The General Economy

Despite the pandemic and severe weather, consumers and the housing industry signaled they were eager to put the dark winter behind them. The economy in the first quarter of the year was stronger than expected, although progress was uneven.

Consumers, emboldened with vaccinations and facing fewer restrictions, emerged to participate in activities they had missed and fuel the economy with stimulus check dollars in both January and March. According to Fannie Mae, personal spending and Gross Domestic Product (GDP) are both projected to reach an annualized rate of 5 percent for 1Q of 2021 – double the GDP and six times the personal spending forecasted just two months ago. Residential building and remodeling defied the normal winter down-cycle and advanced the economy by an unanticipated 15.9 percent. Continuous improvement in employment also brought unemployment down to a surprising 6.0 percent.

The recovery was a bit tenuous. Retail sales were bumpy during the quarter and severely affected by bad winter storms in February. Companies ramped up for expected demand, but weather impediments, prolonged supply chain issues, pandemic-related workforce reductions and increasing input prices all restrained business investment. Industrial production and durable goods manufacturing faltered.

The Real Estate Market

Residential

Demand for homes remains robust, but there are signs of moderation in the market. Climbing prices and creeping mortgage rates led to a quarterly decline in existing and pending sales. The Mortgage Bankers Association (MBA) estimated that the Federal Housing Finance Agency (FHFA) House Price Index for Q1 of 2021 increased 9.8 percent year over year. The benchmark 10-year treasury rate, responding to strong economic growth and potential inflation, pushed the average 30-year fixed rate over 3.0 percent for the first time since last summer. But it is the depleted housing stock that overshadows other influences. The National Association of REALTORS® (NAR) cautioned that the inventory crisis is pushing down existing home sales. Total housing inventory shrank a record 29.5 percent from February 2020, worsened by an unprecedented gap between homes sold and homes built.

Several trends may lead to a prolonged structural downward force on housing inventory.

Days on the market for homes have dropped to 20, a new low. Growth in the use of online resources is a contributing factor. According to the NAR, these online resources have reduced hours spent researching and buying a home by two weeks, on average. Moreover, buyers are hurrying to put in attractive bids. The National Association of Home Builders (NAHB) reports that, for the first time, the number one reason for not buying a home was that the house hunter was outbid by others.

Despite the hot market, many homeowners are staying put, reducing the pool of existing homes for sale. Some worry they will not be able to find or afford a replacement home, and those who recently refinanced have little incentive to sell.

There are also fresh impediments to building homes. According to the NAHB, the top concerns for builders are the price of materials, availability and delivery times of materials, and labor. Surging lumber prices, which add approximately $24,000 to the price of the average home, have builders struggling to keep home prices affordable. Both the number of single-family homes permitted but not yet started and the sale of homes not yet started have jumped as a result.

While some pandemic-related trends are here to stay, such as online resources, others may fade as the year progresses (a Canadian lumber agreement, perhaps). Despite a recent drop in home sales, most industry observers expect the market to continue outperforming pre-pandemic sales.

Commercial

Office tenants and landlords were in limbo for most of 2020, wondering whether and when people would return to workspaces. This quarter, the outlook became clearer and many are now laying groundwork for the future.

The primary issue is supporting permanent remote work. According to the Atlanta Federal Reserve, on average 14.6 percent of work will be done at home, nearly triple the pre-pandemic level. Creating healthy and effective offices for returning employees will be a challenge. It could mean investment in new HVAC systems, de-densification of open floorplans or building out more Zoom rooms. If hot-desking (the practice of employees taking whatever desk is available) is promoted, companies will require not only the appropriate configuration of furniture, but also scheduling software. Businesses are crafting policies on this new workstyle and proper hygiene practices, while searching for ways to keep a cohesive corporate culture.

Some firms look at this period as an opportunity. “There’s a short-term nature to many leases, with an increase in renegotiations for more favorable terms in the interim,” according to JLL. Employers are jettisoning legacy practices and leveraging improved workspaces as a selling point in their recruiting. Some are even following their workers’ movement to the suburbs or to smaller cities. Real Capital Analytics reported that office prices rebounded 3.3 percent in January, mostly for suburban space.

A Glance Forward

With spring in full bloom, estimates for annualized GDP growth are encouraging, ranging from 6 percent to 8.4 percent. Consumers are expected to provide ample fuel for this boom. In addition to the current round of stimulus checks, personal “excess” savings are about $2.0 trillion above the pre-COVID baseline, and climbing stock and home values are bolstering both portfolio and home equity wealth. Spending, particularly on leisure activities, should buoy the hardest hit sector of job losses and lower unemployment. Improved job numbers should promote a further reduction in the 2.5 million bucket of distressed mortgages that need to be dealt with when forbearance programs expire.

There are a few clouds on the horizon. Manufacturing delays are expected to persist. Thus, there will likely be too much money chasing too few goods. Inflation is expected to nearly double to 3 percent for the quarter. Mortgage rates will likely respond to this pressure, settling around 3.2 percent for the next three months. Consequently, the pace of housing investment is projected to drop, but only to 4.4 percent. Fortunately, the dampening impact will be minimal, with forecasts for even brighter days to come over the summer.