



## **Home Prices**

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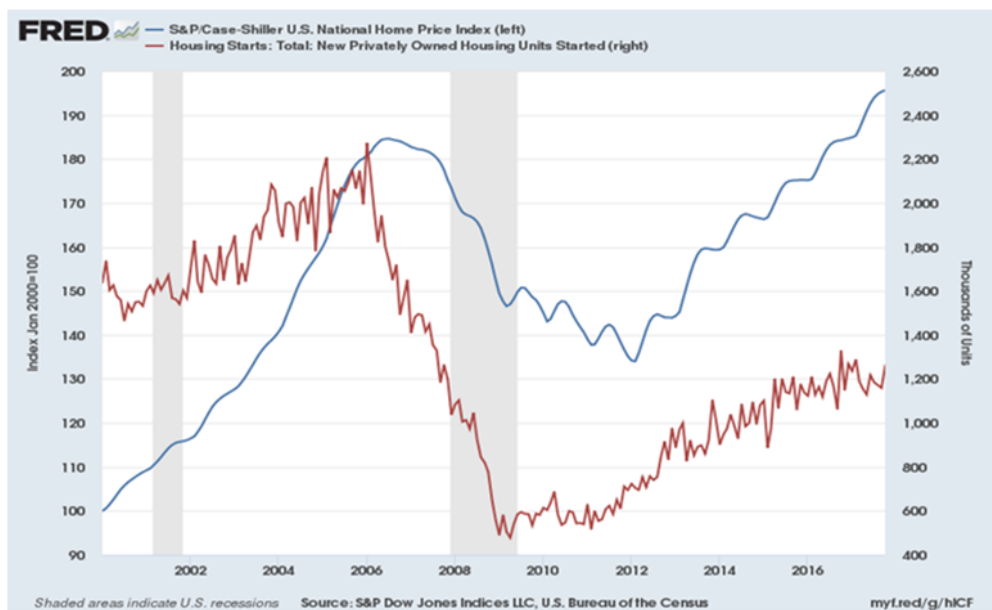
My first job was as a real estate appraiser for Crocker Bank. I visited hundreds of homes and commercial properties over the course of two years and learned some things about cyclicity and the quality of demand. Real estate, especially residential real estate, is a very important part of the economy. Over 60 million homeowners in the U.S. agree. When housing is strong, as it is now, consumer confidence builds, ancillary enterprises thrive and the economy grows. When it is weak, as it was in 2008, the opposite effect occurs and the hangover can last for several years. A variety of factors are currently working in favor of a continued good run in housing and possibly in other areas of real estate. Interest rates are still on the low end of their historic range. Demographics are good as the millennials are reaching family formation age. The economy remains strong, and the new tax law (see accompanying article) may well make commercial property ownership more lucrative. The law however, does dampen enthusiasm for high end homes.

### **Residential**

Existing home sales as well as home prices continue to be strong. The latest Department of Housing release shows that on an annualized basis 5.81 million homes were sold in November. This was the highest level since December 2006. Prices have also improved. The Black Knight Home Price Index shows a country wide year over year increase of 6.5%. This was after six months of positive but more moderate growth. New home sales and prices also had a surge from 624,000 annualized to 733,000, also a ten year high. The median price for a new home was \$313,000 at the high end of the recent range, and was up 5% year over year.

Millennials comprise a rising percentage of the population and are hitting prime household formation age... late twenties to mid-thirties. This will bode well for home builders as well as for banks, appliance sales and home improvement stores. New home construction is ramping up to meet the demand. In the October HUD report the private residential construction spending was \$517 billion, an increase of 7.2% from the prior year. Any new housing supply will be welcomed – the current monthly supply of houses in the United States (ratio of total houses for sale to houses sold) is 4.6 months, a historically low level that has generally been very supportive of home prices.

## Home Prices



Source: FRED

### Non Residential

The typical domestic REIT (Real Estate Investment Trust) had mixed results last year attributable to increasing interest rate expectations and exposure to underperforming sectors within the broader commercial real estate market. Retail REITs were hit particularly hard in 2017 as Amazon and internet based retailers chipped away at market share. Office REITs fared alright but investors continued to grow nervous as the U.S. economy approaches full employment. The industrial space is a cyclical segment of the market and began to sell off towards the end of 2017 on fears of rising rates and the sustainability of the current economic recovery. Other REITs are doing better. These include data centers, health care and storage facilities. International commercial real estate also performed well and has proven to be a good investment. Low interest rates, an improving employment picture and increasing business confidence helped foreign REIT's outperform their U.S. peers in 2017.

### Stay Home

The current best investments in real estate continue to be ones that are associated with residential development, whether they are the builders, the brokers, the banks or the home improvement operations. A strong economy, the demographic effect of maturing Millennials, low unemployment, low interest rates and a shortage of new housing lead us to continue to like this area. The tax law does limit the attraction of buying expensive homes by limiting mortgage and local tax deductions, but all other aspects in favor of owning a home are in place. A stable demographic uptick in demand and pricing in sync with inflation are key to this investment.

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