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ECONOMIC STRAIGHT

Real estate economic analysis, insight, and advice from Selma Hepp, Pacific Union Chief Economist & Vice President of Business Intelligence

Housing Market Predictions for 2018

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Below, Pacific Union offers our perspective on some key U.S. economic and housing market trends that we believe will play out in the coming year. For a longer-term forecast for Bay Area housing markets over the next three years, read our recap of Pacific Union's Real Estate and Economic Forecast to 2020, which was held in mid-November in San Francisco.

1. **Mortgage interest rates will keep rising:** Mortgage interest rates will continue their slow, gradual increase, and we anticipate that rates will rise by about 20 basis points by the end of 2018. Despite further anticipated increases in federal funds rates, mortgage rates are being held down by low inflation and low overseas central banks' interest rates. We would have to see much higher inflation than has been the case to notably increase mortgage rates.

2. **The real estate market will remain in favor of sellers:** New construction would have to ramp up considerably, or some combination of higher mortgage rates and an economic downturn would have to dampen buyer demand to tip the market. Neither event appears to be in sight for 2018.

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4. **Affordability will continue to deteriorate**: As long as severe inventory shortages persist, affordability issues will keep getting worse. In 2018, buyers not only face potentially higher mortgage rates, but combined with higher home prices, they will spend more of their monthly incomes on mortgage payments. Affordability will fare the worst in areas with high job growth and a lack of new supply, especially in states with high regulatory constrictions such as California. Some lower-priced housing markets where job growth remains steady may provide relief for potential buyers who are willing to relocate.

5. **The U.S. economy will further strengthen:** Though with cautious optimism, experts believe that the economy will gain strength in 2018 — due in part to tax impacts that are expected to stimulate consumer and investment spending. Consumer spending has already firmed up, bolstered by gains in jobs and wages, as well as wealth gains from the financial market and home equity, but also improved consumer expectations. According to data from the University of Michigan, consumer sentiment is hovering near the decade-high that it reached in October. With tax reforms clearer, consumers should be concerned with fewer uncertainties around legislation. Still, more than half of Americans who were concerned about tax implications thought that the changes would be positive for the economy. Furthermore, the strength in retail sales gives credence to the strong increase in consumer confidence that has occurred during the past year. The latest retail holiday sales numbers showed a jump of 4.9 percent, which is the biggest increase since 2011. Business are also expected to continue spending. Overall, there do not appear to be any obvious excesses that could destabilize markets, and economic risks are balanced. Furthermore, the global economy is doing well, and the financial system is on firm footing.

6. **First-time homebuyer activity will pick up:** Millennial first-time buyers impacted the market in 2017, and as more of them turn 30, they will be increasingly active over the next few years. Millennials will face greater affordability challenges that will prevent some from buying, but overall, we project first-time buyer activity to ramp up.

7. **Millennials will spark development in affordable urban areas**: Following the central-city boom led by millennials, their venture into homeownership will probably lead them to areas with more single-family homes and townhouses that contain elements of higher-density, amenity-rich neighborhoods. Millennials will likely further spur revitalization efforts in affordable areas adjacent to downtowns. Baby boomers, on the other hand, will remain the largest group of home sellers as they reach retirement. Demand for retirement communities in the Southern and Southwestern U.S. will likely pick up again.

8. **Proposed tax changes will negatively impact the housing market:** The House Republicans' tax reform could be very detrimental to housing markets across the country, especially ones where buyers are already constrained by affordability and a lack of homes on the market. The reform further disincentives existing homeowners to sell, especially if they lose the grandfathered tax deductions when buying again. Some buyers will certainly be discouraged by tax changes; real estate professionals have already reported receiving emails from clients who have decided to stop their home searches.

Selma Hepp is Pacific Union's Chief Economist and Vice President of Business Intelligence. Her previous positions include Chief Economist at Trulia, senior economist for the California Association of Realtors, and economist and manager of public policy and homeownership at the National Association of Realtors. She holds a Master of Arts in Economics from the State University of New York (SUNY), Buffalo, and a Ph.D. in Urban and Regional Planning and Design from the University of Maryland.