CENTER FOR CALIFORNIA REAL ESTATE PRESENTS...

01.10.24

HOUSING 2024: THE CALIFORNIA DREAM IN FOCUS

CCRE CENTER FOR CALIFORNIA REAL ESTATE

BACKGROUND

The Center for California Real Estate (CCRE), an institute of the CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.), is dedicated to intellectual engagement in the field of real estate. Its mission is to advance industry knowledge and innovation with an emphasis on convening key experts and decision-makers. CCRE reflects C.A.R.'s increasing role in shaping the future of the industry by advancing innovative policy solutions and active dialogue with experts and industry stakeholders. Additional information on CCRE and C.A.R. can be found online at CCRE.us.

EXECUTIVE SUMMARY

The Center for California Real Estate hosted an informative panel discussion, gathering renowned economists and housing experts to dissect the state of California housing for the upcoming year. The panel, moderated by CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.) CEO John Sebree, included Selma Hepp, Chief Economist for CoreLogic; Robert Kleinhenz, Director of the Office of Economic Research at California State University, Long Beach; Ben Metcalf, Managing Director at the Terner Center for Housing Innovation at U.C. Berkeley; and Logan Mohtashami, Lead Analyst for HousingWire. Together, they delved into critical issues, from projecting Federal Reserve interest rate cuts to the challenges of affordability in a state grappling with limited housing supply.

The panel shared a cautiously optimistic perspective for continued economic stability and home sale growth in 2024, despite elevated mortgage rates and a dip in home sales in 2023. Economic indicators such as a strong labor market, GDP growth, and decreasing inflation rates, coupled with potential Federal Reserve interest rate reductions, maximize the likelihood of a stable economic environment ahead. Predictions for an uptick in home sales were also discussed, particularly if mortgage rates decrease throughout 2024.

California's pronounced housing supply shortage, with the state issuing building permits at rates comparable to individual cities in other states, underscores the acute demand-supply imbalance. This is further exacerbated by long-standing policies and economic factors that have hindered construction rates and innovation in housing development.

The increasing frequency and severity of climate events, particularly wildfires, have significantly impacted the home insurance sector, driving costs up and leading to a reliance on the California FAIR Plan. Efforts by C.A.R. to address these challenges through advocacy and engagement with state regulators were highlighted.

The critical roles of state enforcement in addressing housing shortages and the proactive involvement of REALTORS® in advocating for policy changes and development initiatives were emphasized. The need for collaborative action and community involvement to navigate the complex housing landscape was deemed paramount for securing a sustainable and equitable future in California real estate.

KEY TAKEAWAYS

1. **Projected growth in 2024 home sales**: Panelists predicted an uptick in single-family home sales, aligning with C.A.R.'s forecast of an approximate 23 percent rebound from 2023.

2. **Supply challenges still mar would-be buyers**: California, facing a housing shortfall of a state-estimated 2.5 million units, is among the most constrained markets in the U.S.

3. **Limited single-family housing permitting**: In 2023, the entire state of California issued a similar amount of single-family housing building permits as the city of Houston, TX.

4. **Upzoning trends aid long-term supply**: From downzoning in past decades, cities like Los Angeles went from a capacity of 10 million to 4 million residents. However, current trends – spurred by state enforcement – are favoring pro-development initiatives.

5. **National shortage of single-family units**: The panel highlighted a U.S. Census Bureau report showing only 78,000 completed single-family homes available nationwide.

6. **Supreme Court case on impact fee**: A favorable ruling could alleviate development costs, where some areas charge up to $100,000 per unit.

7. **Rise in ADU supply**: Annual accessory dwelling unit permits increased from approximately 1,000 permits to more than 20,000 over the span of a few years.

8. **Expectation of lower interest rates**: The Federal Reserve's decision to cut rates should enable more qualified buyers to enter the market.

9. **Wealth of older Americans could buoy economy**: Individuals aged 55+ holding approximately $100 trillion could provide economic stability as they retire and spend their wealth.

10. **Challenges in commercial-to-residential conversion**: High costs make converting commercial buildings to residential spaces difficult. Across the country, there are just over 200 conversion projects in development.

ECONOMIC OUTLOOK

The Federal Reserve's decision to raise interest rates in 2022 was an attempt to curb inflation. This led to mortgage rates soaring to around 8 percent by fall of 2023, causing a considerable slump in home sales. However, the cloud of a potential recessionary downturn that loomed over the past year never fully materialized. The panelists shared a cautiously optimistic outlook for the upcoming year, predicting that even if a recession were to occur, its impact would likely be minimal, with most Americans hardly noticing its effects.

Kleinhenz highlighted four major economic indicators that should be closely watched: the labor market, the rate of inflation, average GDP growth, and interest rates. He pointed out the strong signs in the labor market, with unemployment rates just below the normal 4 percent. This robust labor market coupled with a strong growth in GDP, the rate of inflation decreasing, and a likely decrease in interest rates following the Federal Reserve's announcement, paints a hopeful picture for the economy.

Metcalf reinforced the notion of economic stability by highlighting the yet-to-be-spent funds from the 2022 Inflation Reduction Act. This COVID-era federal legislation, intended to spur economic activity, still holds unutilized resources, which could serve as a buffer against potential recessionary trends.

Furthermore, Kleinhenz brought attention to the significant wealth held by older Americans, estimated at around $100 trillion. As this demographic moves into retirement and begins liquidating assets, even a modest rate of 3 percent could inject a substantial $300 billion into the economy which, according to him, is "enough to add another 1 percent of growth to the U.S. economy."

However, one concern raised wasn't directly related to the economy's performance but rather to public perception. Hepp pointed out that while the state of the economy continues to improve, there's a "disconnect between what people are saying and how the economy is doing." She noted surveys showing the impacts of inflation may well continue to infiltrate the minds of Americans. Additionally, she expressed concern how the pending 2024 presidential election and rhetoric around the economy could suppress any optimism about the economy.

"There's a disconnect between what people are saying and how the economy is doing."

- Selma Hepp

Selma Hepp
Chief Economist, CoreLogic

HOME SALE PREDICTIONS

The panelists delved into the intricate dynamics of the housing market. Mohtashami forecasted that national existing home sales could surpass 4.6 million units, which he notes as significant considering the current state of mortgage rates. Kleinhenz suggested that while mortgage rate decreases might be postponed to the latter half of the year, this timing could align perfectly with the traditional home sale season, potentially boosting sales.

The panel also touched upon how the landscape of homebuying has evolved in recent years. Changes in federal policies, such as the 2017 Tax Cuts and Jobs Act, which capped state and local tax deductions, have had a disproportionate impact on states like California. Additionally, the Qualified Mortgage rule and the stringent lending practices mandated by the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, emerging from the subprime mortgage crisis, have led to a more limited pool of potential homebuyers.

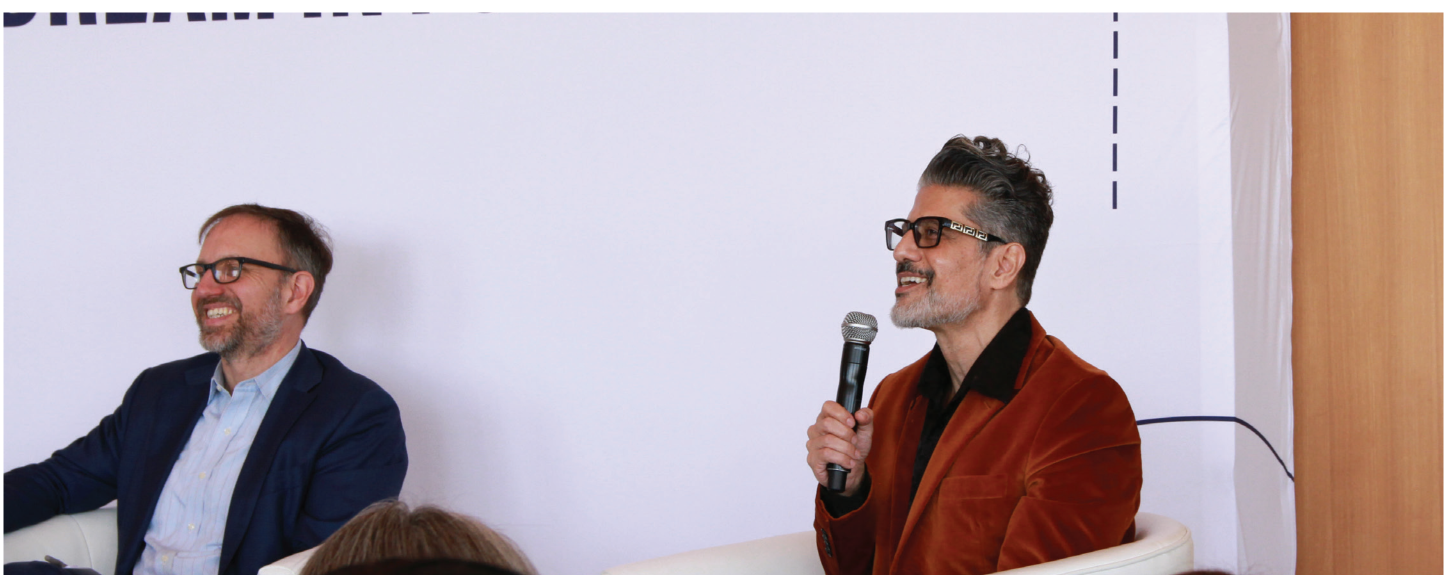
However, as mortgage rates decrease throughout the year, the pool of prospective buyers will likely increase. Therefore, Mohtashami encouraged those who do qualify and want to purchase should get pre-qualified sooner than later.

HOUSING SUPPLY CHALLENGES

Hepp emphasized the pent-up demand in the housing market, highlighting the stark contrast between the limited inventory of available homes and the ongoing housing needs. She labeled California as the "most inventory constrained market" by highlighting the fact that last year the state of California issued approximately the same number of housing building permits as the city of Houston, Texas.

Mohtashami provided a critical analysis of the Federal Reserve's decision to maintain elevated interest rates for so long, noting its dampening effect not only on housing demand but also on the pace of construction. He cited the most recent data showing that new homes available for sale across the country totaled only 78,000, a clear indicator of the supply crunch.

The panel unanimously agreed that the scarcity of housing supply is a key driver of the high cost of housing in California. Noting the Terner Center's 2023 study shedding light on homeownership affordability in the state, Metcalf pointed out the data compares the years 2000 and 2020, which finds "we are still in a multi-decade period of woefully building fewer homes than what we should." The study reveals that California's homeownership rates lag approximately 15 percentage points behind the rest of the country, with supply constraints being a significant factor.



Ben Metcalf
Managing Director, Terner Center for Housing Innovation at UC Berkeley

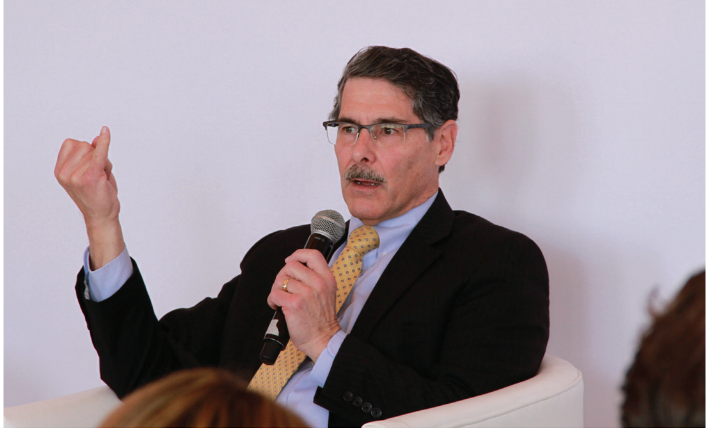
Logan Mohtashami
Lead Analyst, HousingWire

> **"We are still in a multi-decade period of woefully building fewer homes than what we should."**
>
> **- Ben Metcalf**

LACK OF HOME INSURANCE AVAILABILITY

In recent years, the state has faced escalating risks due to climate change-related events, notably the increasingly frequency and severity of wildfires, which have fundamentally altered the landscape of home insurance. These increasing risks have led to a significant surge in insurance costs, prompting some insurers to either stop issuing new policies or exit the market altogether. This has led to a growing reliance on the California Fair Access to Insurance Requirements (FAIR) Plan, the state's insurer of last resort, which is often the only option for many in high-risk areas.

The panel addressed these insurance challenges head-on, emphasizing their impact on both homeowners and potential buyers. Sebree discussed the proactive steps taken by the C.A.R.



Robert A. Kleinhenz
Director, Office of Economic Research, California State University, Long Beach

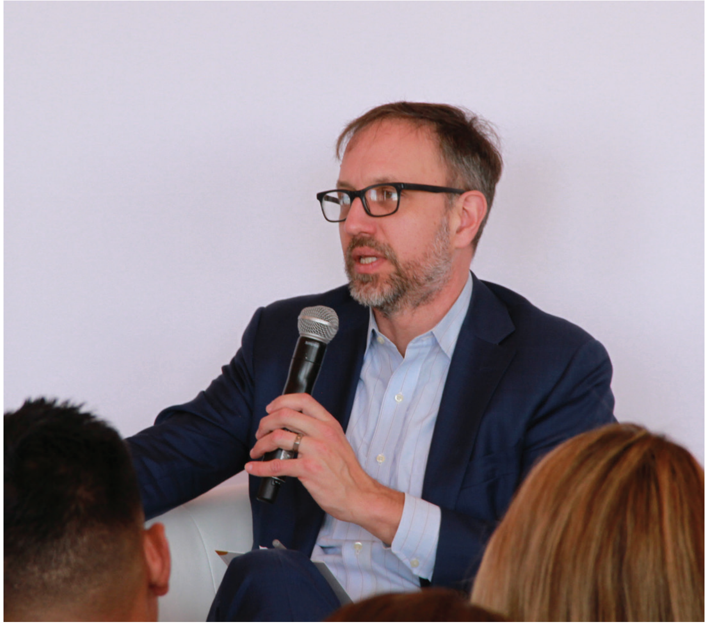
leadership team in addressing these insurance challenges. He noted that team members have actively engaged with the FAIR Plan president and the California Department of Insurance (DOI), advocating for solutions to the insurance crisis. Drawing on his experience with similar climate-related insurance issues in Florida, Sebree highlighted the complexity of the problem and the importance of working closely with state regulators to develop effective solutions.

The panel also delved into the significant regulatory reforms announced by the DOI in September 2023. These reforms, aimed at stabilizing the home insurance market and providing more options for homeowners, represent a crucial step towards addressing the insurance crisis. However, Sebree cautioned that the effects of these policy changes might take time to become apparent, though he expressed optimism that "we will start feeling them soon."

THE ROLE OF STATE AND LOCAL GOVERNMENTS

The panelists discussed the critical role of state government enforcement in addressing the housing shortage. The California Department of Housing and Community Development (HCD) estimates a shortage of 2.5 million housing units via its Regional Housing Needs Assessment (RHNA). Through RHNA, the state mandates local municipalities to develop plans for proportionally adding housing units based on HCD's formula.

The precursor to this shortage, partially stems from decisions of decades past. Multiple panelists pointed to the historical trend of down-zoning in the late 20th Century, which has significantly contributed to the current housing shortage. Hepp highlighted the example of the Los Angeles metropolitan area, which experienced a drastic reduction in its zoning capacity. During the final decades of the last century, the region



Ben Metcalf
Managing Director, Terner Center for Housing Innovation at UC Berkeley

was downzoned from 10 million to 4 million residents. Kleinhenz, an advisor to local municipalities, elaborated on the reluctance of cities to issue more building permits. He explained that housing developments often do not generate sufficient tax revenue to cover city expenses, leading to political pressure from residents against densely built communities. This sentiment, often characterized by the acronym NIMBY (Not In My Backyard), reflects a common resistance to housing development.

Additionally, the impact of local impact fees on construction costs cannot be overlooked. Ben Metcalf noted that in some parts of California, these fees can soar to $100,000 per unit. A looming Supreme Court case regarding these fees could potentially reshape how local governments manage them, potentially altering the housing development landscape. However, recent policy changes at the state level and shifting public opinion might be reversing. The state government has passed several bills to enforce RHNA numbers, leading to a more streamlined zoning process that limits local official subjectivity in decision-making. While it might take time for these policy changes to manifest in increased development, Metcalf is hopeful for a positive shift in the upcoming RHNA cycle.

REALTOR® ENGAGEMENT

In the face of these challenges, the panelists stressed the crucial role of REALTORS® in engaging with state and local government officials. Recognizing the incremental progress toward pro-development movements across the state, Metcalf cautioned that opposition to pro-housing policies is still strong. He emphasized the importance of REALTORS® being present and vocal at local council hearings to advocate for additional housing.

The call for wider community involvement was also echoed by other panelists. Kleinhenz observed at various city council meetings that certain segments of the resident population, such as renters and seniors, are often underrepresented. While the perspectives of REALTORS® and homeowners are vital in the broader development conversation, there is a need to enlist diverse community voices to address the varying housing needs of different populations. John Sebree summed up this sentiment, stating, “We have to build coalitions, and we need to work with others.”

“We have to build coalitions, and we need to work with others”

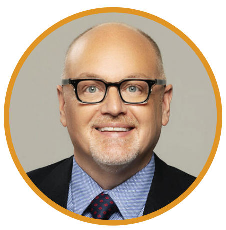
- John M. Sebree

John M. Sebree
CEO. CALIFORNIA ASSOCIATION OF REALTORS®

CONCLUSION

The panel discussion underscored the multifaceted nature of California's housing challenges and the importance of collaborative efforts across various sectors. From economic forecasts and housing supply issues to the role of government policies and community engagement, the insights provided by the panelists offered a comprehensive overview of the state's housing market. As California navigates these complex issues, the active participation of REALTORS®, combined with informed policy decisions and community involvement, will be key to addressing the state's housing needs and ensuring a sustainable and equitable future for all residents.

MODERATOR:

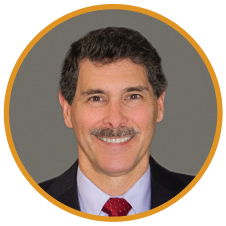


John M. Sebree
CEO. C.A.R.
Sebree oversees the objectives, business development, strategic planning, and legislative policies for the CALIFORNIA ASSOCIATION OF REALTORS® (C.A.R.). He previously served as chief executive officer of Missouri REALTORS® and worked in the Government Affairs division of the NATIONAL ASSOCIATION OF REALTORS® (NAR). He earned an MBA from The George Washington University in Washington, DC.

PANELISTS:

Selma Hepp
Chief Economist, CoreLogic

Hepp leads the team responsible for analyzing, interpreting and forecasting housing and economic trends in real estate, mortgage and insurance. She frequently appears on local and national radio and television programs and has been widely quoted in *The Wall Street Journal, The New York Times* and many industry trade publications such as *National Mortgage News* and *HousingWire*. Hepp holds a Ph.D. from the University of Maryland and has held previous roles at both NAR and C.A.R.

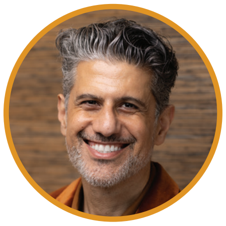


Robert A. Kleinhenz
Director, Office of Economic Research, California State University, Long Beach

Kleinhenz has more than 30 years of experience in urban and regional economics, with expertise in transportation and land use analysis. He has produced a variety of economic forecasts, industry studies, and housing and public policy analyses. A frequent contributor to the media, he has been interviewed by NPR and other national outlets, as well as statewide outlets including *Los Angeles Times, San Francisco Chronicle*, and *Los Angeles Daily News*. Kleinhenz holds a Ph.D. from the University of Southern California.

Ben Metcalf
Managing Director, Terner Center for Housing Innovation at UC Berkeley

Metcalf leads the expansion and deepening of the Terner Center's work addressing housing affordability challenges through rigorous research and policy analysis. His previous roles include the Director of the California Department of Housing and Community Development and Deputy Assistant Secretary of the U.S. Department of Housing and Urban Development. His past responsibilities included oversight of the Federal Housing Administration multifamily guaranteed loan portfolio and a subsidized affordable housing portfolio. He has a Masters in Public Policy and Urban Planning from the Harvard Kennedy School.



Logan Mohtashami
Lead Analyst, HousingWire

Mohtashami is a renowned expert in the mortgage and housing ecosystem, recognized for his insightful analysis and commentary on the U.S. economy and real estate market. With a background spanning over two decades in the mortgage industry, Logan — nicknamed "The Chart Guy" — has the remarkable ability to decipher complex economic data and translate it into understandable, actionable insights. This knowledge has made him a sought-after commentator, and his expertise has been featured extensively in news outlets, including CNBC, where he is a frequent guest.