Opening Commentary by Dr. Bill Conerly

US Economy Overview:

- The United States economy is experiencing slow growth.
- While the general economy has experienced growth in 2022 and 2023, the real estate sector has seen fewer transactions, effectively feeling like a recession within the broader economic growth.

Global Economic Context:

- **Asia:** Growth has significantly slowed.
- **Europe:** Economic activity has plateaued.
- **Latin America:** Struggles economically, with Mexico as a notable exception.
- **Canada:** Experiencing moderate economic performance.
- The global economy, previously a booster for US exports, is now providing less support.

Interest Rates and Monetary Policy:

- The Federal Reserve (Fed) chose to neither cut nor increase interest rates recently.
- The decision was informed by various challenges in forecasting inflation accurately.
- Interest rate decisions are critical for real estate businesses and heavily influenced by the broader global economic environment.

Fed's Decision-Making Process:

- Emphasis on long-term goals: maintaining high employment and low inflation (dual mandate).
- Recent strategy involves achieving low and steady inflation to avoid economic volatility.
- Recognizes the lag effect of policy changes on employment and inflation.

- Takes a risk management approach, weighing potential errors in different decision directions.

Arguments for and Against Cutting Rates:

- **For Cutting:**
    - Declining inflation trends, with further improvement anticipated.
    - Early indicators of a softening employment market.
- **Against Cutting:**
    - Inaccuracy of inflation forecasting models, leading to uncertainty.
    - Potential high cost of prematurely cutting rates and failing to permanently reduce inflation.
- **Fed's Current Stance and Outlook:**
    - Fed displays humility in acknowledging challenges and unpredictability.
    - Probable cautious approach to cutting interest rates: two cuts expected in 2024, additional gradual cuts in 2025.
    - Gradual reduction in long-term interest rates expected, including for mortgages, though mortgage rates may decrease more slowly.
- **Real Estate Market Implications:**
    - Long-term interest rates, including the 30-year mortgage rate, may take longer to align with declining short-term rates.
    - By the end of 2025, mortgage rates are expected to drop below 6%, reflecting a cautious but steady downward trend.

Opening Commentary by WFG Chairman and Founder Patrick Stone

- Patrick Stone discusses potential concerns about a real estate crash in 2027, which he doesn't believe will take place.
- Stone explains why he doesn't expect a crash, highlighting the differences between the real estate and financial markets, and emphasizing that only about 10% of real estate is speculative.

Supply-Demand Dynamics

- **Supply Side Elements:**

  - **Resales:** There are about 85 million single-family homes in the US, with 16% rented and the rest owner-occupied. People are staying in their homes longer due to low interest rates and social changes.

  - **New Construction:** Over the past five years, the US has averaged 1.448 million new home starts annually, with an average of 1.397 million homes completed each year.

  - **REOs:** Currently a non-factor, with an estimated 35,000 foreclosures nationwide due to high equity and low-interest rates.

  Demand Side Elements:

  - **Need:** There is a significant group of homebuyers aged 20-40, comprising around 90 million people.

  - **Desire:** Pandemic heightened the desire for homeownership. Recent surveys indicate 95% of people aged 20-42 want to buy a home.

  - **Affordability:** The biggest challenge due to high interest rates and home prices.

Historical Context and Market Trends

- People are staying in homes longer. Average tenure has increased from 6.5 years in 2005 to 12.3 years currently.

- Annual sales volumes fluctuated from 5.64 million in 2020 to an estimated 4.25 million in 2024, with predictions for an increase to 5 million in 2025.

Construction and Underbuilding

- Various estimates on the degree of underbuilding in the US range from 1.7 million to 6 million homes.

- Largest estimates of underbuilding come from institutions like Zillow and Fannie Mae.

Economic and Market Projections

- Anticipation of two interest rate cuts this year, expected to impact mortgage rates and increase home-buying activity.

- Optimistic projections for market recovery, with significant improvements expected by 2026.

Conclusions

- Stone is optimistic about the future, expecting a gradual recovery in the real estate market starting in the second half of this year and growing more robust by 2026.

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?

Dr. Bill Conerly's response:

Skepticism Towards Campaign Promises:

- Candidates may not follow through on their promises after being elected.
- Legislative approval is required for many initiatives, which might not always be granted.
- Even with approval, the expected impact of policies may vary.

General Economic Impact:

- Both presidential candidates are inclined towards substantial government spending.

Specific Economic Policies:

- Donald Trump (with Republican Congress)*:*
  - Likely to maintain low corporate tax rates.
  - Personal tax cuts are expected to remain.
  - Less regulatory constraints, particularly on financial and real estate sectors.
- Joe Biden (with Democratic Congress)*:*
  - Expected to allow Trump-era tax cuts to expire.
  - Increased regulation in financial and real estate sectors, subject to court approvals.

Uncertainty and Variables:

  - Exact outcomes are contingent on numerous factors and legislative dynamics.

Do you see real estate-specific implications of the presidential election?

Patrick Stone's response:

- Historical evidence does not show a consistent or regular impact of presidential elections on real estate.
- The tangible impact on real estate is more likely to occur if there is significant anxiety surrounding the election.
- This anxiety may lead to hesitation in decision-making among potential buyers and sellers.
- The primary concern for this election is the level of anxiety, rather than the outcome of the election itself.
- There is currently no meaningful influence on real estate based on political party or outlook.

- Optimistically, the hope is that the presidential election will not affect the real estate market either positively or negatively.

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:

- **Comprehensive Data Analysis**: The Federal Reserve employs approximately 400 PhD economists who scrutinize every available piece of economic data.
- **Primary Indicators for Laypersons**: Dr. Conerly suggests that non-professionals closely monitor two primary indicators to gauge the Fed's stance on inflation:
  - **Job Increase Trends**: Focus on the increase in the number of jobs rather than the unemployment rate. This data is typically released on the first Friday of each month.
  - **Consumer Price Index (CPI)**: Although the Fed utilizes a different specific index, the CPI is widely reported and serves as a reliable barometer for inflation trends. It is generally released in the middle of the month.
  - **Simplified Approach:** By consistently tracking job growth and CPI fluctuations, individuals can gain insight into the Fed's potential actions regarding rate adjustments.

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

Patrick Stone's response:

- Patrick Stone highlights the key issues of need, desire, and affordability.
- He notes there is no direct relationship between this cycle and previous cycles but draws a comparison to the post-World War II era.
- The pandemic, much like World War II, has had a profound social, psychological, and behavioral impact.
- There is a heightened focus on home ownership as a priority for individuals.
- State governments are putting in significant efforts to facilitate home ownership.
- There is a notable increase in discussions about the social benefits of owning a home.
- Stone likens the current social trend to a reset button pushed 50 or 60 years back, emphasizing home ownership as a crucial life goal.
- He views home ownership as a means of accumulating wealth and achieving life stability.
- Stone is cautiously optimistic about gradual improvements in home ownership throughout the rest of the decade.

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

Dr. Bill Conerly's response:

Housing Affordability Outlook (2024-2025):

- **General Prediction**:
    - Housing affordability will remain a concern, but is expected to improve slightly.
    - Anticipated cautious and gradual improvement.
- **Key Factors Affecting Affordability**:
    - **House Prices**: Prices are not expected to decrease.
    - **Interest Rates**: Mortgage rates are expected to decline, but slowly.
    - **Wages**: Wages are rising faster than inflation, enhancing the ability to pay.
- **Minor Influences**:
    - Homeowner's Insurance:
        - Not a major influencer compared to house prices and mortgage rates.
        - National average increase of 11% last year, but improvement is anticipated.
- **Market-Specific Trends**:
    - **NIMBYism (Not in My Backyard)**: Declining in some markets.
    - **YIMBYism (Yes in My Backyard)**: Increasing in more communities, fostering housing growth.
- **Summary**:
    - Overall, expect small improvements in housing affordability, with some variability across different markets.

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

Patrick Stone's response:

Understand Your Market:

- Make every attempt possible to gain a deep understanding of the residential real estate market.
- Gather and analyze market data and trends comprehensively.

Relay Information to Clients:

- Provide clients with up-to-date and accurate information.
- Address clients' anxieties by keeping them informed, even if the news is occasionally negative.
- Ensure clients understand what is happening and why, which reduces their concerns and builds trust.

Become Conversant in Market Trends:

- Continuously educate yourself on market trends and information specific to your region.
- Strive to be as knowledgeable and conversant as possible about current market conditions.

Hard Work and Focus:

- Dedicate substantial effort to know your business inside and out.
- Focus on understanding and conveying important information competently and clearly.

Client Relationships:

- Aim to ensure clients appreciate your thoroughness and expertise.
- Clients are likely to use your services more frequently if they trust your knowledge and insights.

Strive for Accuracy:

- While it's impossible to be 100% correct all the time, strive for high accuracy in your information.
- Understand that professionalism and effort in providing accurate market insights are highly valued.

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

Dr. Bill Conerly's response:

Tear Down and Repurpose Options:

- Commercial office spaces and malls may be torn down when they are no longer economically viable in their original form.
- Repurposing such structures, particularly for residential apartments or condos, is a frequently discussed alternative.

Construction and Renovation Challenges:

- Existing properties provide foundational elements such as walls, roofs, and initial structural integrity.
- Comprehensive overhauls are necessary; converting offices to residential spaces involves significant changes like relocating restrooms and renewing electrical and plumbing systems.

Real Estate Examples in Seattle:

- A smaller, struggling local mall has been transformed into a mixed-use space comprising offices and apartments, utilizing its ample real estate.
- This repurposed space includes new apartment buildings and small local offices, with the food court remaining operational for residents.

Regulatory and Economic Factors:

- Efforts are being made to ease regulations and fees associated with converting office buildings for residential use in metropolitan areas.

- High office vacancy rates and low utilization exacerbate the need for innovative redevelopment strategies.

Long-term Outlook:

- While some properties may be successfully repurposed, others may remain idle due to the extensive work and high costs involved in transforming them.

Where do you see CRE lending heading?

Patrick Stone's response:

- **Current State of CRE Lending:**
  - As of Q1, 2023, $88.6 billion in distressed commercial real estate loans exist.
  - This represents approximately 3% of the total $2.99 trillion in commercial real estate loans.
- **Q1 Breakdown:**
  - $9.9 billion in new distressed property.
  - $7.2 billion of these were resolved, leaving $2.7 billion unresolved.
- **Sector-Specific Distress:**
  - Offices: $38.2 billion in distressed loans.
  - Retail: $21.9 billion in distressed loans.
  - Hotels: $14.2 billion in distressed loans.
  - Multifamily: $10 billion in distressed loans.
- **Future Projections:**
  - About $1.5 trillion in loans from community and regional banks are expected to come due or require refinancing by the end of 2025.
- **Capital Availability:**
  - A significant amount of capital is seeking opportunities in the distressed property market.
  - Despite issues, the capital available is likely to mitigate a severe deflation in commercial real estate values.
- **Prognosis:**
  - While there are challenges, the abundance of capital should facilitate refinancing and purchases of distressed properties.
  - Although a minor disruption is anticipated, a major downturn is not expected due to the capital influx.

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 stabilize or even fall as the supply of homes for sale grows faster than demand?

Dr. Bill Conerly's response:

- **Initial Impact of Interest Rate Changes**:
    - Generally, when interest rates decrease, home prices tend to increase.
    - This trend is seen across various asset classes, including stocks, real estate values, commercial real estate values, and bonds.
- **Current Mortgage Scenarios**:
    - A significant number of homeowners currently hold mortgages with rates around 3% to 4%.
    - Many of these homeowners are content, but a considerable proportion are interested in moving to newer, larger homes.
- **Budget Constraints and Mortgage Lock-In**:
    - Homeowners considering moving face budget constraints due to the jump from a lower mortgage rate (3%-4%) to a higher one (around 7%).
    - The increased mortgage rate could effectively consume the budget for home improvement or purchasing a more expensive home, without actual additional expenditure.
- **Uncertain Future Activity**:
    - It's unclear how many homeowners are eagerly waiting for interest rates to drop before listing their current homes and moving.
    - Some homeowners are currently purchasing with the hope of refinancing their mortgages in the future.
- **Potential Reverse Effect on Home Prices**:
    - While there's a possibility that prices might ease due to an influx of homes being listed once rates fall, this scenario is uncertain.
    - Dr. Conerly's instincts suggest that a significant price drop is unlikely.
    - The mortgage lock-in effect could moderate the usual tendency for home prices to rise when interest rates decrease, creating an equilibrium effect.
- **Conclusion**:
    - The future direction of home prices amidst changing interest rates is uncertain.
    - The mortgage lock-in phenomenon will play a pivotal role in influencing market dynamics.

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:

- **Population and Housing Growth Disparity**:
  - From 2010 to 2020, California's population increased by 6.1%.
  - During the same period, housing growth was only 4.7%.
  - Since 2020, California remains about 50% short of the required 180,000 new housing units needed annually.
- **Future Housing Needs**:
  - By 2025, California will need approximately 3.5 million more homes than currently available.
  - There is a significant imbalance between housing supply and demand in the state.
- **Legislative Efforts**:
  - The Governor of California is actively pushing for legislative changes to remove restrictive city regulations on home building.
  - Historically, cities along the West Coast, particularly in California, have implemented proactive measures to control housing types, locations, and quantities.
  - Current legislative efforts focus on reducing these metropolitan-level restrictions.
- **Effectiveness of Legislative Changes**:
  - The likelihood of these legislative changes being effective is uncertain, estimated at a 50-50 chance.
  - Considerable movement exists in the California legislature aiming to address the housing crisis.
- **Current Housing Development Stats**:
  - In 2022, 123,000 single-family homes were built in California, the highest since 2008.
  - Despite this, the state remains far behind in meeting the housing demand.
- **Long-Term Outlook**:
  - Patrick Stone is skeptical about California's ability to balance housing supply and demand within the next 10 years or possibly ever.
  - The state's housing shortfall is projected to persist, indicating ongoing challenges in meeting the housing needs.

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

Dr. Bill Conerly's response:

- **Drivers of Homeowners Insurance Rates:**
  - Homeowners' insurance rates are predominantly influenced by the cost of claims.
  - Small claims are covered directly by the insurance company.
  - Major disasters lead the insurance company to seek excess coverage from reinsurers.
- **Recent Trends in the Reinsurance Market:**
  - The reinsurance market saw significant cost increases in 2023 for insurance companies to secure excess coverage.
  - In 2024, there has been a 5% reduction in reinsurance costs from last year's peak.
  - Rate negotiations in both January and June reflected this downward trend in reinsurance costs.
- **Impact on Local Insurers and Homeowners:**
  - The reduction in reinsurance costs should provide some relief to local insurers.
  - This relief translates into a slight decrease in the premium rates charged to homeowners.
- **Regulatory and Legal Environment:**
  - Regulatory measures intended to shield homeowners from high insurance costs can sometimes have the opposite effect.
  - Such measures have led to some insurers leaving the market, thereby affecting overall costs unfavorably.
- **Forecast for Homeowners Insurance Rates:**
  - A modest improvement in the cost of homeowners insurance is anticipated this year and next.
  - Despite the forecasted relief, the overall cost will still be substantial, and homeowners may not perceive insurance as an affordable option.

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:

- Wholesalers, potentially including iBuyers, have faced challenges in achieving success on a large corporate scale.
- Wholesaling on an agent basis, where an intermediary steps into a transaction, presents significant risks and must be handled with caution.
- Title agents are strongly recommended to consult with their underwriter and the underwriter's legal department to gain thorough understanding and guidance on managing wholesale transactions.

- Due to the potential for high levels of fraud in these transactions, it's crucial for title agents to be well-versed in identifying and mitigating risks.
- While wholesaling can be necessary and effective in certain cases, it is inherently complex and requires careful oversight.
- Patrick Stone emphasizes the importance of seeking comprehensive advice from general counsel and underwriters before engaging in wholesale transactions to ensure awareness of potential issues and risks.

What do you see for commercial? Do you feel foreclosures will climb in both markets, commercial and residential?

Dr. Bill Conerly's response:

- **Residential Foreclosures:**
  - Very few foreclosures expected.
  - Significant positive equity among homeowners.
  - Limited instances of negative equity due to recent price increases.
- **Commercial Market Overview:** Commercial real estate cannot be generalized as a single category.
  - **Office Space:**
    - **Suburban Offices:**
      - Generally performing well.
      - Key tenants include local title insurance companies, medical offices, legal practices.
    - **Downtown Offices:**
      - Performance varies by city, but generally underperforming.
      - Higher risk of foreclosures in certain urban areas.
    - **Industrial and Warehouse:**
      - Strong performance historically.
      - Slight overbuilding observed in some regions.
    - **Storage:** Another distinct sector with its own dynamics.
    - **Retail Sector:** Mixed performance.
      - Underperformance in some traditional malls.
      - Strong performance and underbuilding in other retail spaces.
      - Continued demand for suburban locations including:
        - Restaurants

        - Activity locations, such as yoga studios
        - Grocery stores
    - **General Commercial Outlook:**
        - Overall, commercial real estate is performing adequately.
        - Selective foreclosures anticipated, especially in downtown offices and some outdated malls.

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

Patrick Stone's response:

- Homeowners now have significant equity:
    - Due to an average appreciation of 84% over the last five years.
    - This equals about 16.8% appreciation annually.
- Criteria to identify potential leads without buying leads:
    - Homeowners who have owned their home for over three years likely have a substantial amount of equity.
    - Nationally, homeowners have about 48% equity in their homes.
- Applications of equity information:
    - Those looking to refinance their mortgages.
    - People interested in home equity loans.
    - Homeowners potentially motivated to sell their homes.
- Strategic approach:
    - Utilize the length of home ownership to identify leads.
    - Prioritize homeowners who have owned their properties for three years or more.

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 stands for state and local tax deduction limit.
- The possibility of eliminating the SALT cap is highly dependent on the political landscape.
- If Republicans control either House of Congress, the SALT cap is unlikely to be eliminated.
- Elimination of the SALT cap might occur if President Biden wins and gains control of Congress.
- Even some Republicans in high tax states may favor keeping the SALT cap as a strategic move.

- Retaining the SALT cap can be seen as a way for politicians to challenge their counterparts in 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:

- **Focus on Core Competencies**: Tailor efforts based on professional roles. Title agents should concentrate on top producers, while Realtors should target high-end market clients.
- **Prioritize Top Producers**: The prevailing economic conditions and ongoing NAR lawsuit necessitate focusing on those who are already generating substantial business.
- **Build Relationships and Provide Value**: In Q3, the emphasis should be on cultivating relationships and adding substantial value to clients.
- **Gain Insights through Surveys**: Regularly conduct surveys (via tools like Survey Monkey or through hired professionals) to understand client needs and market trends.
- **Leverage Available Tools**: Utilize available data and analytical tools to gain clear insights into market directions and client preferences, avoiding decisions based solely on assumptions.
- **Customized Client Engagement**: Understand and address specific needs and aspirations of potential clients to enhance engagement and satisfaction.

Dr. Bill Conerly's response:

- Turn off the news
- Focus on relationships: clients, past clients, referral sources

Closing Thoughts

- **Patrick Stone:**
    - **Prediction:** Interest rates will be under 6% by the first quarter of next year.
    - **Further prediction:** Interest rates will be at five and a half percent by this time next year.
- **Dr. Bill Conerly:**
    - **Assessment:** Slightly more conservative outlook.
    - **Prediction:** Interest rates will be under 6% by the end of 2025.

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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/