PALOS VERDES RESIDENTIAL PROPERTIES

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Rockyfield Newsletter

US Economy & Housing Market

We seem to have an expanding list of economic concerns: disappointing high-tech earnings, inflation, rising interest rates, growing risk of a recession and geopolitical turmoil. They are all inter-related with one common denominator: Supply shortage of many kinds of resources, materials, parts and products. The supply shortage originated in supply chain disruptions by COVID-19, and the Ukraine war occurred like a perfect storm. Now the supply shortage has spread from logistics to resources and food productions. China is locking down due to new waves of COVID variants. The bottom line is: Ending the war and COVID will improve all those economic issues. While the future of the war is totally uncertain, we should eradicate COVID. Although the current BA.2 does not seem to cause serious symptoms, it has been widespread in the US and a new variant that causes serious health problems may appear.

Once the pandemic disappears globally, energy and raw materials from the war zone can be better sourced from other countries. For example, Brazil is sitting on large oil and gas reserves.

The WSJ reported investors' concerns over the weak Yen which has been a safe haven for a few decades. However, the US dollar used to play that role during the time of international turmoil. And Japan is susceptible to energy shortages as they import almost 100% of its oil. Japan's economy has been in recession, deflation and meager growth since the late 1980's. We opposed the weak Yen policy in the 90's and advocated rate hikes because ordinary people's net assets were large with little debt and consumption was frozen. Higher rates would stimulate consumption. More importantly, lower import prices did not reflect on domestic prices; larger domestic profit margins would support exports which accounted roughly 1/3 of the economy. Japan's economy is still stagnating today. Although today's Japanese economic structure is different, the weak Yen worsens the energy import costs. However, BOJ is still keeping near zero rate policy.

The relationship between the West and Russia would not be restored in a short term even if the war ends soon. We hope new supply chains will be established in short order to get economy growing without inflation and disruptions.

How This Frenzy Boom May End

Effects of Higher Rates

A few scenarios can be considered with rising interest rates.

First: direct effect on the housing demand, simply a combination of higher prices and increased mortgage payments discourage buyers. "Soft Landing" would be possible with this condition.

Second: Escrow failures may increase. The rate at the time of Acceptance could be much higher than the rate at the time the pre-approval letter was made. Given the unexpectedly higher payments, the buyer may cancel the escrow. Or the buyer may fail to satisfy the debt/income ratio. This scenario is still not so disastrous; it would increase downward price pressure.

Third: Currently, 5 ARM (fixed rate for 5 years and then variable rate) is still mid 3%. Lenders and borrowers may go for 3-7 ARM, or even shorter like 1 year ARM may revive, though we do not believe "teaser rate" will come back. This would be "Highway To Hell" or a repeat of the pre-melt down mortgage trend in 2005-2007.

Those scenarios are unlikely to happen immediately in a large number in the Palos Verdes market. Buyers in lower price markets are more vulnerable to higher interest rates. However, once those troubles start happening in lower income areas, it would spread rather quickly to our market, too.

Historically, even small ups and downs in rates affected housing sales; however, this time, larger and sharper rate increases did not suppress sales. This mysterious phenomenon rather makes us uneasy. We are on the verge of a high cliff with dark cloud of inflation, high interest rates and economic slowdown looming.

Palos Verdes Housing Market

Why sales have not been suppressed even a bit by rapidly rising mortgage loan rates is a MYSTERY. Last month, we concluded the slowdown in new contracts was due to the lack of enough market inventory, not necessarily due to the higher rates. Now, we have started seeing increased escrow failures and slower sales. While quite a few properties are being closed at much higher prices than listed prices, the median price of closed listings is no longer soaring. The market inventory is now expanding because more sellers are rushing to the market with fear of rising rates. Including all those factors into consideration, "Confusing" may be the conclusion.

Our hypothesis is as follows: The number of buyers has already decreased due to higher prices and rates. There are still desperate and obsessed active buyers. Listings used to receive many offers; now maybe a little fewer, still with many exceptions. The final price can be driven up by a couple of frenzy buyers. Nowadays, we see new listings priced quite higher than comps, already taking a possible premium into consideration. Nonetheless, some crazy buyers can drive up already high list prices even higher.

Now, stock prices are falling eroding many people's portfolio, including 401K. Talks of a recession now dominates the market. May is normally the best month for the housing market. Not necessarily this year. Even though this hot market condition may survive a little longer, conventional wisdom points to a dark prospect in the future.

When many sellers are rushing to the market, the best strategy is to price it a little lower than direct competitors and sell quickly before the market cools.

SF Bay Area: Ticking Time Bomb?

You may think our housing market is crazy; it is astonishing to know how far the San Francisco Bay Area has gone. It is now common to have no contingency at all: inspection, loan or any. The Inspection is a buyer's legal right and a seller cannot force no investigation contingency; however, desperate buyers are voluntarily offering no inspection contingency, repairs or credit, and such practice is becoming a norm. A buyer cannot rescind the contract even if they find an unacceptable defect without losing their initial deposit (3%). Since no loan contingency is now a must, loan companies are offering "fully underwritten pre-approval letter." Fully? Really? Without a specific property and its appraisal, it cannot be a full approval. It Is impossible to lock the rate without knowing when escrow would be opened and closed. As mortgage rates are on the rise now, an "approved" loan may fail due to the much higher monthly payment amount than the estimate made at the time of such approval. Then without a loan contingency, the buyer would lose the initial deposit. As the seller can get another buyer so quickly, the forfeited deposit is a windfall profit for the seller. If this starts happening in a large scale: i.e, many buyers lose their deposits, then we are afraid the housing market may collapse. Once such burst happens in the Bay Area market, it will spread very quickly to our PV and other markets which have been all overheated. We have been hoping for soft landing; however, the San Francisco market seems to be a ticking nuclear time bomb.

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Please make an appointment with Catarina at 310-544-0857

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SELECTED LISTINGS

Please Contact

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A: Active U: Contracted P: Pending S: Sold
Prices in '000s. Source: MLS (as of 05/03/22)