

SMARTER PERSPECTIVE: FORESTRY

The Housing Market Catch-22: Implications for Lenders in a Challenging Economic Landscape

By Jesse Marzouk

As concerns about high mortgage rates and speculation about the likelihood of an impending economic downturn continue to escalate throughout 2024, the U.S. housing market finds itself in a position of stagnation—one that poses far-reaching implications for lenders, homebuyers, and the industry as a whole. Many such stakeholders are left wondering: what lies ahead for the housing and lumber products sector?

This article examines the current state of the housing market, including the divergence between new construction and existing home sales, analyzes the factors influencing mortgage rates, and discusses the interplay between economic conditions and housing demand. By exploring these elements, we aim to provide insight into the multifaceted challenges facing the housing industry and the potential long-term implications for market recovery.

Market Bifurcation: New Construction vs. Existing Homes

The housing market is experiencing a pronounced bifurcation between new home construction and the existing home market. Per the U.S. Census Bureau and U.S. Department of Housing

and Urban Development's most recent report, new residential construction in June 2024 reached a seasonally adjusted annual rate of 1.353 million units. This figure, which represents both single-family and multi-family homes, marks a 3.0% increase from the preceding month but a 4.4% year-over-year decrease.

Despite a 54% increase in home prices over the past five years—and a 5.8% increase in the past year alone—new construction activity has remained relatively stable, with this subsection of buyers undeterred by the aforementioned spike in expenses. That stability, however, is tempered by the fact that new construction only accounts for roughly 15-20% of the overall housing market.

The existing home market, which constitutes 80-85% of the total housing market, tells a wholly different story. As of 2024, approximately 40% of homeowners own their house outright, with the other 60% holding mortgages; of those mortgages, 60% were secured at a rate of under 4%. With rates for a 30-year fixed conforming mortgage hovering at about 6.5% in the first half of the fiscal year—and even higher for jumbo loans—the existing market has essentially frozen.

This stagnation can be directly tied to economic changes brought about during the COVID-19 pandemic, during which 30-year fixed mortgage rates dropped to a historic low of 2.65%. While the traditional factors which drive market turnover—divorce, death, and downsizing—remain active in this sector, homeowners who were able to successfully lock down a mortgage under 4% between 2020 and 2021 are increasingly reluctant to make any kind of elective change to their ownership status. Doing so would require taking on a far higher mortgage rate for the purchase of a home that is now 20-40% more expensive than it was five years ago. This is a situation that is simply untenable for the average American consumer.

Interest Rate Dynamics and Economic Factors

Given these circumstances, consumers and lenders alike are both asking the same question: When will mortgage rates return to a more tenable position for those seeking to purchase a home? While it is a popular misconception that mortgage rates are directly tied to short-term rates like the Federal Funds Rate, the direction of such rates are more closely based on medium to longer-



term interest rates, with the 10-year U.S. Treasury bond yield acting as the superior indicator. The relative stability of that yield suggests that mortgage rates are likely to remain stable for the foreseeable future.

More broadly, two primary factors can be cited as keeping longer-term rates elevated: core inflation and government spending. In the case of the former, core inflation has held relatively sticky, running at a 3% annualized rate year-over-year. This figure is nearly twice as high as the rates seen in the 2010s, which averaged 1.7% on a year-over-year basis; the lower rates of that decade can be attributed to the United States' emergence from a recession and spurts of economic growth, an abundance of labor, and the cheap production and export of Chinese goods. As current inflation rates remain high, they continue to exert upward pressure on interest rates and, in turn, mortgage rates themselves.

In the case of the latter, the federal budget deficit is anticipated to reach \$1.9 trillion, or 7% of GDP in the 2024 fiscal year. Contextualized by the reality that the country is enjoying a time of peace and relative economic prosperity, this high of a deficit might best be described as unheard of-and is certainly also

responsible for upward pressure on rates.

Potential Scenarios for Lower Mortgage Rates

Thus, for the housing market to see any significant change, one of two scenarios must unfold: either the federal government will need to rein in deficit spending to ease inflationary pressures or the U.S. economy will need to experience a significant economic downturn.

Put directly and taking into account the fact that 2024 is an election year and the political climate itself, a reduction in federal deficit spending is unlikely due to a lack of bipartisan interest in fiscal tightening. The second scenario, while more probable, comes with its own set of challenges. Current economic indicators show pockets of weakness: per the July 2024 Jobs Report, the unemployment rate has crept up to 4.3%, and while total job numbers have grown, that growth is predominantly in the part-time sector, with 1.8 million full-time jobs disappearing in Q1 of 2024.

The Housing Market Catch-22

It is in the mismatch between the future number of available homes and the

scope of buyer ability that the paradox facing the housing market truly lies. Lower rates as the result of a recession or downturn could certainly provide much needed relief to the housing market, inducing greater supply as U.S. consumers once again become comfortable with the prospect of buying and selling homes at a lower monthly payment.

However, the lived realities of such a downturn—such as the subsequent loss of jobs and fear of layoffs as businesses slow and readjust—is just as likely to lower demand. Consumers torn between their desire for home ownership and concerns about their personal financial security will be less equipped to afford the costs of a home purchase in the immediate future. In the event of a weakened economy, lenders with concerns of their own will focus on keeping lending standards tight—a necessary limitation, but one that will ultimately prevent a subsection of hopeful homebuyers from entering the market.

This is the catch-22 of the current housing market: that mortgage rates are unlikely to fall without the country entering a significant economic slowdown or recession, but that such conditions will inevitably throttle the purchasing



confidence of the average buyer.

Long Term Consequences for Lumber and Building Products Demand

Regardless of which scenario—if any—comes to fruition, an ongoing period of challenges for the housing and lumber markets undoubtedly lies ahead. The stagnation of the existing home market has resulted in the overall demand for lumber products remaining relatively low; that drop has consequently placed downward pressure on lumber prices, which have decreased slightly since the beginning of 2024.

Sawmills tasked with supplying lumber are coping with inflationary costs, which have impacted operations. Industry agnostic hourly wages in the United States have increased by 4% in the past year, with benefit costs rising by 3.5% in Q1 of 2024 alone. Across British Columbia, job openings within the forestry sector are being driven not by economic growth, but by a diminishing labor force approaching retirement.

Increased labor costs and shortages have also impacted transportation networks, which have struggled to employ enough drivers and logistics personnel to meet their needs. The impact of the COVID-19 pandemic is still keenly felt across related supply chains, with the transportation industry forced to cope with ongoing challenges ranging from rising fuel costs to evolving environmental regulations. The expenses associated with remaining in compliance with such new policies means sawmills have been made subject to cost pass-through.

Due to ongoing concerns about profitability and an exodus of insurers from this severity-driven market, increased emphasis is being placed on risk mitigation by the insurers who do remain. Insurance pricing for sawmills has risen dramatically as a result, driving up premiums and deductibles.

These increased costs and decreased selling prices—coupled with environmental restrictions designed to regulate lumber cutting in British Columbia and the Pacific Northwest—have led to the closure of many sawmills in North America over the past year and a half. Nine sawmills closed in 2023, and an additional six have shuttered their doors thus far in 2024.

Conclusions and Implications for Lenders

The housing market's current predicament presents a complex challenge with no easy solutions. Lenders and industry stakeholders must recognize that a mere drop in interest rates is unlikely to result in the housing and building products markets self-correcting to their pre- and early-pandemic states. Instead, the impact of the current situation will be felt sustainably for years to come. While lower interest rates could provide much-needed relief and potentially increase housing supply, the economic conditions necessary to bring about such a decrease in rates would likely dampen demand simultaneously. This catch-22 puts the market in an exceptionally challenging position, making it difficult to extract itself from the current stagnation in the foreseeable future. It's crucial to understand that the massive increase in demand and refinancing activity between June 2020 and early 2022 has created a long-lasting effect on the market. With a significant portion of homeowners locked into low mortgage rates, the reluctance to move or sell their homes will continue to impact market dynamics for the foreseeable future. This situation will likely keep demand for lumber and building products suppressed, further affecting related industries.

Lenders should prepare for a prolonged period of adjustment in the housing market. Rather than anticipating a quick

return to pre-pandemic conditions, they should adapt their strategies to account for:

1. Sustained lower demand in the existing home market
2. Continued pressure on lumber prices and related industries
3. Potential shifts in new construction trends as the market seeks equilibrium
4. The need for innovative financing solutions to address the needs of potential homebuyers faced with higher interest rates

Ultimately, the housing market is navigating uncharted waters, and the path forward will be neither quick nor straightforward. Lenders and industry participants must remain vigilant, adaptable, and prepared for a protracted period of market realignment. By understanding the intricate dynamics at play and the long-term nature of the current obstacles, stakeholders can better position themselves to weather ongoing challenges in the housing and building products markets.



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