SPRING / SUMMER 2014

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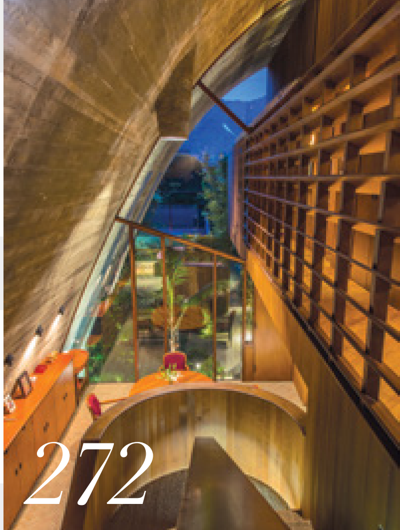

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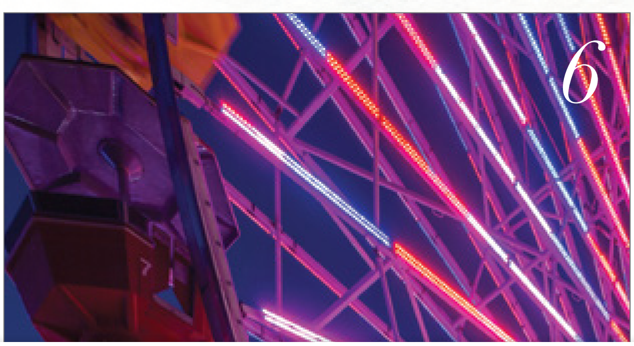

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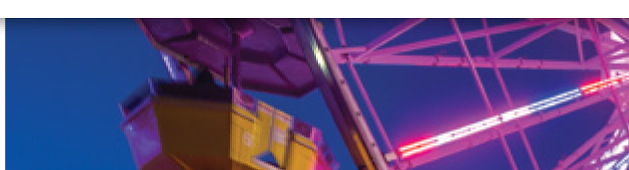

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DEMANDING MORE

Both low inventory and cash define the current housing market and the terms of sale are now as important as the agreed upon price.

by JONATHAN MILLER

As many US housing markets improve, there remains one of the largest challenges in decades: the shortage of houses available for sale. Home affordability remains at near record highs despite rising home prices. Many housing markets are experiencing heavy sales volume, yet listing inventory remains at or near historic lows. The low inventory phenomenon has pressed housing prices higher despite modest economic conditions.

Although the limited supply is causing housing prices to rise, mortgage rates remain near historic lows (even despite the uptick last year). A "sweet spot" has been created, wherein people looking to take advantage of the high affordability in historic context have been enticed to buy quickly before rates increased. However, though mortgage rates are attractive, the barriers to entry remain challenging—higher credit score requirements; tougher mortgage underwriting guidelines—and access to credit has become more difficult to obtain in 2014 than it was in 2013. As a result, there has been a rise in cash purchases in a number of housing markets as buyers vie for an advantage over the competition.

WHY IS LISTING INVENTORY SO LOW?

The supply of homes typically falls as sales increase in a classic supply and demand scenario. Yet the decline of inventory began a few years before home sales began to rise a few years ago. As a result, rising sales do not fully explain this low inventory era.

While many in residential real estate like to say housing is "local," it is important to note that access to credit such as residential mortgages is "national." Low listing inventory is a national phenomenon, not one unique to a handful of housing markets; primarily due to tight credit conditions in the US. The following situation has played out across millions of US homes over the past several years.

A typical homeowner who is unable to sell today may have read about record low or near record low mortgage rates and how much their local housing market was improving. They tested the market, researching how much their home was worth and how much of a mortgage they would qualify for to make a new purchase. After researching their options, many of those homeowners discovered they did not qualify for the

photo by Evan Joseph

mortgage they needed. Some of the reasons include higher credit score requirements, tougher mortgage underwriting guidelines and limited available equity for an adequate down payment. If they don't qualify for a mortgage—which might enable a trade-up to a larger home, a lateral move to a similar property in another location or even downsizing—they won't place their home on the market. They are forced to wait until housing prices rise or credit eases before they can consider entering the market again.

And would-be sellers who did qualify for mortgages have trouble finding what what they want with the already limited selection, and will not list their homes either until they are successful. This additional scenario has helped "double-down" on the shortage of inventory, making the problem chronic.

In an ideal situation, mortgage lending standards would ease as the economy noticeably improved, which would boost consumer confidence and stimulate both buyers and sellers alike; with easier access to credit, more potential buyers would qualify for mortgages and therefore be more likely to purchase new homes, helping to bolster sales volume in the market; sellers, on the other hand, would be encouraged by the increased activity in the market and the larger pool of potential buyers and would be more willing to list their homes, helping to ease the inventory shortage. However, this is not the situation in which we find ourselves.

DEAL TERMS ARE AS IMPORTANT AS THE SALES PRICE

With low inventory and an increasing number of buyers competing for limited choices, terms a buyer can offer to a seller have become as important as the sales price itself. Tight credit conditions have not only held back inventory in many markets, but created a disadvantage for buyers who rely on mortgage financing. An agreed-upon purchase price is no good to a seller if a buyer can't close. Sellers and their real estate brokers are more focused on the qualifications of the buyer than ever before. "Flexibility of terms," "limited contingencies," and "paying with cash" have become well-used phrases in the current home-buying process.

ARE WE BEGINNING TO SEE AN END TO THE LOW-INVENTORY ERA?

There are signs that listing inventory levels have reached a "bottom" or are near a "bottom." According to data from the National Association of Realtors, US listing inventory has fallen 43% over the past four years but likely reached "bottom" about a year ago. The supply of houses increased 5.3% from the past year, but inventory remains low in an historical context and continues to challenge most US housing markets.

Despite the "bottoming" of inventory in many US housing markets, don't expect ample housing supply anytime soon. A key driver of this low-inventory era has been tight mortgage lending conditions, and they are not expected to ease within the next few years. Until then, deal terms and cash will remain king.■

MANHATTAN MARKET: 1Q14

High sales momentum in the New York real estate market has carried in to the new year, with higher sales and prices expected to gradually bring more inventory onto the market. What is the state of the market so far this year, and what can we expect for the future?