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# The Brave New Housing Cycle 2.0:

## A new U.S. housing cycle started in 2020 and it could be 10 years long

*By Joshua Pollard | December 2020*

**Summary**

- The U.S. housing market is essentially starting a new 7-10 year upward cycle, supported by Housing Turnover and fueled by an economic recovery from the COVID-19 pandemic.
- Structural forces—technology, the accommodative role of the Fed, investor behavior—have created "The Brave New Housing Cycle" in which housing recessions are less frequent.
- The "dark side' of "The Brave New Housing Cycle" can be harsh, but labor shortages are a considerable risk mitigant.

# 1. Housing Turnover and other critical metrics suggest housing can grow materially

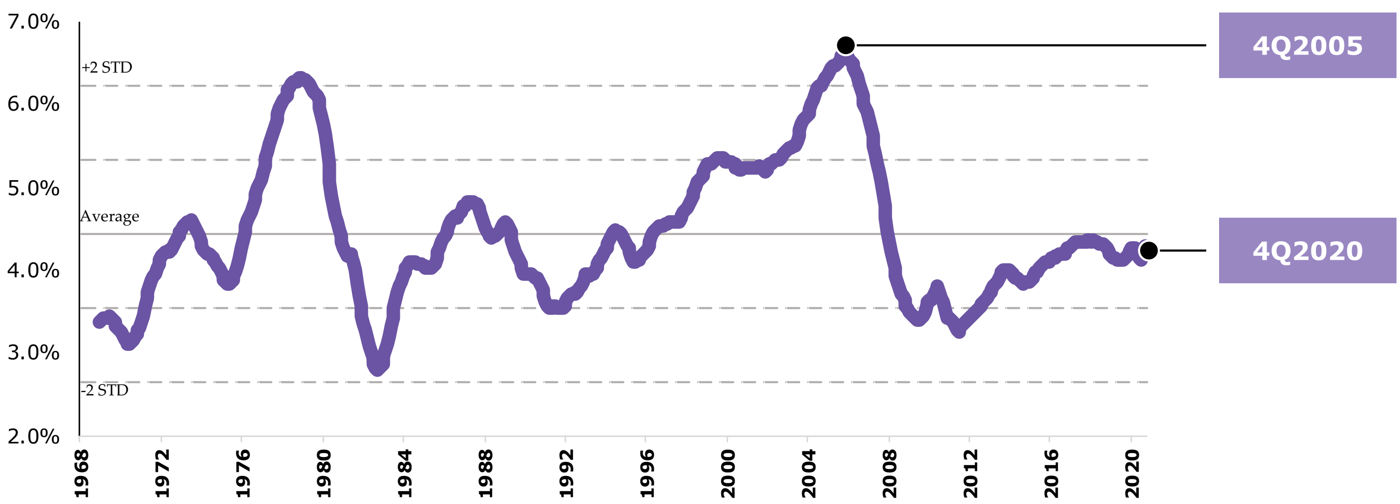
In November 2005, Goldman Sachs initiated coverage of U.S. homebuilders with a cautious view of the sector. This view shocked Wall Street as well as some within the firm itself. Goldman was one of the largest financiers in the growing high-risk mortgage securitization market that depended on a healthy U.S. housing market. From the outside looking in, it appeared that Goldman was betting against itself.

As an analyst on the team that made that bold call, I can attest to the shock, both externally and within Goldman, following our launch. Housing executives unscrupulously defended the housing market, insisting it was "different this time." The risk-focused parts of Goldman, meanwhile, began to ponder how business would be impacted if we were right in our assertion that the market was at its peak.

As we did our research, however, there was one trend no one could ignore: Housing Turnover. Housing Turnover, a complete measure of housing activity, was two standard deviations above its long-term average in 2005. Today, in an otherwise strong housing market, Housing Turnover is just below its long-term average, suggesting that **the housing market is on pace for a multi-year, even potentially decade-long, upward trajectory**.

**Housing Turnover is at normal levels, supports multi-year growth in U.S. housing**

Housing Turnover = (New Home Sales + Existing Home Sales)/Total Households – 12 mo. moving average




*Source: U.S. Census, National Association of Research, Omicelo Analysis*

In addition to historically balanced Housing Turnover, the projected growth of the U.S. economy represents a positive tailwind for the U.S. housing market. The COVID-19-induced global pandemic caused a 34.3% decline in U.S. GDP in the second quarter of 2020; there was a 33.1% rebound in the third quarter of 2020.

Forecasts by the Federal Reserve and Goldman Sachs are for a full year contraction of between 3.5% and 5% for 2020. However, an increase in GDP growth between 4.0% and 6.5% is projected for 2021, with further expansion anticipated in 2022 and 2023. Growing GDP, shrinking unemployment, and moderate inflation have traditionally formed a strong backdrop for the U.S. housing market and those conditions are expected to prevail yet again over the next decade.

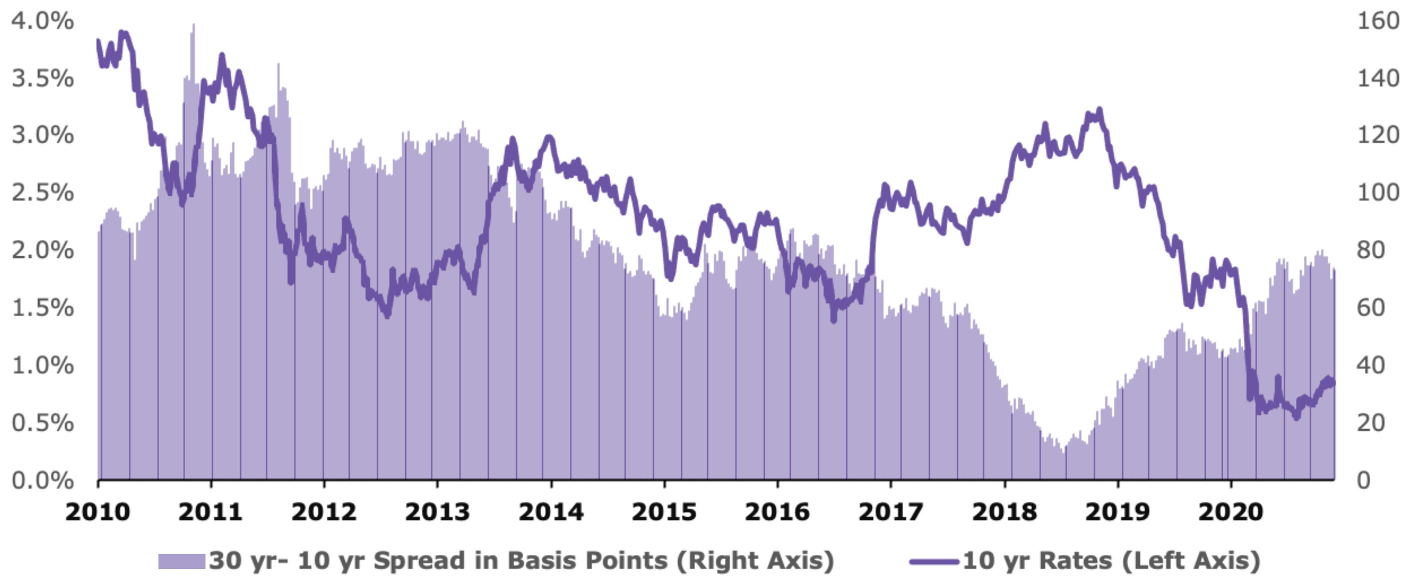
**Pending GDP growth represents a tailwind for U.S. Housing**
2020-2023 Real GDP (%) Estimates as of December 2020

| | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|
| The Federal Reserve | -3.7 | 4.0 | 3.0 | 2.5 |
| Goldman Sachs | -4.8 | 6.4 | 3.4 | 2.2 |

*Source: The Federal Reserve, Goldman Sachs*

COVID-19 has been a perverse positive for the housing market. Here's why: During the first major wave of COVID-19 (Spring 2020) the pandemic shut down the global economy, which, predictably, is traditionally bad for housing. However, in what we all hope is a once-in-a-lifetime pandemic event, the monetary policymakers responded by employing the safety toolkit built during the Great Recession to safeguard the financial system. The mechanisms that were built over three years to support global financial liquidity during that U.S. housing-induced bank and monetary crisis were all recharged and deployed within three months to protect the U.S. economy. The unintended effect of this action, which lowered interest and mortgage rates, was to boost home prices. Typically, when interest rates are lowered by policymakers for reasons that are not directly related to housing and banking (like the dot.com burst and the 9/11 terrorist attack two decades ago, and the COVID-19 crisis happening now), housing benefits directly from the interest rate reduction and then again from the eventual improvement in the economy. That scenario appears to be playing out once more.

**Low interest rates and normalized interest rate spreads are positive for housing**
10-year treasury rates (%) vs. spread between 30-year treasury rates and 10-year treasury rates (bps)




*Source: U.S. Treasury Department*

# 2. The Brave New Housing Cycle is at work

In 2015 I authored a report called The Brave New Housing Cycle, which made the case for much longer housing cycles overall. The title, Brave New Housing Cycle, was a reference to the 1997 report “The Brave New Business Cycle—No Recession in Sight” by Bill Dudley, the former president of the New York Federal Reserve Bank. In that report, Dudley made the case that structural changes—technology, a supportive monetary policy regime, positive impacts from external factors—had altered the frequency and magnitude of U.S. recessions.

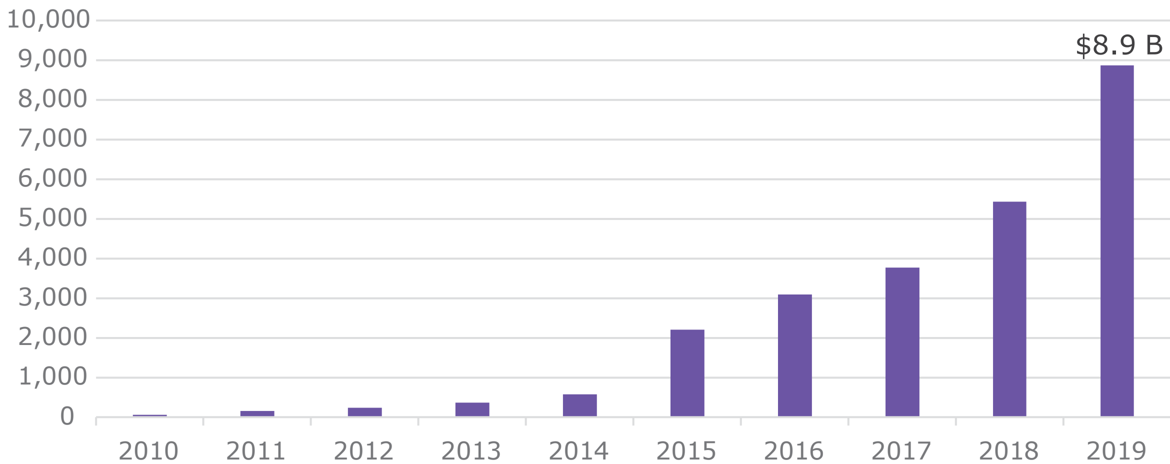
I believed then and, five years later, I believe even more so now, that the Brave New Housing Cycle is alive and well. Easy monetary policy, the advent of real estate technology, and non-traditional investments have created a material shift in the nature and expected frequency of housing collapses.

Let’s take a close look at each of the factors that are driving those longer cycles and the evolution of the housing market.

## Technology growth in real estate

The U.S. real estate market remains in the pre-dot.com phase, in technology life-cycle terms, but is moving quickly into a new phase. In 2015 the U.S. had just reached critical mass for electronic deed recordings for two-thirds of the U.S. and all major cities. Today, over 85% of the U.S. population lives in a jurisdiction that offers electronic deed recording, according to the Property Records Industry Association. Additionally, real estate technology is attracting enough capital to catch up with other major pieces of the digital economy, such as e-commerce and online travel. Real estate technology investment has grown at a 66% compound annual growth rate over the last 10 years. The direct impact of these investments is a real estate industry that may catch up to the broader economy in its digitization.

**Real estate technology investments are creating cycle-shifting efficiencies in the housing market**
Equity funding in real estate technology company (Millions USD)



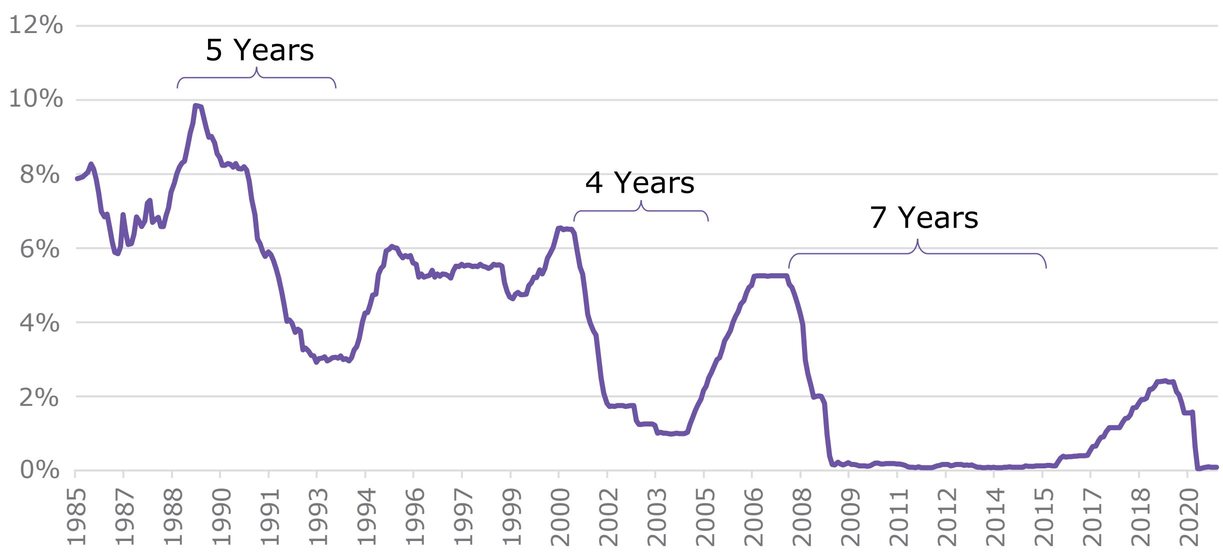

*Source: CB Insights*

## A supportive monetary policy framework

The Federal Reserve is signaling that it may not raise rates for five years and there are clear precedents for an elongated period of low rates. The Fed began lowering rates in 2007, in an early response to the Global Financial Crisis, and set rates to ostensibly zero by 2009. The Fed Funds Rate stayed at the zero lower-bound until 2016. Similarly, the Fed began lowering rates in late 2000 as the dot.com bubble was bursting and lowered or left the Fed Funds Rate unchanged until 2004 before beginning raising it again.

Looking back to the 1980s and 1990s, during that recession, the Fed began lowering rates in 1989 and lowered or left rates unchanged until 1994. Over the last three major recessions, the target Fed Funds rate has been lowered or flat for nine, four, and five years, respectively. This easy monetary policy, which is expected to remain in place, is a boon for housing for at least the next five years.

**The Fed has a history of leaving monetary policy easy for long periods**
Effective Federal Funds Rate set by The Federal Reserve




*Source: The Federal Reserve*

## Emerging institutional investor activity in housing

Housing is in the midst of a longer-term shift from individual ownership to corporate ownership in the hardest-to-manage section of the housing economy—rentals of single-family homes. This gave rise to the single-family rental industry.

Four events in just six months created this industry:

> 8/10/2011 - The FHFA would receive 4,000+ responses from banks and investor groups in the three months following its August 2011 Request for Information seeking opinions on converting foreclosures to investor-owned rentals.
> http://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/RFIFinal081011.pdf
>
> 12/21/2011 - Supply of available homes artificially dropped from nine months to seven months. In one day, this closely watched, critical data point that is a go-to measure of supply/demand balance was "re-benchmarked" by the National Association of Realtors.
> http://economistsoutlook.blogs.realtor.org/2011/12/14/qa-on-re-benchmarking-of-home-sales/

> 1/4/2012 - Ben Bernanke, the then-current Federal Reserve Chair, writes a letter to Congress proposing a possible solution to the housing crisis: "Converting foreclosed properties to rental units will help redeploy the existing stock of houses in a more efficient way."
> http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf
>
> 2/27/2012 (Video) – In a live television interview, Warren Buffett tells CNBC that "single family homes are cheap right now. If I had a way of buying a couple hundred thousand single-family homes…I would load up on them…it's a leveraged way of owning a very cheap asset. It's probably as attractive of an investment as you can make."
> http://www.youtube.com/watch?v=KMvQPeBAesw

Owning individual homes for rent, which was traditionally a mom-and-pop business, has since become a Washington-fueled, investor-led $60+ billion industry. Among the leading players is The Blackstone Group (via Invitation Homes), one of the world's largest alternative asset managers. Single-family homes have made up 50-60% of the rental housing stock over the last 30+ years, and this material transition to institutional ownership is adjusting the cycle for U.S. housing.

**The top 10 single family rental companies own a quarter-million homes vs. owning almost zero only 10 years ago**

Number of single-family rentals owned by corporations

| | |
|---|---|
| Invitation Homes | 82,260 |
| American Homes 4 Rent | 52,464 |
| Progress Residential (Pretium) | 26,000 |
| FirstKey Home | 20,730 |
| Main Street Renewal | 20,000 |
| Tricon American Homes | 17,000 |
| Front Yard Residential | 15,000 |
| Connorex-Lucinda | 7,500 |
| Vinebrook Homes | 4,500 |
| Gorelick Brothers Capital | 2,440 |
| **Top 10 Total** | **247,894** |

*Source: Company Filings, Americans for Financial Reform*

These companies, especially the largest private equity firms, owned no individual homes in 2010, yet by 2020 they have assembled the human capital, financial capital, and technology to manage hundreds of thousands of properties. Further, Fannie Mae issued the first-ever government-sponsored securitization (Fannie Mae Grantor Trust 2017-T) of amalgamated single-family rental homes owned by institutional capital in 2017. This test-and-see experiment ended this way:

> "While the Enterprises' single-family investment home rental programs have played an important role for small investors, the market for larger investors has performed successfully without Enterprise participation. As a result, FHFA is directing the Enterprises to conclude their single-family rental pilot programs. However, the Enterprises will continue to participate in the single-family rental market through their existing Enterprise investor single-family programs – Fannie Mae's Multiple Financed Properties and Freddie Mac's Investment Property Mortgages."
> (https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/SFR-Decision-8212018.pdf)

In what proved to be an interesting test, launch, and close, the regulator of Fannie Mae and Freddie Mac (even under the very pro-business Trump Administration) aptly decided that for large investors, there wasn't a need for government guarantees.

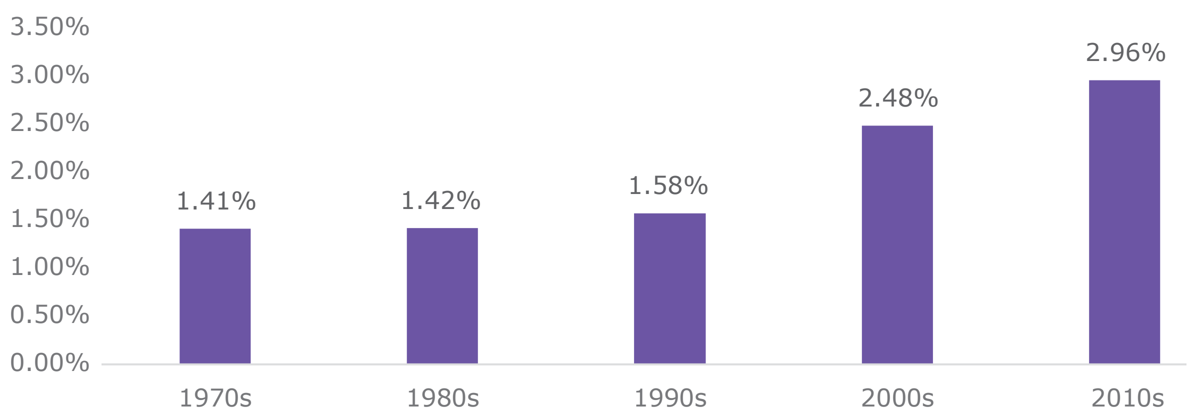
While this may be viewed as a negative from a capital formation perspective, it actually highlighted three unique developments in the functioning of the capital markets. First, there is strong appetite, without governmental guarantees, to finance institutional-quality owners of individual properties. Second, Fannie Mae and Freddie Mac have agreed to continue financing small to medium-sized owner/operators of single-family rentals. Third, if the private financing market were to grow cold to larger institutional investors in single family rentals, Fannie Mae and Freddie Mac already have the internal plumbing to issue and guarantee debt to larger owners for this asset class.

## (3) The Dark Side of the Brave New Housing Cycle

Dr. Janet Yellen, now the proposed Head of the U.S. Treasury Department, described Dudley's depiction of the Brave New Business Cycle in terms that I believe are relevant for the U.S. housing market today: "[Dudley] was one of the first forecasters to see that structural changes associated with the new economy had altered the nature of the business cycle [positively]. He also recognized that the U.S. investment boom could go bust—that the 'Brave New Business Cycle' could have a dark side."

Home prices are more volatile than they were 50 years ago. The average monthly movement in home prices has double since the 1970s and 1980s. This means the speed at which prices can move up or down has accelerated. Within the bounds of the Brave New Housing Cycle this means that the downside risk to home prices is elevated at the end of the cycle. Prior to the Great Financial Crisis, there wasn't a sustained period where home prices declined across the entire country. There had been pockets of declines in California and other places, but the decline was never country wide. Investors and policy makers are wise to be aware of the reality that home prices have more "bounce" than they used to, especially when considering investments and policy that require historical analysis.

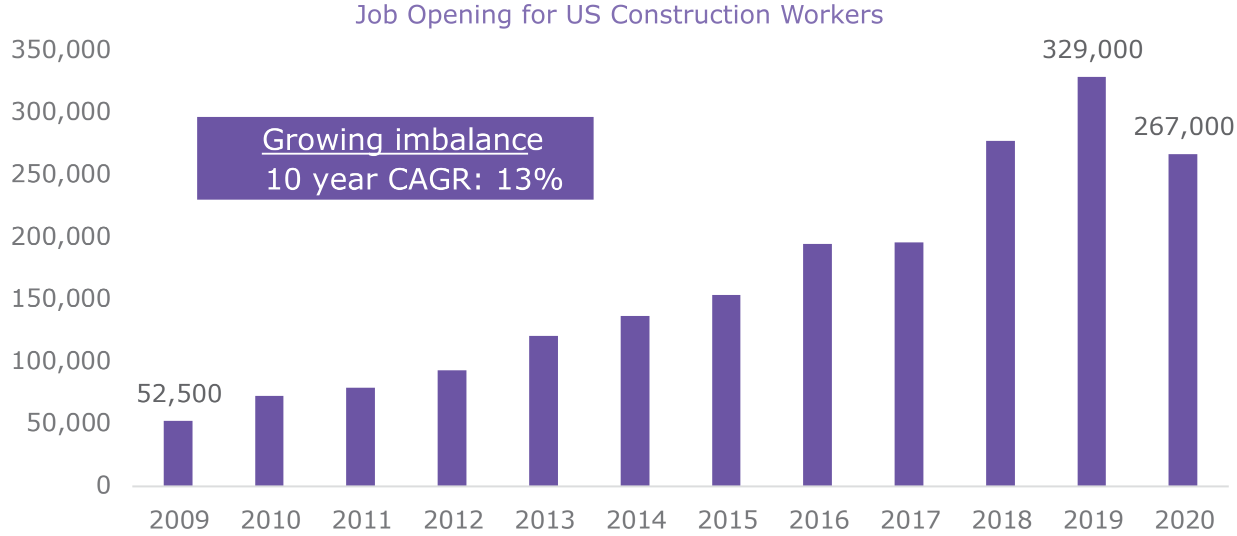
**The volatility of home prices has more than doubled since the 1970s and 1980s**
Standard deviation of annual home price movements of existing homes




*Source: National Association of Realtors, Omicelo Analysis*

One factor that could potentially mitigate the dark side of the Brave New Housing Cycle is a shortage of construction workers. Current figures from the U.S. Bureau of Labor Statistics point to 267,000 open and unfilled construction jobs. The construction supply demand imbalance has grown at 13% CAGR since the Global Recession and serves as a retardant to unbridled growth in the supply of homes, which is an abnormal positive for the traditionally boom-bust U.S. Housing market.

**There is a material supply/demand imbalance for construction workers which is preserving the housing market in constructive way**




*Source: National Association of Realtors, Omicelo Analysis*

## 4. Conclusion

The U.S. housing market is 10 years into the current housing upcycle, where, historically, these cycles have been less than seven years in length. Our Brave New Housing Cycle framework suggests that housing cycles will be longer; however, a "new" cycle essentially started in 2020 as a result of the pandemic-related monetary policy, technology investments and the role of investors in the U.S. housing market. This "new" cycle could be another 7-10 years in length.