Jerry Howard (00:08):

Welcome to Housing Developments. I'm Jerry Howard.

Paul Lopez (00:11):

And I'm Paul Lopez for Jim Tobin.

Jerry Howard (00:14):

Paul, thank you for filling in for Jim, who is missing in action today. I know it's a beautiful day outside. One can only surmise that he may be golfing somewhere. I have no idea, but thanks for filling in on short notice. We're very happy to have you. And returning once again, one of our most popular guests is what was he called the last week? The Nostradamus of Economics?

Paul Lopez (00:42):

Yeah, that's right.

Jerry Howard (00:43):

The [inaudible 00:00:44] Piper of Housing. Dr. Rob Dietz is back again. Rob, good to have you.

Dr. Rob Dietz (00:50):

It's good to be here, guy.

Jerry Howard (00:51):

Rob, you have been studying this very closely. You and I had a conversation about it a few minutes ago. What's the story about inflation for the rest of the year?

Dr. Rob Dietz (01:03):

Yeah, I think we heard from the Federal Reserve when we took the senior officer team to meet with Chairman Powell and the governors earlier this year, that their expectations about inflation is that it's going to be higher this year. And builders saw an inflation coming before everyone else, right, with the run-up in lumber costs, with building material costs being 23% higher in aggregate year over year. We expect the Producer Price Index this year to be up 6%, which is two to three times higher than in a normal a year.

Dr. Rob Dietz (01:36):

So the expectation is yes, 2021 is going to see inflation pressures. It's going to continue to cause challenges for builders, but I mostly agree with the Federal Reserve that it's going to be in their words, "transitory," that we're going to see some of these pricing pressures ease as we head into 2022 and the ones that are going to ease are those that are related to some of the supply chain bottlenecks, not enough trucks and truck drivers, that the appliances, like microwaves, that are in container ships off the port of Los Angeles are waiting to be unloaded. As the reopening of the economy happens, as we get more workers back into the system, some of those pressures should ease.

Dr. Rob Dietz (02:16):

But as I said in our forecast, we think that some of the pressures will remain. It's only going to be a partial roll back. So we're exiting a period where inflation was about 1.8% per year. We think we're probably entering into a period where it's going to be 2.4%. That's not the 1970s, and it's not the 1980. So hopefully the Federal Reserve doesn't overreact to that and tighten up policy, which would cause interest rates to go much higher, but rather we'll look at the individual sectors and try to provide reasonable fixes with them. And that's, of course, what we're doing, and you all have been doing in terms of trying to work with the commerce department on the supply chain for the residential construction industry.

Jerry Howard (02:58):

Rob, let me ask you this, how do you feel that this is going to impact the mortgage markets, if at all?

Dr. Rob Dietz (03:05):

Well, so our expectation for interest rates is they're going to move higher. Now, there's an interesting divide right now in the analyst community. When you talk to economists, they all think, "Okay, the Fed is going to, at some point, have to tighten policy," right? But these inflation pressures mean that they're going to taper the bond purchases that they're currently enacting. They've been remarkably helpful for the mortgage market. Basically since the start of the crisis, the Federal Reserve has been buying $40 billion a month in Fanny and Freddy debt. And that's holding down the 30 year fixed rate mortgage, which has been hovering near 3% for quite a while. They're likely to announce a tapering of those purchases at the end of this year.

Dr. Rob Dietz (03:47):

And then there's a debate about when they start to raise the Fed Funds Rate, which would raise interest rates. And I know you and I have talked about this, particularly during the leadership council meeting. The question is, is it going to be at the end of 2022, or is it going to be at the start of 2023? So sometime in that kind of one-year process, they're going to begin raising rates.

Dr. Rob Dietz (04:09):

So the expectation is mortgage interest rates are going to move from where they are right now, which is around 3% up, closer to four. And as we learned, and if you think back to 2018, when, at that time, when interest rates got close to 5%, we had a housing soft patch that lasted six, seven months. Given that home prices, in fact, we learned yesterday, new home prices are now higher, 18% year over year. Prices are higher, so it'll take a lower mortgage interest rate to cause a similar type of housing soft patch.

Dr. Rob Dietz (04:43):

So what we got to watch for is mortgage rates going up, but if they get closer to say four and a quarter percent, that would be a point of concern in terms of demand. And of course, all of this assumes what we said earlier, the idea that some of these material costs stop growing the way that they have then over the last six to nine months.

Paul Lopez (05:01):

Hey Rob, are there any particular parts of the country that are vulnerable to the softening more than others?

Dr. Rob Dietz ([05:10]):

Yeah, so I think we need to look at those markets where housing affordability is particularly challenged. So there's the markets that have typically been challenged. Paul, you're familiar with California. 16 of the top 20 least affordable markets are, unfortunately, in California. So that's a good example, sort of the coastal markets, where there's a lack of land, of course, but also because regulatory policy is really tight and impact fees are particularly high. It's hard to build in those markets. And so the price to income ratios in those markets are tight, which means when interest rates move higher, particularly first time and first-generation buyers are going to be priced out on the market. In fact, that's that's happening right now.

Dr. Rob Dietz ([05:51]):

The other places sort of outside the traditionally least affordable markets would include the new unaffordable markets. And that's a growing set. A good example, and this would surprise people if you go back in time and 20 years ago and say, Boise, Idaho is an unaffordable market. Now, why is Boise, Idaho unaffordable? Just a huge amount of demand coming into the market. Supply is growing. It's a growing market. It's a large market, but with those higher material costs that we've been grappling with this year and just the sheer amount of demand that's coming in, prices have gone up and they've gone up dramatically. So that kind of market, a little change in interest rates can have a big impact on materialized demand.

Jerry Howard ([06:35]):

Rob, look, I don't want to sound like a, to quote Spiro Agnew, "nattering nabobs of negativism" here, but you've got increased material costs, increased inflationary pressure. You're going to have a mortgage rate increase, ultimately. No look for a downturn in regulation. I'm feeling a little bit like George Clooney in The Perfect Storm here.

Dr. Rob Dietz ([07:01]):

Yeah, we've got a set of challenges. I think this is why it's so important that we kind of keep the pressure up on the advocacy side, both at the federal level. We know we've done a lot of challenges with the regulatory agencies and I think you're right. I think we point to 2018. We point to 2013, which was the taper tantrum and say, "Look, the market is hot right now, but you've got these looming challenges, particularly on the policy side where we can get some help." So I think for the next year and a half, we've got a pretty good runway for the housing market. But if you're looking out towards 2023, I think forecasters are now looking at, and then in our forecast, we have single family starts flat. And I've seen a couple talk about declines in 2023, not big ones, but enough to pull back the market because of all the factors that you just identified.

Paul Lopez ([07:50]):

Well, what kind of advice would you be giving our members, then, and how they can start getting ready for this storm?

Dr. Rob Dietz ([07:57]):

Yeah, I would think in terms of six month increments, in terms of land buying, don't over purchase land. As we moved closer to 2023, the competition for land, in particular, is particularly tight. And I think builders for the most part have been doing this. The one of the reasons that we saw, for example, this week in terms of a new home sales data coming down at a 6% rate, but the pace of new homes sales was the slowest in a year is a function of the fact that builders are acting as a governor on how much construction activity they take. That's a disciplined market reaction to the idea of, "I need to watch my supply chains. I need to make sure I've got the workers in front of me. We know we're going to grow, but we want to have sustainable manageable growth."

Dr. Rob Dietz (08:45):

And you don't want to get into bidding competitions, particularly with land, with other kinds of investors. And I know right now, there's a lot of discussion about big institutional firms coming in and buying housing, buying land, bidding up the price, and you don't want to be in a game of musical chairs and be without the chair when the music stops.

Paul Lopez (09:05):

Okay. And then I have another question for you. I mean, I've never, in terms of build to rent, I've never heard that phrase used so many times in my life in the past three weeks. What what's going on there?

Dr. Rob Dietz (09:16):

Yeah. So it's a little exaggerated, at least if you look in the data and I mean, exaggerated in a sense that exactly right. I mean, you track all of the media on the housing. It just seems like every journalist in the last month or so has discovered this space. And I think you need to think of it in two ways, right? There's the increasingly institutional purchases of existing single family homes. They're roughly about 15 million single family homes and townhouses that are rental housing. In fact, a third of the rental housing stock is single family. It's two thirds multi-family. And for decades, that housing was owned by mom and pop investors. Increasingly, it's a good return space. Rents are going up. We know there was the suburban shift and demand. People want single family housing, but not everyone can afford to buy one. So that space makes sense.

Dr. Rob Dietz (10:12):

But in terms of built for rent, that's another part that's new construction. We estimate that in total, between units that are built and held by the builder and units that are built and sold to an investor, like a REIT for rental purposes, that that's maybe six, six and a half percent of single family starts. So it's not huge, but it is growing. And I think the reason it's getting media attention is whether it's institutional investors increasingly buying these homes, and in some cases, pricing out prospective home buyers, but then also larger builders getting into the built for rent sector, the media is taking notice. That's a warning though, because when the media starts to take notice, that means we're in the later innings of a particular trend. As I said before, you don't want to be the last one in as you're likely to overpay.

Paul Lopez (10:59):

Right.

Jerry Howard (11:01):

Rob, what else are you looking at, both domestically and globally as potential factors on the economy going forward?

Dr. Rob Dietz (11:10):

Yeah. I think we're going to have the best year for economic growth since at least 1984, but it's going to increasingly be talking about a conversation going from material shortages to labor. And we've been focused on labor for a long time, but right now, there are 9.3 million job openings in the economy. It's like the other sectors of the economy have now discovered the skilled labor shortage we've been grappling with. And within the construction industry, we're short right now, in the real-time data, about 340,000 workers for the overall construction industry. And as the unemployment rate goes down, and it will, it's going to get below 5% near the end of this year, it's going to get increasingly more difficult to recruit workers into the space. We actually had a somewhat easier go of it over the last year because other sectors were losing jobs.

Dr. Rob Dietz (12:01):

So policymakers are going to have to be focused on raising the labor force participation rate, which involves, in part, bringing the schools and getting them open and in-person, but raising that participation rate to bring workers off the sidelines, and they're going to have to take a look at the expanded unemployment insurance benefits, which I think the evidence right now is pretty clear. It is holding back filling some of those jobs. And that's affecting everything from truck drivers to ... We've heard from saw mills and, of course, for home builders and remodelers.

Jerry Howard (12:33):

Great. Well, listen, Rob, we appreciate you taking the time to come in. As always, your comments are insightful, and I know that the listeners really, really appreciate it, and I hope you listeners appreciate it enough that you will subscribe to the podcast. Jim Tobin and I, as well as our Paul Lopez, our frequent guest host, he's sort of like the Doc Severinsen of this podcast. We would appreciate it very much of having you become a committed and dedicated listeners. So with that, I will sign off for now saying goodbye from Housing Developments. This is Jerry Howard.

Paul Lopez (13:13):

And this is Paul Lopez with his trumpet.

Jerry Howard (13:16):

We'll see you next time.

Paul Lopez (13:17):

Take care.