

# **Covid-19 and the Impact to Owner Occupied Residential Real Estate**

April 2020



For the first time in modern history, the world economy has ground to a halt by the explicit action of governments globally. Covid-19 has resulted in countries voluntarily halting economic activity in order to mitigate the spread of the virus, minimize fatalities, and prevent healthcare systems from becoming overloaded. Unison's first concern is about the health and wellbeing of individuals and we hope this pandemic resolves quickly. From a business perspective, we contemplate how this sudden economic interruption will affect residential real estate valuation. It is our opinion that the fundamental value of owner occupied residential real estate remains strong with supply and demand factors supporting the financial outlook for the housing market.

## **Shelter is a fundamental need**

At its most fundamental level, residential real estate provides a place of shelter. It is one of the most basic human needs, and a need that is further pronounced during these times of mandatory containment. Housing inherently has utility, which differentiates it from other financial assets such as stocks and bonds, which are not essential to everyday life. This distinction is evident in how equities and fixed income have fared during the recent market downturn. Transaction volume in equities and fixed income have risen sharply in the recent market turbulence as they are expendable and possess only financial value. A home is much more than a financial asset; it is a necessity of life whose value is both fundamental and financial.

## **Home sales will slow in the near term**

People do not take the decision to sell a home lightly. It is often the largest financial transaction in a person's lifetime, with the associated relocation resulting in a major personal change. A home is not only a place of shelter, but is a place where one raises a family, creates memories, and is part of a community. A home is one of the last things a homeowner will opt to sell.

Transactionally, moving is a physical task which requires mobility of work and life. Selling a primary home and moving is logistically difficult in this environment, further suppressing home sales. This has already led to real estate listings being withdrawn from the market at a rapid pace in the month of March, as evidenced by data from New York City and the San Francisco Bay Area.<sup>1</sup>

## **Demonstrated demand for housing**

The implication for the broader real estate market during the COVID-19 pandemic is that transaction volumes will likely decrease in the near term as homes become even more core to everyday life. Despite an anticipated reduction in transactions based on historical observations, consumer appetite for residential real estate remains high. The demand has been demonstrated by the 494% spike in requests for agent-led video tours during the week of March 16th, following an 80% increase the prior week, as reported by Redfin<sup>2</sup>. This demonstrates that demand is so high that many buyers are even willing to adapt

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<sup>1</sup> <https://www.nytimes.com/2020/03/24/realestate/coronavirus-real-estate-spring-sales-season.html> and per MLS - The San Francisco Bay Area, the weekly number of listings being pulled off the market increased more than 400% from the second to third week of March 2020.

<sup>2</sup> <https://www.redfin.com/blog/virtual-home-tours-increase-amid-coronavirus/>

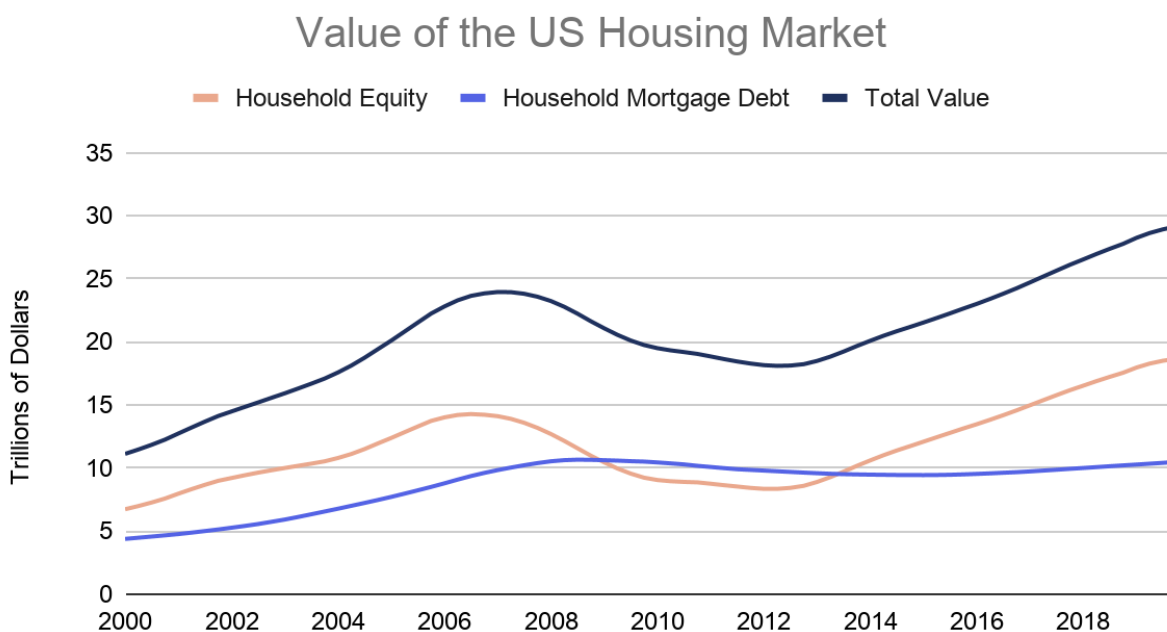
their due diligence process to the current environment. In addition, demand is further driven by the historically low mortgage rate environment. The net result is that while supply is subdued, demand remains high.

### **Current state of the residential real estate market**

The current housing market is much more resilient than it was during the global financial crisis. The market dynamics that led to the significant drop in housing prices at that time do not exist today. The 2008 real estate crash was very much a result of an over-leveraged market built on weak fundamentals. These factors led to a wave of foreclosures, resulting in an oversupply of housing inventory. This was met with an already oversaturated housing market, leading to a breakdown between housing inventory and demand.

- **Household leverage is significantly lower than it was in 2008**

While the value of US residential real estate has grown to \$30.7 trillion, debt levels have stayed relatively flat, resulting in almost \$20 trillion of equity on homeowner balance sheets.

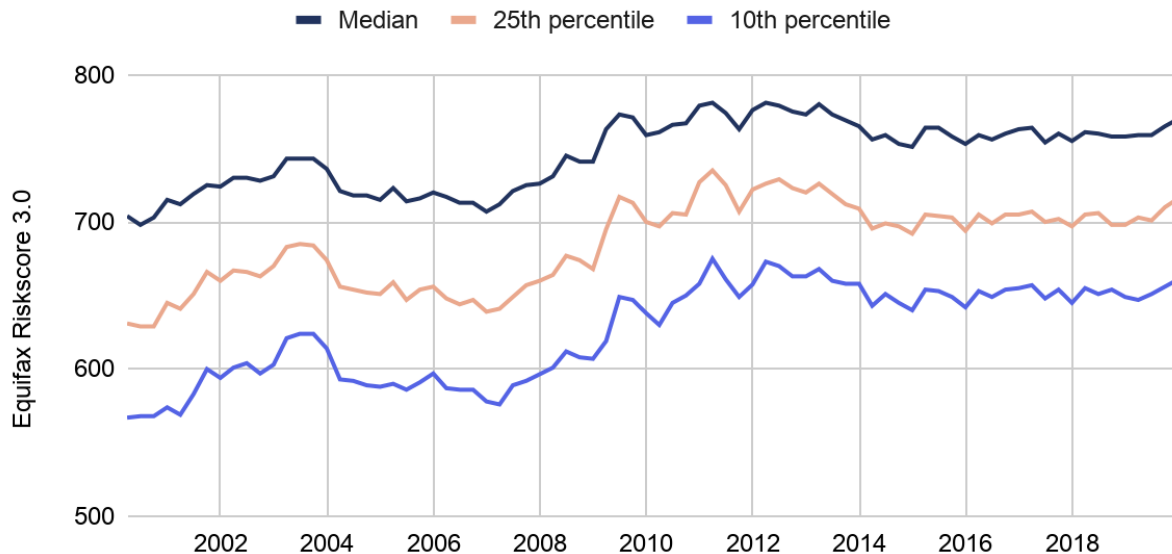


Data provided by FRED

- **Debt products and lending standards have changed since 2008**

Prior to the Financial Crisis, there was widespread use of non-conventional mortgage products including subprime loans with teaser rates, payment option ARMs, high LTV loans, and 40-year amortization terms. Loans were readily available to borrowers with weaker credit, and the documentation required by lenders was much less stringent than what is required to obtain a loan today. Not surprisingly, FICO scores of mortgages originated now are higher than those originated prior to the crisis.

## Credit Score at 1st Mortgage Origination



Data provided by New York Fed Consumer Credit Panel/Equifax

- **US government stimulus measures are supportive of the housing market**

The US government has enacted multiple measures to help stabilize the housing and mortgage markets. The most tangible measure that will affect residential real estate in the short-term is the suspension of mortgage payments and foreclosures for homeowners suffering financial hardship due to the pandemic. Fannie Mae, Freddie Mac, HUD, and some of the nation's largest states such as New York and California have implemented programs that allow homeowners to delay payments without incurring fees or having delinquencies reported to the credit bureaus. The government has also mandated that lenders and mortgage servicers comply.

The Federal Reserve has also committed to an exceptionally low interest rate environment. In addition to cutting the federal funds rate to zero, the Fed is buying Treasury and Mortgage Backed Securities (MBS) through its Quantitative Easing program. Providing liquidity to the MBS market will help keep the mechanics of mortgage origination and securitization running smoothly. These asset purchases will also tend to keep benchmark rates low and MBS spreads from widening, resulting in lower rates to homebuyers and homeowners.

- ***Stimulus implications on long term inflation***

In addition to the Fed's actions, the US government passed a \$2 trillion stimulus bill, which is more than twice the size of the stimulus package passed during the 2009 Credit Crisis. By enabling businesses to keep workers employed and providing funds directly to individuals, the government is shoring up demand for goods and services while shelter-in-place rules are in effect. The combination of these large scale fiscal and monetary stimulus packages will tend to put upward pressure on long-term inflation and

support home price appreciation. Housing is the largest component of CPI, and will benefit from the anticipated demand-pull inflation resulting from the broad increase in both credit supply and direct government spending. In addition to supporting real asset values, household balance sheets will benefit from a reduction in the cost of their liabilities due to lower interest rates. For a fixed schedule of mortgage payments, the real cost of these payments will decline compared to the original nominal basis, improving the aggregate credit profile of US homeowners and enhancing the value of real assets.

- **Housing supply is at a healthy level**

Leading up to the Financial Crisis, both housing starts and the inventory of housing were steadily rising. Current levels of both are still well below those leading up to the Financial Crisis, and the months of supply indicates a relatively tight housing market. This lack of supply is paired with the fact that household formation continues unabated, babies are still being born and population growth continues.



Data provided by FRED

A potentially larger and longer-lasting inhibitor of supply is construction. As non-essential businesses are temporarily shut down, construction workers may be prevented from returning to building sites. Further, there is evidence of supply chain disruption. The National Association of Home Builders' (NAHB) Chief Economist estimated that a third of residential building material products come from China<sup>3</sup>. Similarly, a NAHB/Wells Fargo survey indicated that 33% of builders who responded after March 6 experienced some disruption in supply.

<sup>3</sup> <https://www.forbes.com/sites/dimawilliams/2020/03/21/homebuilders-face-the-effects-of-coronavirus/#4c422a754c6e>

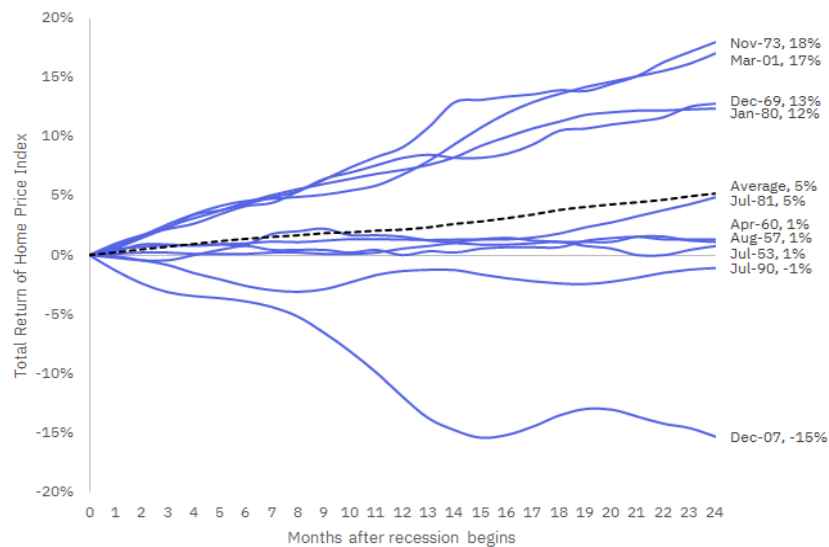


## The recovery will not be consistent across the US

Measuring the economic recovery from COVID-19 will be a challenging task as the impact across the country will not be consistent. Regions dependent on industries such as travel, entertainment, and oil and gas have been hit especially hard by this event, and may experience slower recoveries. Based on an analysis done by the Brookings Institute, there are more than 24 million US jobs in high risk industries from the COVID-19 threat. The largest metros with the most exposure to an economic disruption are Las Vegas, Orlando, New Orleans, Honolulu, and Oklahoma City.<sup>4</sup> The impact on these regions reinforces the importance of diversification within residential real estate. Having a high concentration in an individual city can create a disproportionate amount of risk based on the local industry composition. In this sense, it can be more beneficial for investors to target a broader exposure across the country.

## Residential real estate recovery in a recession

The figure below shows the performance of Robert Shiller's US residential real estate index for 24 months after the beginning of a recession. On average, homes perform reasonably well during economic recessions. The global financial crisis of 2008 was an outlier, where overleverage and oversupply in the housing market led to a downturn in home prices. For all of the reasons discussed in the previous sections, the housing market is well positioned relative to 2008. In all but one other historical recession, housing prices appreciated in the 2 years following the start of the market downturn.



**Total return of Shiller's home price index for 24 months after the beginning of a recession 1950-present. Recession indicators are provided by FRED.**

For additional considerations, please refer to Unison Investment Management's research - [Historic Turmoil & US Residential Real Estate Performance](#) published on April 1, 2020.

<sup>4</sup> <https://www.brookings.edu/blog/the-avenue/2020/03/17/the-places-a-covid-19-recession-will-likely-hit-hardest/>

## Conclusion

Real estate is the largest component of both GDP and CPI, and is the foundation of the economy in all economic cycles. For homeowners, the home is often their most valuable financial asset. For these reasons, the government is incentivized to support housing in times of crisis. In addition to being a financial asset, residential real estate is unique in that it has practical and personal value to homeowners. This value is especially pronounced during a shelter-in-place order.

While the economics of each market will differ, and unemployment will play a role in the near term, supply and demand factors uniquely support owner occupied residential real estate in the United States. This informs our core expectation that while some areas may be materially adversely affected, we expect owner occupied residential real estate to recover rather quickly. Further, we believe that the massive stimulus package released by the government is a recipe for inflation which favors real assets and housing investments.

We suggest there is an opportunity to deploy capital into real assets and housing in the second and third quarter while prices are depressed, with the opportunity to participate in a wholesale bull market for housing across the country over the mid to longer term.

## How Unison Investment Management can help - Risk Assessment Analysis

Our proprietary technology (Greenlight Model) has assessed all 132 million homes in the US, and evaluates each property down to the individual address level. We designed this data analytics tool to select properties for our portfolio and we are now harnessing it to help clients analyze the risk in their residential real estate portfolios.

Please contact [Joe Celentano](#) or [Anna Mori](#) if you would like to discuss a customized risk assessment analysis of your portfolio or a more detailed review of the residential real estate market.

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