Capital Markets Group

Points to Ponder

September 17, 2021

The First Tee...

Transitory Tapering…the financial market has become obsessed with the Fed ending its monetary stimulus programs, deceleration is a more accurate description:

- A reduction in Central Bank's bond buying activity is expected to commence in the next few months, but when the quantitative easing process is completed is more relevant:
  - The market has been flooded with liquidity the Fed has injected into the market, the huge cash infusion has pushed stock prices to record highs and bond yields close to record lows:
    - The Fed took ten months to wind down the $85 billion monthly bond purchase program from the last recession:
      - The bond buying tapering did not commence until almost four years after the economy began its recovery in 2009.
- **Tapering is not Terminal**…once the monthly bond buying program is concluded the Fed will continue to re-invest Treasury and mortgage-backed securities as the balance-sheet holdings mature:
  - The Fed finished tapering in 2014 but did not start reducing the number of holdings on its balance-sheet until October 2017…this reduction lasted almost two-years, with holdings declining from $4.5 trillion to $3.8 trillion:
    - The current Fed bond buying program re-started in September 2019, the balance currently stands close to $9 trillion:
      - The larger question will be when will the Fed begin to reduce the bond holdings on its balance-sheet:
        - The Central Bank is expected to hold almost 25% of all U.S. Treasury debt outstanding for the foreseeable future (long after tapering ends).
- **Benchmark Bandy**…the conclusion of the current Fed bond buying program would be the catalyst to begin discussions about increasing the Federal Fund rate target (currently at a 0% to .25% rate range):
  - The Fed increased the Fed Funds target for the first time fourteen months after ending QE buying:
    - The Fed had held the target at 0% to .25% for seven years…the increase in December 2015 was the first since 2006:
      - The current outlook is predicting the first benchmark rate increase will occur during the first quarter of 2023.
- **The Party's Over**…ultra-low interest rates have been joined by historic debt and extended duration:
  - The cheap money has been universal, low interest rates have forced investors out the credit curve:
    - Tapering and the end of low rates will impact asset values, beginning with periphery items such as cryptocurrencies and meme stocks, followed by the broader market…the inflation wild card could also be a key player in the drama.

Just got paid today, got me a pocket full of change…pandemic labor shortage is pushing the service sector $15 per hour minimum wage into the mainstream:

- Ten states have passed laws raising the minimum wage to $15 over the next few years:
  - Large private employers have also followed suit…including Amazon, Walmart, Target, Best Buy and Chipotle:
    - President Biden campaigned for raising the federal minimum wage from $7.25 to $15…but lacks enough Congressional support:
    - It is estimated that 32 million workers would benefit from a $15 minimum wage by 2025…as 65% would still be earning less:
      - About 40% of the U.S. workforce lives in states that have mandated a minimum wage increase to $15 per hour.
- **Take this job and…**job vacancies exceeded new hires by 4.3 million in July (a new record for data going back to 2000)
  - The $15 threshold is being hit due to supply and demand or state and local wage laws:
    - The share of workers earning less than $15 per hour is declining by 1.5% per month so far this year, almost double the rate seen during the first seven months of 2019…only 20% of U.S. workers still make below $15 per hour:
      - Employers who are resisting raising their minimum pay rates have been struggling with labor shortages *(cost control conundrum!)*
- **Inflation Indiscretion**…rising wages and prices do not work in a vacuum…inflation can be detrimental to both
  - CPI moving above 5% is eroding earnings value…despite pay raises, real average hourly earnings are down .9% from August 2019.
  - Labor is the largest component in the cost of producing goods and services…combined with supply-chain shortages and rising commodity costs, price inflation is under the most upward pressure in decades:
    - According to the National Federation of Independent Business, about half of small businesses have increased prices since June.

At the turn...

The Back Nine…

Own to Rent…despite the pandemic and eviction ban, apartment building ownership has become attractive as occupancy and rents have soared ***(landlords turning lemons into lemonade)*****:**

- National rent rates rose an annualized 10.3% in August…the first double-digit increase in 20 years:
  - The accelerated pace of rising rents has been influenced by several factors…these include:
    - The spike in home prices (up 18.5% year-over-year) has priced-out many household's affordability to own a home, forcing them to pay higher rent rates…this is particularly prevalent for middle and lower income class workers.
    - Younger adults who have been living at home during the pandemic are moving into their own apartments:
      - Many of these renters leaving family households had been working from home and now are returning to the office.
    - There has been a limited growth in new apartment construction, with demand outstripping the supply:
      - **Apartment occupancy rates (a key determinant for rent levels) hit a record high of 97.1% during August:**
        - Household incomes for new renters at professionally managed properties rose to a new high of $70k per year (raising the housing budget).
  - The large discounts on rent tenants enjoyed last year are only a distant memory today.
- Most segments of the multi-housing market are looking strong (after enduring tough times in 2020 and early 2021):
  - Multifamily property values have increased 13% since before the pandemic…more money is being currently invested in apartment buildings than any other type of commercial real-estate (according to Real Capital Analytics):
    - More renters are migrating back to the cities, but the suburban markets are also prospering with high home prices.
- **Alone Again** (naturally)…some individual investor/landlords have been excluded from the rent rally:
  - These investor/owners comprise almost 41% of all rental properties…and a majority of single-family rentals:
    - These landlords do not have the scale to absorb unpaid-rent issues as easy as corporations with thousands of units:
      - A survey of 1000 small rental owners, by the National Rental Home Council, showed that one-third of these owners had sold or were planning to sell a rental home due to the negative impact caused by the eviction moratoriums on their business.
- **Lending Lifelines**…mortgage lending to multifamily owners has returned to pre-pandemic levels:
  - A large portion of pandemic multifamily lending was led by government-backed mortgage programs
    - There has been a ramp-up of other lending sources over the past few months in the multi-family sector.
- **I'm from the government and I'm here to help** (promises, in the dark)…in many cases, for landlords with loan issues the government has crafted forbearance programs to help cover low rent collections:
  - These programs were administered by The Department of Housing and Urban Development, Fannie-Mae and Freddie-Mac…the Fed has purchased over $10.5 billion in mortgage-backed securities since last spring (encouraging more lending):
    - Congress has also provided $46 billion in emergency rental assistance…a majority of which has been paid to landlords.

19th Hole...

Everything is in a state of flux, including the status-quo.

Robert Byrne

Ross Elford, First Vice President

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