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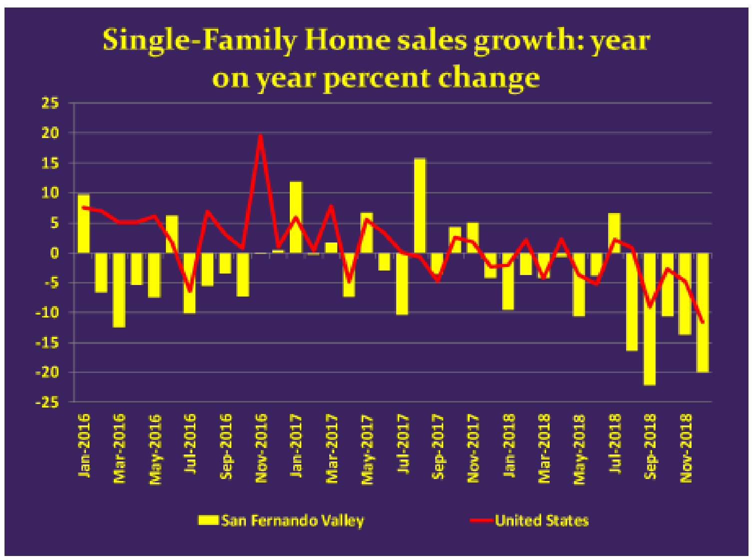
Housing sales are slowing down in many geographies. The December 2018 US existing home sales decline was almost 12 percent, and the average monthly decline during the last four months of 2018 was seven percent. The San Fernando Valley's numbers are worse. The September through December 2018 average decline was almost 17 percent, and the December decline was a wrenching 20 percent.

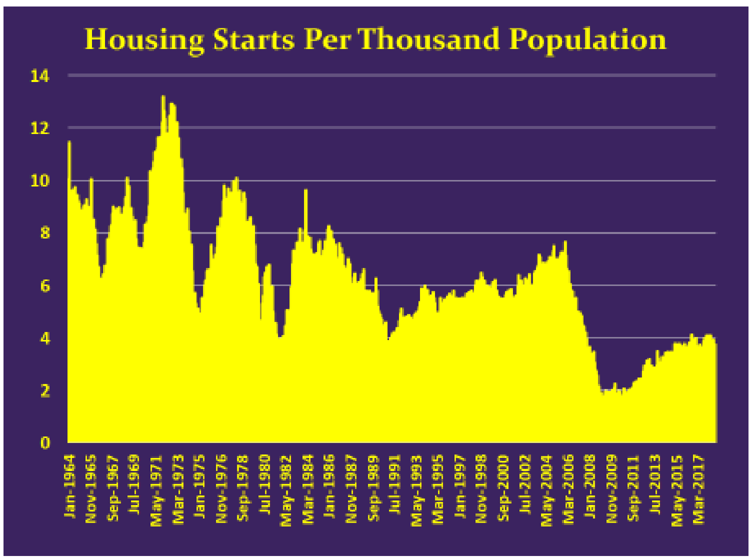
Given the substantial declines in home sales, one might wonder if this is the start of a housing downturn. At the same time, many forecasters are raising their estimates of the probability of a United States economy-wide recession. As of October 2018, the recession probability consensus was 18 percent. As of February it had risen to 25 percent, a substantial climb in a short period of time.



Recessions are seldom precipitated by the same factor. Starting in the 1970s, the 2 recessions in that decade are believed by most economists to have been started by massive oil price shocks. The cause of the early 1980s recession is believed to be financial, a combination of tight credit conditions and credit union balance sheet problems. The early 1990s recession is believed to be due to a substantial defense sector contraction, the early 2000s, a deflation of Y2K fears and the technology bubble. Finally the Great Recession of 2008 was a housing-led contraction.

Could there be a link between the recent rise in recession fears and the current downturn in housing sales? We do not believe so. In short, like any Realtor® will tell you, the current reality in today's housing market is a story about supply. There is a severe lack of housing supply. Coastal communities have been dealing with this for many decades. Coastal housing has been so very constrained by coastal zone regulations and local political winds that the lack of housing supply in these areas is old news.

In contrast to coastal communities, the overall United States market dynamic has been different. Historically, there were areas of the country, typically non-coastal ones, which built significant numbers of new homes. Those communities, their political tendencies, and their local planning departments, all embraced economic growth. However, after 2008, the United States economy experienced a paradigm shift. The rate of new homes being supplied to the market plummeted. Many analysts would say, "of course they did", given the particulars of the Financial Crisis and the Great Recession. We agree, a very large contraction in the rate of home building should have occurred in 2008 and shortly thereafter. But as shown by the chart below, home building has never recovered even though it is now more than a decade after the end of the recession. At this point it is clear that there is something else going on.



The economic detriment of such a low rate of home building is very significant, as has been explained in detail in the Housing Markets essay in the 2018 quarter 4 forecast publication. Returning to the question about a link between the current home sales downturn and rising recession fears, we believe that the link is, at most, psychological. When new home building is allowed to occur, then home sales will be procyclical. But when home building rates are constrained, the link between sales and the business cycle will become disentangled.

Why might sales be turning down relative to the past few years? This is a story about affordability. As the economy has evolved after the 2008 recession, with a very low supply of new homes coming to market, prices have continued to rise. One thing that analysts agree on is that job creation is key to housing sales. Households will not be induced into a 30-year commitment if they do not have a job. Prices have risen even though post-recession job growth was significantly low relative to pre-recession history, meaning demand has been low. Again, the rise in prices must be a restricted-supply story. The story is supported further by relatively low mortgage rates since the recession. Despite low rates, sales are slumping.

Recent San Fernando Valley Housing Statistics

A more detailed look at the recent local housing data shows that the decline in sales is worse for the condominium/townhome segment than for the single-family home segment, and that price increases have slowed down. Our assessment of these trends, as described above, is that the limited supply and lack of affordability are the primary drivers of the Valley's housing market.

The 2018 quarter 4 San Fernando Valley single family median home price was $670 thousand dollars. For condos, the median price was $430 thousand dollars.[1] Prices have risen to a level that workers cannot afford, thus restricting their ability to purchase a home. Thus the lack of new home building restricts sales via two channels, first by reducing the size of the stock of available houses, and second, by raising prices to the point that affordability is a serious and restraining factor on the market.

Table 1: Current Housing Trends

Current Year Housing Trends

San Fernando Valley, the Region, and the United States

	Oct-Dec 2017	Oct-Dec 2018	Change
San Fernando Valley			
Existing Single-Family unit sales	1,461	1,246	-14.7
Existing Single-Family median price	656,000	669,000	2.0
Existing Condominium unit sales	545	399	-26.8
Existing Condominium median price	420,000	430,500	2.5
Los Angeles County			
Existing Single-Family Median Price	563,067	585,527	4.0
Ventura County			
Existing Single-Family Median Price	640,000	644,580	0.7
California			
Existing Single-Family Median Price	547,603	561,453	2.5
United States			
Existing Single-Family Median Price	247,767	257,600	4.0

Sources: National Association of Realtors, California Association of Realtors, Southland Regional Association of Realtors

[1] We use housing data from the Southland Regional Association of Realtors. The definition of the San Fernando Valley here excludes Glendale, Burbank, and the Conejo Valley. The map of the area is included in an appendix.

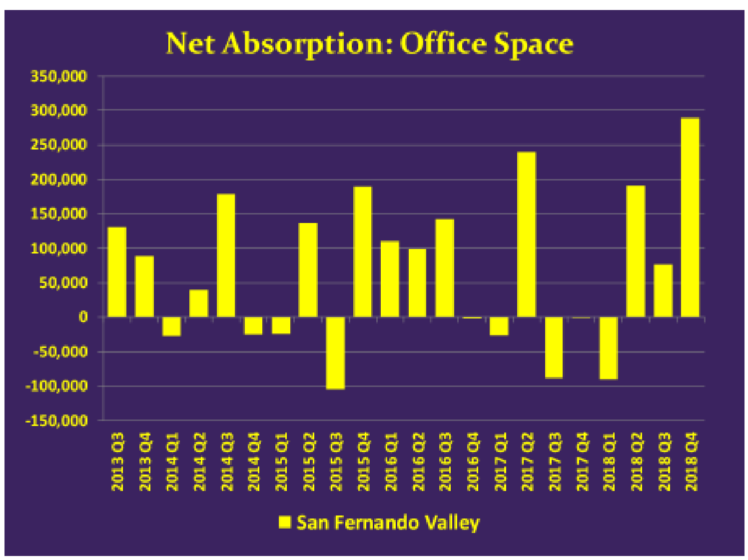
While there might have been fears of significantly higher mortgage rates in November and December of 2018, Fed statements in January of 2019 have put these fears to rest. The Fed has made it clear that they are capitulating to financial markets, and they do not plan to raise rates. We do not expect a single Fed rate increase in 2019. While the Fed desperately needs to normalize monetary policy, for its own sake, it does not have the backbone to do so. For a much more in depth commentary on Fed policy, please see the essay *Extraordinary Monetary Policy & the Next Recession*, from our 2018 quarter 4 *Economic Forecast* publication, and *The Fed Needs to Come Clean,* a blog of January 14, 2019.

Commercial Real Estate Markets

Our review of San Fernando Valley commercial real estate activity includes data through the end of 2018. This data and commentary by commercial real estate brokers provide strong corroboration to what we are seeing in the detailed industrial sector data on establishments, jobs, payroll, and GDP. Economic activity in the San Fernando Valley was booming in 2018.

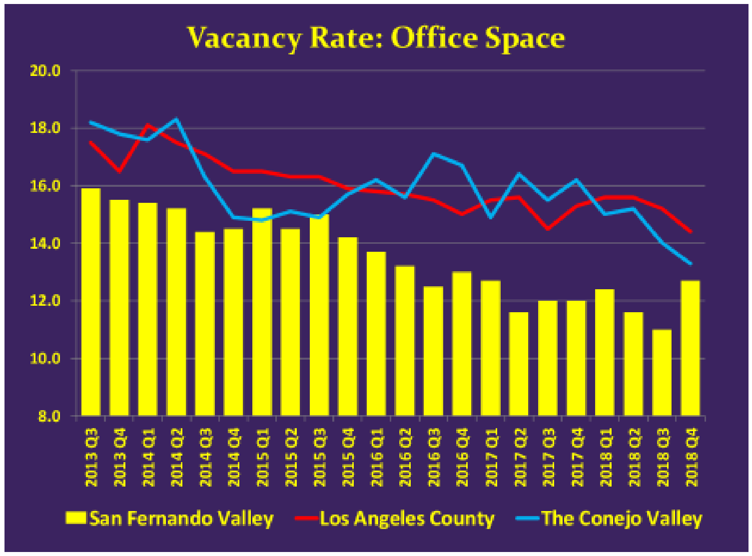
Office Space

The San Fernando Valley office market experienced a strong year in 2018. Net absorption, a critical indicator of leasing activity, was over 460,000 s.f. in 2018, the strongest year for which we have data. This is congruent with analysis of the Valley's jobs and GDP data, which have strengthened in the past year.[2]



Consistent with the relatively rapid economic growth in the San Fernando Valley, office space vacancy rates remain tighter in the San Fernando Valley than in its neighbors, averaging 12 percent during 2018, compared with 14 percent in the Conejo Valley and 15 percent in Los Angeles County.

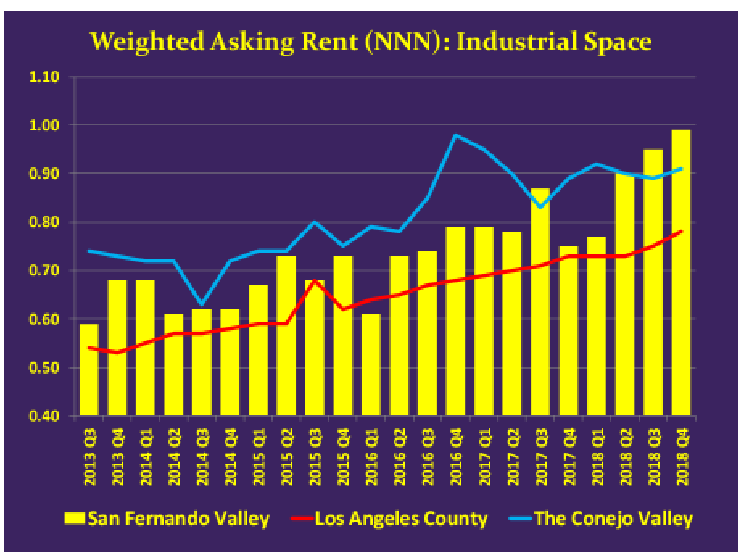
[2] As in previous publications, this data comes from Collier's International by way of the San Fernando Valley Business Journal and is a definition that does not include Burbank or Glendale. This data includes the Office and Industrial space market segments.



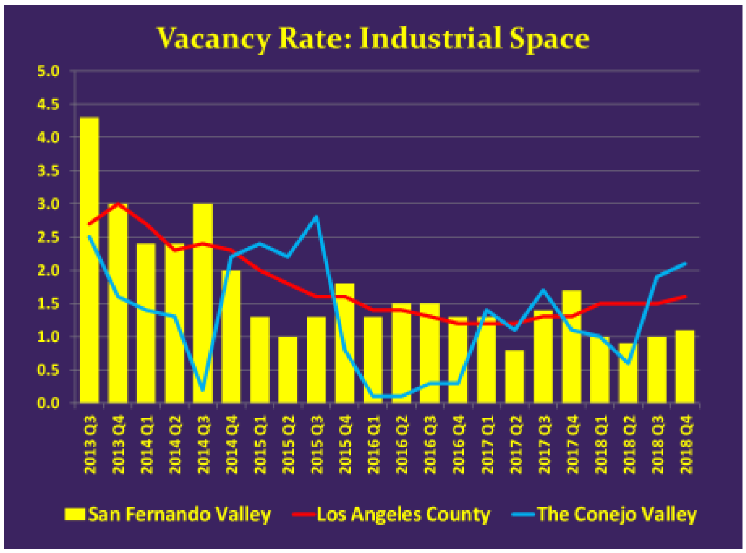
Industrial Space

Lease rates in the San Fernando Valley's industrial market have risen rapidly in the past year. San Fernando Valley industrial lease rates are now substantially higher than those for the Conejo Valley, a first for the time range in which we have data. 2018 quarter 4 San Fernando Valley lease rates were ten percent greater than for the Conejo Valley, and twenty percent greater than for Los Angeles County.

Industrial space vacancy rates have become extremely tight in the San Fernando Valley, reaching an overall one percent level on average, during 2018. This indicates a combination of robust economic activity in the Valley and a relative lack of available space to lease.



In addition to traditional industrial space users in these buildings, there are various non-traditional entities leasing this space. They might not be manufacturing companies, but they are enterprises that are growing and need space, and they are finding and utilizing what affordable space is available. Examples include Cross-Fit gyms, indoor rock-climbing facilities, wine tasting rooms, and more. These companies can get into industrial space for a per square foot cost that is less than half the available office space cost.



At the same time, from a commercial real estate point of view, the entertainment industry is very active in the industrial market, providing strong corroboration to what we are seeing in the jobs and GDP data, particularly in 2018. Quoting from the CBRE publication, *4Q 2018 Industrial Market Overview*, "[activity is] on the rise due to prospering entertainment industry", "biggest local economic drivers: entertainment, cosmetics, goods/services …", and "Warner Center continues to boom … ".

The appendix is on the next page.

Appendix

Figure 1: Southland Regional Association of Realtors San Fernando Valley Coverage Map