**A picture containing text, night sky

Description automatically generatedLos Angeles County Housing Report:**

**A 2023 Forecast**

**December 27, 2022**

**HAPPY NEW YEAR!!! Now, what does that mean for**

**Los Angeles County real estate?**

**First, let us look back at what happened in 2022 in terms**

**of inventory, demand, luxury properties, and the Expected**

**Market Time.**

**Active Inventory**

**After starting the year with a record low number of available homes to purchase, the inventory soared higher but is still far below pre-pandemic levels.**

The year started off with an active inventory of 4,026 homes, the lowest level to start a year since tracking began in 2012. The average start prior to the pandemic was 10,079 homes, so there was nearly nothing available in January. Yet, with a rapidly rising mortgage rate environment, demand slowed substantially as the year progressed. After starting 2022 at 3.25%, rates eventually surpassed 5% in May and eclipsed 6% in June. As a result, the inventory rapidly grew from mid-April until it peaked at the beginning in mid-August at 11,112 homes, a rise of 176% from January 1st. The 3-year average peak prior to COVID (2017 to 2019) was 13,909 homes, 25% higher than this year. From August through year’s end, the number of available homes decreased to 8,612, slightly higher than end of December 2020 levels and 11% below the 3-year average end to December of 9,687.

The inventory would have dropped even more during the Autumn market, but rates eclipsed 7% in October and took an even larger bite out of demand. Many sellers stagnated on the market without success. That changed during the holidays as rates dropped into the lower 6’s, and the inventory dropped by 2,178 homes in the last 6 weeks of the year, down 20%. The inventory is poised to drop to 8,000 upon ringing in a New Year, still not enough available homes to purchase.

COVID suppressed the inventory in Los Angeles County in 2020 and 2021. There were 7% fewer homes placed on the market in 2020, or 6,124 missing sellers, and 2% fewer in 2021, or 1,704 missing sellers. With COVID taking a back seat to life in 2022, this was to be the year where more homeowners were poised to enter the fray. That did not occur as many homeowners “hunkered down” and opted to not move. Homeowners may not have been in love with their homes, but they certainly were in love with their loans. An astonishing 89% of California homeowners who have a loan are enjoying a

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fixed rate at or below 5%. 71% are at or below 4%. And a very fortunate 29% have a rate at or below 3%. From January through November, there were 16% fewer homes placed on the market compared to the 3-year average prior to COVID (2017 to 2019), 13,893 fewer. This trend has grown significantly as the year progressed. In November there were 26% fewer FOR-SALE signs.

The inventory crisis continues, not because of excess demand, but due to homeowners opting to “Hunker Down.”

**Demand**

**After two years of heightened demand due to historically low mortgage rates, demand did an about face and fell to its lowest levels since the Great Recession.**

Demand for Los Angeles County homes (the number of pending sales over the prior month) followed a normal strong housing pattern. The Spring Market was the hottest, followed by the Summer Market, then the Autumn Market, and, finally, the Holiday Market. Demand followed this seasonal pattern which mirrors when homes are placed on the market. The most come on during the spring and the least come on during the holidays.

At the beginning of the year, demand for Los Angeles County homes (the number of pending sales over the prior month) was muted compared to 2021, down 12%. It was still 20% stronger than the start of 2020, prior to COVID impacting housing. At first, demand was muted due to the lack of available homes to purchase. There were simply not enough homes on the market compared to the sea of buyers looking to purchase. But that dramatically shifted as the year progressed and mortgage rates spiked, considerably impacting home affordability. Even with additional purchase options, more and more homeowners accumulating and stagnating on the market without success, demand did not climb much.

After starting the year at 4,026 pending sales, demand peaked at the very end of March at 5,524, its lowest peak since 2014. It was 18% lower than last year’s 6,773 peak, and 9% below the 3-year average peak prior to COVID (2017 to 2019) of 6,042. Demand improved in August when rates dropped below 6% for a few weeks. As rates rapidly increased in September and October, demand plunged to lows not seen since the initial lockdowns of the Pandemic and the Great Recession.

Demand has been deeply impacted by skyrocketing mortgage rates. To put it in perspective, a $900,000 mortgage at 3.25% to start the year had a monthly payment of $3,917. It climbed to $5,541 per month when rates hit 6.25%, a jaw-dropping $1,624 more per month compared to January. It then climbed to $6,201 per month when rates jumped to 7.35% in October, an additional $2,284 per month, or $27,408 per year. Even with rates marching back down towards 6% in December, demand remained muted.

Within the past two weeks, demand dropped by 169 pending sales, or 6%, and now sits at 2,661 pending sales, the lowest reading since April 2020, and the lowest level for an end to December since tracking began in 2012. Last year at this time, demand was at 4,551 pending sales, or 71% higher. The 3-year average end to December prior to COVID was 3,542 pending sales, or 33% higher.

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**Luxury End**

**The luxury home market was at a record pace but fell short by 14% through November as luxury slowed substantially to wrap up the year.**

2021 was a record-setting year for luxury sales above $2 million in Los Angeles County, eclipsing the prior year by 73%. It looked like it was going to be another record setting year in 2022, up 15% through April, but that changed as financial markets became much more volatile as the year progressed. Through November, luxury sales were down 14% compared to 2021’s record pace. It was still up 53% compared to 2020, the second-best year for $2 million plus sales; yet, luxury sales fell short compared to 2020 starting in July.

The luxury home market started off extremely strong. In the first quarter of 2022, there were 19% more luxury sales year over year. The second quarter of 2022 was down 5%. It was down by 32% during the third quarter, and down substantially during the fourth quarter, off 41%.

During the pandemic, the luxury market evolved to an incomprehensible fast pace. Luxury homes that typically took months upon months to sell were selling almost instantly. In April, the Expected Market Time (the time between coming on the market and opening escrow) dropped to 75 days for homes priced above $2 million. As the volatility of the financial markets took hold, the luxury inventory rapidly increased as demand dropped. It surpassed the 100-day Expected Market Time level in June and breached 200 days in November.

As of the end of December, luxury demand is at 220 pending sales, 44% lower than last year. The inventory is at 1,787 after plunging by 11% during the last two weeks, 38% higher than last year. The Expected Market Time for luxury finished the year at 244 days.

**Expected Market Time**

**The amount of time it took to sell a home continued to grow longer as the year progressed.**

The Expected Market Time, the amount of time it would take to place a home listed today into escrow down the road (based upon current supply and demand), started the year at an extremely fast pace of only 33 days. It was an insane market that heavily favored sellers. Homes were flying off the market and buyers were willing to pay way over the asking price to obtain a home. It reached a record low level of 30 days in March.

Yet, as mortgage rates continued to climb, demand receded, the inventory rose, and the Expected Market Time grew. It surpassed 40 days in May, after 15 months below 40-days, an insane, nearly instant pace. It eclipsed 50 days in early June, 60 days in late June, and 70 days in July. It retreated slightly in August when rates dropped back below 6%, but then increased as rates soared in September and October. It surpassed 100 days in November before retreating to 97 days by year’s end as rates eased to the low 6’s to finish off the year. In the past two weeks, the Expected Market Time for all of Los Angeles County dropped from 103 to 97 days, a bit slower than the 72 days posted in December 2019.

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**The 2023 Forecast**

**A subdued year for housing.**

After two years of runaway home prices, the Federal Reserve stepped in to reverse engineer rampant inflation and has been utilizing the housing market as one of the main economic engines to achieve its objective. They increased the Federal Funds Rate from nearly 0% at the start of the year to 4.5% in December, its highest level since 2007 and its fastest rise in more than 40 years. Long-term mortgage rates responded rising from 3.25% at the start of the year to over 7.25% in October, more than doubling. They eased below 6.5% in December as inflation numbers began to improve for the second consecutive month. Yet, inflation remains elevated, up 7.1% year over year through November. It hit 9% in June. Core inflation, less the volatility of food and energy, is currently at 5.96%, after reaching 6.7% in September. The Federal Reserve’s core inflation goal is 2%, so they have a long way to go. The overall United States economy has remained resilient backed by a very strong labor market, sky-high job openings, low unemployment, and increasing consumer spending. Yet, the high-interest rate environment has been rocking the financial markets. The unrelenting Federal Reserve policies will eventually instigate an economic recession in 2023 that will most likely begin by mid-year. As a result, the local housing market is going to be subdued in 2023, especially in the first half of the year. Here is the forecast:

* **Active Inventory** – the year will begin with close to 8,000 homes, the third lowest start to a year since tracking began in 2012. Only the start to 2021 and 2022 were lower with 6% and 45% less respectively. Prior to COVID, the average start was 10,079, with 26% more available homes to purchase. The inventory crisis will continue. Expect the inventory to rise on the back of diminished demand, only to be hampered by the “Hunkering Down” effect where homeowners opt to stay in their homes due to their underlying low mortgage rates. More homes will enter the fray once mortgage rates drop below 5.5%, most likely sometime in mid-2023. Expect the active inventory to peak around August eclipsing 12,000 homes, well below the 13,900 home peak average prior to COVID.
* **Demand** – due to the persistent high mortgage rate environment, buyer demand will continue to be muted. With less competition and pressure on affordability, buyers will be extremely cautious and unwilling to stretch above the asking price. They will be looking very carefully at price; so, expect home values to drop between 6.5 to 8.5% for the year. There is a strong potential for mortgage rates to dip below 5.5% by the summer due to the combination of a slowing economy and falling inflation. With lower rates, demand will strengthen along with affordability. The combination of lower rates and lower home prices will prompt this rise in pending sales activity.
* **Housing Cycle** - the housing market will follow a normal housing cycle. The strongest demand coupled with the highest levels of new sellers will occur during the Spring Market. This will be followed by slightly less demand and a continued new supply of homes in the Summer Market. From there, demand will drop further along with fewer homes entering the fray in the Autumn Market. Finally, all the distractions of the Holiday Market will be punctuated with the lowest demand of the year and few homeowners opting to sell.
* **Closed Sales** - the number of successful, closed sales will decrease by 6.5 to 8% compared to 2022, with around 51,000 (the lowest sales volume since 2008).
* **Luxury Market** – luxury housing will be sluggish and will continue to transition to normal, longer market times, often taking months to procure a sale. The Spring Market will be the strongest for luxury and will become a bit more sluggish and susceptible to Wall Street volatility during the second half of the year.
* **Interest Rates** – look for mortgage rates to start around 6.5% and slowly, but methodically drop as the economy slows, and inflation gradually eases. As the United States economy slips into a recession, expect rates to fall to below 5.5% and may even fall to below 5% by year’s end. If mortgage rates recede to these levels, housing will stabilize, and home values will stop their decline.
* **Distressed Inventory** – do not expect a wave of foreclosures. The number of active forbearances has dwindled to very low levels. Of the over 7.8 million forbearance exits, 91% are either performing monthly or paid off their loans. Only 1% are in active foreclosure, less than 100,000 across the United States, and the current delinquency rate is at its lowest level in decades. Expect slightly more distressed sales in 2023 as there are some homeowners who will be susceptible to an economic downturn. Nonetheless, the total numbers will be very low and undetectable in the broader housing market.

The bottom line: 2023 will continue where housing in 2022 left off, extremely sluggish. Housing is particularly interest rate sensitive, where even with anemic, low inventory levels, values will still drop due to severe affordability issues. Values will stop retreating only when mortgage rates drop below 5.5%, instigating more demand and more homeowners to stop “Hunkering Down” and list their homes at a more normal rate. The housing market is no longer insane, homes are for the most part not selling above their asking price, not selling immediately, not selling with multiple offers, and there is far less activity and buyer competition.

Happy New Year!

Sincerely,   
**Steven Thomas  
Quantitative Economics and Decision Sciences**

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