Housing Markets

2019 Q4

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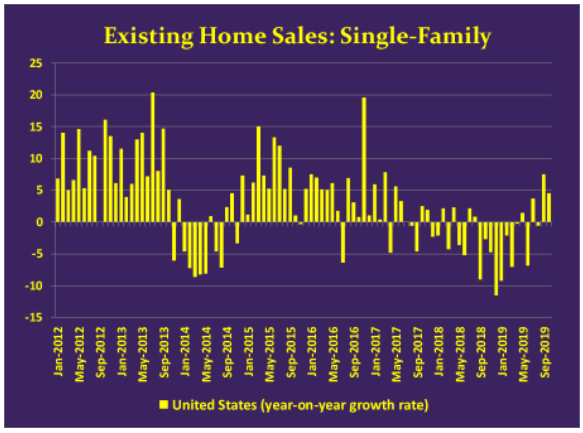
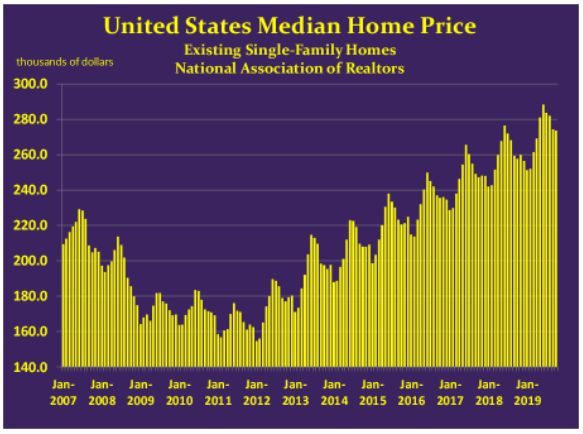
Single family home sales growth has recovered a bit in just the past couple of months. Until two months ago, sales growth was negative for 14 out of 20 months, so the uptick is welcome. We would not necessarily expect the 2 recent months to be indicative of a new trend of home sales growth however. Prices have risen to the $270-280 thousand range, which is unaffordable for many households.

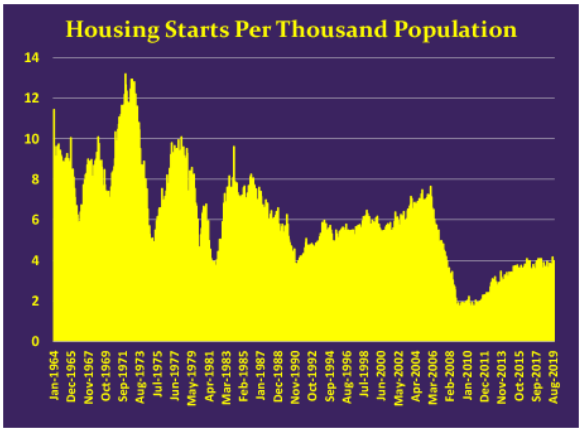


A lack of affordability is part of the reason for anemic sales, a phenomena which has been in effect for most of the period since the end of the Great Recession. The other drivers of a slow U.S. housing market include: job creation at a rate that is low relative to most of U.S. history, and a horrifyingly low new home construction rate.

The dismal rate of new home construction has various market-harming effects. These include not just the direct supply impact, which raises prices, but also a choice-restricting effect. The lack of choices provided by the existing housing stock in turn reduces move-up housing purchases. Fewer move-ups further reduces the supply of homes in lower price ranges, exacerbating the affordability problem even more.



The low new-home production rate has a direct impact of slowing the housing market. As harmful as this is, it is also responsible for a reduction in related economic activity. The output and income from industries that are interlinked with housing such as building materials, construction, furnishings, and a variety of support services, are all foregone for each new housing project that does not get launched.



A low new-home production rate has yet another impact. It exacerbates income inequality. Most households who embark on moving up the socio-economic ladder do so via the purchase of a primary home, and then when possible, investing in a second home. The higher prices slow or prevent this from happening.

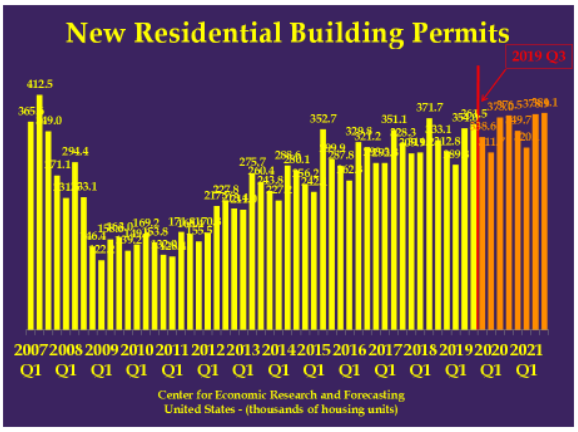
A rational economic development policy requires a rational real estate development policy.

Unfortunately, an agency problem exists in US real estate, especially housing markets. Policy for housing development is set locally. The economic impacts are local of course, but they are also national.

Local governments, and their constituents, face incentives to block new housing production. The perceived costs to the community of new construction included increased traffic and diminished *character* of a community. In this way, *local* incentives run counter to the *national* benefits (and incentives) of a reasonable rate of new home construction. This discontinuity between local versus national incentives is the essence of the agency problem.

The policy solution for this problem is probably best driven by the states. California has a regional housing needs assessment process, RHNA, whereby the state's department of housing and community development, the HCD, estimates future housing needs based on reasonable forecasts of future population.

The RHNA is the process by which the state's future aggregate housing need is decomposed geographically, first to multi-county COG areas, then to counties, and finally to cities. While CERF rarely supports government intervention in markets, RHNA is a process we support. The reason that we support this intervention, of course, is due to the agency problem.



CERF's current housing market forecast was computed under the assumption that local housing development policies do not change during the next eight quarters. New home production remains low, prices continue to grow at a slow rate, sales remain uninspiring, and the economic contribution of housing to the overall economy is miniscule.