

John Campbell, a research analyst who focuses on real estate-related stocks at investment research firm Stephens Inc., refers to the five "D's" that drive the housing economy even in times like these, when the finances of homebuying are out of whack: diamonds (or marriage), diapers (or having children), divorce, downsizing and death.

Major life events, he said, will eventually overwhelm a subset of families who are trying to wait it out.

"Like you're not going to live in your house with your ex-wife, right, and her new husband," Campbell said.

It was the last of the D's — death — that finally made things come together for Branche.

The co-op that she fell in love with was being offered at a competitive price because its former owner had died.

When she got off the subway in the Hudson Heights neighborhood, it felt familiar.

And then she realized why: An avid runner, she had gone for long runs along the Hudson River ending at Fort Tryon Park, a slice of green that is walking distance to the co-op.

The apartment has a curved archway and a blue mosaic tile in the bathroom that reminded her of the bathhouses she had visited

She loved it immediately: “I’m not a grand person, but it makes you feel grand,” she said.

In August, her offer was accepted in a convergence of two forces — lower interest rates and one of the D’s.

Since the CEO of Redfin made his blunt comments, the company’s stock price has jumped from just over $7 to just under $10 — a far cry from its height of $96 a few years ago, but also significantly better than earlier this summer.