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Is this the future today? New residential market problems

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New residential market problems keep popping up. Things appear to be getting worse rather than better and clear end looms in sight. No one is quite sure what to say. Some sectors are much better off than others. But, in nearly all areas, from most prosperous to least, most if not all price levels are experiencing price dislocations and directional confusion.

Growth in inventories is ominous and unhealthy. Another rate cut might help, assuming the one just past works its magic.

Observers keep revising further into the future when promising the coming of the "recovery" and "return to normalcy." Homebuilders have massively written down land portfolios. Real estate agents, appraisers and mortgage brokers seek new opportunities.

What began as a small "dip," a mere "correction," seems to be moving towards becoming a fully fleshed out trend. The herd is moving and once it gets moving, there's no stopping it easily

Further, commercial markets are not immune. Debt markets are experiencing some turmoil as well which has commercial market participants worried about demand, pricing, spreads, ratios, and appropriate capitalization rates. Even such things as REITs not invested in 1-4 family housing are feeling the effects as a sort of collateral damage.

Perhaps what was thought to be a passing phase is the reality for now. Perhaps then some adjustment and reconciliation is needed today and less attention paid to how things were or how they once again will be.

Let's examine some "trends" that got us here. And then let's consider some and may be with us for a while.

Residential Real Estate as a Source of Wealth. This is a great and noble concept that got completely transformed for the worst during this last cycle. As a safe source of wealth, real estate is a great constant over the long run. As a speculative commodity, hopefully, those days are over for a time. However, real estate will be looked at more traditionally as a necessity, i.e., for shelter and for an inflation hedge.

The Cyclical Nature of Real Estate. All asset classes have peaks and valleys in their cycles. Real estate seems to have a particular vicious set of up and downswings. When things get bad, they go quickly from bad to worse. And the warning signs are not at all predictable.

Real Estate Always Appreciates or "Prices Never go down (much)'. This is a corollary to the preceding but really needs its own heading. This is not true. Anyone who has read about real estate cycles or has experienced more than one knows this.

The Role of Financing. It has become evident that the availability of cheap and easy credit was a strong driver in the recently concluded real estate boom and creating the current bust. Debt drove demand which in turn drove up prices beyond anything realistic.

The Role of Greed Should not Be Overlooked. This last cycle made it particularly easy for two groups to work together: eager, greedy buyers and clever, unprincipled, and greedy lenders. A particularly volatile combination when regulatory indifference as a policy was the order of the day.

Fraud. The fallout from the gross abuses committed will continue for a long while. Homeowners, lenders, appraisers, and others will be pulled down as investigations and prosecutions follow their course.

What are some of the positive aspects that may result from this turmoil?

Less Extravagant Residences. Perhaps the era of overbuilt, over designed homes is finally over as a general architectural and market principle. With higher energy costs, an aging population, and less upside on future appreciation, sanity will return to the building mainstream.

Sanity in Lending. Whether enforced by law and regulation or by self-policing and market forces, a return to some semblance of underwriting basics will create more sustainable credit conditions among borrowers and lenders

Lower Price Expectations. Going forward, market participants should look at a more realistic playing field in residential markets. Perhaps the days of continued double digit price inflation, bidding wars, and hyped up housing product are over.

Better Regulation of the Lending Industry. The current model doesn't and hasn't worked. All that happened is that the risk got pushed downstream. Better models needs to be found. Otherwise, the cycle is poised to repeat.

Market Sanity. Sanity will prevail for 3 or 4 days. Then it will be back to the ways things always have been and always will be. This does not change. No amount of regulation will restrain "free" markets, except the fallacy of free markets.

There is a lot of very tangible unhappiness out in the 1-4 family markets right now. It would be nice to think that it's hit bottom but it's impossible to know. It's a good time to take stock and envision how things will work in an environment like this.

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