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Wealth gap impact on real estate: Large, and hard to fathom

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It is not new news that the gap between the richest and poorest Americans widened in the years after the great recession, despite overall economic recovery, according to the Federal Reserve. The average pretax income for the wealthiest 10% of U.S. families rose 10% in 2013 over 2010, but families in the bottom 40% had declines in their average inflation adjusted income. The top 3% of families saw their share of national income rise from 27.7% in 2010 to 30.5% in 2013, while the bottom 90% saw their share fall. Most of this has affected the middle class.

This wealth schism is showing up dramatically in the demand and pricing for housing. I will try to remain neutral about the social issues embodied here, and focus on how this all affects real estate, specifically housing. This income and wealth gap is showing up in housing patterns in ever more dramatic ways. For example, between abutting towns, there can be differences of over 100% in average price range. Even neighborhoods and streets have price differences that are difficult to fathom. This phenomenon is not new in real estate, and brokers often talk about one end of the market being hot and the other end, not. The difference here is that the price differentials reflect and even surpass growing income differentials, making real estate analysis a difficult task.

As we know, this is all about demand. But the "powder" behind this demand is packing more wallop than in previous times. Moderate priced housing demand is affected by moderate people's ability to pay debt service, maintain good credit, have large proportions of equity, and make their way through tough banking regulations. Upper end buyers respond to these issues with all cash sales, large income to debt ratios, high net worth, and good banking connections. In a sense, demand for real estate is becoming bifurcated, similarly to income patterns, and that is why someone will pay hundreds of thousands over the asking price in a bid war in one area, while another property will languish nearby.

This growing differential makes it harder for real estate professionals to understand the market. The first area of confusion is obviously the statistics of average house prices. In the past, the curve of moderate income housing to upper end housing was smoother, with less spikes. In that scenario, an average price of, say $700,000, for a unit in Cambridge was a useful measure. Now, by way of example, the average price has recently gone over a million dollars, clearly impacted by five to ten million dollar single family sales, and new condominiums being bought immediately for well over a million dollars. These statistics make their way into the press, and demand is fired up even further. All that said, these statistics belie areas of Cambridge were such demand does not exist, and pricing is thus dramatically lower.

In a similar way, establishing fair market value is more difficult. Using comparable sales with similar neighborhoods, school zones etc. but with perhaps a 100% differential in sales price, is challenging. Adjusting for such comparables where construction quality, house amenities, size etc. are less meaningful, can lead to spurious results. The fact that a house sold for $5 million, $1 million over the

asking price within a few days, may relate less to overall market value than to a single buyer's perception of an extra million dollars here or there.

Stories abound reflecting this phenomenon. Co-ops in New York can jump from highest price of $30 million to $50 million for no apparent reason. Condominiums in Cambridge may move more slowly, but can move from $600,000 to over $1 million in relatively short time frames. While this volatility can be a windfall for real estate pros in the know, it can be misleading, difficult to fathom, for others.

Best advice: drill down deep to understand your specified market niche; work hard to gauge depth of demand; expect the unexpected.

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