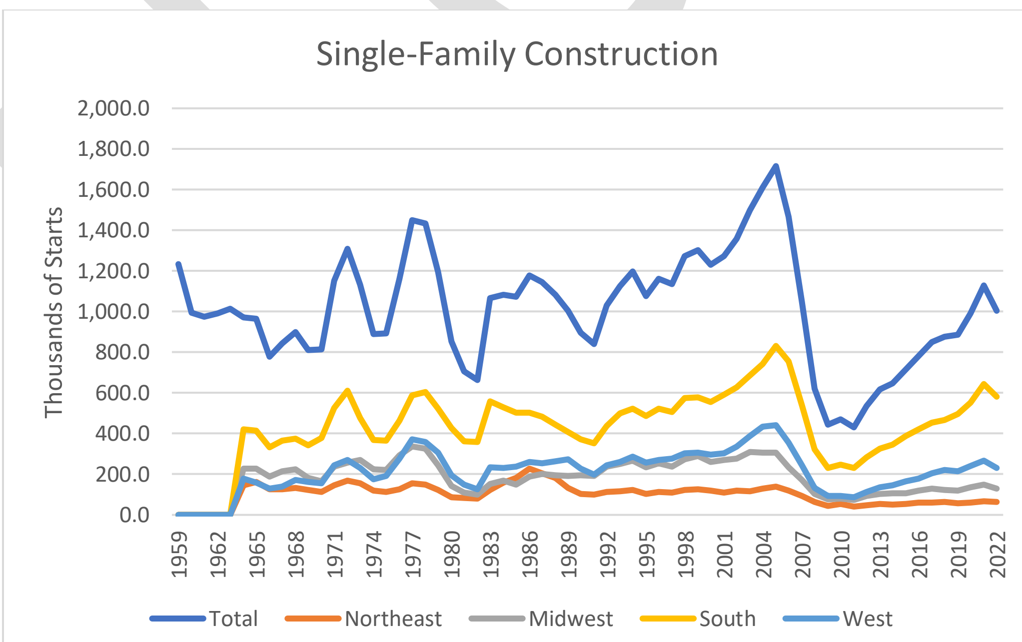
U.S. Housing: 15 Years of Underinvestment

"It is a joke in Britain to say that the War Office is always preparing for the last war.'" -Churchill 1948

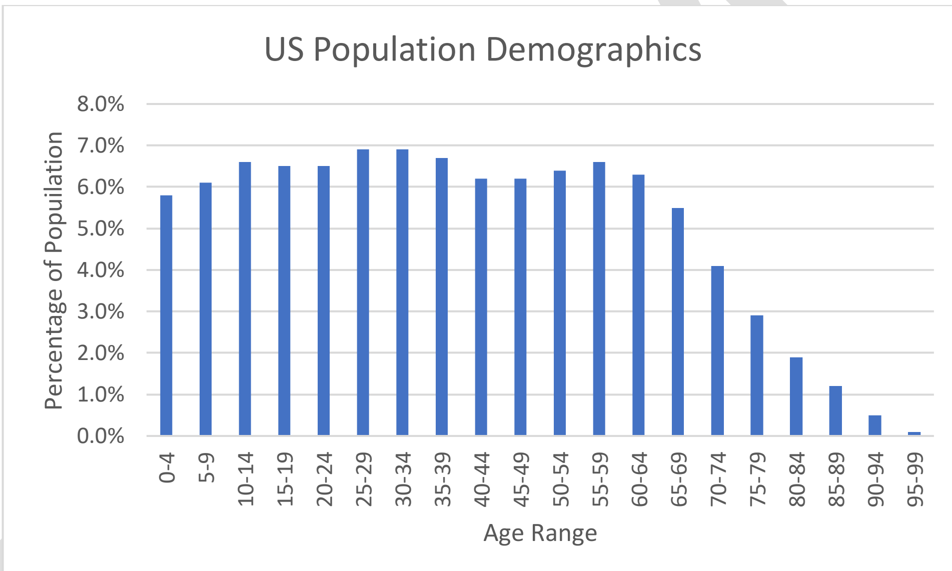
In June 2023, the median sales price for US single-family homes reached $416,000 – more than 60% higher than it was immediately before the notorious housing crash of 2008. The near-record home prices have not gone unnoticed. As housing represents the largest expense for most households, the rapid increase in prices has provoked individuals, families, regulators, and investors to various forms of worry. Prospective home buyers, the media, and regulators primarily worry about unaffordability. Current homeowners and housing speculators worry about a meteoric correction that will destroy significant amounts of equity. In general, parties seem to agree that high home prices are caused by some combination of greed and rampant speculation. They assume there is a bubble in housing and draw the conclusion that "this is 2008 all over again."

Our opinion differs from the consensus. In contrast to *greed and speculation*, we attribute the increase in home prices to nearly 15 years of *fear and conservatism.* In short, since the GFC of 2008 nearly everyone has been hesitant to invest in single-family homes. Builders have been hesitant to build. Banks have been hesitant to lend. Institutions have been hesitant to invest. As a result, the country has underbuilt, underfinanced, and underinvested in single-family homes for over a decade. From 1959-2007 the US constructed an average of 1.1 million new homes per year. Since 2008, this number has dropped 33% to 733,000 new homes per year. To us, this signifies 15 years of underinvestment caused by the hangover of 2008.



Source: US Census / FRED

While there has been limited construction of new homes, there has been no corresponding decline in demand. Home ownership is still a goal for 74% of Americans and the trend of reurbanization and apartment-living is sharply reversing. The millennial generation (the largest generation since the baby boomers) have begun to form families and desire the space and convenience afforded by homes. Further, older Americans have progressively chosen to stay in their homes longer which has further reduced the inventory of homes available for sale. Economists from every reputable institution (Harvard, Stanford, Freddie Mac, etc.) agree that there is a shortage of homes and estimate the deficit to be between 3-7 million homes. Said differently, *the current shortage of homes is larger than the surplus of homes during the peak of the 2007-2008 housing bubble.*



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There is significant nuance to the issue. Single-family markets vary widely from region to region and some markets are riskier than others. For example, the COVID home-buying frenzy was most acutely felt in specific markets where speculators (especially large institutions) projected the greatest post-COVID growth. Backed by Wall Street, the median home price in these “hot markets” skyrocketed beyond what the median incomes in these markets can afford to buy. While prices in markets like Phoenix remain stable, we believe that the current unaffordability to the general populus will prove a headwind to further price increases; the expectation of future growth is to some extent priced in.

In other markets, the impact of the COVID-induced real estate boom was far less dramatic. In the face of a wave of onshoring and the return of domestic manufacturing, homes in industrial, logistic, and manufacturing centric MSAs seem like relatively good deals. Homes in cities like Louisville and Kansas City are generally affordable while employment and job opportunities are robust. In our view, these

[1] Source: PopulationPyramid.net citing United Nations (https://www.populationpyramid.net/united-states-of-america/2020/)

markets have been generally overlooked and as a result have better risk/reward profiles than the "hot markets" that have already seen home prices explode.

While median home prices are at near-record highs, the reason for these prices likely has nothing to do with the greed and speculation associated with the 2008 housing crisis. Years of underdevelopment have created a significant supply shortage at the same time US demographics have created strong secular demand. Supply won't appear overnight; it will take years to build enough homes to cover the current deficit. Even when supply does eventually come online, it's doubtful that new homes will be built at significant discounts to existing ones (regulation, entitlements, and zoning have only made building more difficult). Unless an unforeseen event causes a dramatic change to the basic supply/demand imbalance, high home prices will persist for years to come.

Best Regards,

FFCM

Notes:

- A common concern is that higher interest rates will drastically impair home prices. If higher rates caused forced selling, this might well be true. However, most homeowners have fixed-rate, long-term mortgages. Their monthly payments will remain fixed, and they likely won't become forced sellers (at least not forced for financing-related reasons). This phenomenon stands in stark contrast to commercial real estate financing where 5-10 year terms and interest rate resets are the norm.
- As an interesting anecdote, In Q2 2023, Berkshire Hathaway (Warren Buffet's conglomerate) made new investments in US public homebuilders D.R. Horton (DHI), NVR (NVR), and Lennar (LEN/B). Either this is a direct bet on the business of homebuilding or an indirect bet on the US single-family housing market.

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