ECONOMIC OUTLOOK

WEBINAR
2nd Quarter 2024

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

FULL TRANSCRIPT

Welcome with WFG Chairman and Founder Patrick Stone

“Welcome to the second quarter Economic Forecast with Bill Connolly and Pat Stone. I'm going to introduce Bill real quick and then turn it over to him. Those of you've attended before have heard this, but I'll say it again. He's one of my favorite people that uses economics to make a living. I've known Bill for, I think, 42 years. He is an accomplished business economist. He actually consults and advises businesses and does so very well. He's also a Forbes contributor and a personal friend. So with that Bill, take it away.”

Opening Commentary from Economist Bill Conerly, PhD

“Thank you, Pat. The United States economy is growing but growing slowly. You who facilitate real estate transactions are part of that economy, but you're kind of a small part and you're kind of a strange part. I don't mean that in a pejorative way, but the last two years, '22 and '23, the US economy overall grew, but your sector went into the doldrums of fewer real estate transactions and you may be justified in feeling that you have been in recession, but the overall economy, like the 99% of folks who are not facilitating real estate transitions, they've been okay but are now slowing down. I'm going to spend most of my time talking about interest rates, which are the most important part of the economy for your business. But, just to give you perspective, the overall US economy is growing, but at a slower pace. We're in the midst of a world economy that is not quite growing.

“Asia is still growing, but much slower than it had been. Europe is flat-lined. I mean, they're not in the tank, but they're not expanding at all. Latin America, not so great, although Mexico is the brightest star of the Spanish-speaking world. Canada, doing okay, but the rest of the world had been a boost to the US economy, helping us export more, and it will be less of a boost this year.

“So interest rates are important for the overall economy and really important for you folks. You know that the Federal Reserve decided last week not to cut interest rates. They also decided not to increase them, and the Fed's decision has led to questions such as, 'What the heck are these idiots thinking?' Now I have edited that question so that this would be a family friendly video. Some of the feelings about the Fed not cutting rates ran kind of tough.

“I'm going to help you get into the head of the Fed, not because you're particularly interested in the psychology of it, but understanding the Fed's thinking will help you understand my forecast. I am polishing up my crystal ball to give you a forecast. In addition, it will help you understanding the evolution of interest rates after June and on into next year.

“So monetary policy, that's changes in interest rates and some other tools that the Fed has. Monetary policy is a committee decision by 19 people. I have listened to all of them give speeches, make statements, and they all talk about the Fed's goals, which is great leadership to begin by talking about goals. And they all talk about keeping employment high and inflation low, employment high and inflation low. They call that the dual mandate. And there are two aspects of their thinking that I would encourage you to write down and keep in mind as the year goes on.

“The first is that when the Fed thinks about maximizing employment, they are taking a long view. Now, the Fed used to take very short-term views like, 'Hey, employment is soft. We need to do something to help next month's numbers or next quarter's numbers or next year's numbers.' But now they're saying 'what is the right strategy to have continued, sustainable, strong employment markets?' And they have concluded based on both theory and historical evidence, that keeping inflation low and steady will be the best for the job market over the long haul. Avoiding the booms and busts, they look back to the 1970s and early eighties and say, we don't want to return to that. So low and steady inflation is the key to healthy sustainable employment markets year after year after year. That's the first point in their head.

“The second point that they're very aware of is that monetary policy acts with time lags. So they cannot simply look at today's statistics and adjust the economy. They need to account for the fact that it takes a while before changes in interest rates affect employment. It takes a while for them to affect inflation as well. So the Fed has to do a Wayne Gretzky move. Not skate to the puck, but skate to where the puck is going to be. Not adjust monetary policy for today's conditions, but what the conditions will be when they take effect. So those are the two parts of their thinking.

“Now here we are in June 2024. The Fed just made the decision. There were some voices saying, 'Hey, the Fed should cut rates. It's time to cut rates.' I want to explore that argument a little bit and then we'll understand why and we will come around to the argument against cutting rates.

“The argument for cutting rates had two parts. First of all, inflation has been coming down for a while, though it's still above the Fed's target. The argument for cutting rates was that we had more inflation improvement in the pipeline. So interest rates have been high for a while and those time lags mean that we have improvement in inflation, kind of baked in the cake by the interest rates behind us, and we will get to that 2% inflation target even if the Fed eases. Now, that's argument number one. Argument number two for cutting rates in June was that the Fed needs to anticipate employment. We're seeing fewer job openings and with fewer job openings, fewer employee quits. These are early warning signs that the employment market is softening, and if the Fed waits until we have an unemployment problem, they will have waited too long. Those were the two arguments for the Fed cutting. The Fed obviously rejected those. Let me explain what the Fed was thinking and that will lay the groundwork for the forecast.

“The Fed decided to keep interest rates level for two reasons. First of all, their inflation forecasting model, the computer model of the economy that spits out, among other things an inflation forecast, has not worked very well. And it's not just the Fed's own computer models. My model of the inflation outlook has not done well. Wall Street's models have not done well. Nobody's very good at this, and that has led the Fed to have something that is really rare. The Fed is headquartered in Washington, DC and they have something that you hardly ever see in Washington, DC. They have, you're not going to believe this. The Fed has now humility. Yeah, they've got humility in Washington, DC. Who would've thought it?

“So what does that mean for monetary policy? It means the Fed does not trust that inflation is going to come down to its target of 2.0%. They've brought inflation from 7% to 2.7, but the Fed just is not yet confident that inflation is going to hit their target. So they're being humble. And then the second aspect is they're doing what they call a risk management perspective in their decision making. You do that, I bet. So, you've got a decision to make. Maybe it's like how much to spend on marketing? How much to spend on IT? And we live in an uncertain world. You don't know what the effects will be. You gather information. You make your best estimate of what is the right choice, but along the way, when you're on top of your game, you're saying, 'what is the cost of being wrong in this direction? What's the cost of being wrong in that direction?' And you're saying, 'oh, how painful will it be if I'm erring in one direction or the other?' And sometimes you'll adjust that decision. So the Fed says, 'what if we keep interest rates too high, too long? What's the cost of keeping interest rates too high, too long?' And they say, 'well, we get more unemployment than is necessary. It's a little tougher for people looking for work, but it's temporary.' Then they say, 'what if we cut interest rates too soon?' In that case, the potential cost is that they do not bring inflation down to the target, and if they don't get inflation down to the target, inflation becomes embedded in people's thinking. And then people as consumers, people as workers, people as business decision makers expect inflation and it becomes embedded in their behavior. And then it becomes really hard to get rid of. The Fed would have to precipitate a more severe recession to get rid of inflation. So they're saying, 'Hey, the cost of

being wrong in one direction is small. The cost of being wrong in the other direction is very big. So we just need to wait a little bit to cut interest rates.'

"So that brings us to where we are in the forecast world. What is going to happen going forward? Well, I'm going to trust a little bit my own inflation forecast. I think inflation is going to slowly, gradually come down. The Fed will do two cuts of a quarter point each in short-term interest rates this year. Two more cuts. Then in 2025, probably three quarter-point cuts in short-term interest rates. So they'll move cautiously and gradually. Now the interest rates the Fed is cutting is an overnight rate and you're not borrowing at that. And more importantly, your business is really not dependent on short-term interest rates. It's more dependent on things like the 30-year mortgage and those of you doing commercial transactions, more like five-year term interest rates. So let's talk about that.

"Those long-term interest rates like a treasury bond of 10 year maturity are driven first of all by the global economy, global demand for credit, global supply of savings. But the short-term fluctuations in those interest rates are heavily driven by short-term expectations about short-term interest rates. So long-term interest rates driven by expectations for short-term interest rates. And in the past few weeks, we've seen things like the 10-year bond yield come down with the market expecting more cuts in short-term interest rates. So we're getting, and we will get long-term bond rates coming down, but that 30-year mortgage is being a little bit strange. It normally tracks the 10-year bond at a percent and a half to two percentage points higher, but now it's like two and a half percentage points higher.

"Let me tell you what's going on. The people who make long-term investments like pension funds, life insurance companies, university endowments, they're looking at these interest rates and saying that they want to lock in the high interest rates. They're anticipating interest rates being lower in the future, so they want to lock in these rates. If they buy a 10-year treasury bond today, they lock in today's interest rates for 10 years, guaranteed. If they buy mortgage backed securities, a package of mortgages that are paying say 7% on the consumer side, they are locked into high interest rates until those mortgages refi, and when those mortgages refi, the investor gets cash back at a time when the investor does not want cash back. The investor does not want to get cash back when interest rates are low. The investor wants to invest when interest rates are high. So the long-term investors are saying mortgage-backed securities are not a great way to lock in interest rates. So in order to get them to buy mortgage-backed securities, the spread over treasury bonds has to be hot.

"So the future, I believe, is that long-term interest rates will come down and the mortgage rates will come down, but the mortgage rates will come down more gradually. They will get under 6% by the end of 2025. I think I've penciled in something like five and three quarters for the end of 2025. It's a forecast. It's not guaranteed, I don't mind saying. But I think in the ballpark, we'll see them come down. But more importantly than the numbers is the concept. I expect interest rates to be coming down cautiously and gradually. And with that, I am concluding my portion of this presentation cautiously and gradually, and I'm turning the discussion back to Pat cautiously and gradually. Pat?"

Opening Commentary from Patrick Stone

"So just for fun, I was going to take a little bit different angle today. I had the chance to hear a former government official express concern over a real estate crash in 2027. I was stunned by that because I think the thought process there is looking at the real estate market like the financial market and that is that it's based on speculation, and so forth. I will tell you about 10% of real estate is speculative in any sense, and I really think real estate is probably one of the places in our economy that we really see the supply-demand function really illustrate itself clearly and functionally. So just going through that for fun, look at supply-demand. So on the supply side of real estate, we have resales, we have new construction, we have REOs. On the demand side, we have need, desire and affordability.

"Now, there's a lot here and obviously it's hard to precisely guess or ascertain exactly where all those elements are. But for fun here, let's look at resale. There's about 85 million single family homes in the US right now. About 16% are actually rented. The rest are lived in. People are staying in their homes longer now than they have before. The press attributes a lot of that to what they call an interest rate lockdown. People have low interest rates, so why would they

move? And I think that probably does have some impact. I would also suggest that socially we have changed considerably. And by that I mean that from about 1948 to 1980, about 20% of the people moved on a regular basis or annually. So about 20% of our population relocated on an annual basis. Then we started a very slow decline from about 1985 to 2019. We went from about 20% moving annually down to 8.9% moving annually. So socially there was a change. People became more focused on their home, the quality of where they lived. They were more focused on upgrading the quality of their home. And I think also perhaps the job market affected that to a degree. But anyway, moves declined considerably outside of just interest rate impact.

“So, right now about 12.3 years average tenure in a home that's down slightly from 2020 when it hit 13.4, which was a high. That compares to 2005, which was the highest year for home resales in history. And in 2005, the average tenure was 6.5 years. So we stay in a home twice as long as we did in 2005. 2012 was about 10 years. So sales, look at sales volume. You all are painfully aware of this, but I'm going to go over it anyway. In 2020 we had 5.64 million sales, 2021, 6.15 million; 2022, 5.03 million; 2023, 4.09 million; 2024, 4.25 estimated. And that's Uncle Pat's guess for the year. And then my guess for next year, they will get it up to 5 million because, I agree with Bill, we'll see two rate cuts this year and I think that will impact mortgage rates and get more people involved.

“So supply side of resale and new construction. So five years from 2019 to 2023, we averaged 1.448 million new homes started each year. 1.397 million homes completed every year. Since 1959, that average of completed homes has been 1.433 million a year. Again, going back to 2005, which is an outstanding year, we actually had 2,068,000 homes completed that year. So just how far underbuilt is the US? I mean, we're not building and haven't been building at a rate to keep up with the population becoming of home buying age. And so there's a lot of conversation. We're horribly underbuilt. That's one of the reasons we had such tremendous price appreciation during the pandemic.

“So I did a little survey here to see what everybody thought. And of course you're going to find that they're all exactly in alignment. And I'll give you the numbers right now. John Burns says 1.7 million homes underbuilt. Moody's says 1.7 million. JP Morgan says 2.25 million. Morgan Stanley says 2 million to 6 million. Freddie Mac says 3.8 million. BofA says 4 million. Zillow says 4.3 million. And Fannie Mae says, we're underbuilt 4.4 million. Not much consensus here. It is really a wide range, and I think it's almost impossible to be precise about it. I think one thing is evidently clear; we are underbuilt. The other component of the supply side, so we have resale, we have new construction, other components, REO, and that's almost a non-factor right now. My guess is that foreclosures this year will be somewhere around 35,000 nationwide. That is extraordinarily low, and I don't see it picking up anytime soon because there's a tremendous amount of equity in homes. And again, there's a lot of people with very low interest rates. So they're not under any sort of pressure, or under a lot less pressure. As long as the economy stays relatively healthy and people maintain their jobs, I don't see any problem or growth on the REO side. So that's the supply side.

“The demand side. We have a large group in home buying age right now, probably the second biggest home buying group since the baby boomers. We have 42% of the population born between 1981 and 2012. I know there's not many 12 year olds that buy homes, but there are a lot of people in that range right there. Probably 90 million are of home buying age between 20 and 40. 90 million people between 20 and 40 in our country right now. Some people might say, 'well, that's not that many.' Well, that's more than live in Iran, Turkey, Germany, Thailand, Great Britain. I mean that's a lot of people. 90 million people are in the prime home buying age. So the need is there. The need is there at a very, very large scale and will continue to be for at least 10 more years.

“Desire. I think the desire for home ownership dramatically heightened during the pandemic. I think from 1945 to 1985 was very high with the post-World War II and the Baby Boomers coming of age. So the desire now is back up because of the pandemic. How high is it? 95% of the people between 20 and 42 years of age say they want to buy a home. This was a recent survey. 68% view listings online twice a week. 41% follow Realtors on social media. 37% expect help from the family in buying a home. So I think the desire is very, very high. And the interesting thing about it, so I'm talking about 25 to 40 year olds, how are they going to do? Well, here's an interesting number. 25 to 54 year olds are employed or looking for jobs at rates not seen in two decades. Changing the labor force participation rate is extraordinarily high because the people at home buying age are looking for jobs. And we're seeing kind of a fundamental change, I think because of the pandemic and the way people look at things and their desire to own a home. So the need and desire are

there, the big question is affordability and affordability is a huge problem. And it's been sort of the reason we've seen the significant decline in home purchases. I'll give you some perspective there. And Bill did a good job of talking about interest rates and, again, I agree with him. You'll see a couple of interest rate cuts. You'll see interest rates come down. Not drop quickly or severely, but they will trend down.

"I started in this business, not that you care, but I started in this business in 1975. Interest rates were 9.05% in 1975. That was the average mortgage rate. 1982, it got down to 8.39. That was the first year under 9%. That was 1982. 1998, it finally got under 7%. 2003 it got under 6%. So if you look historically at US housing, interest rates have been high forever. I mean, we are really right now probably at or below the average over the last 50 years. So are they high? Yes. One of the factors that kind of changes the equation a little bit is the cost of the home has gone up tremendously. So the interest rate has more impact now than it did back in 1975. So again, referring to 2005, which was the biggest year for home sales in the US, we had 7.25 million single family homes sell in 2005. The average mortgage rate that year was 5.87%. So I am optimistic that even with a couple rate cuts, you are going to see a meaningful change in home ownership, and I think you're going to see a meaningful change in people engaging to buy and their ability to buy. Is it going to be a hundred percent easier? No. Is it still going to be issues? Yes, but we're going the right direction and I think we will see a significant increase in business next year. I think it'll start the second half of the year gradually. As I said earlier, picking up a little bit and then picking up much more next year. Getting back to a market where we can all get excited, we're probably looking at 2026 to get there. I think 2025 will be better, but probably 2026 before we get to the point where we really want to be. And so with that Bill, I think I'll probably get into questions if you're ready."

Question and Answer Segment

What are your thoughts on the presidential election and the economy, and what is the potential economic effect of the presidential election?

Bill Conerly's response:

"I get that question a lot even aside from these webinars, and first of all, I'm not going to tell anybody how to vote, but let me address first of all something that comes to my mind. I remember once voting for a candidate because I thought that a couple of the points, that the promises the candidate made would be good for the country, voted for the candidate, the candidate won, and then the candidate did not advance either of those two areas that I was really excited about. The candidate just ignored it. So if you listen to a candidate say, 'I'm going to do this, I'm going to do that,' first of all, the candidate may not follow up on that. Secondly, even if the candidate, the winner does try to follow up, Congress or the state legislature may not go along with it. And even if there's legislative approval for the candidate's position, it may not have the effect that we expect.

"So yeah, I take everything with a grain of salt. In terms of the presidential election, let me address more specifically the economic impacts. Both of our candidates are big spenders. President Trump was a big spender in his administration. President Biden's a big spender. So I expect more spending, more government spending in either direction. Where there is a difference, I think that if we have Donald Trump elected president again with Republican control of Congress, we're likely to keep corporate tax rates low and the personal tax cuts in place. I think that if President Biden is reelected and the Democrats control Congress, the Trump tax cuts from a few years back would be allowed to expire. They're on a sunset. We'll also see regulatory changes based on who is elected president. I think if President Biden is reelected, there'll be more regulation to the extent that the courts will allow and including regulation of financial and real estate transactions, less of that regulation if President Trump goes into power once again. So there will be some differences, and I think that those in a broad brush are very likely, but the details are all dependent on what goes on."

Same question for you Pat. Do you see real estate-specific implications of the presidential election?

Patrick Stone's response:

"I can't find any historical evidence that presidential elections impact real estate on a consistent or regular basis or in a consistent and regular manner. I think obviously if there is a lot of anxiety around a presidential election, there'll be a tangible impact on real estate in the sense that that anxiety will carry over and people will be less inclined to make a decision. That probably worries me more about this election than whoever wins. In terms of how it impacts real estate, I just do not see any meaningful impact based on political party or outlook right now impacting real estate. So fingers crossed it won't have an impact on real estate one way or the other."

What indicators does the Fed look at to determine that inflation is sufficiently in check to warrant a rate decrease?

Dr. Bill Conerly's response:

"Yeah, well, that's an easy question. The Fed looks at everything. They've got 400 PhD economists working at the Federal Reserve, every piece of data that comes out gets looked at. I think the better version framing of that question would be what can an individual who's not a professional economist monitor to figure out what the Fed is thinking? And to make it easy, I think you look at the increase in jobs, not so much the unemployment rate, but the increase in the number of jobs. That comes out typically the first Friday of the month, and then the Consumer Price Index. The Fed actually looks at another index, but this CPI comes out in the middle of the month, it's well reported and it'll give you an idea of whether the Fed is on track. So for the amateur just trying to follow, watch for the job count and watch for the CPI."

What lessons should we be most aware of from previous cycles that are starkly similar to our current environment?

Patrick Stone's response:

"Well, again, I think need, desire and affordability are the key issues here, and I think there's no direct relationship between this cycle and the previous cycle, but it does remind me a little bit right now of where the country was post World War II. The pandemic wasn't a World War, but it sure impacted us socially, psychologically and behaviorally. And so consequently, I think people are focused on home ownership now. We are actually seeing a tremendous amount of effort by different state governments to facilitate home ownership. We're seeing a lot of interest on the part of everybody in how do we make it possible for people to afford a home. More conversation than I've seen in a long time, Bill, around the social benefits of home ownership. So in terms of a parallel cycle or a cycle that I can refer to exactly, no. In terms of a social trend, it's like we went back 50 or 60 years and pushed a reset button.

"Owning a home now is where you want to be. That's what you want to do. That's how you want to get ahead in life. That's how you accumulate wealth. It has become meaningful and important to people to control where they live, how they live, the environment they're in and where they go from here. So it is pretty interesting to watch what's happened. How it manifests itself; I am cautiously positive that we are going to see the rest of this decade be gradual improvement in the number of homes owned and buying of homes and so forth. So pretty optimistic."

Will housing affordability continue to be a problem throughout 2024 and 2025?

Dr. Bill Conerly's response:

"Yeah, I think it will be, but less of a problem. I see cautious and gradual improvement. The two biggest issues on housing affordability are of course the price of the house and the interest rate that the borrower has to pay. I do not believe that pricing is going to come down, but I do think, as I said, mortgage rates will come down. And the ability to pay goes up with wages. Wages are rising faster than inflation. They weren't a couple of years ago, but they are now.

And there are a couple of minor things. Homeowner's insurance, it may not feel minor, but in the big picture compared to the price of the house and the mortgage rate, homeowner's insurance is minor. Like an 11% increase of national average last year, but I think it will be a little bit better. So small improvements, probably the most potential is in some markets -- there's huge variation from market to market -- in some markets where you're starting to see NIMBYism decline and YIMBY, yes in my backyard, increase and more communities are thinking, 'yeah, we need to build more housing.' But I think that's going to be fairly small. So a little bit of improvement, but not huge."

Are there any recommendations for those who focus on residential real estate?

Patrick Stone's response:

"Yeah, I think this is going to be nothing new, but I really strongly recommend making every attempt possible to understand your market and have data and information to relay to people. It is a time in which anxiety is extraordinarily high and anxiety frequently is a direct reflection of concern or misinformation or lack of information. So when people know what's going on, they have less anxiety, even if the information is slightly negative from time to time, people need to know what's happening. So as a real estate professional, I strongly recommend everybody do whatever they can to become as conversant in market trends and information in your market as possible. Relay that to people because the people that are going to be successful in the next couple of years are the people that know the business, work hard at it, focus on the information, and do their best to make sure that the people they interact with understand what's happening and why it's happening. Now, nobody's ever precisely 100% correct, but do your best. Try to be as conversant and as knowledgeable as you can about what's happening and why, and the people you are doing business with will not only appreciate it, they will use you more. So that's my 2 cents worth on that subject."

What do you see as the long-term plan for the empty commercial office spaces and dead malls?

Dr. Bill Conerly's response:

"Yeah, there's been a lot of speculation on that, and offices are sometimes torn down. Sometimes there's more talk about repurposing them for apartments. Malls can be torn down or repurposed. But the first thing to think about is that what you've got in these properties that are no longer economically viable as they were planned is you've got a foundation, you've got walls, you've got a roof, and if you've seen a house being built, when you got the foundation, the walls and the roof, it feels like it's mostly done. But the fact is, it is nowhere close to done because what you need is the finished flooring. You need the walls, the interior walls, you need the plumbing, the electrical, and for an office building, you need to basically gut it and start over. Like in a typical office tower, the restrooms are right next to the elevators, and that's not maybe where the restroom or bathroom should be if you convert that to a condo or an apartment. So it's going to be tough.

"There are some efforts underway, and two different ones in Seattle come to mind. There was one of the smaller malls. Some of the big mega malls are doing just fine, but some of the smaller, more local focused malls are not doing well. And one of them is becoming offices and apartments. They've got a lot of real estate, a lot of parking lot, and around the periphery are apartment buildings coming up, and then the food court is staying to serve those people in the apartments. And there'll be some small offices, local offices, insurance, healthcare, that kind of thing there. So there is some potential for using, but there it's using more of the land than the building. And another project going on in Seattle is they're trying to ease the regulations and fees that are involved in repurposing an office building for apartment living or condo living. And that metropolitan area has something like a 24% office vacancy rate, and the actual utilization is even worse because people aren't coming into the office. So we need to be thinking about it, but just having the foundation, the walls and the ceiling is not a big step forward. So some of them are going to sit idly."

Where do you see CRE lending heading?

Patrick Stone’s response:

“I think that's a very important question, Bill, because at the end of Q1 of this year, there was about $88.6 billion in distressed commercial real estate loans. Now, $88.6 billion sounds like a lot of money, but there's $2.99 trillion out there in commercial real estate loans. So it's about 3% of the commercial real estate loans that are actually in distress at this point in time. Q1, $9.9 billion in new distress property, $7.2 billion of it was worked out, so $2.7 billion wasn't. If you break it down, like I mentioned earlier, $88.6 billion in distressed loans. $38.2 billion is in offices, which kind of plays to what you were talking about, Bill. $21.9 billion in retail, $14.2 billion in hotels, $10 billion in multifamily. A lot of this is, I think, going to be refinanced. There's a tremendous amount of loans in community and regional banks. About $1.5 trillion estimated to come due or needed to be refinanced by the end of 2025.

“There is a tremendous amount of capital out there looking at the opportunities around this. Is it a problem? Yes. Do I think it's going to be a tragic problem or create a tremendous deflation in commercial real estate values? No, because again, there's so much money out there looking for opportunities that I think a lot of the problems will be taken care of through refinancing or by people buying properties that are distressed. So yes, there is a big problem, but again, I think there's so much capital that we will get through it. There'll be a little bit of a hiccup, but I don't think it'll be tremendous.”

A recent report from the FHFA showed that the mortgage rate lockdown effect has actually pushed home prices higher due to the supply of homes for sale becoming suppressed due to homeowners not wanting to transition housing in a high rate environment. When rates do begin to drop, could we see the opposite take place? Might we see a scenario where home prices stabilized or even fall as the supply of homes for sale grows faster than demand?

Dr. Bill Conerly’s response:

“Yeah, that's an interesting question, and the short answer is I don't know. The long answer gets to that same conclusion, but let's work through the issues. First of all, as a general rule, when interest rates go down, home prices go up. In fact, asset prices across the board: stocks, real estate values, commercial real estate values, bonds. When interest rates go down, all of those values go up. So that's the first thing I expect. But there is a large number of people who have mortgages at three or 4%. Some of them are happy where they are, but many of them would like to move up. Moving up is fairly common, and if you have a budget for a move up house and you have to walk away from a 3% mortgage and get a 7% mortgage, you've probably used up your budget for home improvement without spending more on a house just by having to change mortgages. So the mortgage lock-in is a real factor. What I don't know and nobody knows is how many people are right on the edge of their chairs saying, 'oh, we want to put this house on the market and move to something bigger, newer, better as soon as the mortgages come down a little bit.' Some people are doing it now, figuring that they'll refi their new mortgage. A 30-year mortgage doesn't last 30 years in most cases, but there could be a reverse effect with prices easing because so many people are coming down. My gut says probably not, but we're not positive. However, this lock-in effect would moderate the tendency for existing home prices to rise from the lower interest rates.”

Are new home developments on track to meet the housing shortage in California by the end of the fourth quarter 2024?

Patrick Stone’s response:

“Yeah, I would agree, Bill. And then the answer to that is no. From 2010 to 2020, California population grew by 6.1%. Housing grew by 4.7% since 2020. So California is about 50% short of the 180,000 new units that the state needs each year. But by 2025, California will need about 3.5 million more homes than it has. So California is really, really upside

down. Now, I will give the governor of California some credit. He is trying very, very hard to affect change by getting legislative efforts to have individual city restrictions on home buildings removed. One of the things that happened all over the West Coast, and I think everybody will identify this with this, is that we had cities be proactive about protecting I guess values or people living there by the type of homes built where they could be built, how many could be built. A lot of government restrictions on a metropolitan level all over the West Coast, but California led the way by far. California has a tremendous amount of restrictions on a city-by-city basis, and there is a significant movement in the California legislature to try to deal with this. Will they be effective? I don't know. I think it's 50-50 at best. We'll see what happens. Single family, 123,000 built in 2022, the highest since 2008, but we are still way behind. I don't see California catching up and actually having a balanced supply-demand. I don't see it happening within the next 10 years, if at all. So I'm kind of skeptical that we're going to get there in terms of California."

What's the status of the homeowners' reinsurance market and when can we expect any relief in rates?

Dr. Bill Conerly's response:

"Yeah, well, that's interesting. So homeowners insurance is largely primarily driven by the cost of claims, and the insurance company bears the cost of small claims, but if there's a major disaster, the insurance company turns to their reinsurer who covers the excess claims, and the reinsurance market has just turned. 2023 was a big increase in the cost for an insurance company to get excess coverage. But that has come down in 2024, both in January, and then there's another round of rate negotiations in June, and the cost of reinsurance is down 5% from last year. That's 5% down from a high number. So I think that we'll see a little bit of relief and on both the direct cost to the local insurer plus their cost of reinsurance. There's also a matter of the regulation and the legal environment there, and some states in an effort to protect homeowners from high insurance bills have driven insurers out of the market, which doesn't help those costs. So I'm forecasting a little bit of improvement in the cost of homeowner insurance this year and next year, but it is not going to make anybody feel really comfortable that insurance is cheap and a good deal."

What are your thoughts on wholesalers and how title companies should support real estate agents and their wholesale concerns for their clients?

Patrick Stone's response:

"Well, on a high level, wholesalers could include iBuyers and so forth, and there's not a lot of evidence that's worked for large scale corporate efforts to buy homes and sell them, or whatever. So wholesaling on an agent basis where the agent or someone steps in as an intermediary on a transaction can be fraught with danger, candidly. It's got to be done right. So I strongly recommend that all title agents here talk to your underwriter and your underwriter's legal department to make sure you're well-versed on how to handle this, because this could potentially have a high level of fraud, but it is necessary in some cases, and it is effective in some cases. But I'll just be straight up with everybody. I got a very nice complete briefing from our general counsel on this, and it is fairly complex. So what I'm going to do here is recommend you talk to your underwriter. You've got a transaction, you're a title agent, please talk to your underwriter and make sure you understand what the issues are, where the risk is, because it can definitely be a problem."

What do you see for commercial? This is kind of repetitive, but do you feel foreclosures will climb in both markets, commercial and residential?

Dr. Bill Conerly's response:

"Well, residential is easy. No. Very few foreclosures because so many people have positive equity. Very few people are underwater given the price increases we've seen. On commercial, I think the most important thing to keep in mind is

that commercial is not a category. Even in the office category, you've got downtown high-rises and you've got suburban office. The suburban office market in most communities is doing okay. People are going to their local title insurance company, their doctor, an attorney, and a local suburban office is doing okay. Downtown, it varies from city to city, but generally not very well. But industrial and warehouse did very well. It's a little bit overbuilt in many areas, but that's a different sector. There's storage, there's retail. Though we hear about the malls in many areas, retail is doing very well and is underbuilt because everybody thought we would never go to a store again. But suburban restaurants, yoga studios, grocery stores are doing fine. So I think that in general, commercial is okay, but there will be some foreclosures, particularly in downtown offices and some of the outdated malls."

What is the best way to find homeowners with equity without buying leads?

Patrick Stone's response:

"The level of appreciation in the last five years has been just about 84%. So obviously anybody that's owned a home for five years probably has a lot of equity. And probably whether you're looking to do refinances or home equity loans, or just looking for someone that has a tremendous amount of money already in their home and would like to perhaps sell it, I don't know what the motivation is for finding the lead, but I will tell you that it's a function of time right now. I think anything over three years has a very, very, very good chance. Anybody that's owned a home for three years probably has a phenomenal amount of equity in that home. So 84%. Average per year has been about 16.8% appreciation over the last five years. Homeowners have about 48% equity in their homes nationally. So all homes altogether about 48% equity. Anyone in the home for three years plus probably has a meaningful equity, and it would be someone I would look at. So I'd use time in the home as a way instead of buying leads."

Do you think the SALT cap will be eliminated in high tax states like California where it's set to expire in 2025?

Dr. Bill Conerly's response:

"SALT, of course, being state and local tax limit on deductibility, that's a political forecast. Not if the Republicans control either House of Congress, but if Biden wins in a landslide with Congress, then yeah, that probably goes. And even Republicans in high tax states, I think, think of keeping this limitation as a way to put a thumb in the eye of their counterparts who represent those high tax states."

Given the data and analysis being provided, what is the number one action needed now to win in Q3 at scale?

Patrick Stone's response:

"Oh, I think focus, depending on what your job is obviously. If you're a title agent, focus on the top producers. Let's be real candid. The NAR lawsuit, the general economic conditions, everything going on would argue in favor of focusing your time and energy on the people that have the business. If you're a title agent, take a look at the top producing Realtors. If you're a Realtor, look at the people in the higher end markets. I mean, let's just be real candid about it. I mean, it is going to be a race to the top producers in every segment of the real estate market. So Q3 focus on establishing relationships and adding value. And the thing about adding value, I talked earlier about knowledge. Take a look at your potential client and try to really ascertain what they need, what they want, what they need to understand. One thing I would recommend people do more often than they currently do is do surveys. You could either do a Survey Monkey or you can hire somebody or do it yourself, but try to find out, get a good idea which way the wind is blowing and the segment that you're going after. Don't just operate in the dark. You don't have to. There's enough tools out there that you can end up with a pretty good idea of what's going on and how to pursue the business. Go ahead, Bill."

Dr. Bill Conerly's response:

"Okay. In late 2008, late in the year of 2008, remember 2008, the middle of the recession, and we had a presidential election that year that was quite divisive in many ways, and I was invited to speak at a trade association convention, and at the cocktail reception, I asked the guy, how's business for you? He said, 'I'm having a great year.' I'm like, let me check my calendar. Is it really 2008 and you're having a great year? He said, 'let me tell you what I did.' He said, 'I got so disgusted with the news, both the financial news, the business news about the recession, all of the election and all the sort of acrimony in that. I stopped watching the news' and he said, 'what I did was I got on the phone and I said, let's call my past clients and just say, Hey, how are you doing? Touch base with them, and then let's get on the phone to potential referral sources.' In his, it was like attorneys and accountants, and he said, 'I just talked to people. I just connected with people I already knew. I wasn't cold calling. It was just personal relationship with people I already knew.' And he says, 'man, I didn't ask for the business, but the business is coming in.'"

Closing Thoughts

Dr. Bill Conerly:

This has been great. Are we going to do it again next quarter, Pat?

Patrick Stone:

I think so. And I am going to offer a quick prediction before we go if that's okay, and then I'd ask you to do the same Bill real quickly. I think interest rates will be under 6% by the first quarter of next year, and five and a half percent by this time next year.

Dr. Bill Conerly:

That's a little more aggressive than I am, but I will go with under 6% by the end of 2025.

Patrick Stone:

All right. So we have a year difference there. It's going to get better, folks. Thank you, Bill.

Dr. Bill Conerly:

Thanks for joining us, everybody.

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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/