Sunwest Bank
BUILT FOR ENTREPRENEURS BY ENTREPRENEURS

Market Data

Interest Rates	Current	Month Ago	Year Ago
Bank Rates (As Of 8/31)			
WSJ Prime	8.50%	8.50%	5.50%
1 Month Term SOFR	5.33%	5.32%	2.51%
Fed Funds Rate	5.33%	5.33%	2.33%
30 Year Mortgage Fixed	7.18%	6.81%	5.66%
Treasury Rates (As Of 8/31)			
10 Year	4.09%	3.96%	3.16%
7 Year	4.20%	4.08%	3.27%
5 Year	4.26%	4.18%	3.31%
3 Year	4.57%	4.52%	3.47%
1 Year	5.39%	5.39%	3.50%
1 Month	5.40%	5.38%	2.31%
1-Month SOFR Term SOFR Swap Rates (As Of 8/31)			
10 Year	3.75%	3.64%	2.92%
7 Year	3.83%	3.74%	2.96%
5 Year	3.97%	3.90%	3.07%
3 Year	4.32%	4.30%	3.32%

Inflation Data	Current	Month Ago	Year Ago
CPI Headline YoY	3.3%	3.1%	8.4%
CPI Core YoY	4.7%	4.9%	5.9%
PPI Headline YoY	0.8%	0.2%	9.7%
PPI Core YoY	2.7%	2.7%	5.8%

Economic Data	Current	Month Ago	Year Ago
PMI Manufacturing	47.0	49	51.3
PMI Services	51	52.4	44.1
Case/Shiller U.S. Home Price Index	308.3	305.4	308.3
Housing Permits	1,443k	1,441k	1,658k
Housing Starts	1,452k	1,398k	1,371k
Retail Sales	$605b	$601b	$593b
Unemployment Rate	3.5%	3.6%	3.5%
Non-Farm Payrolls	+187k	+185k	+568k

LETTER FROM THE PRESIDENT

Resiliency of the Housing Market

The American housing market has remained resilient in the face of a broader economic slowdown and an overall decline in asset prices. Everything from the stock market to the manufacturing indices would suggest double-digit declines in home prices. In reality, U.S. home prices have seen declines of less than 5%, which have retraced to be only down 1% in recent months. Despite the numerous challenges the housing market has faced, particularly higher mortgage rates, residential housing prices have held firm. We will discuss why prices have continued to be robust and whether this will continue in the year ahead.

Why has housing remained resilient?

Housing in the U.S., a $45.3 trillion market, has dynamics that are unique from the rest of the economy, and there are specific variables that are different in the current environment. The largest driver of single-family mortgage prices and volume are typically mortgage interest rates and employment. Employment has remained resilient and mortgage interest rates have risen significantly, now above 7%, a key mental threshold for consumers. However, the increase in mortgage rates to 7% from less than 3% in 2021 has trapped homeowners in their current residence because their affordability at current mortgage rates means that their monthly mortgage payment would increase 66% from roughly $3,000 to $5,000 on a $750,000 loan. Additionally, when First Republic failed and was assumed by JPMorgan, this eliminated nearly all jumbo mortgage pricing competition because they were the largest lenders in the country. These higher mortgage payments are causing homeowners to stay in their homes, drastically reducing the volume of for-sale inventory. When this is combined with the fact that the U.S. housing market was already considerably undersupplied in single-family housing, there remains a very large spread between the prices that buyers are willing to pay and sellers are willing to accept.

Equity Markets	Current	Month Ago	Year Ago
Indices (As Of 8/31)			
DJIA	$34,875	1.94%	10.66%
S&P 500	$4,524	1.42%	14.39%
NASDAQ	$14,082	1.84%	19.18%

Sports Fact of the Month:
In January 2016 it was announced that SoFi Stadium would be constructed in Inglewood, CA, and over the next 5 years median home prices nearly doubled to $655k

The market drivers from this lack of inventory in the single-family resell market are confirmed by data from new home sales and publicly traded homebuilders. New home sales through homebuilders have seen strong volumes due to pent-up single-family housing demand, even with the increase in mortgage rates. Builders have lowered prices; for example, LGI Homes has reduced prices by 2.5% quarter over quarter due to rising interest rates and homeowner affordability. Still, they continue to sell home volumes consistent with 2019. This provides better price discovery of where home prices would be if housing supply levels normalized.

Buyers that are unwilling to pay 2021 prices in a 2023 market are being patient, and cash buyers are also considering the opportunity cost of their capital given the return on savings either through bank deposits or treasuries. For sellers, employment remains strong, and most sellers have long-term fixed rate mortgages. As a result, there are very few forced sellers, allowing pricing to stay high, albeit at lower volumes. This is the classic market standoff that occurs when buyers and sellers in a financial market are unwilling to make the first move and an economic stalemate ensues, and only time will determine which side capitulates first, buyers paying higher prices or sellers lowering their asking prices.

Shadow Dynamics and Geographic Weaknesses

There are shadow markets in the single-family residential housing sector that have emerged since the Great Recession and particularly during the pandemic. For instance, there are over 1 million single-family Airbnb's in the U.S., while there are only 600,000 single-family homes for sale. These dynamics can be even more extreme in popular Airbnb markets (Phoenix, Austin, Boise, Boseman, etc.), which are also destination markets that experienced significant price appreciation from remote work policies and travel preference changes. These dynamics have changed, and this is causing lower occupancy and prices for these Airbnb properties. Today, these Airbnb's are not just owned by individuals renting out their residences but are businesses run by individuals that borrowed at low interest rates to buy these homes or even real estate partnerships that purchased large volumes of properties and created a quasi-hotel investment platform (i.e. AvantStay). As a result, declining Airbnb rental rates and occupancy can put downward pressure on the returns from these investments or even create the first set of forced sellers in a market if the owners do not have the liquidity to carry the asset during a downturn. For instance, if only 5% of Airbnb's were listed on the market, it would increase overall for-sale housing inventory by 8-10%. This is a significant enough percentage to adjust overall housing prices lower.

Beyond just the Airbnb market, there is also a very robust single-family home rental business that grew after the Great Recession with large funds buying significant inventory. These pools of single-family home inventory owned for rental usage grew year over year until 2022. This asset class was a product of very low interest rates as investors searched for yields across all real estate sectors. With treasury yields being much higher in the current environment, there is the potential for investors to shift away from this asset class into higher yielding real estate investments, bonds, or short-term treasuries, creating additional supply for the housing market, which could adjust supply imbalance we discussed earlier and create downward pressure on prices.

Conclusion

Single-family residential housing prices have remained far more stable in this rising rate environment than most predicted in prior cycles. As we discussed, there are fundamental supply and demand dynamics driving the resiliency in prices, albeit on lower transaction volumes. If supply remains constrained, which it likely will in the traditional resell market, prices may remain stable in their current range because buyers will ultimately be forced to purchase from existing inventory and pay current prices to do so (excluding the COVID boom, secondary home markets which are already seeing declines). However, if some of the shadow supply, either through Airbnb or single-family rentals, begins to enter the for-sale market, it could significantly increase inventory and begin to push single-family residential housing prices lower.

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