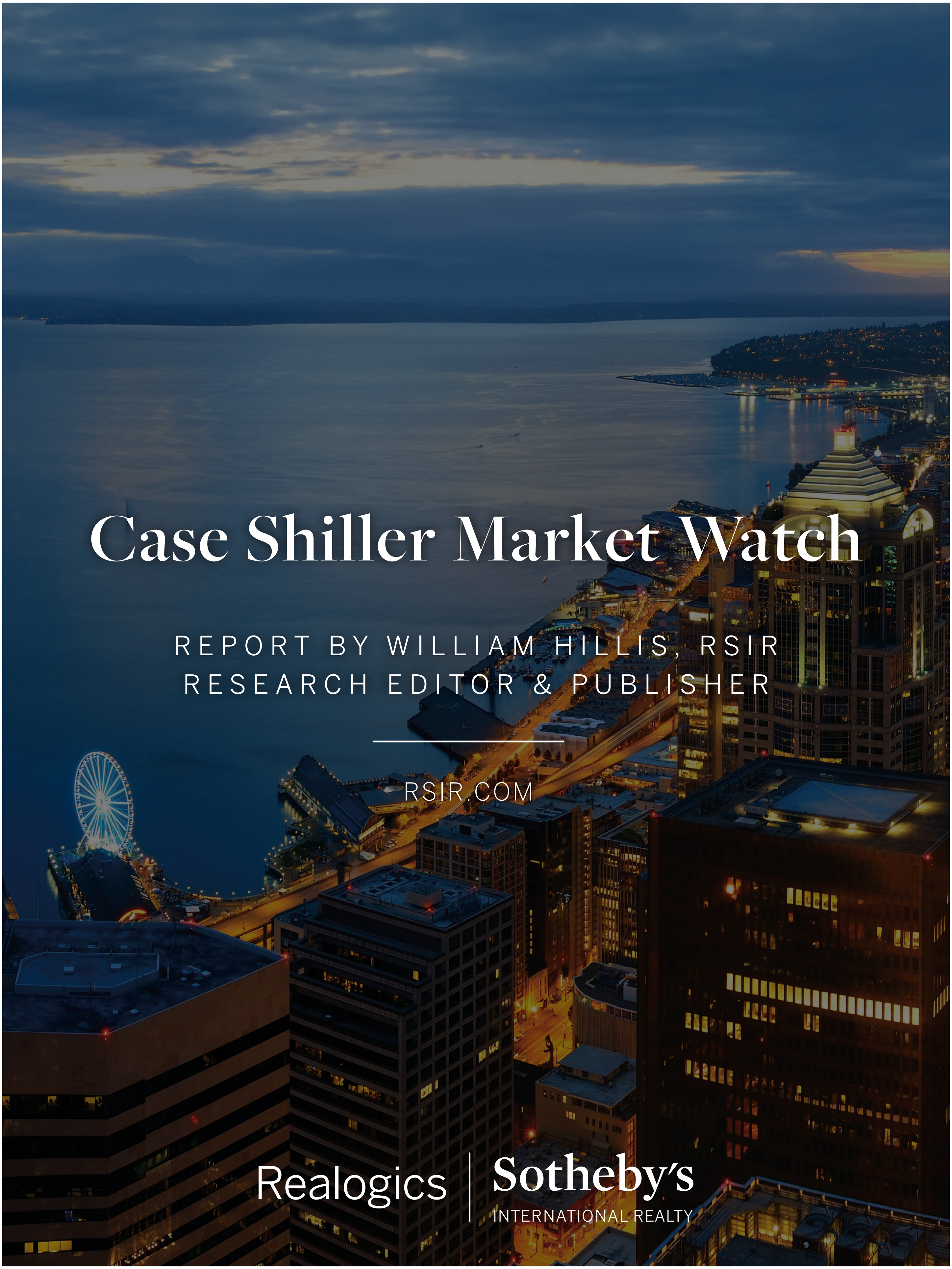

Case Shiller Market Watch

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Another year of strong home price growth amid a shift to remote work.

With 2020 behind us, we will not belabor the COVID-19 crisis too much further in this year's annual market report. Instead, we will take an in-depth look at two very different views of how the emerging work-from-home trend may reshape our communities. Prior to that, we will explore the facts surrounding two recent Seattle Times articles concerning last year's migration to and from the city of Seattle. First however, we begin by

The Index reported that Seattle ended the year ranked second in the nation for residential price growth for an eleventh straight month. At third place, San Diego failed to close its narrowing gap with Seattle.

Chart A

One-year Changes In The Monthly S&P
Corelogic Case-shiller Indices Of Seattle And Four West Coast Cities

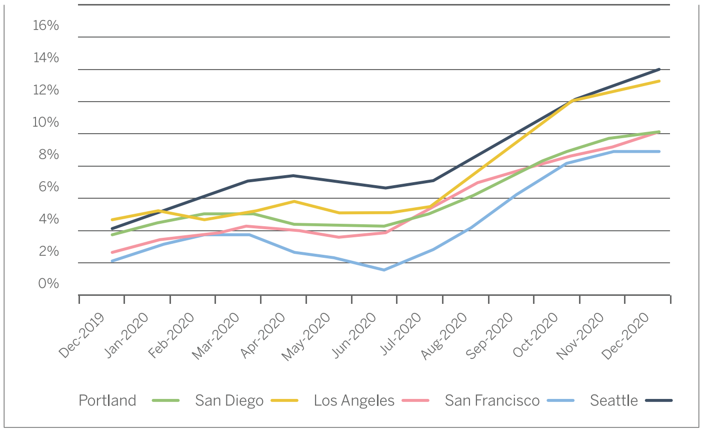
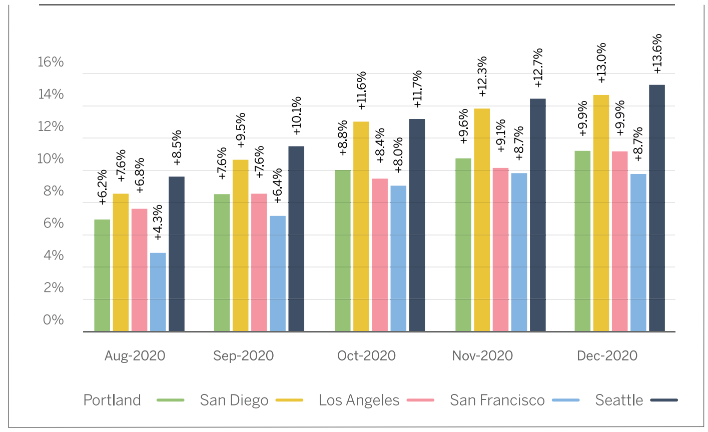


Chart B

West Coast residential price trends year-over-year; Case Shiller Home Price Index 12-month growth.
August to December 2020



discussing the December Case-Shiller Home Price Index for the Seattle Metropolitan Statistical Area ("Seattle MSA").

Phoenix continued to lead the nation, with the usual caveats about lingering base effects on that city's recent price gains. West Coast cities other than Seattle and San Diego continued to see year-over-year price increases of less than 10 percent.

The CoreLogic Case-Shiller index results published by S&P Dow Jones on 26 January showed year-over-year growth on the West Coast residential price indices advancing to 13.6 percent from 12.7 percent at Seattle; to 13.0 percent from 12.3 percent at San Diego; to 9.9 percent from 9.6 percent at Portland, Oregon; to 9.9 percent from 9.1 percent at Los Angeles; and remained flat at 8.7 percent at San Francisco (Charts A and B).

Craig J. Lazzara, Managing Director and Global Head of Index Investment Strategy at S&P Dow Jones Indices observed,

> "2020's 10.4 percent gain marks the best performance of housing prices in a calendar year since 2013. From the perspective of more than 30 years of S&P CoreLogic Case-Shiller data, December's year-over-year change ranks within the top decile of all reports."

Repeating his speculation from the November 2020 Case-Shiller report, Lazzara noted,

> These data are consistent with the view that COVID has encouraged potential buyers to move from urban apartments to suburban homes. This may indicate a secular shift in housing demand, or may simply represent an acceleration of moves that would have taken place over the next several years anyway. Future data will be required to address that question.[2]

“It Isn’t An Exodus”

In his 22 February 2021 Seattle Times article, Times “FYI Guy” Gene Balk reported findings of the Cleveland Federal Reserve Bank[3] on precisely the movement described above by Craig Lazzara. Among those findings, Balk described the peculiarity that while Seattle joined other leading cities whose monthly inflows of new residents had steeply declined, the monthly outflow of residents from Seattle was unremarkable at one person per 100,000.

> *“Seattle tied for the second-biggest drop in people moving into its dense, urban neighborhoods,” said Balk. Yet “while there has been an uptick in the number of people leaving urban neighborhoods in Seattle ..., it isn’t anywhere near what you’d describe as an exodus.”* [4]

The geographies analyzed in the Cleveland Fed’s report cited by the Seattle Times are metropolitan statistical areas. The Seattle MSA comprises King, Snohomish, and Pierce Counties, not just the city of Seattle. By comparison, L.A.’s MSA comprises Los Angeles and Orange Counties in California. The San Francisco MSA comprises the city of San Francisco, the Peninsula, East Bay, and Marin County. These areas were first established by the federal executive Bureau of the Budget (later, the Office of Management and Budget) in 1949.

Quick Takes

At RSIR, we continue to maintain that the movement to the suburbs does indicate a shift in secular demand as suggested by Craig Lazzara at S&P/Dow Jones. This is consistent with our own observations since spring 2017.

The geographical diversity of the Seattle MSA means that demand for homes can shift away from the city of Seattle without its residents exiting the metropolitan area.

The mix of urban, suburban, and exurban development within the MSA means that the Case-Shiller index for Seattle does not only reflect residential price trends inside the city, but also prices in suburban and exurban towns beyond the city.

The origins of the high-tech industry in both the Bay Area and the Puget Sound region disconfirm the notion that only urban environments allow talent to concentrate.

Homebuying demand has not fled the Greater Puget Sound. It is simply realigning with the preferences of the millions who enjoy the quality of life this region offers.

In the ensuing decades, some of these cities developed much more quickly and densely than the others. With two large, navigable lakes to the east, Seattle's topography historically presented obstacles to its development. The states of Washington and Oregon both enacted growth management acts that added regulatory constraints to the physical ones.

Today, the Seattle MSA's geographic diversity still comprises such remote exurban locations as South Prairie, Darrington, and Skykomish. Vashon, Maury, and Fox Islands are included as well, as are satellite cities and suburban population centers whose densities generally fall short of "urban." That is why demand for homes can shift away from the city of Seattle without its residents exiting the metropolitan area. That this is what has been happening was confirmed in March by Seattle Times reporter Danny Westneat, using a different approach to evaluate migration: by analyzing U.S. Postal Service change of address requests. Westneat found that "the number of households filing change-of-address requests to move into Seattle was about the same as it was in 2019. But the number leaving the city limits soared, by 36 percent," quite a difference from the monthly outflow of one person per 100,000 reported by the Cleveland Fed.

> In all, 43,350 households requested moves into the city in 2020, and 69,432 moved out. That means the net migration out of the city was more than 26,000 households. In a city with about 351,000 households, that's a big change, a potential decline of seven percent.

This Fed's method failed to detect this outmigration because those residents never left the Seattle MSA. Instead, "nearly 10,000 households in 2020 [moved] to the suburban crescent of Bellevue, Shoreline, Kirkland, Bothell, Lynnwood, Renton, Redmond, Edmonds and Kent. More than 1,700 Seattle households moved to Tacoma, with about 1,000 moving the other way, for a net shift to Tacoma of 700 households."[6]

The mix of urban, suburban, and exurban development within the MSA means that the Case-Shiller index for Seattle does not only reflect residential price trends inside the city, but also prices in suburban and exurban towns beyond the city, including many that are sparsely populated.

CONCENTRATION OR DISINTEGRATION— **WHICH WAY FOR THE CONNECTED WORKFORCE?**

The past year's enormous disruption to services, commerce, and everyday work schedules, and the resulting impact on office and living space vacancies has prompted soul searching among local business leaders and government officials. Advisors have stepped in to make sense of it all and help others to chart a course forward, prompting a new debate centered on working from home in the aftermath of COVID-19. The contestants in this debate propose alternative paths to the destinies of Seattle and other metropolitan regions.

RICHARD FLORIDA **SEES THE LIGHT**

Richard Florida is a familiar voice on urban development in the U.S. Florida is a professor at the Rotman School of Management at the University of Toronto and a Distinguished Fellow at NYU's School of Professional Studies. Two decades ago, he developed and popularized the concept of a "creative class" and its relevance to urban redevelopment. Florida's ideas have influenced an entire generation of city planners and developers. As so much of his work has centered on cities, it happens that the work-from-home response to the COVID-19 crisis, and the potential endurance of that trend even as the public health threat diminishes, have together posed a challenge to Florida's longstanding message.

While acknowledging the durability of a work-from-home shift, Florida's initial response framed that shift as a contingency that has not diminished the influence of cities. "What remote work does is to enable people who might've moved to outlying suburbs before to consider moving to entirely new metropolitan areas," Florida declared in a February interview.[7] Ambitious youth will continue to move to cities, he argued. "They are not going to live in isolated suburbs, they're not even going to live in small cities." All the pandemic did was to make moving to cities more affordable to this cohort. They will move in as families are moving out. "What we'll see are lots of young people working remotely and living in big cities. Mainly because this is where most of the remote work jobs or jobs that are doable as remote work are located." The only adverse impact Florida saw was "reduced demand for offices and office space."

Florida insisted that a migration to the suburbs or even more remote locations is not on the cards. "I have long said that we will see the rise of the rest given the incredible expensiveness and affordability ***[sic]*** of existing superstar cities. But it's not going to be the rise of everywhere. It's going to be the rise of a dozen or two dozen places." Florida contended that cities, not the suburbs or the exurbs would continue to draw talented remote workers, "because talent concentrates and clusters, and needs to be around other talent."

Yet the origins of the high-tech industry in both the Bay Area and the Puget Sound region disconfirm the notion that only urban environments allow talent to concentrate in this way. And as reported by Westneat in the ***Times***, last year's outmigration from Seattle "wasn't to Austin or Charlotte or any of the other supposed 'Zoom cities.' It was to Bellevue and Shoreline and Kirkland." [8]

> The top 10 destinations for Seattle leavers, measured by 'net migration,' were all within 35 miles. No. 1 was Bellevue. According to the USPS, 3,521 Seattle households decamped to Bellevue in 2020, while 1,941 Bellevue households moved into Seattle. The difference, or net migration, is a 1,580-household shift from Seattle to Bellevue.

That's triple what the shift across the lake was in 2019. Speculation grew that COVID-19 had already changed the relationship between work and workplace—that if the skilled workers that companies need were to demand remote work, their employers would strive to meet that demand. [9]

By March 2021, Florida himself appeared to have been converted by such a vision. In a report for the ***Wall Street Journal***, Florida and Adam Ozimek wrote, "Surveys of employers and employees alike suggest a fundamental shift. While forecasts differ, as much as a quarter of the 160-million-strong U.S. labor force is expected to stay fully remote in the long term, and many more are likely to work remotely a significant part of the time." [10]

Just weeks before, Florida seemed certain that no more than a couple dozen superstar cities would reap the benefits of a decentralized workforce. Yet in March, he proclaimed the benefits as reaching to not only second- and third-tier cities, but to even smaller towns, such as Bozeman, Montana; Jackson Hole, Wyoming; Truckee, California; and New York's Hudson Valley:

> This rapid reordering … is affecting the economic fates of cities and communities large and small, but especially smaller ones: They can now develop and build their economies based on remote workers and compete with the big-city business centers and West Coast high-tech meccas that have long dominated the employment landscape.
>
> ….
>
> Skilled techies and knowledge workers, in particular, can enjoy the kind of freedom and flexibility that used to be available only to successful novelists, artists and inventors—the ability to work when and where they want to. They can increasingly 'vote with their feet,' selecting the kinds of places that best meet their needs without worrying about what they can earn in the local labor market.

Kim-Mai Cutler: "We'll see a huge step" toward "a fully remote or decentralized model"

As Florida was clarifying his response to the COVID-19 dislocations, an alternative view was advanced by Kim-Mai Cutler. (Florida subsequently acknowledged Cutler's insight in his WSJ article.) A partner at San Francisco-based venture capital firm Initialized Capital Management LLC, Cutler has more than a decade of prior experience as a technology author and editor.

Writing for the Initialized blog in January, Cutler described a likely outcome informed by years of her own research within the firm, but with relevance far beyond the venture capital business.[11] She begins with an assertion that "Peak Bay Area was seven years ago in 2014." As she explains, this milestone was a step along the path toward decentralization of newer companies with IPO plans, a journey that began in the mid-2010s when, as "the stresses and pressures of the rising cost of living became widely known, it became much harder to compete against Big Tech companies on recruiting and so [the previous trend of concentration in the Bay Area] began reversing as companies began spreading out."

Aside from Cutler's thesis, this process was evident locally as the Seattle MSA was among the first regions to benefit from the Bay Area exodus.

Cutler observes that decentralization away from the Bay and California generally has implications for tax revenues in that state, which rely heavily on income and capital gains taxes of the same sort now threatened by the Washington State Legislature and the governor's office. (Read more about the capital gains tax passed during this state legislative session in our next section.)

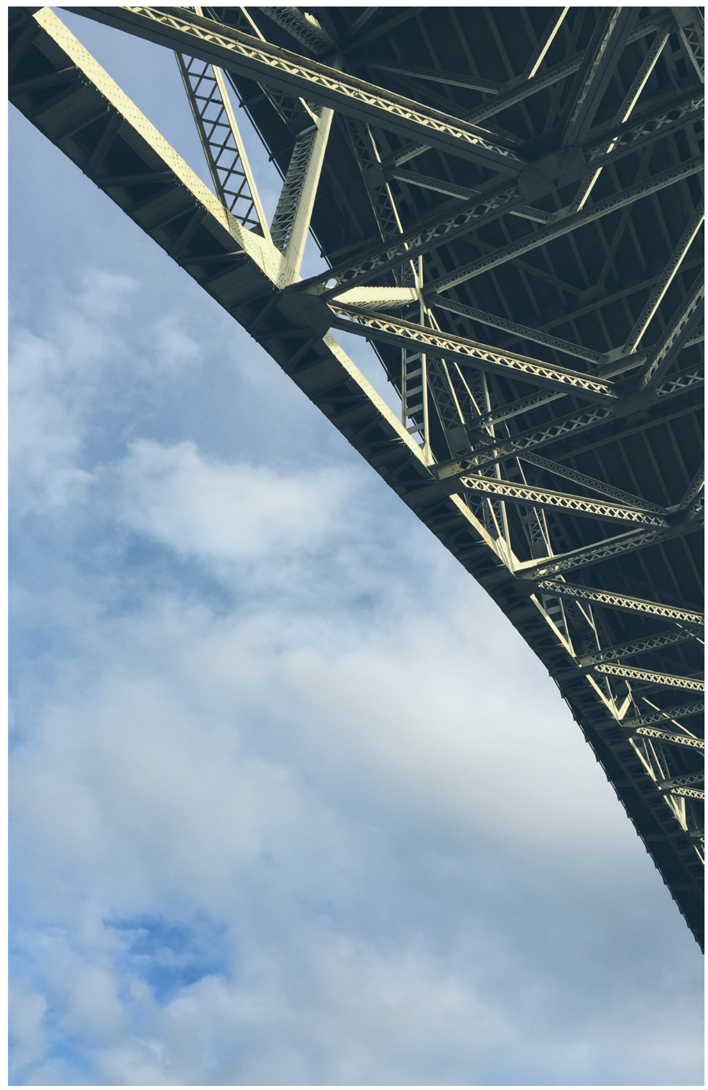
However, this ongoing trend reported by Cutler took a new turn with effect from COVID-19. "Post-pandemic, we expect to see the remote or decentralized share [of portfolio companies] to nearly double to 36 percent … Two-thirds of our portfolio companies will still use an office, but we'll see a huge step change pre- and post-pandemic, with more than one-third of companies moving to a fully remote or decentralized model."

Asked, "If you were to start a company today, where would be the most beneficial place to found it in the interest of the company's long term success," 41.6 percent of Cutler's respondents in 2020 named the San Francisco Bay Area. Just over ten percent named Seattle. In her 2021 survey, 42.1 percent chose a decentralized or remote location model. The share choosing San Francisco dropped to 28.4 percent, with those choosing Seattle numbering just 1.3 percent.

While Westneat's analysis challenges Florida's speculation on the basis of observed trends, Cutler's thesis challenges it on the basis of employee demand and management strategy:

> There's a lot of media coverage about singular cities like Austin or Miami displacing the Bay Area and I am generally skeptical of that because it … assumes a more centralized office model, albeit in cities outside the Bay Area, and we suspect that employee pressure for remote work will probably drive companies towards allowing for more distributed structures. So even if a company technically moves its headquarters to a different city, it's unclear how many actual jobs physically located in that headquarters city the company will attract if the industry continues to embrace a more remote structure.[12]

Cutler writes with portfolio companies in mind, especially technology-driven portfolio companies of the kind for whose location Seattle has historically competed with the Bay Area. Consequently, her analysis is equally apt when applied to Seattle and its satellite cities in the Puget Sound region. Cutler adds a warning for cities that seek to attract these companies and their employees. "If the technology industry moves into a city and doesn't deliver a better quality of life for the average voter or constituent, a backlash and organized political opposition will emerge. This is what happened in San Francisco over the course of a decade and over time, I wouldn't be surprised if the same thing happened in other cities."



A YEAR THAT REDEFINED **BOUNDARIES**

In this report, we have avoided many of the intractable subjects that arose in the past year. As it turned out, 2020 demonstrated just how difficult it is to predict the economic impacts of catastrophic events and broad public policy interventions. Instead, we have narrowed our focus to one result that we anticipate will be among the most enduring: the behavioral impacts of working from home on the demand for homes in our region. We have recounted several opposing views. One supposes that cities still retain their centrality to the concentration of talent. Others factor different measures of human choices that show workforce participants redefining what it means to gather and collaborate. In all the above, the good news is that homebuying demand has not fled the Greater Puget Sound. It is simply realigning with the preferences of the millions who enjoy the quality of life this region offers.

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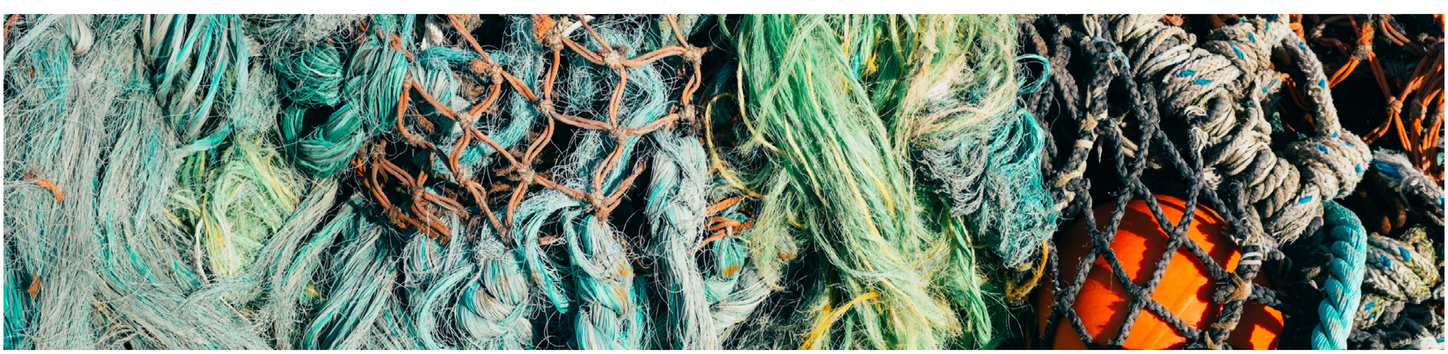

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