

Higher Mortgage Rates Create Favorable Reverberations for Commercial Real Estate

Mortgage rates surge to a pandemic-era high. The 30-year mortgage interest rate is moving up, with the pace of increase accelerating from the mild bump posted in late 2021. The rate has climbed more than 40 basis points during the past few weeks to reach the mid-3 percent range, now once again in line with the late 2019 figure. Upward movement is likely to continue during the coming months amid indications that the Federal Reserve will attempt to rein in record-level inflation. A higher cost of borrowing is already impacting the decisions of would-be homebuyers. The four-week moving average of mortgage purchase applications has dropped 12.6 percent relative to the year-ago volume.

Rising prices and rates to curb affordability. While demographic and lifestyle influences pushed up home sales volumes and prices since the onset of the pandemic, barriers to entry for first-time buyers were mitigated to some degree during the past year or so by the low interest rate environment. That opportunity to lock in favorable financing has seemingly passed with rates on the climb. Meanwhile, the median sale price of an existing home has soared more than 16 percent year-over-year, and prices should continue to rise. People lower on the income spectrum are struggling to find homes that meet their budget restrictions. Shortages of available for-sale product will continue to push housing demand toward other living options, especially multifamily and manufactured housing. Both segments are now logging vacancy rates at least 100 basis points below their respective 2019 measures.

Housing trends could benefit retail spending. Many homeowners are realizing sizable equity gains amid rapid increases in home prices. In turn, balance sheets are in good shape for a large block of households that are exhibiting a willingness to spend for a variety of goods and services. At the same time, housing developers are ramping up construction in response to strong demand. Each home built generates an average of three jobs for one year, aiding the local economies in places where development is active and providing wages to workers who help fuel spending. Each home purchase spurs new retail sales that average \$5,200.

Developing Trends

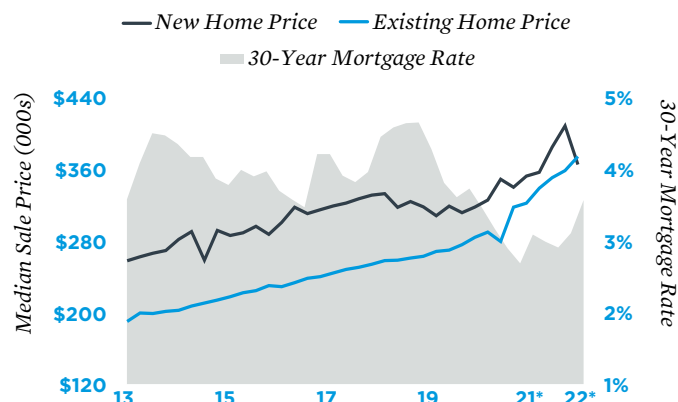
Stock of existing homes for sale on the retreat. Last year's strong home buying activity compressed the inventory of existing product listed for sale to a record low of 923,000 units in December. The count is down roughly 12 percent from 2021's July peak, and just half of the available stock recorded in 2015. This trend further elevates barriers to entry for first-time buyers, as older, existing homes tend to be more budget friendly than new homes. Further demand amid limited supply should sustain upward price movement that will create more challenges for buyer prospects in a higher mortgage rate climate.

Residential housing starts notch a nine-month high. Led by an 11 percent month-over-month swell in multifamily starts in December, the overall count of residential construction starts at year-end grew to the highest level since March. As such, the overall housing shortage may be moving past its most severe level, but product availability will still be less than ideal over the near term. It will be tough to sustain housing demand at the level recorded in 2021, but young adults are forming new households and millennials are advancing in age to their prime homebuying years.

34.8% Y-O-Y Change in New Homes for Sale

9.7% Share of New Homes for Sale Completed When Listed on the Market

Home Prices Elevated as Rates Move Higher



* Through December; 30-Year Mortgage Rate as of January 20, 2022

Sources: IPA Research Services; Capital Economics; Freddie Mac; Moody's Analytics; Mortgage Bankers Association; National Association of Home Builders; National Association of Realtors; RealPage, Inc.; U.S. Bureau of Labor Statistics; U.S. Census Bureau; Wells Fargo



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