Choreo

May 2024

Market Perspectives: The Dynamic World of Residential *Real Estate*

Choreo®

MARKET PERSPECTIVES: THE DYNAMIC WORLD OF RESIDENTIAL REAL ESTATE

MAY 2024

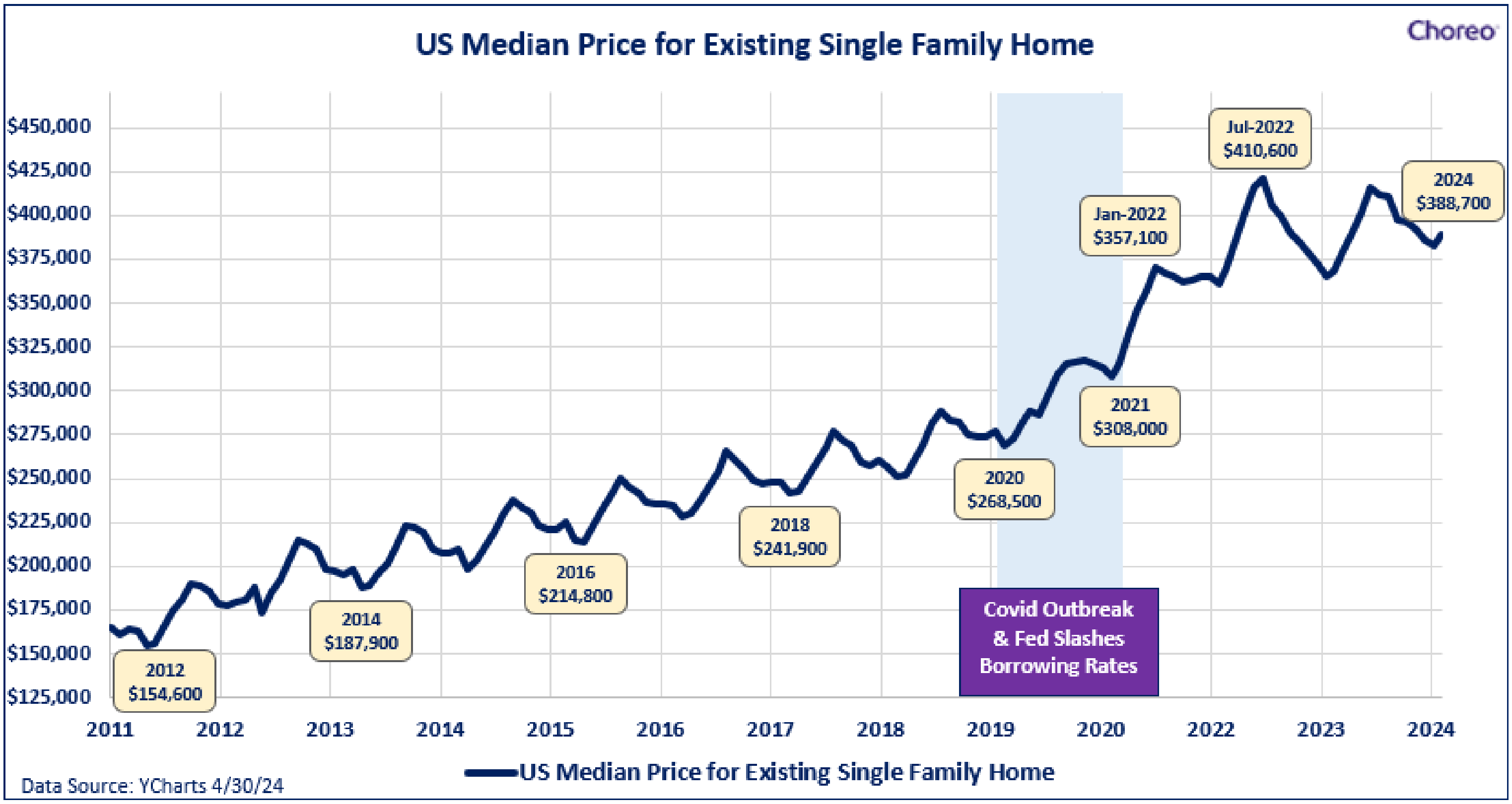
"There is no place like home."

~Dorothy, Wizard of Oz

- In recent decades, Americans have seen significant gains in home values which has been a major contributing factor to household wealth.
- During the early stages of the COVID-19 pandemic, the housing market experienced a surge due in part to low interest rates and high levels of liquidity. These conditions allowed for increased home mortgage refinancing volumes and ultimately home purchases.
- Separately, inflation surged, and the Federal Reserve (the "Fed") utilized its tool of raising interest rates to combat inflation. The aggressive actions saw 30-year mortgage rates soar from 3% to over 7%.
- This sudden increase in rates presented a financing dilemma for home buyers, particularly first-time home purchasers, who faced higher monthly expenses. Since homeownership is one of the largest assets for many Americans, the pricing dilemma had and continues to have significant implications.

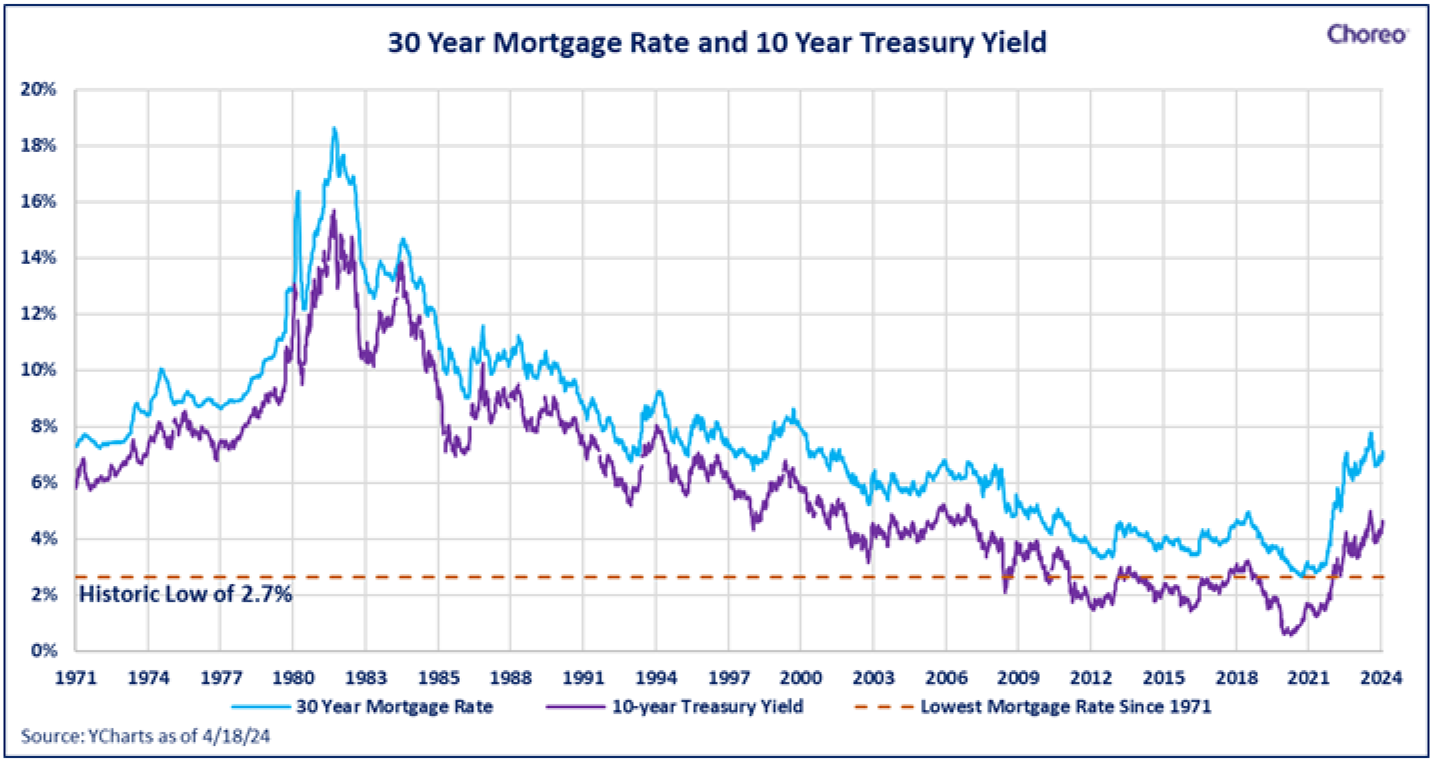
Throughout time, shelter has been seen as one of the most fundamental human needs. According to the Smithsonian Institute, the earliest known human shelters were created almost 400,000 years ago of simple materials. Over time, shelters have evolved and today owning a home has become a key milestone in pursuit of the so-called "American Dream." This strategy of real estate ownership has also been seen as methodology for building wealth over time. Since the Great Financial Crisis (GFC) of 2008, home equity values have more than doubled, rising from $20.8 trillion to $44 trillion more recently (Source: Federal Reserve). There are many reasons for this growth, such as a low cost of capital (i.e., low interest rates) and a mismatch of supply and demand, among other reasons.

The graph below shows the average price of a single-family home in the U.S. since 2011. As noted, price increases have stalled, having peaked in July 2022 although remain near highs. The pause may in part be due to the Fed rate hikes beginning in March 2022.

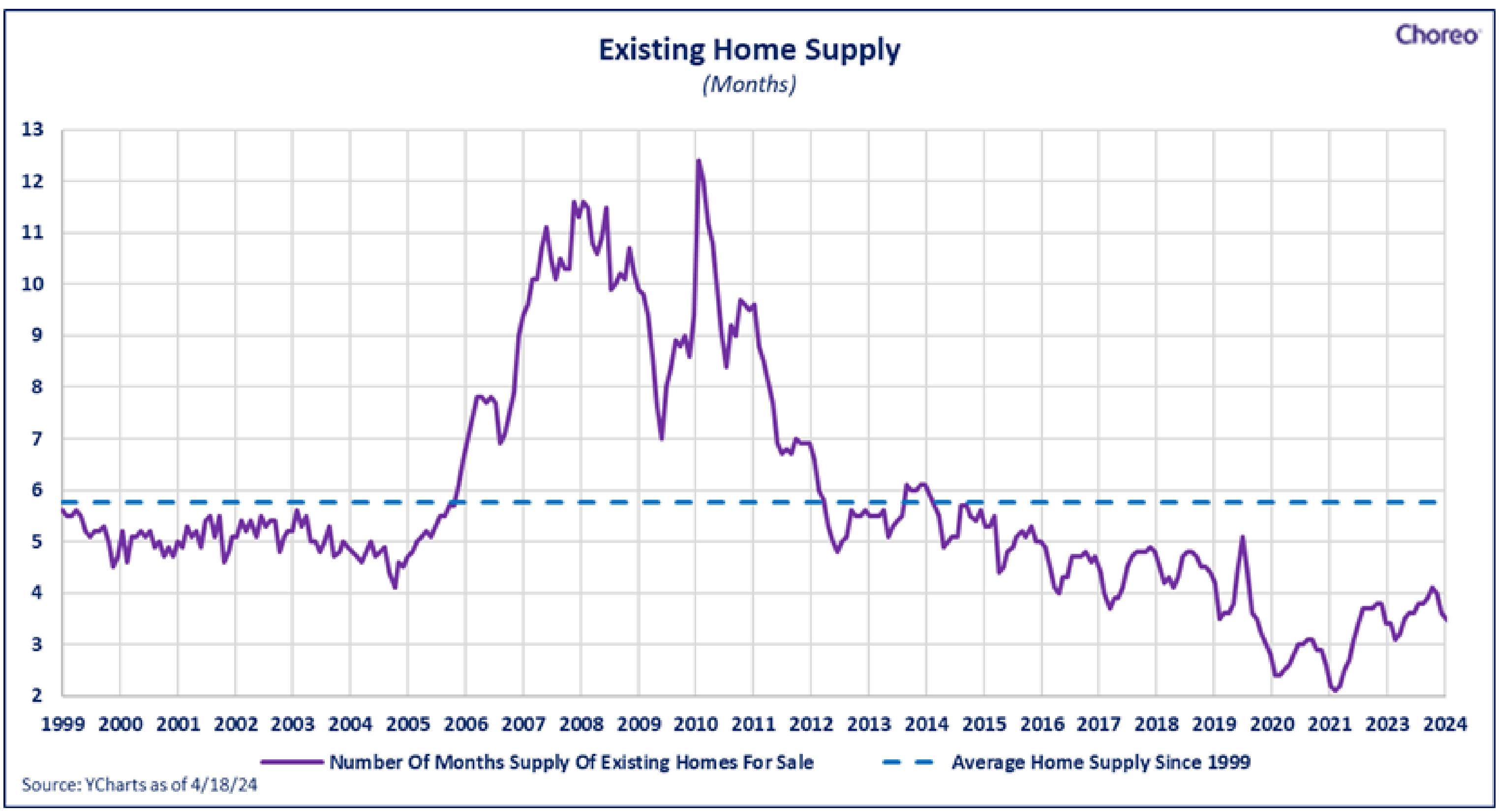


Historically, interest rates and asset prices have been inversely related (i.e., when rates rise, prices fall). When the Fed started hiking rates to combat inflation, there was a widespread expectation amongst market participants that home prices would fall, along with other interest rate sensitive assets. Surprisingly, the opposite happened – home prices surged. The average selling price of single-family homes rose from $308K in early 2021 to $389K today, a 26% increase (as shown in the first graph above), and up from $268K pre-covid.

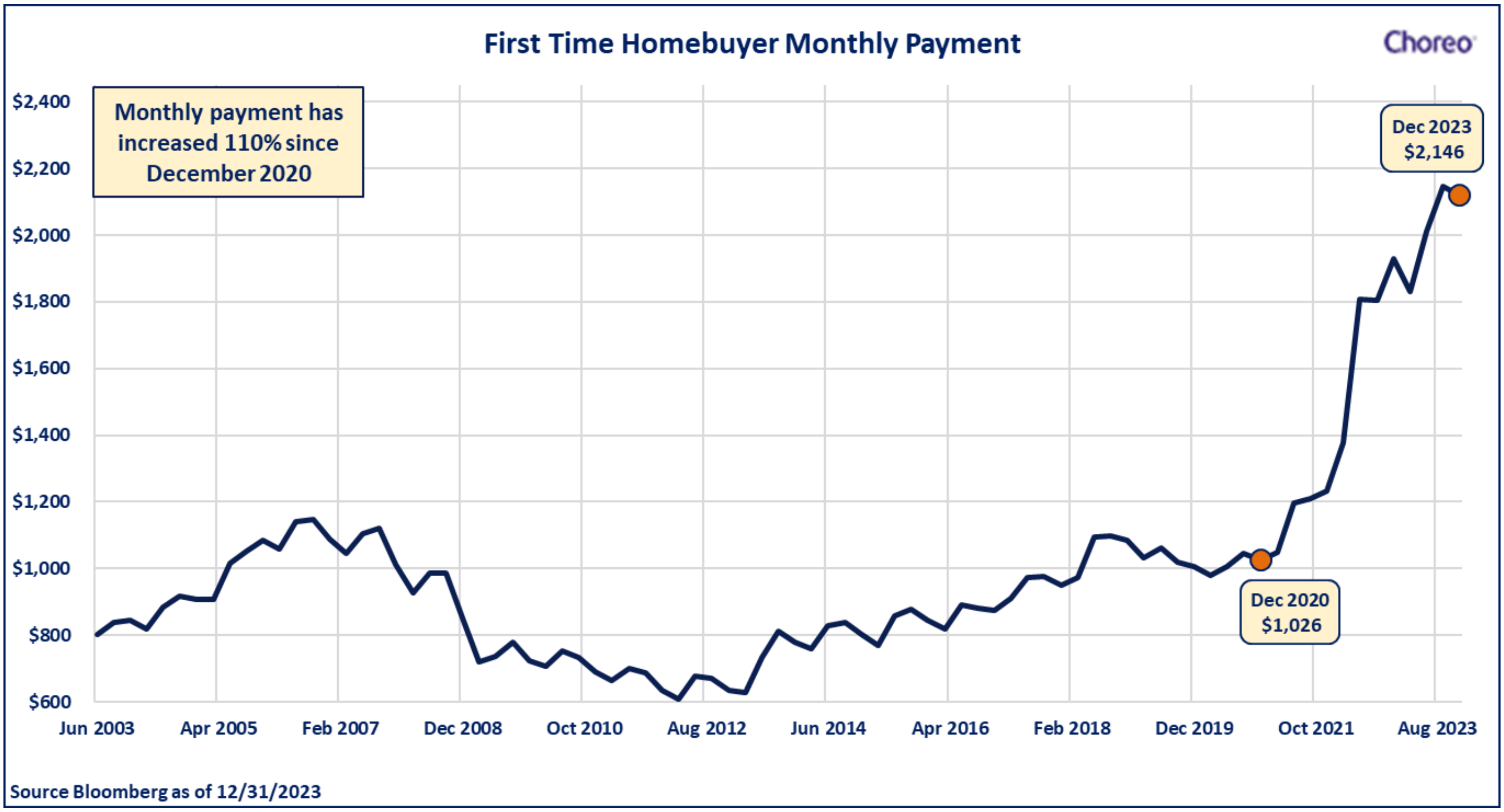
Interest rates have long been a major factor in house prices. Lower interest rates make homes more affordable since it reduces the monthly mortgage payment. The rate environment had been declining steadily since the 1980's until the recent bout of inflation took hold, prompting the Fed to intervene. The low water mark for the 30-year mortgage was 2.7% and has steadily risen since then. The graph below shows the 10-year Treasury yield and the 30-year mortgage rate. From the historical low point several years ago, rates have more than doubled causing strain amongst borrowers.



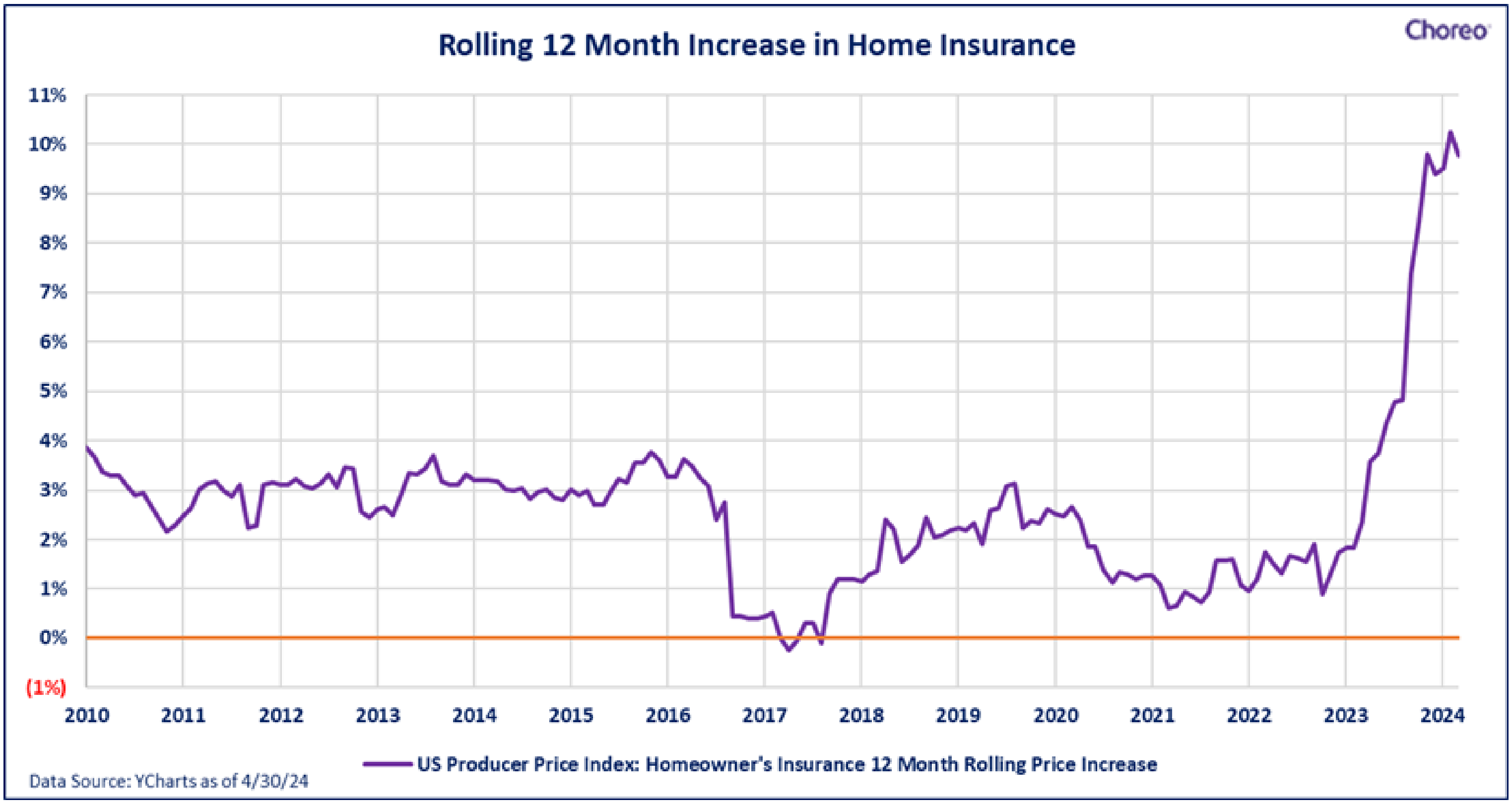
Another major force for the resiliency of home prices has been the continued collapse of homes available for sale. With lower supply on the market, buyers have fewer options and prices have remained firm. The graph below shows the decline in "months of supply" of existing homes. The lower the months' worth of supply, the lower the availability of inventory for homebuyers to search. Currently supply sits at roughly 3.5 months, down from the long-term average of just under six months.



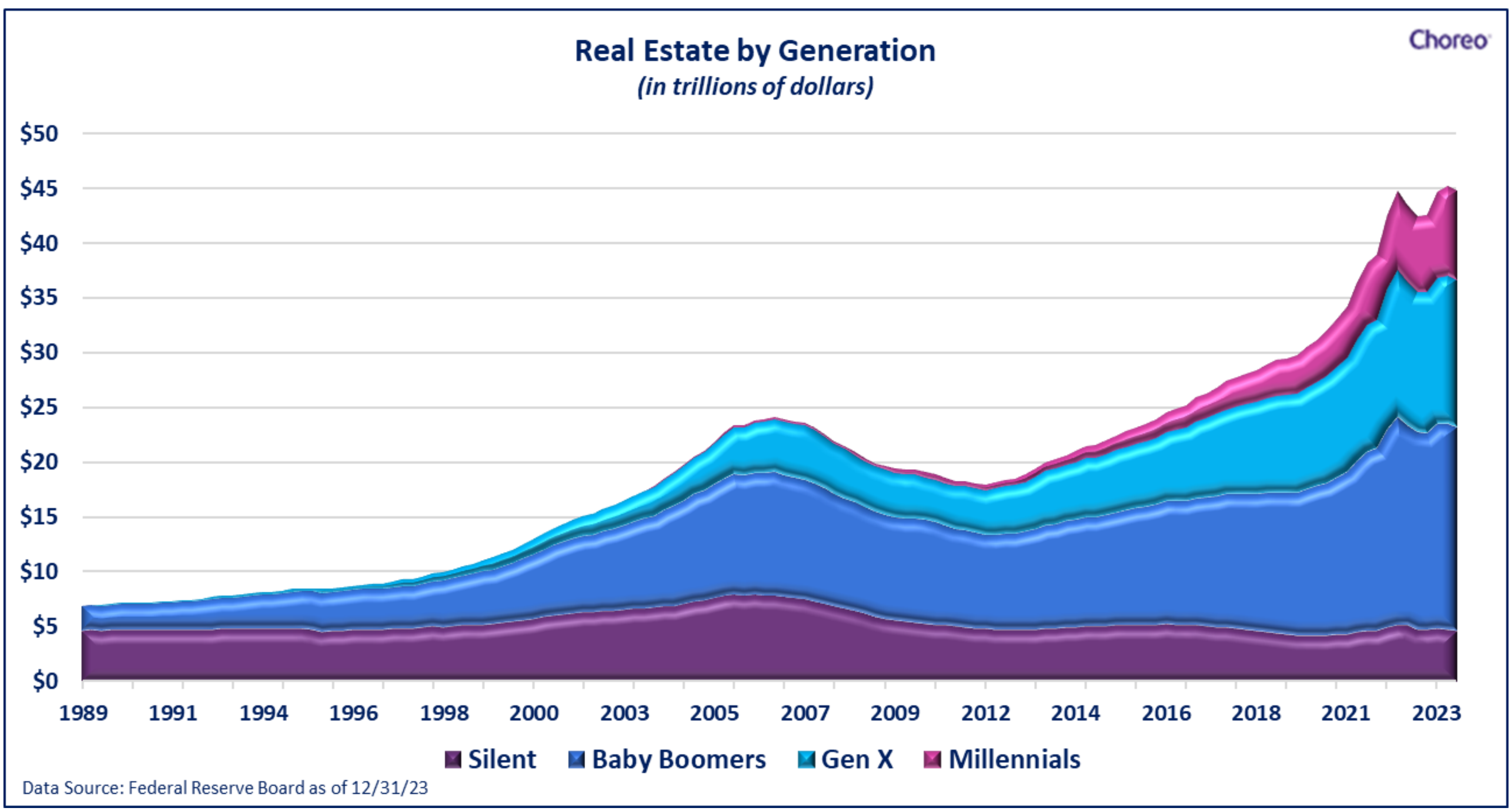
Additional challenges relating to the costs of home ownership are significant; particularly for first time buyers, who have seen costs roughly double since 2020 as rising interest rates coupled with home prices increasing have created difficulties with affordability. Currently the monthly payment for a first-time homebuyer sits at over $2,100 vs. $1,026 in December 2020.



Not only are the first order impacts meaningful, but the derivate impacts are notable as well. For example, as home prices rose, the cost of insuring the home has risen. In fact, coupled with materials costs, labor and other factors, insurers have raised prices on home insurance at the fastest pace in at least a decade as shown in the graph below.



Finally, it is worth noting that the home ownership dynamic is generational. Millennials represent a growing portion of homeowners, although baby boomers still represent the largest share. Accumulating wealth via real estate compounds over a lifetime. This trend will impact economic conditions as wealth builds over time.



There are many other possible factors at play in the dynamic world of residential real estate, including ongoing population growth, supply/demand dynamics, as well as the prospects for the end of the rate hike cycle and ultimately the rate-cut cycle beginning (i.e. changes in interest rates). When viewing the overall picture of economic health, including at the individual level, housing is an important component. As one of the largest assets on the balance sheet of many American's (retirement savings being the other), this asset — and its impact on the broader economy — is worth monitoring.

As always, we encourage you to reach out to your Choreo advisor with any questions or comments.

Disclosures

Opinions are as of the date referenced and are subject to change based on market or economic conditions. There is no guarantee that any of these expectations will become actual results.

The performance numbers displayed herein may have been adversely or favorably impacted by events and economic conditions that will not prevail in the future. Past performance does not indicate future performance. The indices discussed are unmanaged and do not incur management fees, transaction costs or other expenses associated with investable products. It is not possible to directly invest in an index.

This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, insurance, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. Information has been obtained from a variety of sources believed to be reliable though not independently verified. Choreo, LLC, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed. Past performance does not indicate future performance. The sole purpose of this document is to inform, and it is not intended to be an offer or solicitation to purchase or sell any security, or investment or service. Investments mentioned in this document may not be suitable for investors. Before making any investment, each investor should carefully consider the risks associated with the investment and make a determination based on the investor's own particular circumstances, that the investment is consistent with the investor's investment objectives.