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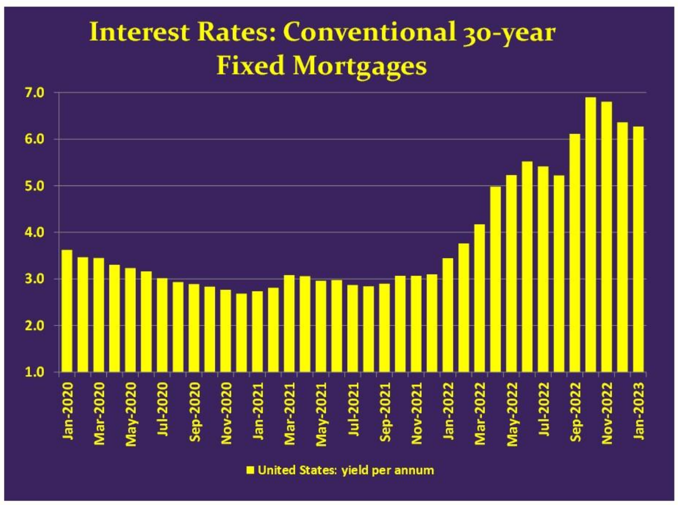
February 19, 2023

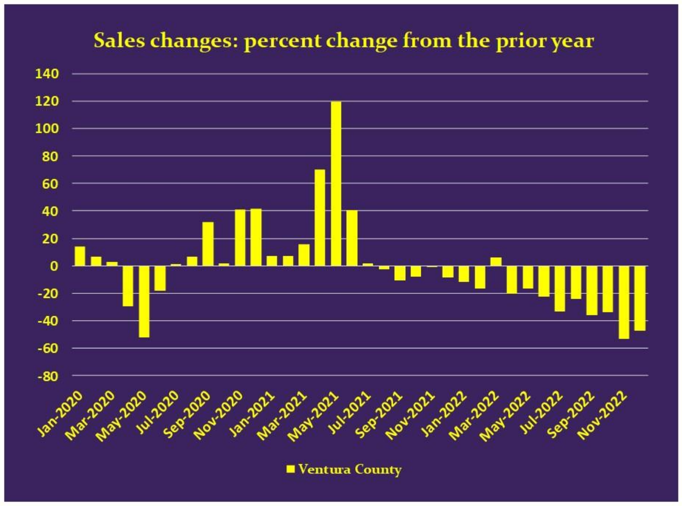
Recent Market Activity

With the Fed's recent and very belated rate hikes to fight off a nasty bout of inflation, mortgage rates more than doubled by October 2022 compared to the year prior. Mortgage rates have since subsided a bit, but they are still double the prevailing rates at the end of 2021. This was a shock to the market. Market participants had become accustomed to the excessively low rates that prevailed since the Fed's extraordinary monetary policy changes starting in late 2008.



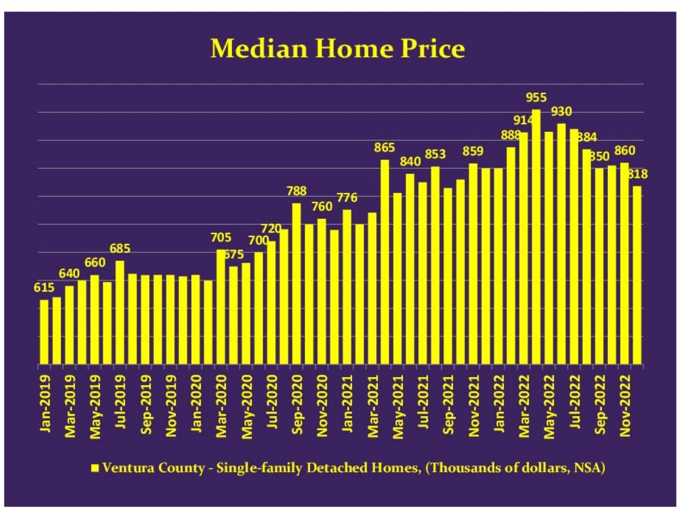
If we consider the historical reality of 12 to 18 percent mortgage rates experienced during the 1980s, we know that six percent rates seem very moderate. The long-run average since 1971 is 7.75 percent. The 1990 through 2008 average, which excludes the extraordinary periods of the 1980s and 2009 to current, the average is 7.32 percent. Six percent rates are not outlandishly high, in fact, they are well under long-run averages. If we consider the CPI inflation rate of 6.4 percent released February 14th, we see that a six-percent mortgage rate is not even positive in inflation-adjusted terms.

Other considerations aside, the 2022 run up in mortgage rates was a shock to housing markets across the U.S., including Ventura County. Sales of existing single-family homes responded as one might expect, with declines in 15 of the last 16 months ending in December of 2022. The sales declines were severe. For example, the number of transactions in each of November and December of 2022 declined more than 40 percent compared with those months in 2021.



What occurred to the prices of existing single-family homes? They peaked and began falling. However, it is important to note that they are declining from a historically high level, a level that was truly astonishing in mid-2022.

Median home prices had reached a record high of $955 thousand dollars in April of 2022. This near $1 million dollar value is remarkable given that it was not the value for a fancy or large home. It was the value for a typical home, perhaps an 1800 square foot 3-bedroom home that was built in 1965, and, not located in a nice neighborhood.

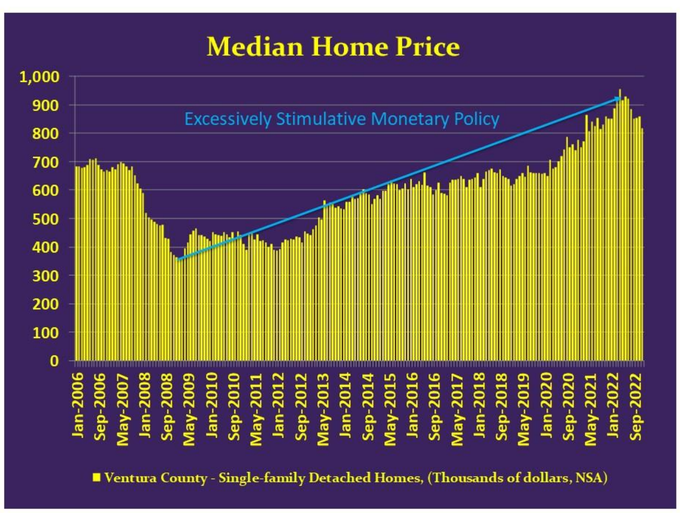


While the Ventura County median home price did continue to rise in late 2021 and early 2022 despite rising mortgage rates, they peaked in April, and then slid to $818 thousand dollars in December 2022. This level of median home prices is excessively high. While the median price is down by 14 percent from the recent high, it is still up 24 percent from the pre-Pandemic level in January of 2020. In quarter 4 of 2022, only 16 percent of the households who live in Ventura County could afford a median priced home. This compares with 38 percent for the United States.

Longer Term Monetary Policy Impacts on Ventura County Housing and our Communities

The recent movements in the housing market are embedded in in Ventura County's longer-term trends.

In late 2008 the Federal Reserve embarked on a stunning monetary policy regime that they essentially continue to follow today, where credit is too inexpensive, as the Fed seeks to systematically subsidize risk. This 14-year long policy regime has had consequences. Precisely as the Fed intended, households, individual and institutional investors, businesses, and non-profits, have all been forced to search for yield. As a result, risky assets have seen the development of a full-blown bubble. These include the stock market and crypto currencies, and it also includes housing. Ventura County home prices experienced an impressive run indeed, from $350 thousand in early 2009 to well over $900 thousand in mid-2022. While Ventura County's mid-2020 to now price run-up was also partly fueled by Pandemic-induced urban flight, the monetary policy has been a factor for the entirety of the last fourteen years.



At this point a reader might say "hang on, the Fed is tightening policy". Indeed they are. However, markets are predicting that the Fed will cease their rate hikes after March. The current rate hike episode, which is just under a year in length now, is a relatively brief and not-so-significant policy regime in the context of the Fed's broader policies since 2008. As mentioned above, the real mortgage rate is negative. Negative interest rates are not thought of as expensive credit, rather, they indicate cheap credit. And, the current rate hiking episode will end very soon.

It is interesting that the Fed believes that the cheap credit policy of the past decade "helped" households. While cheap credit *might* help households in the depths of a severe recession, it is not the right policy to pursue for decade after decade, including episodes of economic growth. As mentioned, the Fed's policy led to an impressive bull run in both financial assets and real assets such as housing. The resulting extremely high prices across a wide spectrum of assets in the U.S. has consequences that the Fed should take much more seriously.

The Fed's multi-decade easy money policy is regressive. That is, it hurts the lower income households, and it hurts Latino (of particular significance in Ventura County) and other communities of color. The near-$1 million dollar median home prices are harmful. With housing being the most common way for a lower-income family to climb the socio-economic ladder, this prevents some of our County's households from reaching for the next rung.

The Fed's multi-decade easy money policies have not adversely impact high income households very much. Higher income households are better positioned to adjust to high asset prices and they can more easily commit wealth to risky investments. As a result, high income households have fared quite well since 2008.

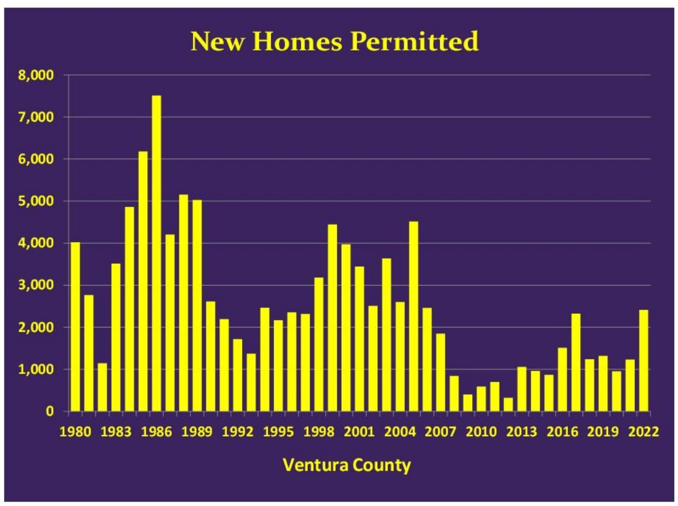
Thus, the Fed's policies have worsened income inequality, something the Fed has professed to be concerned about in recent years. The Fed's own internal research reveals this. The Fed does not seem to care that some of its policies are at odds with its stated policy goals.

As Matthew and I have both called for before, and I will do so yet again here, we request that the Fed to adopt a rational and rules-based Monetary Policy. It is better for overall economic performance, and it better supports Ventura County's communities.

Long Term Local Policy Impacts on Ventura County Housing

Ventura County has one of the most restrictive land-use policies in the United States. As Matthew wrote in October of 2017: "*A series of eight City and one County land use measures, known collectively as Save Open Space & Agricultural Resources (SOAR), require voter approval of any expansion of urban areas—and residents have a decidedly one-sided record of rejecting urban expansion.*" Make no mistake, SOAR represents the most stringent growth restrictions ever adopted by any county in the United States. It should not surprise anyone that the county with SOAR is among the three most unaffordable in the nation.

In addition to SOAR, a palpable anti-real estate development sentiment has existed during the past two decades that has blocked projects to add to our housing stock. Importantly, these attitudes have improved decidedly in recent years. For example we see localities (and their consultants) doing the hard work required to proceed with infill and multi-family development.



The impact of the last two decades of land-use policies, and the attitudes about growth that they underscore, can be seen in residential permit data. From the 1980s to now, in each decade, the permit levels for new housing units has subsided dramatically.

Ventura County

New Residential Housing Permits: The 1980s through the 2020s

	All New Units	Single Family	Multiple Family
The 1980s	44,386	28,804	15,581
The 1990s	24,821	19,016	5,805
The 2000s	26,232	17,917	8,315
The 2010s	10,888	4,490	6,398
The 2020s	4,599	1,460	3,139

Sources: 1980-2012, US Census; 2013 to now, CIRB. The 2020s are through 2022

With only 3 years on the books for the 2020s, we are on track to better the roughly 11,000 units from the 2010s, which is good news, and a testament to the hard and good work that some of our cities are doing. Yet, there have been only 2 good permitting years in the last 15. There is still tremendous work to be done to fill the gap created by the 13 years in which almost no housing was permitted.

The long-term supply-constraint on housing in Ventura County is real. And, it has impacts. It contributes to low housing affordability in the County, is harmful to our lower-income communities, and contributes to income inequality as mentioned above. As well, it is another factor restricting upward socio-economic mobility, in addition to the Monetary Policy factor mentioned above. Thus, Ventura is not only one of the most unaffordable, it is one of the most unequal counties in the nation.

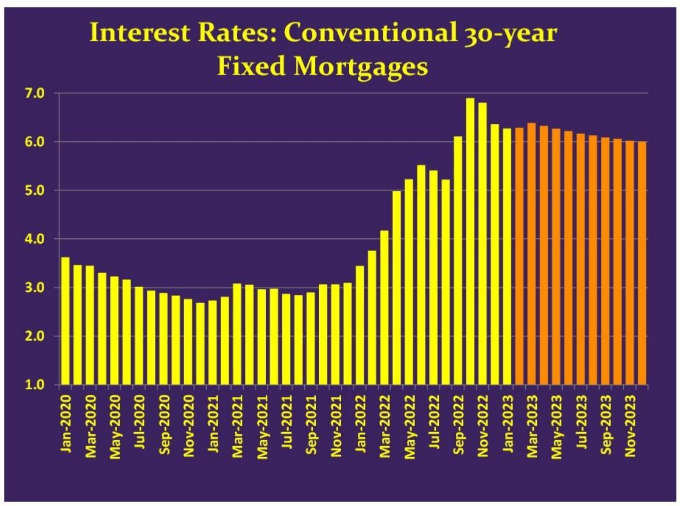
Slow growth policies, including restrictive real estate development, are positioned in the local policy debate as being better for quality of life and for the environment. However, these policies succeed in harming the environment. Because housing affordability is so low, workers must commute. In fact, more than 100,000 people cross the county line each day as they sort between home and work. The impact on our freeways is significant. Mass commuting causes congestion which is a quality of life problem. And, slow or idle traffic increases vehicle emissions compared with flowing traffic. These policies are at odds with environmental consciousness.

A rational economic development policy requires a rational real estate development policy. Real estate development brings various economic benefits. A new building or house has a large multiplier effect on the economy, with the various and substantial improvements, furnishings, appliances, and so on that will then be purchased upon occupation. And it creates economic opportunity via lower prices.

These economic benefits are in addition to providing a better region to live for our lower-income households by increasing affordability and reducing income inequality.

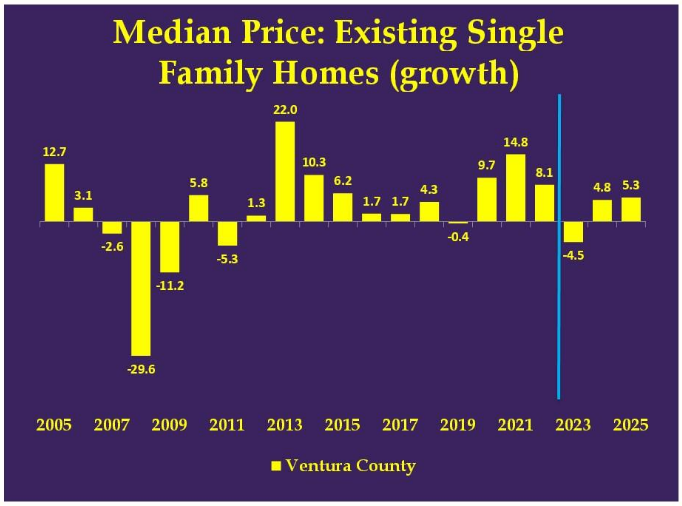
The Housing Forecast

CERF's assumptions for this housing forecast include: the Fed will soon end their rate hikes. We predict that, after a 25 basis point hike in March, the Fed will cease raising rates. With the mortgage rate already subsiding from its recent peak, we expect that the mortgage rate will continue to subside slowly during most of 2023.



The recent efforts to develop more housing in infill areas and more multi-family units will continue. There have been approvals in East County in excess of 2,000 units, which should be in the County's permits over the next two years. These are in addition to project approvals in 2022 that were double the 2021 approvals. We project building activity will range from 1,800 to 2,400 units per year for the next few years, which is well above the most recent five year average.

With that said, the relative under-supply of housing in the county will not change significantly in the near term, and once the current cyclical pull back in sales restores itself by 2024, housing price growth will resume. We forecast a drop in median home prices of 4.5 percent in 2023, a very modest decline compared with the Great Recession, although this 4.5 percent will be on top of the 14 percent decline from the April 2022 peak in home prices.



For 2024 and 2025, we forecast median home price growth, not contractions, of 4.8 and 5.3 percent, respectively. These growth forecasts imply that the 2025 average annual median home price will reach well over $900 thousand dollars. The severe lack of housing affordability is currently expected to persist in the County through 2025.