

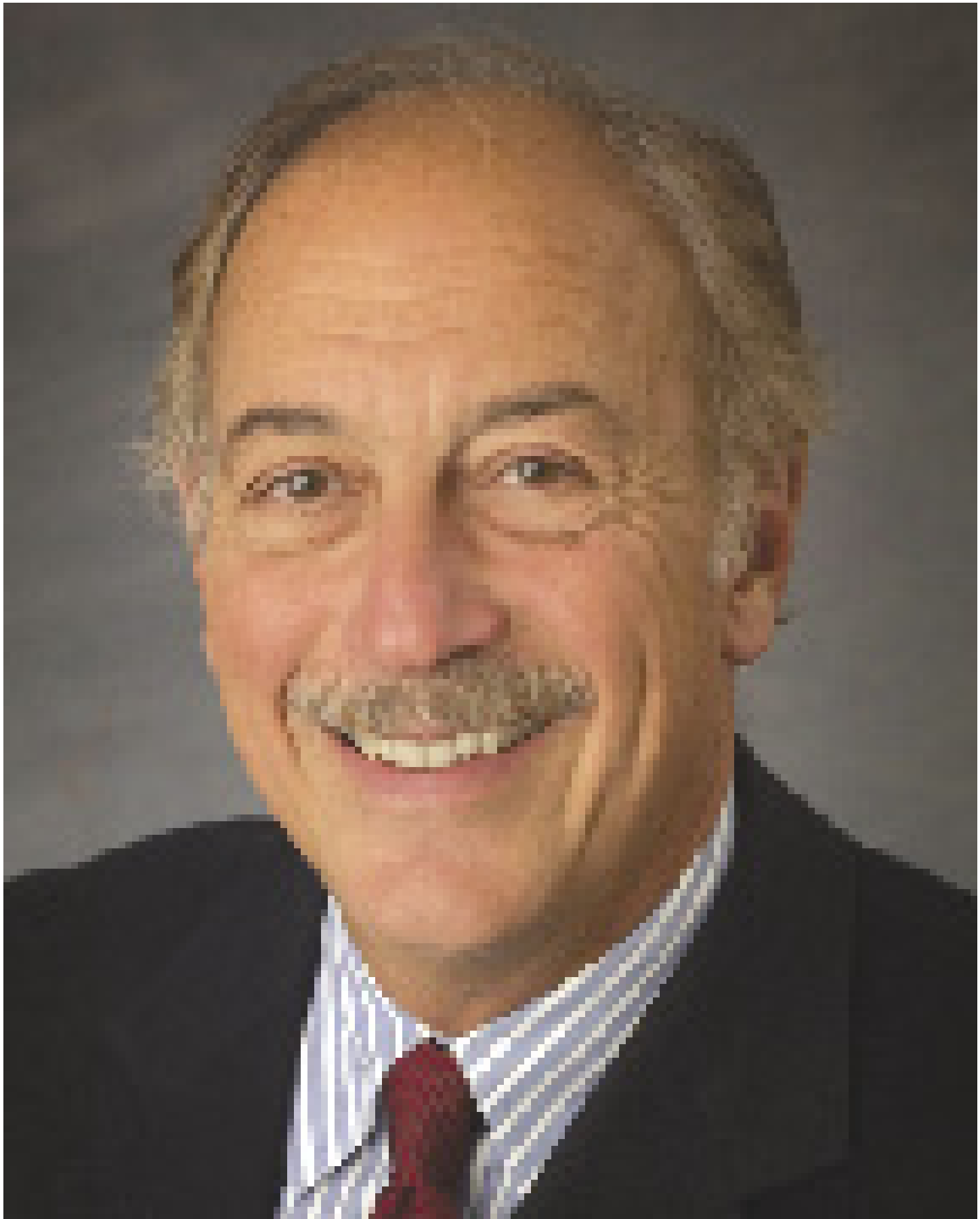


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Real estate as cash machine: Not so clear now - by Daniel Calano

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When you need money, you go to the bank cash machine, leave the car running, type in your pin, get how many hundreds or thousands you need. If you need more you go into the bank, refinance your home mortgage, or pile on a second mortgage or HELOC. In short order, you could borrow and use the money for the renovation you wanted, pool, garage, whatever. Your real estate was the cash machine waiting to be tapped.

Not so easy anymore. With long-term interest rates up, recently to 7.2%, particularly if you have variable rates that could increase, your house may be already tapped out for further funds. The same holds for commercial real estate where you might have relied on rents, or high valuation to borrow against. As real estate analysts, we know that it is not only harder to get money at higher rates, but those higher rates also reduce imputed value of your asset. If you want to sell, the cap rate is suggesting a lower value.

As I have written about a fair amount, the Federal Reserve is increasing rates to dampen inflation. It wants to do so in order to make things that have become expensive due to flooded money markets, more affordable. This is a good idea, but also a double-edged sword, in that the Fed intends to lower the values/costs of real estate, lower labor costs, lower salaries. So, while real estate may become more affordable, one's income may be lower, or in the worst case, one may have lost their job. Your "wealth effect" has gone lower or negative.

As an example in housing, your new mortgage, if you can get one, may cost double what your last one did. While you may be interested in buying something, credit is much harder to get; loans take longer. As a result, you may back away, and statistics show that cancellations of contracts have increased by as much as 25% year over year. Demand for housing, however measured, has allegedly dropped by 30% to 50% since last year. Mortgage applications are down by 25%. Sellers are more reticent, or unable, to sell and move, thus reducing available supply, which will counteract price reductions.

Get it? There is a circle of interactive impacts, unforeseen consequences, contrary externalities. These actions have also impacted stock market and other investments, further compounding a reduction in wealth needed to support your real estate aspirations. Also, with less wealth, consumers who make up 75% of GDP, may either buy less or buy more cheaply. This will impact retail sales, which indicator will show up in short order on the holidays.

All this said, the impact of these rate hikes will not be immediate and then over, but more likely will trickle out over the next year or two. This could be good i.e. less dramatic, or bad, tiresome with constant uncertainty. No one knows the outcomes. Everyone has an opinion. Whatever impact, whatever time-frame, make sure you review your worst case scenario in your spreadsheet.

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