Looking Ahead to 2023

Important trends to maximize headway on an ocean of opportunity to provide much needed housing

By **Don Neff**

As we look ahead to 2023, we hope that the challenges we faced in 2022 like supply chain disruptions, inflation and interest rate increases are behind us. We see important trends to study with rational minds to sort the wheat from the chaff.

Building booms and busts are regional in nature, absent other national and international impacts, like wars and pandemics. It follows that the building industry roller coaster provides both exhilarating highs and punishing lows. Successful builders and investors diligently time their acquisitions and construction activities by taking advantage of interest rate cycles requiring flexibility in their operations. With an expected recession by late 2023 or 2024, prudent builders are limiting exposure, starting construction only upon executed buyer contracts and minimizing standing inventory. The cycle times have already lengthened in 2022, and this will continue well into 2023, even as supply chain disruptions are expected to balance out by mid to late summer.

Job growth creates household formation, which is a direct relationship. The continuing strong employment growth numbers are good for creating demand, though it is becoming pent-up with rising interest rates. Rate hikes have resulted in dramatically lower home prices in 2022. This is an inverse relationship and will also continue in 2023 as the Fed seeks to tame inflationary trends. We do not expect home prices to recover until interest rate relief arrives by way of a recession. The Fed is fighting inflation like a salmon swimming upstream against the flow of easy money from the United States government. These are conflicting policies.

There will be a continuing mismatch of pricing, affordability and locational preferences. While senior cash buyers are insulated from interest rate fluctuations, younger millennial buyers have paused until interest rates recede. In perspective, however, 6 to 7% mortgage rates are still at generational lows, relative to prior inflationary cycles. We may not see 3 to 4% mortgage rate programs for a long while without creative buy-down programs. These were popular back in the 1980s when rates were pushing 18% or more. Even then, buydowns to 12% coupled with dual master designs for two-income buyers were welcome solutions for builders and buyers alike.

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Certainly, good news is that remote work technology solutions will continue improving and provide many opportunities to achieve work/life balance with healthier lifestyles rather than sitting in two-hour one-way commuter traffic to and from the office. In fact, with location flexibility buyers can find more distant yet affordable communities, with the advantage of working from home. Some corporate offices will require repurposing. Senior team leaders will also need to adjust, learning how to manage remote workers and keeping their teams together.

Even while for-sale housing has suffered pricing declines, partially sidelining buyers, this has enhanced demand in the rental market. People need to live somewhere and growing millennial families will need larger rental units—in either Multifamily Apartment (MFA) communities or Single Family Detached (SFD) build-to-rent configurations. The out migration from high-priced places to more affordable markets will continue, pushing strongly into the Southeastern U.S. Studies show that of the top 10 markets for migration, five are in Florida (in this order: Miami, Tampa, Cape Coral, Sarasota and Orlando), three are in other business friendly states (Nevada, Arizona and Texas) with strong regional economies and two are in California (Sacramento and San Diego).

Major building booms in business-friendly Florida markets have launched again, with many new rental and condominium projects breaking ground, limited only by access to capital and insurance.

Natural disasters have constrained global and domestic insurance capacity through recent claims activity—limiting affordable policy options. The resulting surge in property/casualty insurance premiums has temporarily stalled many large projects. And it was already an extremely hard insurance market. In the face of the Surfside tower collapse (likely driven by HOA deferred maintenance), legislative reforms in Florida have been enacted, and following Hurricane Ian we expect another round of stronger building codes and land development regulations. This is not dissimilar when the Northridge earthquake hit in 1994, resulting in significant structural code updates with significant construction cost increases.

All that said, builders are measured risk takers, inventive and optimistic, trimming their sails to maximize headway on an immense ocean of opportunity to provide much needed housing for hungry buyers in many diverse markets. B&D

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