ZAIS Insights

Some light for housing

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Summary

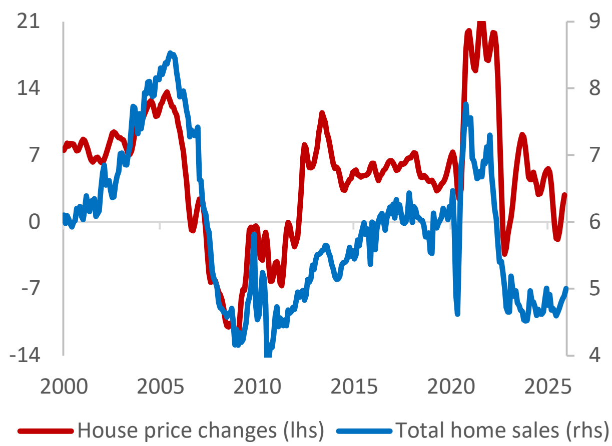
- New policy initiatives likely to stimulate housing activity …
- … but not enough to resolve affordability and supply hurdles quickly
- We see opportunities shifting outside core agency mortgage credits

Housing has been in a slump for three years since the collapse of sales activity in the wake of Fed rate hikes in 2022 (see Chart 1).

However, housing does not appear distressed, to us. House prices softened a bit in the first half of last year but recovered again in the second half (see Chart 1 again) and remain far above pre-Covid levels.[1] Importantly, existing home owners face no debt service pressures as in the runup to the financial crisis.[2]

Chart 1: Home sales and house prices

% over 3 months annualized (lhs), million units annual rate (rhs)



Source: U.S. Census Bureau and U.S. Department of Housing and Urban Development, National Association of Realtors, S&P Dow Jones and FHFA [3]

To improve housing affordability and revive the housing market, the Trump administration has ordered Fannie Mae and Freddie Mac to buy 200 billion USD of their own mortgage-backed securities (MBS).[4]

President Trump also announced that he wants to ban private equity firms from buying single-family homes, in a bid to lower house prices.[5]

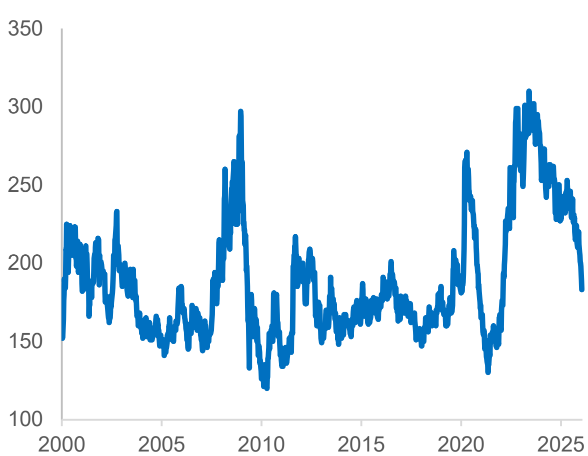
We believe the government will soon announce further initiatives to support the housing market, such as the provision of Federal land for housing projects, regulatory changes to free up bank capital for new home loans and MBS purchases and adjustments of the credit score system.

In our opinion, efforts to bring the Fed to lower interest rates also have a housing focus.

Thirty-year mortgage rates dropped 10 to 20 basis points following President Trump's MBS buying order for Fannie Mae and Freddie Mac[6] and the spread of mortgage rates over 10-year Treasury notes dropped below 200 basis points for the first time in nearly four years (see Chart 2).

Chart 2: Mortgage spread

Basis points



Source: Freddie Mac and Board of Governors of the Federal Reserve System[7]

The affordability hurdle is high

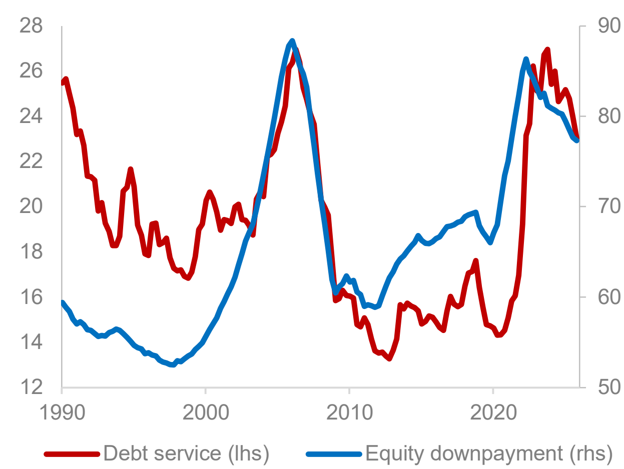
We expect these policy measures will have a positive impact on housing activity but we do not expect a boom, as seen in 2020/21.[8]

Even a return to the pre-Covid sales level of six million total homes per year is unlikely to be achieved quickly, in our view.[9]

Housing affordability has improved somewhat over the last two years but remains a major hurdle for the median household (see Chart 3).

Chart 3: Housing affordability*

% of median household income



*Estimates are based on 80% loan-to-value and full amortization over 30 years (see also footnote 10).

Source: US Census, Freddie Mac and the author's calculations[10]

The gap between current mortgage rates and the effective mortgage rate payed by existing home owners has also narrowed but is still wide by past standards, limiting the incentive for existing home owners to sell their current home and buy a new one (see Chart 4 on next page).

Chart 4: Mortgage interest rates

% p.a.

Source: Bureau of Economic Analysis and Freddie Mac[11]

In our view, it will be very difficult to lower mortgage rates enough to overcome the affordability hurdle quickly.

Under favorable conditions, we estimate that the 30-year mortgage rate can drop to 5.5%, which would imply a 10-year Treasury yield of around 4% and a mortgage spread of around 150 bps, which would be at the low end of the historical range (see Chart 2 again).

We are concerned that more aggressive policy measures – for example further large MBS purchases by Fannie Mae and Freddie Mac through an increase of the retained mortgage portfolio caps or steep Fed rate cuts –risk triggering inflation and credit concerns that could push Treasury yields and the mortgage spread higher.

This seems particularly concerning in the current environment of heightened fiscal and monetary policy uncertainty.

Table 1 shows our estimates of current housing affordability conditions, possible scenarios and historical averages.

Table 1: Housing affordability scenarios

% of median household income

	Equity down-payment*	Debt service payment*	Debt service with 100% LTV**
Current	77.0	22.6	28.3
Scenario 1	77.0	21.1	26.4
Scenario 2	70.6	19.4	24.3
1990-2025	66.1	19.2	23.9
2012-2020	66.4	15.1	18.9

* With 80% loan-to-value
** With 100% loan-to-value

Source: US Census, Freddie Mac and own calculations[12]

- The first scenario assumes that the 30-year mortgage rate drops to 5.5% in 2026, all else remaining equal. In that scenario, the equity down-payment remains unchanged and the debt service payment eases somewhat but remains well above the long-term average (1990-2025) and above the average of the low-interest-rate period (2012-2020).
- The second scenario assumes, as well, that the 30-year mortgage rate drops to 5.5% and that income growth outperforms house price appreciation by 10 percentage points over a three-year period. In that scenario, the equity down-payment declines significantly but still remains high by past standards, while debt service payments decline to the long-term average (1990-2025) but stay above the average of the low-interest-rate period (2012-2020).

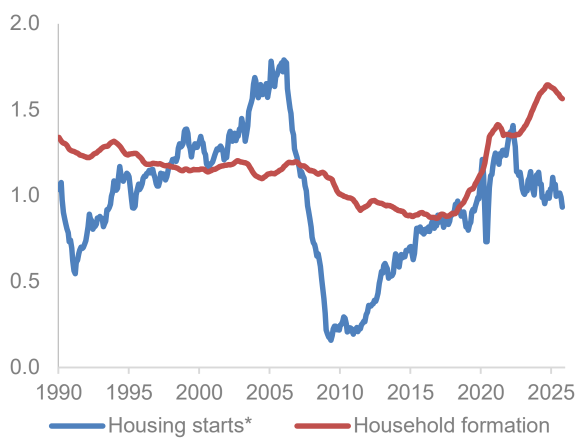
These scenario simulations suggest to us that a quick normalization of affordability conditions is unlikely. Based on our calculations, even a normalization of affordability conditions over several years would require favorable financial conditions and strong income growth well above house price appreciation rates.

Structural supply impediments

Improving affordability conditions would support housing demand but not necessarily housing supply. We see a potential risk is that improved affordability raises demand but not supply, resulting in rising house prices, which again undermines affordability conditions.

Chart 5: New household formation and housing starts

Million households and housing units annual rate



*Excluding replacements.

Source: US Census [13]

Chart 5 shows that the supply of housing (starts) currently limps far behind the natural demand for housing (household formation). We believe this gap is not simply a function of affordability. Zoning laws, land use regulations, building codes and permitting processes and fees heavily restrict the supply of housing, in our view.

Furthermore, cost pressures are higher in construction compared to the rest of the economy: prices for construction materials rose twice as much since the pre-Covid period than the GDP deflator and hourly wages for non-supervisory workers are 20% higher in construction compared to the overall private sector.[14]

We believe these supply impediments are largely structural and unlikely to be overcome quickly. Some impediments could even get bigger. The crackdown on illegal immigration, for example, seems likely to result in a tightening of labor supply in the construction sector.

In summary, we believe that demand and supply conditions point to a continuation of the status quo, resulting in only gradual improvements in housing activity. We worry that aggressive stimulus efforts risk backfiring if they trigger inflation and credit concerns or just fuel demand without improving supply conditions.

Opportunities moving outside core agency mortgage credits

From an investment perspective, ZAIS's main exposure to the housing sector in recent years has been through Agency CRTs (see ZAIS Insight "Housing slump supports Agency CRT notes," November 2023).[15] We still think that Agency CRTs are not a bad place to be, given the strong credit fundamentals of existing home owners.

However, the opportunity looks less compelling to us amid reduced issuance of CRT notes by the agencies and tightening spreads.

Thus, while holding a core position in Agency CRTs, we are looking for opportunities outside core agency mortgage credits. One area is Mortgage Insurance CRTs (MI CRT), which we see offering roughly 200bps pickup over Agency CRTs.

We believe MI CRTs bear only small additional risks related to the insurance and payout structures while the credit fundamentals of the underlying home-owners are similarly sound as for Agency CRTs.

We also continue to see value in second-lien mortgages (see ZAIS Insight "Unlocking home equity values"; August 2024).[16]

Given the high creditworthiness of the borrowers, the built- up home price appreciation and still relatively low combined leverage, we think second-lien mortgage products can provide strong returns relative to the risk.

In this area, we view Closed-End-Second Mortgages (CES) and Home Equity Investments (HEI) as particularly attractive.

The main risk is prepayment speed in an environment of rapid interest rates declines, which we cannot rule out but think is not very likely.

Finally, we are exploring opportunities in Residential Transition Loans (RTL). We think this sector has potential, if construction activity increases, given its short duration profile and attractive spreads. We note, however, that opportunities in RTL also require additional due-diligence of the operators and the specific markets in which they operate.

More information

As always, we are available to discuss our views with you. Please contact your Client Relations representative at +1 732 978 9722 or zais.clientrelations@zaisgroup.com

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[1] House prices are more than 50% higher compared to the pre-Covid period.

S&P Dow Jones Indices LLC, S&P Cotality Case-Shiller U.S. National Home Price Index [CSUSHPINSA], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/CSUSHPINSA

Federal Housing Finance Agency; FHFA House Price Index, January 29, 2026.

https://www.fhfa.gov/data/hpi/datasets?tab=monthly-data

[2] Mortgage debt service payments as a share of disposable personal income stand at 5.9%, which is at the low end of the past 20-year range and well below the peak of 9% just before the financial crisis.

Board of Governors of the Federal Reserve System (US), Mortgage Debt Service Payments as a Percent of Disposable Personal Income [MDSP], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/MDSP

[3] Total home sales are the sum of existing and new home sales.

National Association of Realtors, Existing Home Sales [EXHOSLUSM495S], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/EXHOSLUSM495S

U.S. Census Bureau and U.S. Department of Housing and Urban Development, New One Family Houses Sold: United States [HSN1F], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/HSN1F

House prices based on the S&P Cotality Case-Shiller U.S. National Home Price Index and the FHFA House Price Index.

S&P Dow Jones Indices LLC, S&P Cotality Case-Shiller U.S. National Home Price Index [CSUSHPINSA], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/CSUSHPINSA

Federal Housing Finance Agency; FHFA House Price Index, January 29, 2026.

https://www.fhfa.gov/data/hpi/datasets?tab=monthly-data

[4] National Association of Realtors; President Trump Directs MBS Purchases to Lower Mortgage Rates; January 13, 2026.

https://www.nar.realtor/washington-report/president-trump-directs-mbs-purchases-to-lower-mortgage-rates

[5] Reuters; Trump threatens to ban Wall Street investments in single-family homes; January 8, 2026.

https://www.reuters.com/world/us/us-will-ban-large-institutional-investors-buying-single-family-homes-trump-says-2026-01-07/

[6] Mortgage News Daily; 30-year fixed mortgage rates.

https://www.mortgagenewsdaily.com/mortgage-rates/30-year-fixed

[7] Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States [MORTGAGE30US], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/MORTGAGE30US

Board of Governors of the Federal Reserve System (US), Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis [DGS10], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/DGS10

[8] See Chart 1.

[9] See Chart 1.

[10] Housing affordability measures the debt-service and equity down-payment of a median homebuyer family and is calculated based on median home prices, median family income and the 30-year mortgage rate. We assume a loan-to-value ratio of 80% and full amortization of the mortgage over the 30 year duration. No other costs related to the house purchase (fees or taxes) or other maintenance costs (e.g. insurance) are included.

U.S. Census Bureau and U.S. Department of Housing and Urban Development, Median Sales Price of Houses Sold for the United States [MSPUS], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/MSPUS

U.S. Census Bureau, Median Family Income in the United States [MEFAINUSA646N], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/MEFAINUSA646N

Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States [MORTGAGE30US], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/MORTGAGE30US

[11] Freddie Mac, 30-Year Fixed Rate Mortgage Average in the United States [MORTGAGE30US], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/MORTGAGE30US

Bureau of Economic Analysis; Mortgage Interest Paid, Owner- and Tenant-Occupied Residential Housing; January 29, 2026.

https://apps.bea.gov/iTable/?reqid=19&step=3&isuri=1&select_all_years=0&nipa_table_list=6082&series=q&first_year=1990&last_year=2021&scale=-99&categories=miscpublic&thetable=#eyJhcHBpZCI6MTksInN0ZXBzIjpbMSwyLDMsM10sImRhdGEiOltbInNlbGVjdF9hbGxfeWVhcnMiLCIwIl0sWyJuaXBhX3RhYmxlX2xpc3QiLCI2MDgyIl0sWyJzZXJpZXMiLCJRIl0sWyJmaXJzdF95ZWFyIiwiMTk3NyJdLFsibGFzdF95ZWFyIiwiMjAyNSJdLFsic2NhbGUiLCItOSJdLFsiY2F0ZWdvcmllcyIsIlN1cnZleSJdLFsidGhldGFibGUiLCIiXV19

[12] Same as footnote 10.

[13] U.S. Census Bureau and U.S. Department of Housing and Urban Development, New Privately-Owned Housing Units Started: Total Units [HOUST], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/HOUST

U.S. Census Bureau, Household Estimates [TTLHHM156N], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/TTLHHM156N

[14] U.S. Bureau of Labor Statistics, Producer Price Index by Commodity: Special Indexes: Construction Materials [WPUSI012011],

retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/WPUSI012011

U.S. Bureau of Economic Analysis, Gross Domestic Product: Implicit Price Deflator [GDPDEF], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/GDPDEF

U.S. Bureau of Labor Statistics, Average Hourly Earnings of Production and Nonsupervisory Employees, Construction [CES2000000008], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/CES2000000008

U.S. Bureau of Labor Statistics, Average Hourly Earnings of Production and Nonsupervisory Employees, Total Private [AHETPI], retrieved from FRED, Federal Reserve Bank of St. Louis; January 29, 2026.

https://fred.stlouisfed.org/series/AHETPI

[15] https://www.zaisgroup.com/housing-slump-supports-agency-crt-notes.html

[16] https://www.zaisgroup.com/unlocking-home-equity-values.html

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