# The annual fall checkup - by Bill Pastuszek

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Some items worth thinking about. There are a lot of questions asked here. Many of the answers may not be yes or no response but may have a lot of “it depends….”

Housing. The housing markets seem to be in some disarray. It’s a bit amazing to see how the price of debt drives economic behavior and nowhere so much as with housing. The cost of financing a home purchase has essentially doubled in 12+ months. Affordability already was an issue before the deleterious effects of inflation and higher interest rates.

Affordability Index. The National Association of Realtors publishes a Housing Affordability Index (HAI). In July 2021, the index was 146.5 when the mortgage rate was 2.92% with a principal and interest payment of $1,240 based on 80% LTV calculated against the median single family home price of $371,400.

A year later, the index dropped to 102.2 – a dramatic change – with a mortgage rate of 5.48% with a principal and interest payment of $1,861 – 50% higher in 12 months. The median home price was $410,600, a 10%+ increase over the year.

Affordability, continued. Given interest rate increases, similar scenarios play themselves out for automobile costs. Kelly Blue Book reports that new vehicle prices set a new record in July 2022, at just under $50,000. Used car prices have stabilized somewhat as new car inventories have improved.

Edmunds reports the APR for newly financed vehicles was 5.7% in July, a peak not reached since the third quarter of 2019.

Home Prices. More recent information suggests that home prices are flattening. Interest rates may continue to go up; that’s the Fed’s call. If housing markets end up in worse shape that just a slowdown in the rate of increase, do we now have to start worrying about a housing bust?

Builder Sentiment. The National Association of Home Builders reported in September that builder sentiment fell for the ninth straight month in September as the combination of elevated interest rates, persistent building material supply chain disruptions and high home prices continue to take a toll on affordability.

Lumber Prices. After a sharp spike in March, prices seem to be headed down. Pandemic pressures caused lumber price volatility to cause average single-family costs to increase by $14,000. Hopefully, the worst may be over but then what will be the effect on materials in the aftermath of the huge hurricane?

Apartment Rents. What about rents? Affordability, again an issue. If one can’t own, one must rent, yes? Short-term data indicates that apartment rents appear to have leveled off, but it’s too soon to tell. Rents are just so high, having increased in Mass. more than 20% in the past year, Rent.com reports. Will the rental market finally reach its limit or will government step in and institute rent controls?

Zoning. There's an opportunity here, though. Many communities could relax zoning, which has developed to be exclusionary and a barrier to entry, to allow for more creative solutions to the shortage of affordable housing.

Jobs. The Labor Department reports a decline in job openings. Based on my very unscientific information, it might be that employers just gave up posting openings after so much time hoping somebody might apply.

Office Market. Office attendance may never be the same. Kastle Systems reports that office use is still at early September peaks but is far off pre-pandemic levels. As leases roll over, more and more tenants are going to answer the question: "how much space do we really need?"

Factory Orders. The trend seems to be downward. With job openings stabilizing and factor orders down, is the economy cooling so much so that the Fed lays off making any further interest rate increases? There's Volcker school of thought that says: "don't hit the brakes, wring out all the excesses of the low interest era, COVID, and the aftermath." Then there are those who say: "hold back on interest rates, save us from recession and oppression of high interest rates."

Industrial Markets. Indications trend largely positive but, even here, there are reasons to be more vigilant. Nationally rents are up $18.85 per s/f average (CoStar), vacancy and cap rates down. In the Boston market, conditions are much the same, with average rents at $14.31. However, market wisdom indicates caution to be exercised going forward.

Energy Costs. The U.S. Energy Information Administration shows that in Mass. A gallon of #2 oil was at about $3 in October 2021. In October 2022, a gallon costs +-$4.50. That's down from the peak in Q2 2022.

Implications for Real Estate and Real Estate Values. Investors hate uncertainty. On the other hand, living in these uncertain times gets investors used to uncertainty.

Most real estate adapts well to uncertainty, inflation, and higher debt cost. Apartment, self-storage, lodging and many other rental forms can respond to higher costs with built-in rent flexibility. Longer term rent structures found in office and industrial markets are less flexible. And are there ceilings to rents in these property sectors? If so, how close is that ceiling?

On a Different Note. Aaron Judge finally did it, surpassing Babe's record, cleanly (thinking, hoping). And the Red Sox went nowhere this year; better luck next year. In the minds of true Red Sox believers (RSTBs), are the Yankees still the Evil Empire? Or, has that all softened over time. (I grew up rooting for the Phillies, so I don't qualify as a RSTB).

What does this all mean? And seriously, where are we headed? If you have some answers, let me know. For now, believe in the power of markets and that paying attention to the short-term details while focused on the long-term will allow for rational behavior and good sleeping.

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