WFG National Title

1st Quarter 2024 ECONOMIC OUTLOOK WEBINAR

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

TALKING POINTS

Opening Commentary by Dr. Bill Conerly

- While the real estate industry is a relatively small part of the overall economy, it plays a significant role because it influences many other economic sectors.
- The real estate industry, and by extension individual businesses within it, should not be overly concerned with broad economic indicators like GDP or predictions of recessions.
- The primary influence on real estate transaction volumes appears to be mortgage rates, with significant fluctuations correlating with rate changes. Understanding the impact of mortgage rates on market dynamics is crucial for anticipating future trends in real estate transactions.
- Successfully forecasting mortgage rates hinges on the actions of the Federal Reserve and Jay Powell's guidance.
- Historical patterns, like the significant drop in real estate transactions from 1978 to 1982 due to inflation, underscore the importance of understanding economic cycles.
- The lesson from the 1970s and early 1980s is that economies thrive with low and stable inflation, leading to fewer boom-bust cycles.
- The Federal Reserve prioritizes low and steady inflation, as it believes this leads to high-quality jobs and wages.
- Despite common perceptions, the Consumer Price Index (CPI) is not the primary inflation measure for the Fed. They focus on the personal consumption price index excluding food and energy.
- The Federal Reserve's economic models for forecasting inflation haven't been very accurate, and neither have those of private sector forecasters, including Conerly. As a result, the Fed has been cautious about cutting rates until they are certain that inflation is down.
- Despite predictions of a recession in late 2023 or early 2024, the strong performance of the U.S. economy and job market indicate otherwise.
- The Fed's current stance is influenced by the robust state of the economy; they are questioning the need to cut rates to drive additional stimulus.
- Interest rates are considered too high for a long-term healthy economy. The Fed is anticipated to start reducing short-term interest rates later this year, with potential action in either their mid-June or end-of-July meeting.
- Conerly anticipates a quarter-point cut in short-term rates during one of these meetings, followed by two additional quarter-point reductions.
- While short-term interest rate adjustments are under the Fed's control, long-term rates, such as mortgages, remain unaffected directly.

- Mortgage rates don't show as much decline in forecasts compared to short-term rates. A primary reason for this is long-term investors seeking to lock in currently high rates amidst expectations of declines, affecting the appeal and resulting interest rates of mortgage-backed securities.
- The forecast presents gradual improvement in transaction volumes, offering a silver lining despite the ongoing challenges.
- A vital long-term issue for all businesses highlighted is demographics, with historical analysis revealing significant shifts in the workforce population and participation rates.
- The current decade is set to witness the lowest growth in working-age population since the Civil War era, impacting workforce availability.
- Businesses aiming for growth are advised to focus on enhancing productivity through better tools, training, and management.
- Effective employee retention and recruitment are closely linked to the quality of direct management.

Opening Commentary by WFG Chairman and Founder Patrick Stone

Supply and Demand

- Real estate is heavily influenced by supply and demand; more so than other parts of the economy.
- Home prices directly reflect the relationship between supply and demand. When supply is low and demand is high, prices increase. Conversely, if supply is high and demand is low, prices decrease.
- Supply in real estate includes new construction, resale, and foreclosures.
- Demand encompasses need, desire, and affordability.
- The real estate market has been somewhat depressed in recent years for various reasons.

New Home Construction

- There has been a significant drop in the number of single-family housing units completed by builders since the Great Recession and a continuing slow recovery, with new home unit construction still below the 50-year average.
- Many builders were prepared to build homes starting in January of 2022, but pulled back due to uncertainties.
- Builders are cautious about engaging in new constructions until interest rates drop, indicating a clear signal for increased activity due to high demand surpassing available supply.

Homeownership Tenure

- Homeowner tenure has significantly increased, moving from an average of 6.5 years in a home in 2005 to 11.9 years now.

- The moving rate has been declining since 1986, when 20% of the population moved annually, and it was about 8.25% before the pandemic. This trend signifies a sociological shift towards longer homeownership and a shift in focus to home improvement.

- Despite assumptions, low mortgage rates are not the primary reason for decreased mobility but rather sociological factors.

Home Appreciation

- The housing market saw little disruption in prices due to a decrease in moves, despite a construction slowdown.

- A surge in environmental consciousness during the pandemic led to a boom in the housing market, but it's expected to stabilize with annual appreciation rates between 3.5% to 5%.

- The potential for first-time home buyers is significant, with Generation Z and Millennials totaling an estimated 141.7 million people.

- A strong desire for homeownership persists, with 95% of people aged 20 to 42 wanting to buy a home, reflecting a return to the value placed on homeownership as a step towards adulthood prevalent in the 1970s.

- Homeownership is still seen as crucial for the American Dream and as a step towards building intergenerational wealth, with 75% and 68% agreement respectively.

- Despite strong need and desire, affordability remains a challenge. However, with potential adjustments in interest rates and increased housing market activity, there is optimism for balance restoration between supply and demand.

- The median existing home price showed a spike during the pandemic, followed by a decrease.

- In January, there was a 5.1% annual appreciation rate, returning to previous levels, with an expected steady appreciation rate of 3.6 to 5%.

- Median price of existing homes and home sales is also subject to seasonality. Home sale prices also vary significantly by region, influencing patterns of migration.

- In the West, from January 2023 to January 2024, the average existing single-family home sales price was notably higher compared to the Midwest. This price discrepancy has led to a notable migration from the West to more affordable regions.

- Despite past trends, the West saw the smallest decrease in existing home sales volume year-over-year in January.

- WFG's direct operations in seven Western states observed a significant increase in resale business in early 2024.

- Homeownership rates vary by region, with the Midwest having a higher percentage of homeownership compared to the West. The reported homeownership rates include both single-family residences and apartments, with the Midwest seeing over 70% homeownership rates in 2022 and 69.8% in the fourth quarter of 2023, while the West has the lowest rate at 61.4%.

Distressed Sales

- Distressed property sales are currently not a problem; the market is relatively healthy. During the forbearance period, distressed property sales remained low and have started reengaging slightly but remain low.

- Distressed, seriously underwater, or distressed ownership dropped to 2.6% in Q4 2023, reinforcing the health of the real estate market.

Home Equity Trends

- Equity-rich homes in Q2 of 2023 were at 49.2%. By Q4 of 2023, 46.1% of homes had more than 50% equity, indicating a strong market.

- There's a significant opportunity in HELOCs (Home Equity Lines of Credit) due to the tremendous amount of equity in US homes. It's advisable to pursue HELOC business with lenders.

- More supply and affordability in the real estate market are needed in order to increase sales volume.

Credit Risk

- A major reason for the high equity and low distress in the real estate market is the percentage of loans with over 760 FICO scores in the last four years.

- Stone contrasts the current healthy market with the past, noting an average FICO score of 565 in a subprime department in November 2005, illustrating the risky lending practices pre-2007 financial crisis.

- The significant reduction in product and borrower risk after the Great Recession is highlighted, indicating a shift away from the problematic lending practices of 2003 to 2008.

Statistics and Perceptions

- Stone considers the high percentage of mortgage rates under 4% to be less impactful than sociological considerations.

- 26% of US homeowners say high mortgage rates wouldn't affect their selling decision. Of this group, 43% claim they wouldn't need a mortgage for a new home, highlighting a sociological trend of people staying in their homes longer.

- Nepo homebuyers, recent buyers under 30, often rely on cash gifts or inheritances for down payments, indicating the role of intergenerational wealth in home buying.

Mortgage Rate Insights

- At the time of this presentation, the current 30-year mortgage rate was 6.77% versus the 10-year rate at 4.30%, a 2.47% difference, which is above the historical spread of 1.5% to 2%.

- Stone predicts a reduced mortgage rate to 6% by the end of 2024 following expected rate cuts, suggesting an optimistic outlook for home buying.

Commercial Real Estate Concerns

- A potential disruption in late 2025 due to $1.5 trillion in commercial real estate debt maturing, particularly affecting regional and community banks.

- The construction of commercial real estate has significantly slowed down as current apartment needs are met.

- Despite potential banking disruptions, there is a substantial amount of investment capital available to offset potential crises, minimizing long-term impacts.

Overall Outlook

- Stone expects 2024 to show improvement over 2023, with 2025 starting strong, but facing potential disruptions towards the end.

- Stone expressed cautious optimism for the housing market's future, underscoring gradual but meaningful progress despite potential challenges.

Question and Answer Segment

Do crypto transactions pose more risk to the parties?

Patrick Stone's response:

- Valuation of crypto changes dramatically every day, posing issues for escrow.

- Problems exist on the escrow side rather than the title side.

- Complications with completing necessary legal filings (like a 1099) due to the nature of crypto.

- Lack of meaningful functionality in real estate transactions due to various issues.

- Personal skepticism towards monetary instruments not embraced by the government, stating rapid value changes make crypto difficult to use in real estate.

Will lower interest rates drive inflation and prices up?

Dr. Bill Conerly's response:

- In the current environment, lowering interest rates is unlikely to spur inflation.
- The Federal Reserve is cautious, aiming to prevent too low inflation rather than causing inflation.

What are some strategies that title agencies can implement to remain competitive in a challenging market?

Patrick Stone's response:

- Critical outreach to client base to understand and enhance their process.
- Differentiating from competitors by showing genuine interest in the client's success.
- Engaging in conversations about the client's needs, frustrations, and what can be done to assist their success.
- Using personal experience to emphasize the importance of relationship-building and listening to clients to stand out.

What will drive the housing market more: Lower interest rates or more inventory?

Dr. Bill Conerly's response:

- More inventory is currently needed to drive the housing market.
- The existence of low interest rate mortgages has contributed to low housing inventory.
- The concept of path dependence illustrates that the impact of interest rates on the housing market depends on whether they are increasing from a lower rate or decreasing from a higher rate.

Does a down market present any opportunities for business?

Patrick Stone's response:

- A down market is an optimal time for aggressive marketing and sales to gain market share.
- Most competitors will reduce marketing efforts, focusing inward and cutting costs.

- Being active, proactive, and engaging positively with potential clients in a down market can set a business apart and drive success.

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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, Inman News named him one of the year's "100 Most Influential People in Real Estate." Stone received HousingWire's coveted Vanguard Award for lifetime career achievement in 2019 and again in 2021, was recognized in 2019, 2020 and 2023 as a Lending Luminary by Progress in Lending, and was the recipient of 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/