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Supply and demand and capital market; an appraisers view

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Here we go again: "another fine mess you've gotten me into Ollie!'

If you're old enough to remember Laurel and Hardy, this old clichÃ© summarizes our current state of affairs in the economy, quite nicely.

Where to Begin? March 2001 we are officially in a recession. The Fed cuts rates and starts to lower mortgage rates. The market responds and sales increase as well as refinancing. Cash out refinancing fuels the economy and recession ends. In this period of low interest rates and an appetite on Wall Street for residential collateralized mortgages, many loans are written to previously unqualified borrowers and speculators. This pushes housing values to unprecedented highs.

With the recession finished and hints of inflation, the fed raises rates causing increases in mortgage rates. There are many qualified borrowers that did all the right things during this period and were able to acquire their first home, a very positive outcome.

Now Wall Street is impacted. Foreclosed properties valued at less than the purchase price, cause write downs in the portfolios. High supply, low demand equals lower values in the portfolios, which leads to more write downs. Wall Street withdraws from the market.

Another great quote from history in troubling times, from FDR's inauguration speech "The Only Thing We Have to Fear Is Fear Itself"'. There are ups and downs in any market, and you only experience a true loss if you sell when the investment is down. Even in these troubling times, there are companies (GE Real Estate), that are forming new global investment funds specifically targeted to acquire under performing real estate assets and hold until they stabilize.

Now comes the credit crunch coupled with rising oil prices. Everything costs more. Inflation is clicking up. The Fed is now on the horns of a dilemma. They need to lower interest rates to stem the flood of foreclosures, but history says you have to increase rates to curb inflation.

This is not the first economic downtown we have seen, nor will it be the last. Cooler heads will prevail, and a steady hand at the tiller will sail us through to sunshine. The stock market is conflicted, up and down with each piece of news. We can expect the usual symptoms for a while, such as job cuts, higher inflation, and low wage growth. These are predictable responses to supply and demand imbalances, which will also even out over time.

The government will play an important role in stabilizing the markets, which has already begun. From the appraisers view, the key is to quite the effects of the supply demand equation. Right now we have a surplus of residential real estate available for sale with a lessening demand.

The legislation to help us out of this imbalance will be complex. However, it appears to me that any effort that will reduce the supply of properties on the market will help to maintain values. As well as any effort to balance credit tightening rules with prudent safety checks with a view to aiding buyers to make that first home purchase. This will increase demand, without exacerbating the problem.

One idea that comes to mind would be similar to the Resolution Trust Corporation (RTC), created in the S&L bailout in the 1990s. The problem to be solved is to allow a homeowner to remain in their home for a period of time while the real estate market stabilizes. The trigger is when a variable rate loan steps up to a market rate.

When that occurs, and the home owner cannot sell the property because they are upside down (owe more than its worth), then the new RTC would become the lender and charge the homeowner an interest rate that they can afford to stay in the home, regardless of value. This would be a lower than market rate for a period of time.

This gets the original lender out of the equation, they get their mortgage paid off and are no longer concerned about the property. This helps to stabilize Wall Street Investments. It is not put on the market, therefore the supply of property will drop (reduce supply). With strengthened credit markets and a more stabilized supply and demand, credit standards will stabilize bringing more qualified buyers into the market (Increase good demand).

Over a 2-3 year period, most of the value in the new RTC portfolio will come back to something close to the mortgage amount. It can then be sold, slowly, in the normal market, with most of the investment recovered. The only true cost to the government will be the subsidized lower mortgage rate over the holding period, which would not be significant.

Supply and demand is an important part of the appraiser's lexicon. What I wanted to share with you in this article is that supply and demand is a critical element in all markets not just real estate. And one final quote from Annie "The sun'll come out Tomorrow Bet your bottom dollar That tomorrow There'll be sun! Just thinkin' about Tomorrow Clears away the cobwebs, And the sorrow..."

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