

Higher Mortgage Rates Create Favorable Reverberations for Commercial Real Estate

Mortgage rates surge to a pandemic-era high. Following a steady but mild ascent at the end of last year, the growth trajectory of the 30-year mortgage rate became much more extreme in January. The rate climbed more than 40 basis points over the span of a few weeks to the mid-3 percent range, nearly realigning with the late 2019 measure. Upward movement is likely to continue in the coming months amid indications that the Federal Reserve will attempt to reign in record-level inflation. A higher cost of borrowing is already altering potential homebuyers' decision making. The four-week moving average of mortgage purchase applications dropped 12.6 percent relative to the volume a year ago.

Rising prices and rates to curb affordability. Strong demographic demand drivers drove a steep elevation in home prices since the onset of the pandemic, but barriers to entry for first-time buyers were partially mitigated by the low interest rate environment. That opportunity to lock in favorable financing has seemingly passed with rates on the climb. Meanwhile, the median sale price of an existing home soared more than 16 percent year-over-year, and robust demand is expected to keep escalating prices, despite higher mortgage rates. People lower on the income spectrum will have a difficult time finding a home that meets their budget amid current trends. This will continue to push demand toward other living options, especially multifamily and manufactured housing. Both segments logged vacancy rates at least 100 basis points below their respective 2019 measures at the end of last year.

Housing trends could benefit retail spending. Many homeowners are realizing sizable equity gains amid rapid increases in home prices. This boosts household balance sheets and induces a willingness to spend as owners have a source of equity they can tap into for cash. At the same time, developers are ramping up construction in response to strong housing demand. Each home built generates an average of three jobs for one year, aiding the local economies in places where construction is active and providing wages to workers, which ultimately boosts spending. Additionally, the sale of a home initiates \$5,200 in new retail sales on average.

Developing Trends

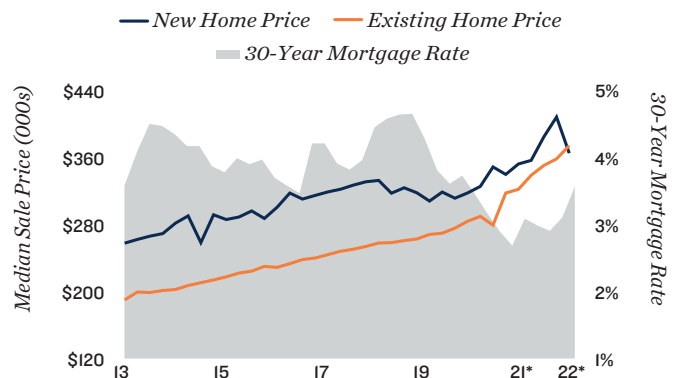
Stock of existing homes for sale on the retreat. Strong buying activity late last year compressed listed inventory of existing homes to a record-low in December. The count of these dwellings available for purchase fell to 923,000, down roughly 12 percent from 2021's July peak, and just half of the volume relative to 2015. This trend further elevates barriers to entry for first-time buyers, as these types of homes are typically more budget friendly than new homes. Healthy demand amid declining supply will likely sustain upward price movement, making it increasingly challenging for buyers in a higher mortgage rate climate.

Residential housing starts notch a nine-month high. Led by an 11 percent month-over-month swell in multifamily starts in December, the overall count of residential construction starts grew to the highest level since March. These new living options will play a crucial role in appeasing the housing shortage, but this uptick will not be substantial enough to resolve the imbalance between supply and demand in 2022. Household creation will remain on an upward trajectory as jobs are added and the millennial cohort advances into an age period aligned with family formation.

34.8% Y-O-Y Change in New Homes for Sale

9.7% Share of New Homes for Sale Completed When Listed on the Market

Home Prices Elevated as Rates Move Higher



* Through December; 30-Year Mortgage Rate as of January 20, 2022

Sources: Marcus & Millichap Research Services; Capital Economics; Freddie Mac; Moody's Analytics; Mortgage Bankers Association; National Association of Home Builders; National Association of Realtors; RealPage, Inc.; U.S. Bureau of Labor Statistics; U.S. Census Bureau; Wells Fargo



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