Real Estate Market Forecast 2022 and beyond

There have been many comparisons between the current real estate market and the market of 2007. Due to extremely high demand and rapid appreciation in the real estate market, some pundits are pointing to a coming bubble! Alarm bells sounded as rates began to move up – this is it! The end is near!

There are several significant differences between the market 2007 and the market of 2022. Some of the differences are subtle, relying on synergistic impact to move the needle; however some of the differences are profound and alone make huge impact. Let's explore a few:

The mortgage market

In the early 2000's exotic loans became all the rage. As a mortgage professional during that time, I saw a huge swing from traditional fixed rate mortgages to adjustable rate mortgages (ARMs) with short fixed "teaser" periods followed by the potential for increases of 6% or more at the first adjustment. Further, lending guidelines were reduced to the point of absurdity. A borrower with a credit score in the 500's could be given a loan with no down payment and no income or asset documentation. Subprime loans were almost always 2 to 3 year ARMs with that short fixed period followed by an almost certain jump of 6%. There are countless stories of bus drivers, daycare workers and nail technicians buying several homes with no money down, planning to flip them on the ever-increasing market. An interesting dynamic, there were fewer Americans in their 30's during this period. Demographically speaking, housing demand and first-time homebuyers should have been at a historic low.

Due to rapid appreciation, and loose lending guidelines, homeowners treated their house as an ATM. Refinancing ever year or more frequently to extract the equity. People were living as if their income had doubled… using equity as part of their annual living expenses. During the refinance BOOM many people with non-financial backgrounds jumped into the business to take advantage of the easy money. For them, the path of least resistance was always to offer subprime products, even when the borrower could have qualified for other, safer options. Putting a borrower in a 2-year ARM with a 6% initial adjustment and a 2 year hard pre-payment penalty was the quick solution, especially since it didn't require the borrower to provide any documents.

That was the financial environment in 2007. Bad mortgages were being bundled up and sold in the mortgage bond market as good healthy, low risk Mortgage Backed Securities.

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So what happened??? SUPPLY and DEMAND

The insatiable appetite for houses created by easy money and rapid appreciation put the home builder market into overdrive. New home production spiked and an over-supply was created. This was camouflaged by the artificial consumption of inventory. It is expected that a percentage of investors will buy multiple homes to create passive income. The market didn't account for the feeding frenzy created by loose lending guidelines.

It doesn't take long to figure out what is going to happen when you give a mortgage to someone with a 500 point credit score. Predictably, mortgage default rates started to climb. Unpredictably, Wall Street's appetite for these toxic mortgages didn't reduce accordingly. Even as defaults skyrocketed, new mortgage bonds continued pouring in and builders continued erecting homes as quickly as they could. Both sides looking to capitalize on the climbing prices and artificial demand.

December 2007… critical mass!

Due to mounting defaults and a sickening realization that the sky was actually falling, many lending institutions began dialing back their guidelines and almost overnight, the plug was pulled on subprime lending and the dominos began to fall.

Housing inventory was at all time highs and demand suddenly STOPPED. Homeowners who couldn't really afford their homes were unable to pull equity out as an income supplement. Foreclosure filings piled up. Lenders reacted by further tightening their guidelines. Suddenly qualified buyers were struggling to get approved for traditional mortgages. Liquidity in the mortgage market stopped.

And the Bottom Fell Out

We were in the perfect storm of excessive inventory and virtually no demand compounded by a lack of liquidity. September 2008, we all learned a new phrase: "too big to fail." Bear Stearns and Lehman Brothers filed bankruptcy… the government pumped out trillions of "bailout" dollars in a panicked effort to prevent the total collapse of our banking system.

Housing values plummeted. Exacerbating the crisis, many homeowners, suddenly finding themselves "upside down" walked away from houses… even when they could afford them. We all learned another new phrase: "Jingle Mail." The sound of house keys being mailed back to the bank, hoping to avoid foreclosure by offer the deed in lieu.

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Home values continued to plummet, losing 20% to 25% of their values in the worst market correction in memory.

15 Years Later – is history repeating itself?

No. The short answer is that there are few similarities between today's market and that of 2008.

Lending – mortgage guidelines, documentation and equity requirements are all working together to ensure that homebuyers in today's market are qualified and that homes have enough equity at the time of purchase to protect the lender in the less likely event of default.

Liquidity – we have a healthy Mortgage Backed Securities market. Even a majority of homes that were in forbearance during the COVID-19 shutdown of 2020, have been caught up or were easily absorbed into the market. Money is readily available and rates are reasonable. The extremely low mortgage rates we saw during pandemic period are now climbing up, but they are climbing up to "normal" rates. Between 1971 and 2022, the average 30-year fixed rate has been 7.7%. Rates in the 2% to 5% range are simply not sustainable for long periods of time.

Will rising rates cool demand? Of course, but there is such a shortage in the housing market that a demand reduction will only start to bring the market into balance.

Demand – there are several factors impacting demand in our market. Simply put: we have a housing shortage. All real estate is local, but averaged out on a national level, the National Association of Realtors (NAR) reported in May of 2022 that there is a "shortage of 5.5 million homes in the U.S. – a gap so large it would take more than a decade to dig out of, even with accelerated new construction." NAR Statement issued May 16, 2022 by Leslie Rouda Smith, NAR President.

Contributing to the demand shortage is the material and labor shortages still plaguing the homebuilding industry since the COVID shutdown. Globally sourced materials either didn't get produced overseas or languished in the supply chain for months and months. Experts and pundits point to a decline in building permits and housing starts as evidence of a cooling market. What they fail to consider is the record backlog of unfinished homes and material shortages that are slowing down production. Why would you start new houses when you have permitted homes and partially built houses waiting for materials?

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Even if mortgage rates move into the mid-6% range, which I predict for 2022 – 2023, the real estate market will not suffer a significant erosion in values because of a simple, fundamental principal: Supply and Demand.

Wrinkles and variables – there are a few variables that can impact the housing market. At the top of the list is inflation in our economy! A double-edged sword, inflation can reduce demand by forcing mortgage rates up and reducing the pool of qualified buyers. This could result in a softer housing market. The other side of the inflation sword is rising inflation can slow down homebuilders due to rising material and labor costs. A reduction in supply. In this manner, the economy would have a tendency to balance itself.

My two cents on inflation: inflation is the single most toxic condition that can impact the economy. It is self-induced and the result of excessively loose monetary policies. Returning the Fed Funds Rate to a "normal level" in a prompt but measured manner will help to tame inflation. Further, reducing restrictions on energy production is critical! Fuel cost impacts the costs of everything we buy. Rising costs of fuel are absolutely the biggest culprit impacting inflation in our market today.

Predictions for the next 5 years:

1 – rising mortgage rates through 2023. Possible touching 7% for a 30-year fixed rate mortgage.

2 – continued housing inventory shortages

3 – continued rising home prices (not as fast as the previous recent years, but still rising)

4 – fewer houses available on the Existing Home market – homeowners won't want to sell and give up their low rates, they will be inclined to stay in their home and renovate.

5 – we will not have a housing market crash as long as we get control of inflation and unemployment levels continue to stay low.

As an investor, it is a great time to be in the real estate market. There will be continued demand for residential properties by homebuyers and renters. Don't overextend yourself, manage your liquidity and reserves so you can weather unexpected twists and turns in the microeconomy.

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Michael has been an active real estate investor since 1998 in both California and Florida. He has been effective in several modes of real estate investing, to include renovating, wholesaling, flipping, renting, private lending, ground-up construction, and land development.

He has a bachelor's degree from Norwich University and a Master of Science in Administration and Finance from Central Michigan University. He is a former Marine Corps infantry officer with combat action in Somalia during his 10 years of service. In addition to his work in real estate and finance, Michael is the father to a teenage son and daughter and his best friend Molly the goldendoodle. He and his wife Mitzy have been married for 20 years.

When Michael left active service in the Marine Corps in 2000, he relocated to the Orlando area and took a position with an accounting firm where he led the tax audit defense department. He additionally provided Small Business Administration (SBA) loan support to many businesses.

Transitioning into mortgage finance in 2002, Michael has been a loan officer and branch manager for 3 major residential lenders before joining his current position with Jet Direct Mortgage. Widely considered a leader in mortgage production and financial education. Michael also owns MoneyStream Financial Solutions, a commercial mortgage brokerage focused on creating lending solutions for real estate investors, builders, and developers. MoneyStream provides access to institutional, "hard" and private money sources.

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