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Magazine of Worldwide ERC®

May 2018

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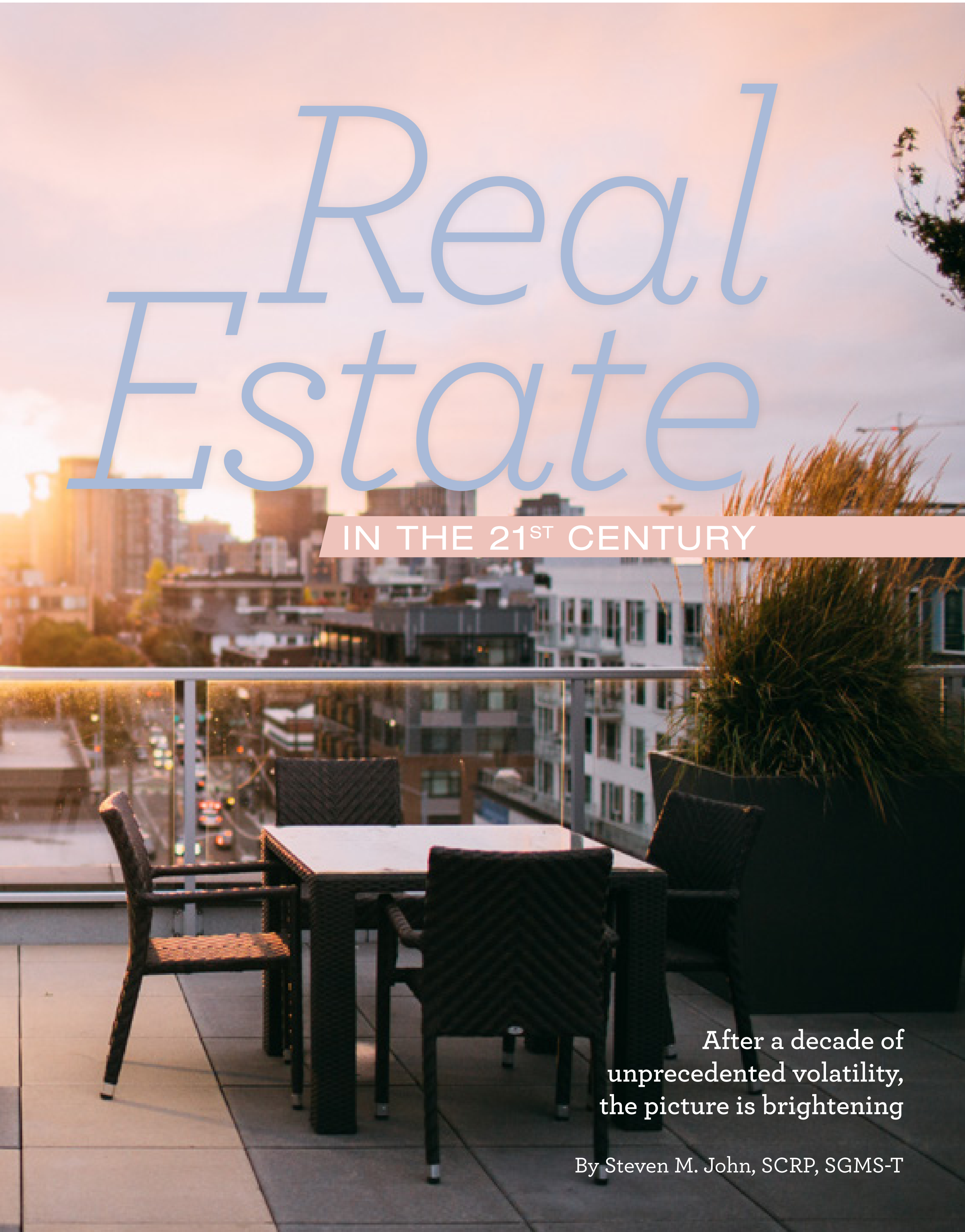


Real Estate

IN THE 21ST CENTURY

After a decade of unprecedented volatility, the picture is brightening

By Steven M. John, SCRP, SGMS-T

When asked, "How's the real estate market?" the traditional real estate agent's response is, "Incredible!" For most of this century, whether it's "incredibly good" or "incredibly bad," that response certainly applies. For many geographies, the average market price graph resembles a scary roller coaster. The S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index (in blue on the chart below) gives a good picture of the roller-coaster effect experienced by most U.S. markets.

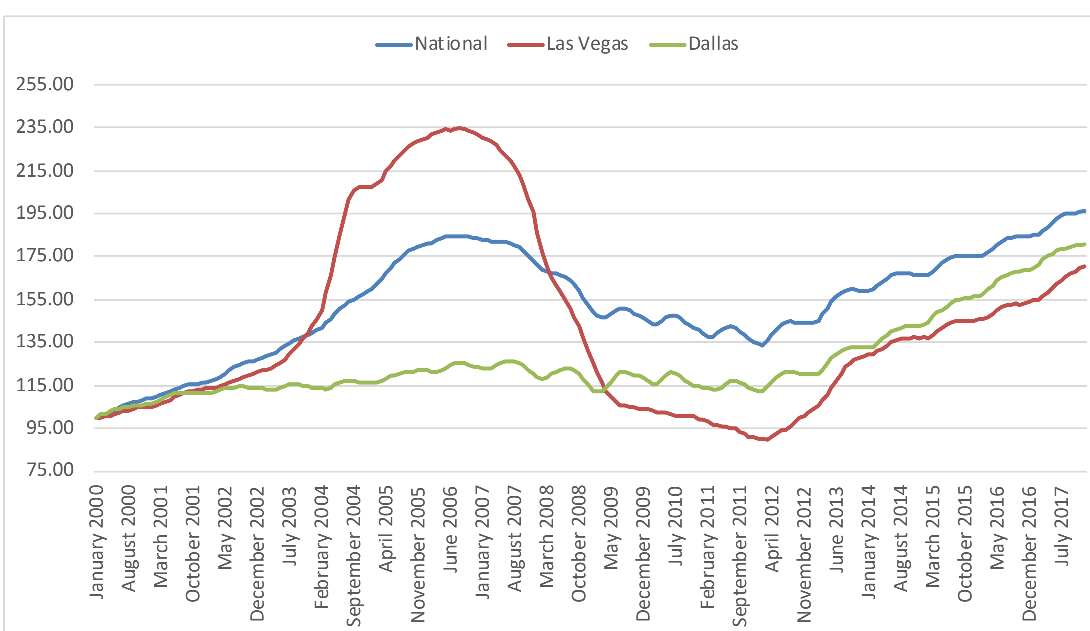
The same stats at a regional level lend serious support to the claim that all real estate is local. People in Las Vegas (red) experienced significantly higher highs and lower lows and still have not quite recovered, while those in Dallas (green) are confused as to just what everyone has been talking about. Truthfully, though, more markets shared the national trend line than the gradual increase shown by Dallas. Most markets have now recovered to above pre-recession levels. On a national basis, the average home price is now slightly higher than it was at the top of the market in 2006.

Home Equity

The real estate bubble of 2006 had a particularly detrimental impact on homeowners who purchased during the peak months. As real estate values declined in the ensuing years, many found themselves underwater with negative equity—a scenario that exists when the home's current market value is less than what is owed on the mortgage. Based on CoreLogic's equity data analysis, negative equity reached a peak of 26 percent of mortgaged residential properties in the fourth quarter of 2009, seriously impacting more than 12.5 million homeowners.

Many of these homeowners ultimately lost their properties in foreclosure or simply walked away. For those who stuck it out, the combination of continued mortgage payments and rising home values has paid dividends. In the fourth quarter of 2017, the total number of mortgaged residential properties with negative equity had decreased to 2.5 million homes, or 4.9 percent of all mortgaged properties, and the national aggregate value of negative equity was approximately $283.1 billion. While much improved, the 2.5 million homes remaining underwater are essentially off the market, significantly contributing to the lack of available homes we see today.

Despite the millions of homeowners with negative equity, Americans as a whole are rich in equity, with a total of $14.1 trillion in home equity at the end of



Source: S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index

Quarterly Homeownership Rates and Seasonally Adjusted Homeownership Rates for the United States: 1997–2017

Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, February 27, 2018; recession data from the National Bureau of Economic Research, www.nber.org

2017, surpassing the height of the real estate bubble of 2006. This bodes well for the economy, as more and more homeowners feel secure enough to invest and make other purchases.

The American Dream

Despite the dramatic ups and downs of the real estate market in the 21st century, homeownership remains the American dream. In Hearth's "2017 State of the American Dream Report," survey data indicates that "all generations—including millennials—agree homeownership is very important to achieving the American dream." More specifically in Hearth's report, respondents rated "owning a home I love" higher than any other options, including starting a family and finding a fulfilling career.

In a 2017 National Association of REALTORS survey, nonhomeowners were asked whether they wanted to become a homeowner in the future: 86 percent said yes, consistent with prior surveys.

Even with the recent tax changes, the benefits of ownership, both emotional and financial, are very strong. Spurred by improving equity and higher credit availability, homeownership in the U.S. is beginning to tick back up from the recent low of 62.7 percent (see chart above).

Mortgage Financing

Credit availability has improved over the last decade. For those who think lending standards are too tight and are afraid they will be denied a mortgage, the good news according to the Mortgage Bankers Association Credit Availability Index is that credit is loosening up. Since March 2012, credit availability has soared to the current level of 180.7 as of February 2018. While still significantly lower than at the height of the market in 2006, the increase in the index indicates credit is becoming more readily available.

In addition to the improvement in general credit availability, lenders are developing new and

innovative products to address some of the thornier problems facing borrowers today. For example, HomeServices Lending has added solutions for recently graduated doctors, foreign nationals, and buyers of nonwarrantable condominiums. All three of these products allow for more lenient lending guidelines to aid the qualification of a potential homebuyer. The Doctor Loan program permits the exclusion of deferred student loans in the debt-to-income calculation and allows for lower down payments. The Foreign National Loan products do not require a Social Security number or a history of personal credit in the U.S. The Non-Warrantable Condominium product allows potential homebuyers the opportunity to obtain financing for properties that are not considered eligible by the nation's largest investors, Fannie Mae and Freddie Mac.

One factor holding back some Americans from buying a home is their level of student loan debt, which has grown dramatically and has likely contributed to the decline in the homeownership rate. Some quick stats:

- $1.48 trillion in total U.S. student loan debt, up from $378 billion in 2005.
- 44.2 million Americans with student loan debt, up from 24 million in 2005.
- Average monthly student loan payment (for borrower aged 20 to 30 years): $351.

As with any other debt, mortgage lenders take student loan debt into account when calculating a borrower's ability to pay. While monthly payments for student loans tend to be relatively low compared with more traditional debt, they still count, and they will push some Americans out of the running when shopping for a new home purchase loan. Additionally, servicing these debts impedes the graduate's ability to build savings for a down payment.

Today's mortgage marketplace is poised to assist Americans in achieving their goal of homeownership, and lenders are again offering low down payment options to support the first-time homebuyer. For example, yourFirst Mortgage offered by Wells Fargo allows for a 3 percent down payment on a fixed-rate loan, allowance for monetary gifts from family members, and the opportunity to earn a closing cost credit when eligible buyers complete an approved homebuyer education or counseling course. Debbie Holiday, CRP, corporate mortgage programs leader at Wells Fargo, says, "The millennial generation is a vital part of the workforce of today and of tomorrow; they are our future. We recognize the importance of providing education, programs, and resources to help millennials achieve the benefits of homeownership."

Home purchase is indeed a major milestone, and the financial services industry is answering the call to ensure millennials have the information needed to formulate plans, understand options, and make decisions that are best for them. Holiday remarks, "Access to knowledgeable consultants and valuable information are critical components to help millennials with their personal wealth-building strategies and first home purchase."

What's Next?

Despite the positive news in market value, equity, and financing improvements, buyers still face some difficulties in buying a home. There is a limited supply of homes from which to choose.

Currently, inventory sits at about a four-month supply. Traditionally, a six-month supply is more representative of a balanced market. Many factors have conspired to keep inventory low:

- 5 percent, or 2.5 million homes, are still underwater.
- Many homes have been converted to rentals and are not for sale.
- Builders have not been able to ramp up due to ever-increasing regulations, lack of developed land, and lack of construction labor.

According to the U.S. Census Bureau, privately owned housing starts in February were at a seasonally adjusted rate of 1,236,000—down about 9 percent from January and down about 10 percent from the 12-month annualized rolling average of 1,360,000. This rate is barely enough to accommodate new household formation, which is expected to increase as more and more millennials move into the market. We can expect to see continued upward pressure on home values as demand continues to outpace supply.

Also, mortgage rates are rising. After many years of favorable rates, mortgage interest is starting to move up, and is predicted to continue to increase over the next couple of years.

Higher mortgage rates can have a dramatic impact on affordability and the ability to secure a loan. A 1 percentage-point increase in the mortgage interest rate on a 30-year fixed $300,000 loan will increase the monthly payment by approximately $175. This impacts the lender's assessment of the borrower's ability to pay, and it may result in a borrower not qualifying, or qualifying for a lower-value home.

U.S. real estate in the previous decade experienced unprecedented volatility. Though the market now grapples with inventory shortages in many markets and mortgage rates are experiencing upward pressure, the national picture is bright. Per Gino Blefari, CEO of HSF Affiliates, "The American dream of homeownership is alive and well. Existing homesales for 2017 topped 5.5 million units on an annual basis, a total exceeded only in the bubble years of 2003 to 2006. As for the housing shortage, rising home values will continue to build equity for typical Americans, who will increasingly consider their real estate options, including listing their homes to purchase others. Concurrently, builders are responding by ramping up construction throughout the country. And, though mortgage rates have risen, they remain historically low and should not impede the market. We see tremendous opportunity ahead for those who want to own a home." ***M***

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