FARM CREDIT OF CENTRAL FLORIDA

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2023 REAL ESTATE UPDATE PART III

BUILD IT... THEY WILL COME. ON ACCESSIBILITY OF FUTURE HOUSING

BY STEVAN NOVAKOVIC, SR. ECONOMIST

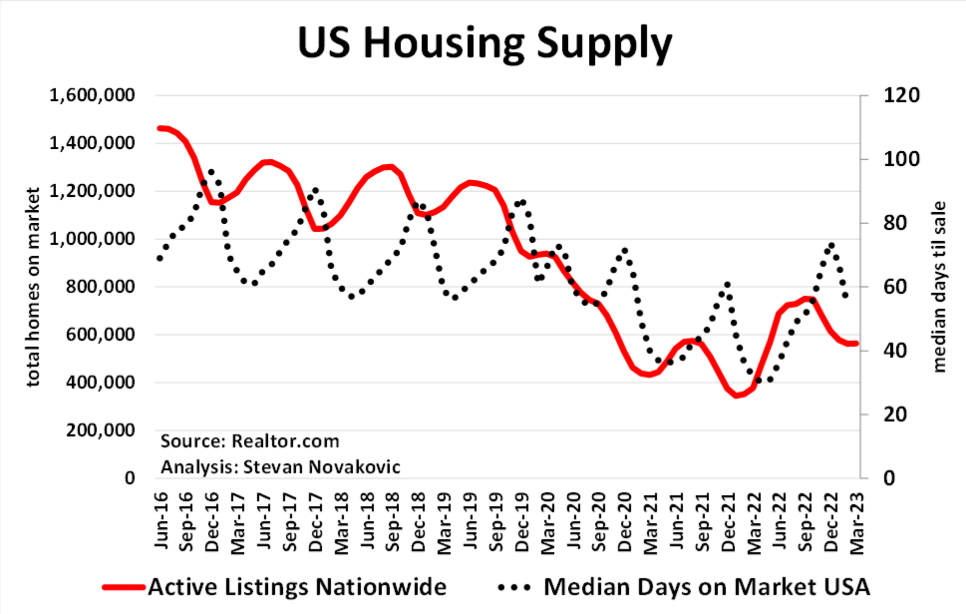
Introduction

In the late 2000s, leaders in the Western media became aware of what they termed “ghost cities” all throughout China. Numerous pieces of journalism, clickbait, and documentaries were published about these fascinating, haunting, and mysterious locations – devoid of human life. Much consternation and even criticism was levied against the towns, but it appears the planners in multiple locations may have the last laugh. Chenggong, oft referenced for its 100,000 empty apartments is now an active suburban town. Kangbashi, a place that *TIME* magazine in 2010 mocked as “a new Chinese city that, apart from people, has everything” now apparently lacks for nothing, with a top-notch secondary school attracting over 150,000. Rounding it out, Zhengdong New District, termed desolate for “miles and miles” by *60 Minutes* in 2013, is now home to over 1 million individuals. In case the reader was becoming concerned, this final piece of our three part series on real estate is not going to analyze the Chinese market, or even America’s hyperinflated northern neighbor Canada, but it will highlight a notion those state planners in Beijing apparently incorporated: if you build it, they will probably come.

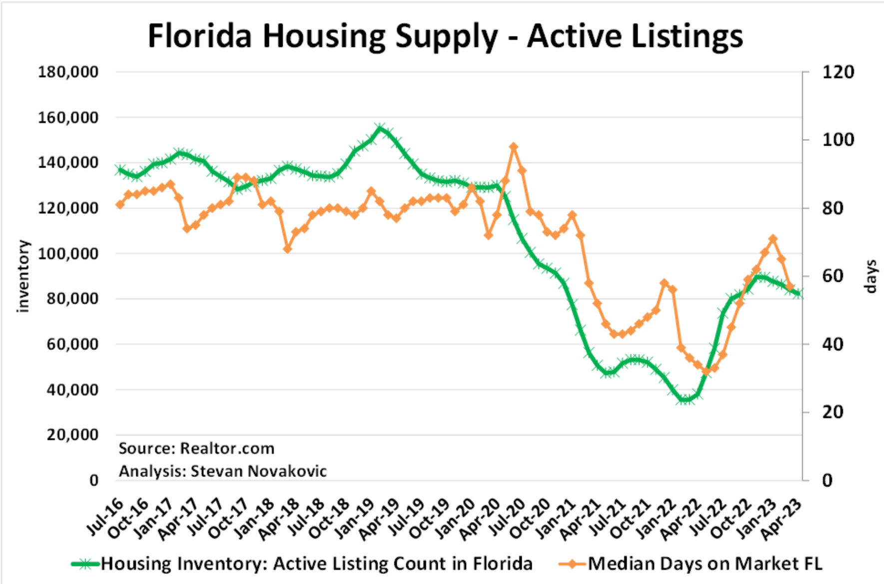
The United States has a few recently built ghost neighborhoods, like the busted mansion-strewn $1.6 billion Indian Ridge Resort in Missouri (our ghost “towns” are generally antique and uninhabitable). We do have “ghosted” cities in parts of Detroit, Flint, Baltimore, Toledo, and Gary, IN (derelict homes therein also effectively unlivable). In the current day, however, if something new is built it is virtually guaranteed to be inhabited. As noted in parts I and II, the US has underbuilt homes for more than 15 years, to the point where we sit in a nationwide deficit of at least 9.5 million units. After the Great Financial Crisis developers became risk averse to speculatively building en masse. Thus, the mantra across Manifest Destiny has been: “they come, and then you will build.”

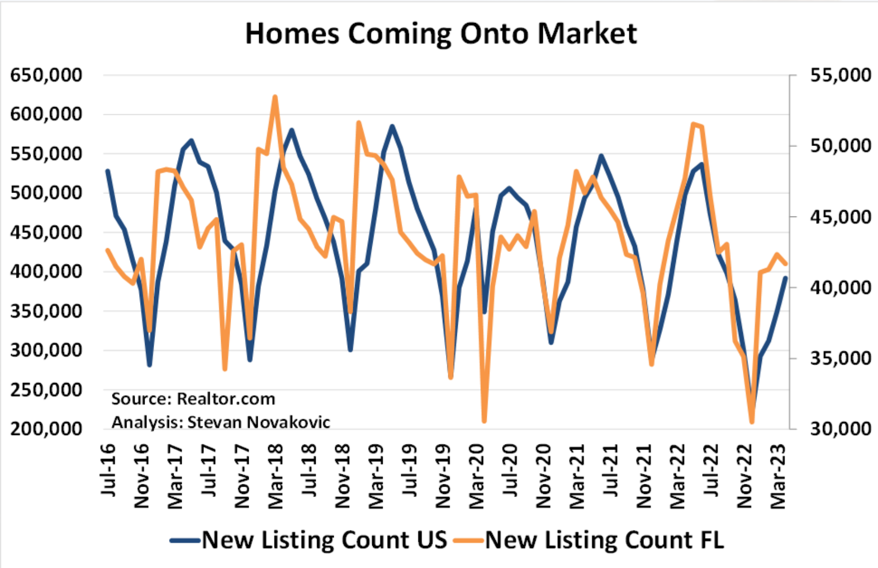
This then begs the question: how accessible will housing be in the future? As alluded to in the last article: it depends… and how quickly are you willing to move? We have two primary sources of procuring housing in this country: buying an existing home from an owner or building/paying for a new home. That’s it. Some may inherit a home, some may have a lovely tent on public property in San Francisco or Austin, but for the purposes of analysis those lucky folks are negligible. So, let’s start with a look at current inventory for sale.

A simple baseline for understanding accessibility is how many homes are available for sale. We have utilized similar charts in other reports but it bears repeating: we are not far off all-time lows in inventory. February 2022 was the nation's all-time recorded low of 344,000 – meaning around one house was for sale for every 970 Americans. Peak recorded availability was in June of 2016 at 1.43 million homes, indicating a drop of 74% from the high. Over the three years leading up to the pandemic the US averaged about 1.2 million homes for sale, currently the nation sits at 564,000 – a decline of 53% from a relative norm. One might retort in this situation that past performance is not a projection of future events, and to some extent that quip holds water, which is why trends are of increasing importance. The pandemic was an outlier, unparalleled events with never-before-seen reactions, so data over that period is often noisy. Look, however, at how the market had been trending over the years prior to coronavirus: incrementally less inventory. During the three and a half years leading up to the pandemic inventory fell 29%, and, while the housing market follows strongly seasonal waves, the peaks were getting shorter and the troughs were getting deeper.



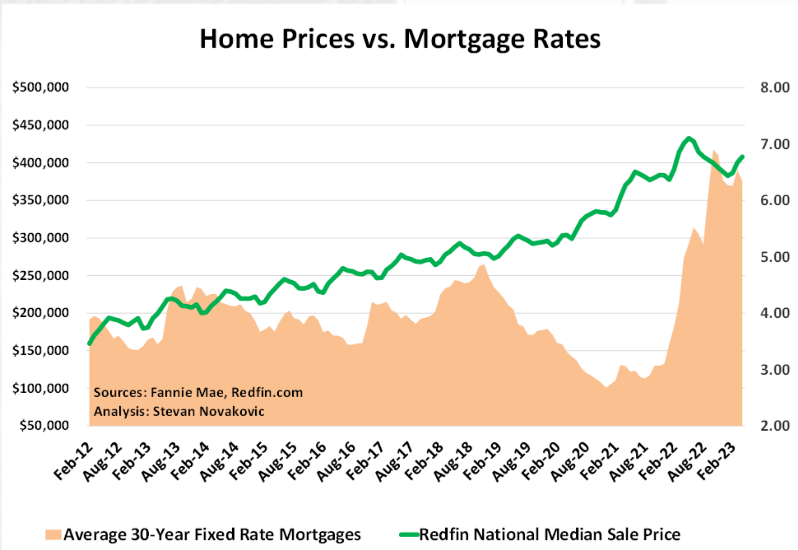
In the Sunshine State, the story is quite similar. Inventory in Florida fell 77% from the high set in February 2019 to the low in March 2022, and is currently 47% below the peak. Another important trend has emerged, however, and that is in how long homes stay on the market before they are sold. The median time on market was on a decreasing trajectory (though volatile) until the inventory minimum in winter 2022, and has been steadily rising both in Florida and nationwide. This indicates that even in low inventory environments a measurable percentage of homes on the market are out of reach price-wise or unattractive. For example, if a fairly consistent number of new listings enter the market, inventory declines but days on the market before sale remain elevated, we can infer those remaining listings are less enticing from a financial or other point of view.

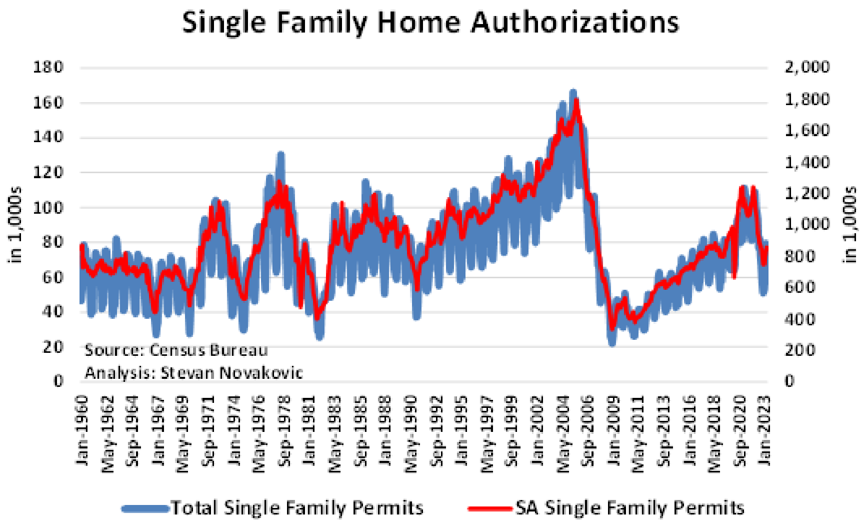




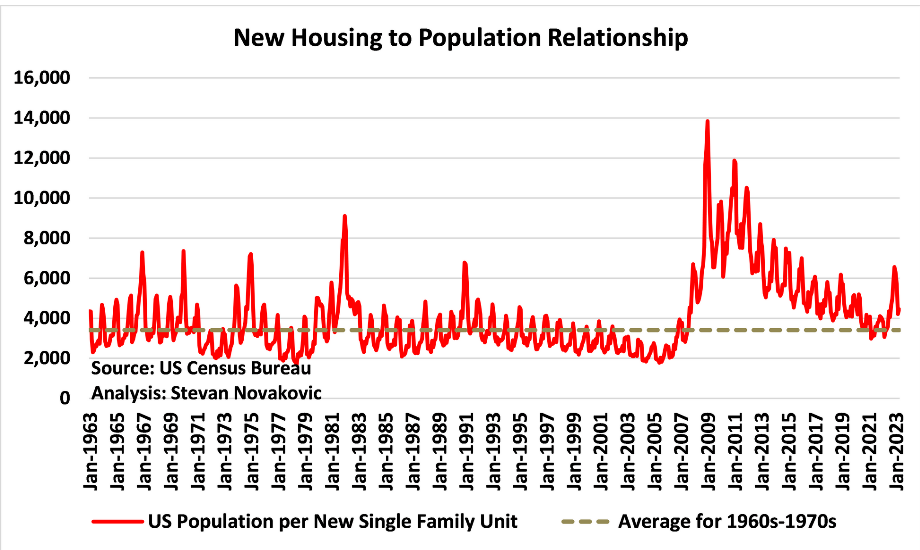
To model this slightly differently we can look at *new listings* coming onto market – those that can be added to what is already for sale. These totals are noisy when looked at on a monthly basis, but are also trending lower. What appears to be the peak on Florida's most recent wave is about 19% lower than the previous, and nationally (though perhaps not yet having peaked for this season) new listings remain 28% below the last high. None of this gurantees we won't see an increase in inventory over the near future, but another wrench has been thrown into the system: mortgage interest rates.

Towards the end of May 2023, for the first time since 2002, average 30-year mortgage rates in the United States eclipsed 7%. As recently as January 2021 that number was 2.65%. In our last piece we highlighted examples of increased payments due to mortgage rate changes, so there is no need to cover that again, but let's consider this from a different angle. Not only have rates risen, but so have median home sales prices. There could be a multitude of factors for this including affordable housing being snapped up and not returning to the market, and buyers at higher price points being less rate sensitive. Where this diverges from previous markets (and perhaps common intuition) is that while interest rates have skyrocketed, home prices have barely budged lower (in aggregate) and over the past few months have begun rising again. This remains a hot market – *with no signs of slowing down*. To further put this in perspective: about one third of all mortgages were refinanced during the low interest rate environment from Q2 of 2020 through Q4 of 2021, a period in which the national average ranged from a low of 2.65% to a high of 3.33%, and some exceptional borrowers even locked in rates around 2.5%. Approximately 45% of mortgages with a remaining balance between $300-400,000 were refinanced, and half of all homes with between $400-500,000 left. Those with small balances were the least likely to refinance as only 9% with balances under $100,000 pulled the trigger and about 22% of those holding notes owing between $100-200,000. Here is the underlying point: those most likely to have refinanced were in the modal range of house prices, generally those within one standard deviation from the median national price. These are competitive homes for middle class families – what incentive do they have to move when prices are significantly higher than December 2022 and rates have more than doubled? Further, for those with less than $200,000 left on their mortgage who felt no need to refinance, why should they move if they are so close to owning their home debt free?



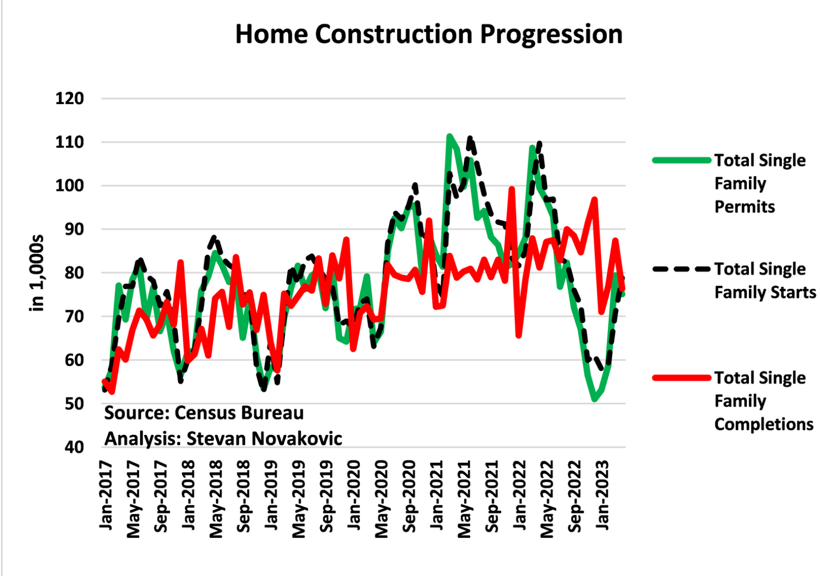


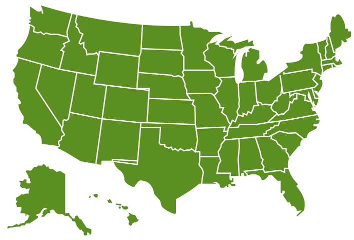
Enough pontificating about the future without a magical crystal ball, instead, let us apply an apt forecasting tool we can access: public data on homebuilding intentions. Looking at existing inventory levels paints a drab portrait of the market for buyers, but what about their other option, new houses? Records of recent authorizations across the country are available and indicate a lack of impending surplus. First, just on a relative basis, new permits have dropped 31% since their pandemic peak in December 2020, and are down 52% from the recent high before the housing collapse of the mid-2000s. The current rate of intentions remains below the average level of the 1980s – when the US population had nearly 90 million fewer people.

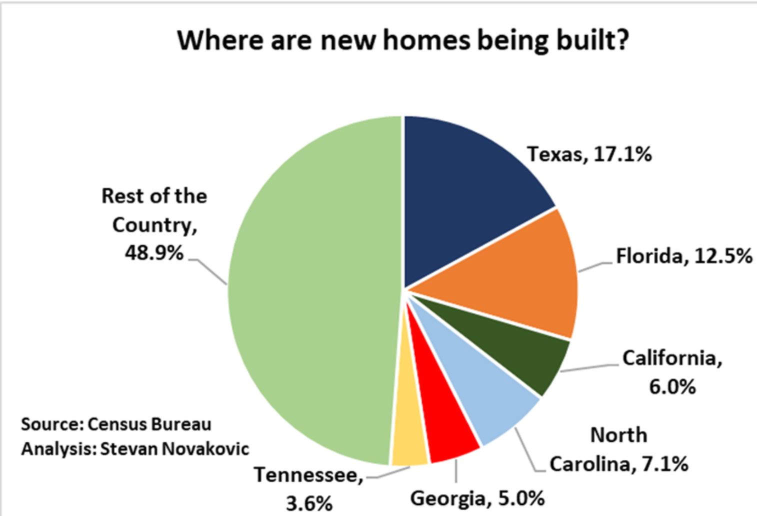


The previous section tells a very similar story to Part I of our series - underbuilding in homes which began with.....*underpermitting.* For those of us in central Florida experiencing I-4, I-275, I-75, or downtown traffic in Orlando, Tampa, or maybe even the worst of those three, *Lakeland,* a shortage of builds and upcoming developments may seem ridiculous. But before touching on where new permits are located, its important to put into perspective how much permitting has slowed down across the country. The following chart's curve might at first glance mimic some we have posted but, it is actually inverted, a delayed lag. What it shows is the relationship between total population and new single family home permits (remember the "American Dream"). Over the 1960s and 1970s the average relationship of US population to new single family housing permits (on a monthly basis) was 3,413:1. At the peak of underbuilding in the mid-2000s there were 13,848 Americans for each new permit issued monthly – nearly quadruple the pool of citizens that could have competed for the upcoming dwellings in the 1960s or 1970s. Most recently, for April 2023, the ratio was 4,459:1 – almost 31% greater than where the US stood a half century ago.

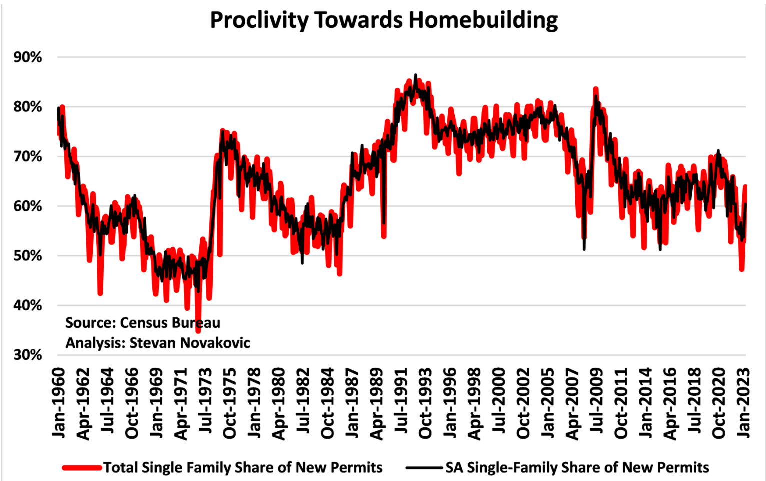
Knowing how many permits are in the pipeline is not the only factor contributing to our forecast: how long it takes to get houses into the hands of buyers is also important. Historically, a general expectation was a year lag between home starts and completions, give or take a month or so. The pandemic supply chain bottlenecks completely changed that, to the point where the majority of starts during that period were completed closer to two years later. As interest rates started rising in 2022, permits and starts plummeted, to the point where now American builders are finishing about the same number of homes as are permitted each month. The decline in permits reflected during a time period of rising borrowing costs has allowed construction firms to catch-up the backlog, inferring more consistency in building times for the upcoming future.



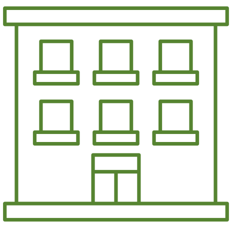


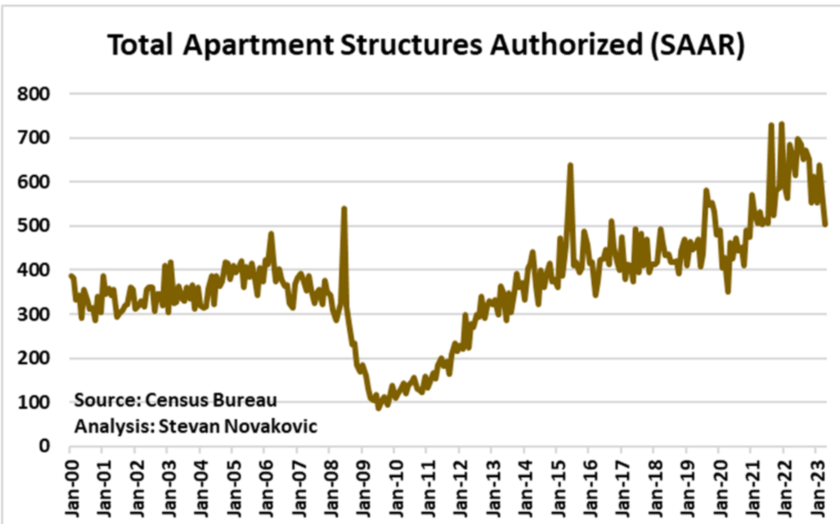


Along with the number of homes coming online and the speed at which they do so, accessibility is impacted by the locations of these homes. So, as some fodder for those of you who might possibly be annoyed at the Sunshine State's explosive growth, we are permitting almost triple as many single family homes as they are in California, though the Golden State's population is nearly double Florida's. North Carolinians, however, traffic-wise, might have more to complain about on a relative basis: its population is 27% of California's yet has a greater number of new houses in the pipeline. Florida and Texas alone account for 29.6% of all upcoming builds nationwide. Five of the top six states are in the South (and South Carolina is closing in) so adding North Carolina, Georgia, and Tennessee to the Dixieland quintet the total is 45.3% of new single-family permits across the country. A host of factors encourages this trend from regulatory environments, NIMBYism, affordable land, room for growth, geographical desirability, and more – but in forecasting accessibility knowing where the upcoming housing will be matters. The entirety of New England permitted only about 11% of what Florida did in April. When the Sunshine State continues to experience elevated prices, while supporting the second most permits in the country, it is both a combination of desirability *and* where new houses happen to be: where it's built folks must go. Would more people move to Kansas? Perhaps, but they only permitted 4% of what Florida did in April. This is a complicated market, but the astute reader might have noticed: why have we only talked about homes – can't people live in apartments?



The American Dream isn't singularly home ownership, it's a nebulous notion that infers opportunity for advancement, upward mobility without barriers. It has never been easy. In the chorus of Hank Williams Jr.'s song entitled the same he laments: "Do you really want it, do you really need it / Ya gotta keep on grindin' just ta try ta keep it." In 1982 at the height of another recession Hank asked the question of how much the fantasy is worth striving for – and in 2023 it is out of reach for more and more people. Homeownership has been inextricably tied to the nation's vision for decades, paying homage to a cultural settler mindset. Both of our series' previous parts on availability and affordability enunciate this, and we have further elaborated in this last section. But there is one sector of housing that has exploded: multi-family. American builders historically have prioritized single-family homes, with those accounting for more than 86% of impending structures authorized in December 1992. By December of 2022, three decades later, that portion had dropped to 53% of new permits. Apartments were in, homes were out. While there are yield, permitting, and space restraining aspects that encouraged this, the Great Recession incentivized it as well. With over 6 million homes lost to foreclosure in the mid-late 2000s and skyrocketing unemployment rates folks needed affordable housing of any sort, especially those with plummeting credit scores. Increases in immigration alone of 14 million individuals between the year 2000 and 2010 outpaced total housing (homes and apartments) permits by more than 1 million. Large scale options were needed to meet housing goals and builders prioritized.



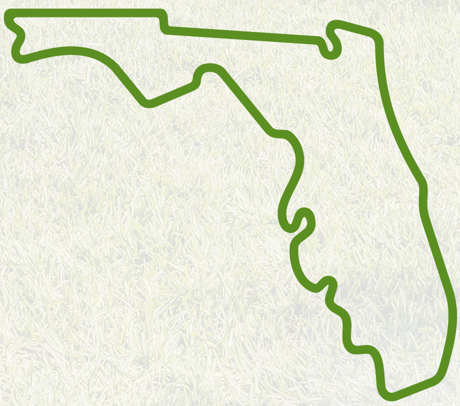


It remains true that total units permitted, built, and sold remain well-below where they were in the past, but this is occurring during a separate transition away from single family structures towards multi-family buildings. During December 2021 the US set a 46-year record high in new apartment authorizations with an annual rate of 732,000 units. Multi-family units have not yet eclipsed single-family homes, but the spread between the two continues to narrow. While apartments may not be the first choice for everyone, they may be the only choice for many across the foreseeable future.

CONCLUSION

Over this three-part series on real estate a few main foundational elements were rooted throughout: a supply side crisis resulting from 15 years of underbuilding fused with government stimulus, work from home, historically low mortgage interest rates, and Millennials finally entering the housing market. This is pertinent to reiterate because the themes underscore the pressures going forward: demand remains unchanged and continues to build, inventory is challenged as owners are disincentivized to move, and the pipeline of upcoming new homes is once again on the decline. Total permits (on an annualized rate) for all types of housing during April of 2023 were 300,000 units below the national replacement rate, exacerbating the shortage. By the beginning of 2024 the United States could very well be facing a national deficit of around 10 million housing units. In the previous affordability piece it was suggested that folks might need to move to bargain neighborhoods in less geographically desirable locations. This still holds true, but inventory in those places is also tight. With more than 50% of new homes being built in six states, mobility is hampered. And, to top it off, who really wants to uproot themselves, let alone their family to move across the country for an affordable *apartment*.

The USA's fame across the globe is often for its freedom, we don't conduct the planning of speculative cities from our capitol as do the Chinese. But something local Mandarin speakers there told the Western media criticizing their ghost cities was that "the people will come, they will come." While some might connotate this phrase with the film *Field of Dreams* ("If you build it, he will come") it's much older than that: from the protocanonical flood narrative. In that rendering, Noah was told to build an ark that would hold his family and the earth's animals, but the shipbuilder was not a cowboy, he was not a giraffe wrangler nor a moose wrestler – he was only told to build the boat, and the animals simply arrived. Despite some analysts predicting a national housing crash spurred by high interest rates, the United States remains in a supply side crisis. Opportunities abound in this market for homeowners, homebuyers, speculators, developers, and builders. As Jerry Garcia, in "St. Stephen," sang: "talk about your plenty, talk about your ills/one man gathers what another man spills." There are monumental prospects for growth and arbitrage across the country as America must build at double the rate we have been for the next seven years in order to make up the deficit. And, while we need apartments, it's hard to imagine John Denver entreating the country roads to take him to one of *those*.



ABOUT OUR ECONOMIST

Stevan Novakovic holds an M.S. in Public Policy from Georgetown University with a focus in econometrics. Prior to joining Farm Credit of Central Florida he conducted economic research on agricultural commodities for IHS Market (previously Informa Economics Group), and spent time in hedging/risk management and as a commodities trader for Central States Enterprises, Inc. Stevan also earned an M.A. from Columbia University and undergraduate degrees from the Moore School of Business at the University of South Carolina, where he triple-majored in International Business, Global Supply Chain and Operations Management, and Finance.

ABOUT FARM CREDIT OF CENTRAL FLORIDA

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