SVN
BLUESTONE & HOCKLEY

SVN | Bluestone & Hockley
4915 SW Griffith Dr. Suite 300
Beaverton, OR 97005

Will increased inflation affect Real Estate Investors?

By: Cliff Hockley, President, Bluestone and Hockley Real Estate Services Executive Director, SVN Bluestone and Hockley

Blog

LinkedIn

Facebook

What are the signs of inflation, key benchmarks?

A survey conducted in March of 2021 found that over three quarters of Americans are concerned about inflation. Not surprisingly, younger Americans who have not yet reached their peak earning years were most worried. The primary reasoning being they are still renters and don't own a home and are unable to participate in the property appreciation afforded homeowners and real estate investors. Home prices have increased by 14.9% in the last year. The median existing-home price across all housing types was $356,700 in August 2021, up from August 2020 when it was $310,400. **This is a clear sign of demand growth that is fueling inflation.** (1)

Thanks to the stimulus checks, real disposable income is set to have its biggest increase ever in any given six-quarter period, says Credit Suisse. The firm expects U.S. consumption to surge an "extreme" 10% this year, triggering a significant jump in new orders and new hiring–**all of which is highly inflationary**. This month, in fact, U.S. manufacturers reported the sharpest rise in new orders since 2014, according to IHS Markit. (2)

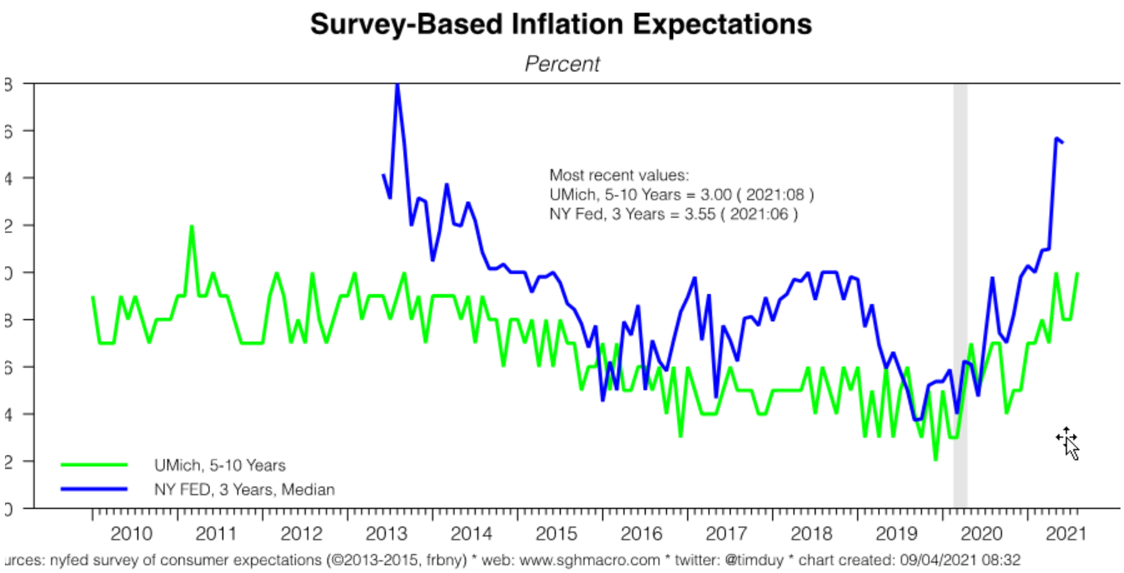
Inflation is up and is more persistent than expected. The path of inflation depends on the interaction of wages/inflation/expectations. The Fed may have to respond quickly to accelerating inflation. The latest inflationary data makes it even more likely that the Fed will soon begin reducing its $120 billion a month in bond purchases, which are intended to keep longer-term interest rates low. (3) At the Fed's November 3, 2021, Federal Open Market Committee meeting, the Fed made the decision to begin reducing the pace of its monthly bond purchases. The process will see a reduction of $15B each month. (4)

The expansion is self-sustaining with solid underlying support from households. Supply side constraints, however, are limiting the pace of growth. These constraints look likely to continue into next year. Some constraints are temporary, but maybe the economy was more finely balanced in 2018/19 than we realized? President Biden is understanding the danger of inflation and is encouraging businesses to break out of the supply chain gridlock.

In all levels of construction, there has been an increase in labor & material costs. Construction is extremely active across most market sectors, with industrial topping the list, but has been slowed down by the lack of materials and labor in the supply chain. This has significantly increased the price of construction. [5]

The Consumer Price Index (CPI) for All Urban Consumers rose 5.3 percent for the 12 months ending August 2021 as compared to approximately 2.2% in 2020.[6]

Inflation Expectations



Wage Increases are significantly fanning the flames of inflation

“Job growth has slowed from its very rapid pace earlier in the summer due to an increase in coronavirus cases and difficulties in hiring,” said chief economist Gus Faucher of PNC Financial Services.

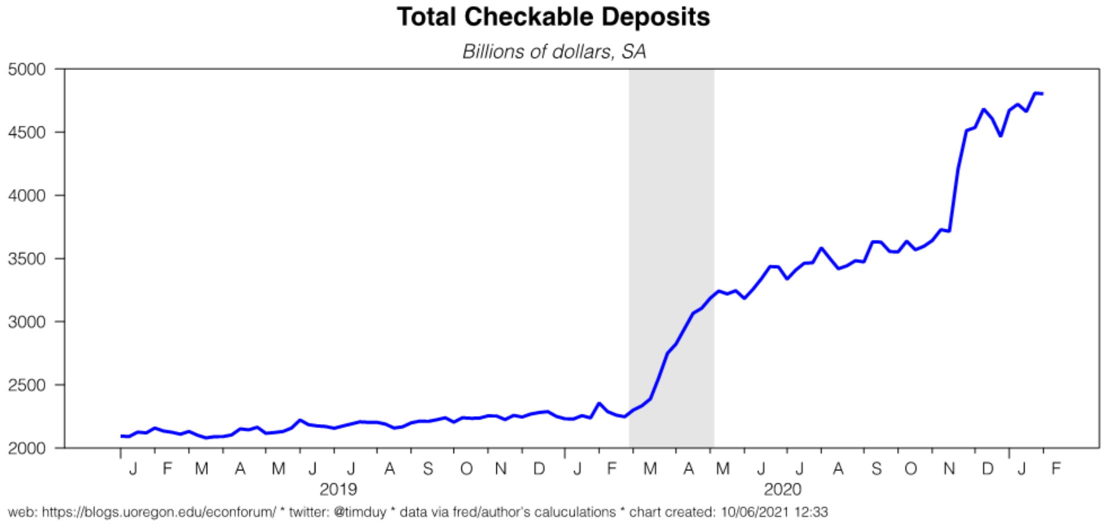
A huge explosion in pent-up demand as consumers spent government aid money is challenging the economy, as demand has overwhelmed many businesses and they can’t keep up. To hire staff, they have been forced to increase their wages significantly.

The Federal Reserve predicts inflation will eventually slow to its 2% target, but senior officials finally acknowledged recently the current bout of high inflation is likely to last at least until the middle of next year (2022).

"The tight labor market likely will create more persistent inflation than Fed officials expect," economists at Citi Research said in a note to clients. U.S. wages are soaring, but high inflation is not leaving workers much better off - MarketWatch

How do all of these factors apply to Real Estate?

As a result of the increased money in the marketplace (3 trillion dollars), investors are looking to place their funds to increase their yields over what they can achieve in a standard Bank. Checkable deposits show that from May of 2020 to February of 2021 there was an increase in deposits of approximately three (3) Trillion dollars.



This money is finding its way into the stock market and real estate investments. This unusual injection of funds is encouraging investors to chase properties, artificially increasing sales prices across the board in every investment class.

This dynamic economy has created an environment where there is not enough inventory to go around to meet every investor's need. This may result in some investments into less than quality properties that cannot generate the expected yield.

Many real estate investors are increasing their down payments to offset price increases to reduce banking risk, but as they do that, they decrease their net effective returns at the same time. This does reduce risk, but at the same time also reduces yield.

As long as interest rates are low, this is a good investment strategy but if interest rates increase as we expect them to, this becomes more problematic, especially for those that will only be holding real estate for the short term.

More importantly, is this an indication of changing real estate fundamentals?

Summary

Inflation is up and is more persistent than expected. The path of inflation depends on the interaction of wages/inflation/expectations. The Fed may have to respond quickly to accelerating inflation (as they have started to do at the November 3, 2021, FOMC meeting).

Residential, multifamily, mobile home parks, industrial properties, and storage facilities are in high demand as well as grocery anchored retail centers, and the prices of these assets are increasing significantly.

Lagging are downtown office buildings and non-grocery anchored retail centers, especially in cities where retail was over built. In some area of the country the overbuilding of retail centers has left significant vacancies where traffic is difficult, and the properties are old and out of date.

More importantly, in the hospitality market, which includes hotels and restaurants owners are struggling to hire staff, which means they can only offer limited service reducing their ability to compete for the increasing tourism marketplace as the threat of COVID lifts.

There is risk in the marketplace, and even with low interest rates, investors need to understand that interest rates for real estate may increase by 300 basis points in the next five years. This information needs to be taken into consideration as investors shape their decisions regarding investing in the current market. Real estate investors also need to consider their investment decisions ahead for seven to 10 years as they plan their exit and from this set of purchases. Every investment in all parts of the United States will take a different set of decisions. Take the time to plan your investment purchases with a view of the future in mind. Inflation considerations should color your decisions.

Cliff Hockley
Bluestone & Hockley, President
SVN Bluestone & Hockley,
Executive Director
503.459.4359

Sources

(1) www.noradarealestate.com/blog/housing-market-predictions/
(2) What If We're Measuring Inflation All Wrong?
(3) https://www.usnews.com/news/business/articles/2021-10-13/inflation-rises-54-from-year-ago-matching-13-year-high
(4) https://www.cnbc.com/2021/11/03/fed-decision-taper-timetable-as-it-starts-pulling-back-on-pandemic-era-economic-aid-.html
(5) https://perlo.biz/2021-construction-trends-a-chat-with-chris-mclaughlin/
(6) https://www.bls.gov/cpi