PALOS VERDES RESIDENTIAL PROPERTIES

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Rockyfield Newsletter

Sales Recover Amid High Rate, Low Inventory

US Economy & Housing Market

Rising rates have begun directing certain buyers to variable rate loans. The rate for 5-ARM (fixed for 5 years; thereafter variable) is about 1.8% lower than the 30 year fixed rate. The qualifications for such loans are more restrictive and shorter than 5-ARM may not be readily available. However, as they are losing business, lenders may be easing the requirements and suggesting riskier loans to borrowers. We encourage financially solid buyers to consider 5 ARM, especially for rental property purchases. FRB's aggressive rate hikes will slow the economy and it is possible to refinance the original 5 ARM loan when interest rates come down within 5 years.

It is shocking to find emerging 2-1 buydown loans that offer an ultra-low interest rate for the initial two years. Interest payment only (no principal repayment) loans are also resurging. 2-1 buydown's principal amount will balloon as unpaid interests will pile up for two years. This is an extremely risky scheme, reminding us of the pre-meltdown mortgage fiasco. As the lending regulations are now much stricter, we hope no repeat of the meltdown.

The FRB's rate hikes have calmed the consumption and brought the housing slump. Although businesses are still going fine in general, high-tech companies are in retreat. Large corporations have put brake on hiring or started laying off, while small businesses are still struggling to fill positions. There are signs that inflation is calming, and a few FRB governors seem to be leaning toward less aggressive rate hikes. We speculate a delay or smaller rate increase in the future. However, the Ukraine war would keep the energy price high, so it is doubtful how much the inflation would come down by depressing the general demand. It is also unlikely that the 10-year T yield would decrease much until the FRB starts cutting the rate; nor would the FRB resume buying bonds, and mortgage rates may not come down soon. However, we expect housing sales to recover, if not fully.

The new UK prime minister seems to have calmed down the financial market; however, the modern UK economy which has been built upon the financial market got heavily damaged. Given the Brexit, a possible renewed attempt by Scotland to be independent and deteriorating fiscal deficit, the UK's future depends on if London can remain as the international financial center.

Capital Gain Exclusion

"More Homes on the Market Act" was introduced in late September by House Representatives Jimmy Panetta (D-CA) and Mike Kelly (R-PA). The bipartisan bill increases the capital gain exclusion amounts on the sale of a principal residence to $500,000 for single filers and $1 million for joint filers and indexes the exclusion for inflation. Because it is a bi-partisan bill, there is a good chance to become law.

The bill will provide the tax relief for long-term homeowners, particularly senior citizens, who have been unable to move because of the onerous tax burden that could result if they were to sell and downsize or move to a retirement home. For working Californians, a home is their biggest and most important investment. However, because the exclusion was set 25 years ago with no indexing for inflation, fewer families have been able to purchase replacement homes using the net proceeds from the sale of their current home, especially for upleg (larger and/or better) houses. This has resulted in fewer affordable homes for young and first-time homebuyers, while driving up prices.

In California, as many as 95 percent of single homeowners and 68 percent of married homeowners who purchased their homes before 2000 could face capital gains tax if they sold their home this year.

For those owners of 1031 rental properties, with a $1 million exclusion if the bill is passed, it may be worth considering to move into a 1031 property as a primary residence for two years and then sell it.

Of course, the above is possible only if the bill is passed. It seems a good progress is expected toward the end of this year. Let's hope for the best.

Palos Verdes Housing Market

During the last week of October, new contracts became consistent though still small in numbers, giving some hopes for the housing recovery. Almost a half of US mortgage borrowers have 50% or more equity, and household savings have increased through the pandemic. There seem to be many buyers with solid financial capacity, and they may be hoping that they can refinance new purchase loans in a few years. More sales would be possible if the market inventory were larger. Those owners who have refinanced during the past few years at a super low rate would face a much higher interest rate if they buy a replacement property. For those reasons, new listings have been extremely few, depleting the inventory, which is not expected to increase through the coming holiday season. On the other hand, buyers are coming back being lured by more reasonable prices, although we do not expect the market price to increase given high mortgage rates. A "reasonable price" is a common attribute for those properties selling in this slumping market. Those properties originally priced too high continue struggling even after multiple price cuts. In short, the importance of original pricing is back.

While the popularity of remodeled properties remains, fixer-upper properties need to be much cheaper. High interest rates raised investors' cost of flipping, and worse, prices may go down in a few months when they are ready to market their flipped houses. Without investors, the housing recovery may be limited. After falling in June and July, contract prices in September and October recovered to last year's level. So, stop gazing at the peak price; today's price is not bad at all; nor do we expect big changes in price for the rest of the year.

The housing market becomes very active in spring every year, except for 2020. We have unusual factors like high interest rates, recession fears and lack of sellers. For more new listings, prices must go up; for higher prices, interest rates must go down; rates would not become lower unless the inflation calms.

The recession fears may give hopes for lower rates; we need to watch how the holiday sales go this year. As large corporations, especially high-tech, have either halted hiring or started laying off; future labor statistics can be a crucial leading indicator.

EV Tax Credit 2023

The new tax credit for electric vehicles will start in January. While there are many good provisions that encourage consumers to buy EVs, there are two requirements that could sharply reduce EV sales: Final assembly and battery components (phasing in) sourced in North America. Currently very few vehicles are qualified for the new tax credit ($7500); especially the majority of foreign makes are not. Although it is intended to help re-gain US manufacturing, it also defeats the main purpose of addressing the climate change. The bill was just passed a few months ago, and it goes into effect without a grace period?

Summary of the new Federal EV tax incentive rules are:

- A vehicle is eligible for 1/2 of the total credit ($3,750) if the vehicle has battery components manufactured or assembled in North America.
- To be eligible for the other $3,750, a vehicle must have critical minerals that were extracted or processed in the U.S. or countries with which the U.S. has a free trade agreement, or use critical minerals that were recycled in North America.
- Final assembly must take place in North America for a vehicle to be eligible.
- Only cars under $55,000 or SUVs, vans, and pickup trucks under $80,000 are eligible.
- The income cap for the credit is $150,000 for single filers, and $300,000 for joint filers.
- Option to apply the credit at point of sale starting in 2024.
- The new credit requirements for battery components and critical minerals will take effect January 1, 2023.

Georgia senator has requested Biden to consider flexibility in the implementation of EV tax credit reforms, and recently made a proposal, which would create a phase-in-period for the EV sourcing and manufacturing requirements. Essentially, the battery sourcing requirement wouldn't go into effect until 2025, and the final assembly requirement would be delayed until 2026. The idea is that if automakers have more time to meet the new EV requirements, more buyers, who purchase electric vehicles, will qualify for the $7,500 EV tax credit.

Japan, Korea, EU are complaining and requesting moratorium and flexible implementation. California incentive still remains.

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A: Active U: Contracted P: Pending S: Sold
Prices in '000s. Source: MLS (as of 11/09/22)