WFG National Title

ECONOMIC OUTLOOK

WEBINAR
3rd Quarter 2024

with **WFG's Patrick Stone and economist Dr. Bill Conerly**

TALKING POINTS

Opening Commentary by Dr. Bill Conerly

Dr. Bill Conerly provides an insightful analysis of the U.S. economy, focusing on the impact of interest rates, inflation, and the Federal Reserve's strategy. He explores consumer behavior, the role of government spending, and the construction sector, while offering predictions for future Federal Reserve actions and their implications for mortgage rates.

- **Overall Economy:**
  - The economy has seen good GDP growth, but Dr. Conerly expects a slowdown.
  - Consumer spending has been moderate, but is likely to slow further as stimulus money runs out in 2-3 months.
  - **Stimulus Impact:** Initial checks in 2020-2021 were saved or used to pay off debt, but their gradual use has supported the economy since then.
- **Construction Sector:**
  - Single-family home construction has been declining throughout the year.
  - Multifamily construction is also down, while non-residential construction has leveled off after a boom in tech-related projects (e.g., chip fabs and data centers).
  - Business spending on equipment is expected to taper as economic growth slows.
- **Government Spending:**
  - Federal, state, and local government spending has been a key short-term positive for the economy.
- **Federal Reserve's Focus:**
  - The Federal Reserve is guided by its dual mandate: maximum employment and low inflation.
  - **Inflation:** The Fed has successfully reduced its preferred inflation measure from 5.5% to 2.6%, but stubborn inflation remains at 2.6% (goal is 2.0%).
  - More inflation reduction is expected in the pipeline due to monetary policy's time lag.
- **Employment Trends:**
  - Employment has been strong, though signs of softening are emerging, such as fewer voluntary job quits and reduced job openings.
  - Despite this, the labor market remains robust, but slight weakness could prompt the Fed to start easing monetary policy.
- **Fed's Interest Rate Outlook:**
  - Dr. Conerly predicts three 0.25% rate cuts by the Federal Reserve in 2024, starting next week, with additional cuts likely in 2025.

    - **Mortgage Rates:** While Fed rate cuts won't immediately translate into lower mortgage rates, he expects a gradual reduction of 0.75% to 1% over the next year.
- **Risks to the Forecast:**
    - Global risks that could derail the forecast include:
        - Middle East conflicts, especially with Israel and Hamas.
        - Worsening of the Russia-Ukraine war.
        - China's economic weakness, which could lead to heightened tensions over Taiwan.
- **Net Impact on Real Estate:**
    - Despite economic challenges, Dr. Conerly expects lower interest rates to provide a net benefit to the real estate sector over the next year.

Opening Commentary by WFG Chairman and Founder Patrick Stone

Patrick Stone highlights the uncertainty facing the real estate and mortgage industries, urging businesses to focus on planning and operational efficiency to navigate the changes ahead. He touches on a variety of critical topics, including the impact of regulatory shifts, the NAR commission lawsuit, housing supply and demand, mortgage rates, and the evolving market landscape.

- **Geopolitical and Domestic Uncertainty:**
    - Numerous challenges across real estate and related industries.
    - Key issues: inflation, housing affordability, regulatory changes, AI, and the impact of attorney opinion letters (AOLs) on title insurance.
- **Real Estate Industry in Transition:**
    - Uncertainty around the NAR commission lawsuit's outcome.
    - The commission lawsuit could reduce the number of Realtors, potentially affecting title and mortgage companies reliant on referrals.
    - **Statistics:**
        - Realtors: 1.3 million active agents.
        - 52% of people find homes online; 28% rely on buyer agents.
        - John Campbell of Stephens Incorporated projects a potential 50% reduction in Realtors to 750,000, though Stone believes the reduction will not reach this level.
- **Mortgage Industry:**
    - The mortgage industry has faced continuous scrutiny since the financial crisis.
    - Regulatory oversight remains high with acronyms like TILA, TRID, HOEPA, CFPB, and RESPA.
- **Operational Efficiency Focus:**
    - Companies should prioritize automation, training, and technology to improve efficiency and competitiveness.
    - Decreasing numbers of mortgage and title companies demand operational adaptability and closer relationships with top listing agents.

- **Improving Mortgage Industry Earnings:**
    - Mortgage companies showed earnings improvement in Q2 2024.
    - A 1% decrease in mortgage rates could generate 7.2 million potential refinances, with about 3 million expected to materialize.
- **Housing Market Inventory:**
    - Inventory remains low but stable:
        - First week of September 2024: 703,000 homes vs. 509,000 in 2023 and 1.19 million in 2018.
    - Average time on the market is seasonal, ranging from 50-90 days, holding steady even in the current market.
- **WFG's Recent Activity Surge:**
    - **Resale orders:**
        - Up 19% from August to September 2024.
        - Up 45% vs. September 2023.
        - Up 49% vs. September 2022.
    - **Refinances:**
        - Up 7% vs. August 2024.
        - Up 152% vs. September 2023.
        - Up 86% vs. September 2022.
    - National Title Services (NTS) orders also up 20% over last month.
- **Fallout Rates Based on Home Prices:**
    - Higher-priced deals have a lower cancellation or fallout rate:
        - $0 - $500,000: 33.3% fallout rate.
        - $500,000 - $1 million: 16.9%.
        - $1 million - $1.5 million: 10.5%.
        - Over $1.5 million: 9.9%.
- **Housing Affordability Impact:**
    - Affordability remains a major issue, with mortgage payments averaging 35% of the typical salary.
    - A 1% rate drop would reduce payments to about 30-31%, significantly improving affordability and business volumes.
- **Commercial Real Estate:**
    - Concerns about commercial loans refinancing by 2025 have lessened.
    - All segments of the commercial market, except for office space, are doing well.
    - **Delinquency rates:** Commercial loan delinquency is at 1.45%.
    - Office foot traffic has returned to 72.2% of July 2019 levels, showing recovery in office space use.

- **Builders and Permits:**
    - Builders are ramping up with significant increases in building permits and units under construction.
    - Regulatory costs for builders remain high at around $98,000 per home, impacting profitability.
    - Expected new home construction: 1.15 million annualized units by the end of 2024.
- **Housing Prices Outlook:**
    - Housing prices are projected to appreciate by 3-5% over the next three to five years, with no major crashes or significant increases expected.

Stone ends on a cautiously optimistic note, suggesting that the industry may see a fruitful period ahead if the projected 1% mortgage rate drop materializes.

Question and Answer Segment

Is the US headed toward a recession?

Bill Conerly's response:

- **Humility in Forecasting:** Economists, historically, have struggled to accurately predict recessions, so forecasts should be taken with caution.
- **Typical Cause of Recessions:** Recessions are often triggered by overly aggressive monetary policy and excessive interest rate tightening.
- **Current Outlook:** The U.S. appears to be heading toward a "soft landing" where tightening has not resulted in a recession, despite earlier predictions of one.
- **Federal Reserve Stance:** Jay Powell avoids using the term "soft landing" to avoid jinxing the outcome, but it seems likely.
- **Recommendation:** Due to the unpredictability of recessions, it's wise for businesses to engage in contingency planning.

How do recessions typically hit the real estate sector of the economy?

Patrick Stone's response:

- **Recessions significantly impact the real estate sector** due to the nature of homebuying as a major financial decision.
- **Homebuyers face uncertainty** about the economy, their jobs, and the future, leading to hesitation in taking on large financial commitments like 30-year mortgages or substantial down payments.
- **The degree of impact depends on the recession's severity and duration**:
    - **Minor recessions** may result in lower interest rates, causing minimal impact on real estate.
    - **Severe or long-term recessions** have a dramatic effect on real estate, reducing buyer confidence and market activity.

What are your thoughts on the value of the US dollar? Some folks think that they're bracing for a recession and that'll impact our dollar.

Dr. Bill Conerly's response:

- The **US dollar fluctuates** for various reasons, including economic conditions like recessions, which typically weaken the dollar.
- **Interest rates relative to other countries** strongly influence the exchange rate: when US rates are higher, the dollar tends to be stronger.
- **The dollar is currently near a historic high**, close to a record level since the 1970s, though not quite at the peak.
- **Local impact of a strong dollar**:
    - Most local businesses won't be significantly affected by dollar strength or weakness.
    - For communities with a lot of **import or export activity**, a strong dollar makes imports cheaper but hurts exports, as foreign buyers have to pay more to exchange into US dollars.
- A potential **decline in the dollar won't have a large impact** unless a community is dependent on imports that could become more expensive.

There's a lot of attention about this in our NAR settlement. Can you go a little bit deeper on what are the changing practices we're seeing and how it's affecting the real estate outlook?

Patrick Stone's response:

- **Title insurance placement varies by market**:
    - Typically, the **listing agent controls title order placement**.
    - For mortgages, the **buying agent influences where the buyer goes** to get a mortgage.
- **Greater impact likely on the mortgage side**:
    - Most title orders are tied to the **sell side** of the transaction, so the impact on the title business is expected to be minimal.
    - The mortgage side will likely see **more impact** from changes in practices.
- **Minimal impact on overall business levels**:
    - Historically, the industry has performed well even at lower commission rates.
    - The rise of **online home searches**, especially among younger buyers under 30-35, reduces reliance on buyer agents, lessening the impact of changes on the real estate business.

Are the numbers we see on unemployment reliable?

Dr. Bill Conerly's response:

- **Unemployment data is based on estimates**:
    - Economic statistics like unemployment, inflation, and GDP are derived from surveys, not comprehensive data.

- These numbers are not perfectly accurate but provide a general trend.
- **Focus on trends, not exact figures**:
  - The exact unemployment rate may not be precise, but the **trend over time** is what matters.
  - A change from 3.5% to 4.3%, for example, signals an increase, even if the exact figures have some error.
- **Economic data fluctuations are normal**:
  - Data often has **normal fluctuations**, so small changes in a single report are not always significant.
  - Headlines may exaggerate minor fluctuations, which are typically within a normal range.

What is the status of title insurance not being required for refinanced government-backed primary homes?

Patrick Stone's response:

- **Title insurance waiver programs in play**:
  - Fannie Mae and Freddie Mac have introduced title insurance waiver programs for certain refinance transactions, especially those with **loan-to-value ratios below 80%**.
  - These programs are seen as politically motivated, aiming to **lower the cost of homeownership**, but title insurance is not a major contributor to overall costs.
- **Risk of removing title insurance**:
  - Title insurance protects against losses, which have averaged **$700 million per year** over the past 20 years, totaling **$14.8 billion**.
  - **Fraud and forgery** account for 30-33% of losses annually.
- **The role of the title and escrow industry**:
  - The title insurance and escrow industries **eliminate 75% of fraud and forgery risk** before it impacts the market.
  - Removing title insurance could increase fraud and forgery risks, potentially leading to significant financial losses.
- **Cautious outlook on the pilot program**:
  - Stone believes the title insurance waiver will likely be **tested on a small segment** of the market but expects **common sense will prevail** after fraud and forgery incidents demonstrate the value of title insurance.
- **Prediction**:
  - After potential setbacks, policymakers will recognize the **essential role** of title insurance in preventing fraud and maintaining the integrity of real estate transactions.

Do you think the economy can get out of the circus of the election? Historically, do presidential elections affect the real estate market and how do you think this election is going to affect the mortgage and real estate industry? How will interest rates differ depending on the outcome of the election?

Dr. Bill Conerly's response:

- **Federal Reserve and Elections**:
  - There's no historical pattern of the Federal Reserve cutting rates to favor incumbents before elections.
  - Interest rates have both risen and fallen in election years without a clear connection to the election itself.
- **Impact on the Housing Market**:
  - Historical data shows **no significant effect** of presidential elections on the housing market.
  - Election outcomes do not have a direct influence on the real estate industry.
- **Focus on Business Fundamentals**:
  - The election is not a major driver of economic outcomes for businesses.
  - Success depends on factors like serving customers, controlling costs, and retaining key employees.
- **Political Influence on the Federal Reserve**:
  - Trump has mentioned wanting more involvement in Federal Reserve decisions, but the structure of the Federal Reserve is designed for slow, gradual change.
  - Even if a president wanted more control, it would take time to influence the Federal Reserve Board due to staggered terms.
- **Caution Against Political Control of Monetary Policy**:
  - Countries that have tried political control of monetary policy have not fared well.
  - The system is built to maintain independence in monetary decision-making.

What are the recent regulatory trends that agents should try to stay ahead of?

Patrick Stone's response:

- **Affiliated Business Arrangements (ABAs)**:
  - Recent enforcement in Washington, D.C. resulted in significant fines for title agents engaged in ABAs.
  - The D.C. Attorney General's actions may have **ignored the safe harbor provisions of RESPA**, appearing politically motivated with a focus on the perceived high cost of title premiums.
  - Other regulators in different states may be influenced to take similar actions.
  - **Recommendation**: Agents should seek **competent legal counsel** when forming ABAs or joint ventures, ensuring they are defensible under corporate law and **do not involve illegal kickbacks to Realtors**.
- **FinCEN Reporting Expansion**:
  - Starting in **December 2025**, title agents and others will be required to report **all cash transactions involving equity buyers**, not just those in selected counties or for transactions of $300,000 or more.
  - This represents a significant expansion of the **US Treasury's FinCEN** reporting requirements.
  - Agents have time to prepare but should be aware of the broad application of this new rule.
- **Key advice**:
  - **Legal counsel** is essential for structuring and defending joint ventures, ABAs, and any new business relationships.

- Regulators are increasingly scrutinizing these arrangements, making it critical to ensure they comply with legal and regulatory standards.

What would be the best response when clients ask about market predictions, especially when it's hard to predict?

Dr. Bill Conerly's response:

- **Market predictions are inherently difficult**:
  - Interest rates and home prices are challenging to predict with certainty.
- **Advice to prospective home buyers**:
  - Buy a home if it is a good fit for your family and you can afford the price and interest rate.
  - Avoid buying based on expectations that home values will appreciate or that you'll be able to afford it in the future.
  - Don't wait to buy solely because you think a better deal is coming, as future interest rate movements are uncertain.
- **Interest rates are particularly hard to predict**:
  - Rates change quickly as soon as people anticipate future changes, making predictions difficult.
- **Home prices are only marginally easier to predict**:
  - Past trends, such as steady price increases, do not guarantee future performance.
- **Return to fundamentals**:
  - Focus on fundamentals like affordability and personal needs rather than trying to time the market.
  - This applies to all stages of the real estate process, including purchasing, mortgages, and refinancing.

I talked about interest rates. Pat, do you have any thoughts you want to throw in?

Patrick Stone's response:

- **Interest rate projections**:
  - Interest rate trends respond quickly to projections due to **arbitrage and investment dollars** chasing changes.
  - **Mortgage rate prediction**: Stone expects mortgage rates to fall **below 6% by the end of the year**, agreeing with earlier comments about potential Federal Reserve rate cuts (at least two, possibly three).
- **2024 mortgage rate outlook**:
  - Stone predicts mortgage rates will reach **5.5% by the end of 2024**.
  - Some predictions from government-sponsored entities (GSEs) suggest 6% by mid-2025, but Stone believes these are **too conservative** and rates will decline faster.
- **Historical comparison**:
  - Mortgage rates typically track **1.5% to 2% above the 10-year Treasury bill**. Based on current T-bill rates, mortgage rates could be in the **5.2% to 5.7%** range.
- **Housing market normalization**:

    - Stone revisited **days on market data** from 2017-2020:
        - **January:** 80+ days on market.
        - **July:** 52-55 days on market.
    - **2024 data** shows a return to similar trends:
        - January 2024: 70 days on market.
        - July 2024: 53 days on market.
- He sees this as a sign of **returning to normality** in the housing market.

Will lenders be open to modifying and extending these commercial loans I was talking about by the end of 2025? And if so, does the Fed interest rate cuts help or hurt commercial real estate landlords over the next one to two years?

Dr. Bill Conerly's response:

- **Commercial mortgages differ from residential mortgages**:
    - Commercial loans often have **floating rates** or adjust every five years, unlike 30-year fixed-rate residential mortgages.
    - Recent interest rate hikes have **hurt commercial landlords** by increasing their borrowing costs.
- **Lender response: Extend and pretend**:
    - Many lenders are engaging in "**extend and pretend**"—extending loan terms without acknowledging potential issues, hoping the loans will eventually be repaid.
    - Some commercial loans may require **concessions on principal** but are not typically deemed "bad" loans.
- **Lenders recognize the need for flexibility**:
    - While some foreclosures may occur, lenders understand that enforcing terms on uneconomic deals is impractical.
    - Relief is expected, but the situation is **not severe enough** to destabilize the commercial banking sector, unlike the 2008 housing crisis.
- **Fed interest rate cuts will bring relief**:
    - If the Federal Reserve cuts interest rates, it will provide significant relief to commercial property owners by reducing borrowing costs.

Do you want to talk about strategic planning? We received a number of questions about that.

Dr. Bill Conerly's response:

- **Start with defining your goals**:
    - The first question to ask in strategic planning is, **"What do you want to do with your business?"**
    - Key goals to consider:

        - Do you want to **grow the business**, protect it from risk, or set it up for a future sale?
        - Personal goals matter: Do you want to retire early, build something to be proud of, or maintain a comfortable lifestyle?
- **Business planning in uncertain environments**:
    - Strategic planning should account for uncertainty, especially in unpredictable economic conditions like a boom-bust cycle.
    - Dr. Conerly emphasizes the importance of **flexibility** in business planning to thrive amid economic unpredictability.
- **Collaborating with smart people**:
    - Seek advice from experienced business leaders and peers to help navigate strategic planning challenges.

The focus is on understanding long-term goals and being adaptable in an uncertain economic landscape.

Patrick Stone's response:

- **Start with an honest assessment**:
    - Analyze your business by **department, function, and client interaction**, and rate each area to identify strengths and weaknesses.
    - Involve **subordinates** to get different perspectives and ensure accuracy.
    - Understanding your current position is crucial for effective planning and seizing opportunities.
- **Ensure competitiveness**:
    - Allocate **time, effort, and resources** to ensure all aspects of the business are competitive in the current environment.
    - The goal is not just to survive but to **thrive and win** in the marketplace.
- **Shorter-term focus in planning**:
    - Develop **one, three, and five-year plans**, but focus more on the **shorter-term** (one to three years).
    - Fix any weaknesses and **position your business** for anticipated growth in the near future.
- **Optimistic market outlook**:
    - Stone expects an increase in real estate activity, with sales predicted to exceed **5 million in 2025**, a **25% increase** in volume.
    - Prepare your business to **capitalize** on this growth effectively.
- **Engage employees**:
    - **Involve employees** in strategic discussions, as they offer valuable insights at all levels.
    - Help employees understand the **entire process** of their work, fostering a deeper understanding of their role and its importance.
- **Continuous learning**:
    - Regular conversations with employees can provide new ideas and improve operations.

Dr. Bill Conerly's follow up response:

- **Assess the worst-case scenario**:
    - Evaluate how badly revenue could decline when facing an economic downturn.
    - Understand the **magnitude of potential revenue loss** and its impact on the business.
- **Plan for expense cuts**:
    - At the start of the year, outline where you can **cut expenses** if faced with a significant revenue drop.
    - Identify areas where expenses **cannot be cut**, to understand the limitations in matching expense cuts to revenue loss.
- **Know the financial impact**:
    - While expense cuts may not fully offset revenue reduction, it's crucial to **estimate the shortfall** so you can prepare for how severe the financial impact will be.
- **Create a contingency plan**:
    - Develop a plan to manage this worst-case scenario, helping your business respond proactively during challenging times.

Patrick Stone's follow up response:

- **Plan ahead to avoid emotional decision-making**:
    - Waiting until a challenge arises leads to **emotional reactions** and hasty decisions.
    - **Proactive planning** allows for quick, **unemotional** responses, leading to more effective and successful outcomes.
- **Preparedness leads to better execution**:
    - By preparing in advance, you can enact changes **smoothly and efficiently** when needed, without being overwhelmed by the situation.

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About Patrick Stone

Patrick Stone is Chairman and Founder of Williston Financial Group, the Portland, Oregon-based parent company of several national title insurance and settlement services providers, including WFG Lender Services and WFG National Title Insurance Company. Stone's lengthy career in real estate and related services includes C-level positions with three public companies and serving as a director on two Fortune 500 boards. His senior executive management positions include nine years as president and COO of the nation's largest title insurance company, chairman and co-CEO of a software company, and CEO of a real estate data and information company. Stone also served as vice-chairman of Metrocities Mortgage, a 2005 top-20 mortgage lender, and as chairman of The Stone Group, an Austin, Texas-based tenant-represented brokerage company. In 2013 Pat was named one of the "100 Most Influential People in Real Estate" by Inman News and as one of the "Top 101 Real Estate Industry Doers" in 2015 and again in 2021. Other accolades include receiving HousingWire's coveted "Vanguard Award" in 2019 and again in 2021, Progress in Lending's "Lending Luminary

Award" in 2019, 2020, 2023 and 2024, Inman's "Best of Finance" award in 2023 and 2024, and October Research's annual "Leadership Award" in 2020.

About Dr. Bill Conerly

Bill Conerly has a Ph.D. in economics from Duke University and more than 30 years of experience helping companies adapt to changing economic conditions. He was formerly Senior Vice President at a major bank and held positions in economics and corporate planning at two Fortune 500 corporations. He is also an online contributor to Forbes, chairman of the board of Cascade Policy Institute, and the author of The Flexible Stance: Thriving in a Boom/Bust Economy (2016) and Businomics (2007), a book about economics for business leaders. To subscribe to Conerly's monthly newsletter, visit: https://conerlyconsulting.com/newsletter/