Housing Trends & What They Mean to Investors

By: Gary Geist

Background:

The 20th Century saw a significant change in the US housing market brought about by three distinct social evolutions - a) the industrial revolution, b) two world wars, and c) the computer age. It is almost impossible to find an area of our lives that has not been impacted by two if not all three of these events. We have seen our society change from an agrarian culture of the early 1900's, to an industrial and metropolitan culture by the year 2000.

The charts in Figure 1 illustrate the impact of these events by showing the population shift in the US housing market during the last half of the 20th Century. This change has been dramatic and the rate of change is increasing each year. To continue succeeding in real estate investing, investors will need to recognize these changes and adjust their financial plan accordingly.

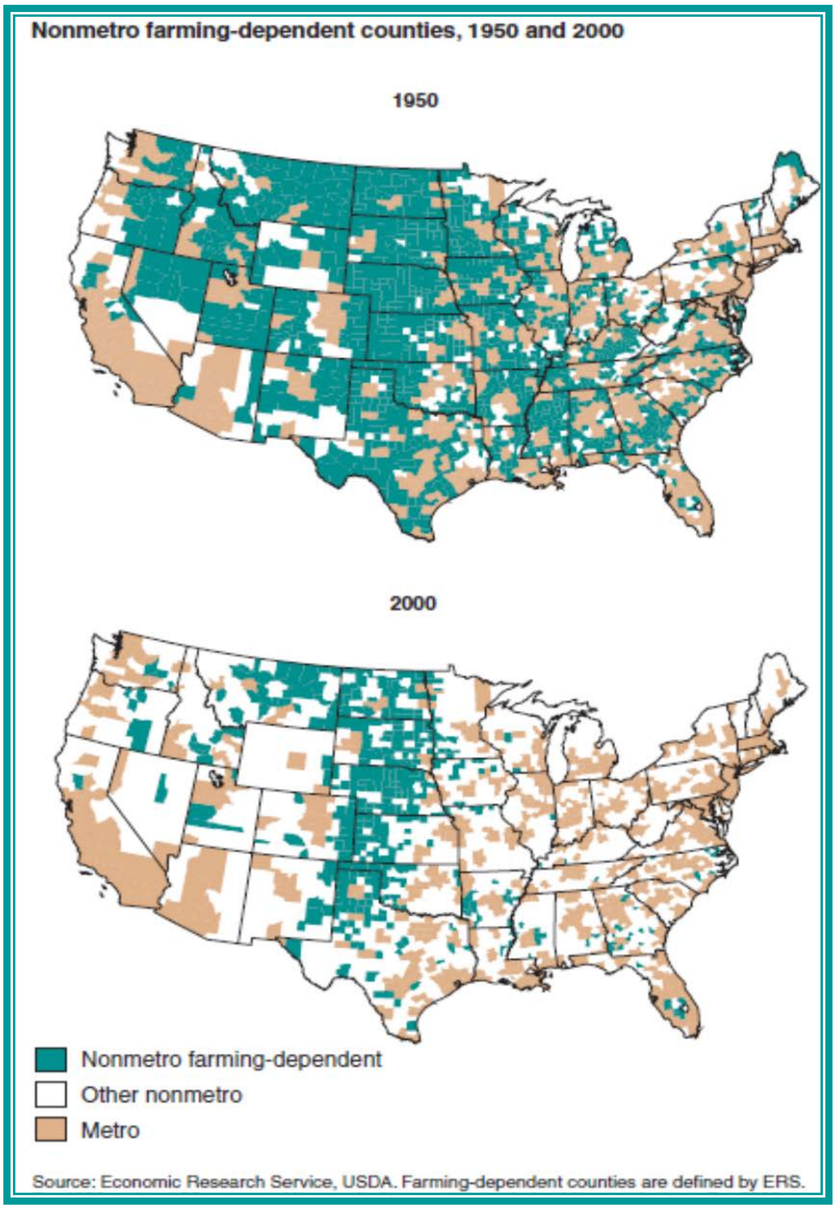

Figure 1 - The Changing US Population Landscape

The Changing US Housing Market

These 20th Century changes that impacted our lives can be defined as:

- ***The Industrial Revolution*** - Great innovations in the way products were made, manufactured, and distributed to clients improved peoples lives and raised living standards all across the country. More work could be accomplished in shorter time periods than ever realized.
- ***Two World Wars*** - Nations no longer were islands unto themselves and acting alone with no effect on the world. Actions by individual countries now affect the worldwide economy.
- ***The Computer Age*** - Has completely revolutionized the way people live, work and play. Most menial tasks of older generations are now accomplished by computers & machines. People today have unprecedented amounts of free time to pursue other interests.

The result is that US society has changed from an agrarian culture of the 1900's where 41% of the people lived and worked on farms, to an industrial/metropolitan culture in 2000, where now only 1.9% of the US workforce is involved in agricultural careers. The introduction of computers in the 1960's and 1970's brought a revolution to the workplace which made many jobs obsolete. This forced large segments of the population into other career fields to take advantage of new jobs.

New technology and inventions have created new products for consumers and new job categories, the majority of which are in the industrial - metropolitan complex. This forced people needing these new jobs to move off the farm and into town to be close to their work. This migration of workers following jobs is the primary reason the US housing market has evolved and changed forever.

Rise of the Mobile Workforce

There were two separate crises in the 1970's that impacted the US workforce and economy. The first was the energy crisis caused by difficulties with Iran and other OPEC countries in the Middle East. This led to the oil embargo, which severely limited our oil supply causing gasoline prices to skyrocket. Higher gasoline prices dramatically increased shipping costs, causing the price of goods and services to rise, which negatively impacted sales. Many businesses were forced to close due to lost sales.

The second major event affecting the US economy and the housing market was the Savings & Loan failures of the late 1970's. Because of runaway inflation in the 1970's and the deregulation of the banking industry where the buying of "junk bonds" was in style, nearly one third of the Savings & Loans failed. Individuals who had placed their life savings in these institutions lost not only their capital, but in many cases their homes as well.

The number of families affected by these events has been well documented by the US Bureau of Labor statistics. Their reports reveal many people lost their jobs and homes during this period and people were forced to move. The tenure of an employee at a specific company fell during the last 5 decades of the 20th Century. Employees who used to work 35 - 40 years at one company (like in the 1950's), had fallen to only 3.5 years by year 2000. This data is shown graphically in Figure 2 below.

Even though employee tenure has risen slightly to 4.6 years by 2012, we still have a highly transient workforce in the US. Employees are constantly moving to new companies for advancement or promotions because of economic conditions. Since employees now have to move frequently for work, the 'American Dream' of home ownership has become a thing of the past. As a result, more and more young people are becoming "renters" as opposed to "home-owners".

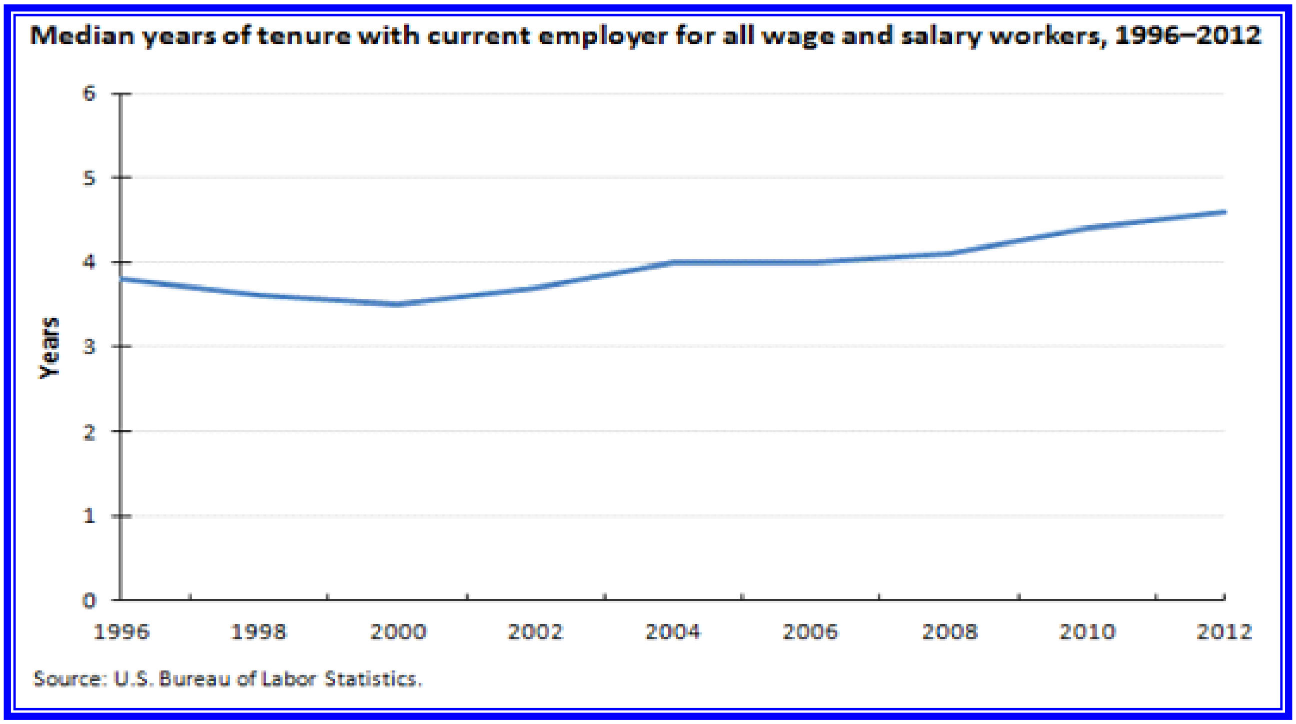

Figure 2 - Employee Loyalty

Impact to the US Housing Market

The effect of these social changes on the US housing market has caused large segments of the work force to move for work. Families who had to leave town before their homes sold were placed under heavy financial burdens and eventually lost their homes to foreclosure. Government agencies such as HUD, Fannie Mae, and Freddie Mac ended up with huge inventories of vacant, vandalized houses in towns all across the country.

The growing number of "unsold" houses were not only problems for owners, realtors, banks and mortgage institutions; but also for home owners in the neighborhoods where these vacant houses were located. These vacant homes were depressing local real estate values, causing local market property values to plummet. This problem grew even worse when the 'Housing Bubble' burst in 2007 causing even more foreclosures.

The record number of vacant houses along with poor economic conditions in the US economy made it almost impossible for home owners to obtain new financing. Many neighborhoods became known as 'high risk' areas making it impossible to obtain home owner financing. As the problems with these houses continue to mount, new investment opportunities are emerging for savvy investors.

The Perfect Investment Opportunity

The growing inventory of vacant houses caused a significant drop in value for these houses as well as the neighborhoods in which they were located. It soon became possible for investors to purchase properties in these neighborhoods cheaper than when they were originally built 50, 60 or even 100 years ago. After renovations as rentals, these properties provided investors a great source of cash flow. The potential of these single family residences even caught the eye of fund managers who then bought these vacant houses by the thousands for their clients.

Looking back at the deals investors found because of the housing bubble crash of 2006, we can see a second wave of deals coming for investors who are prepared to take advantage of the opportunity. As shown in Figure 3 below, the inventory of foreclosed properties in government institutions by 2017 is four times higher than the inventory caused by the 2006 crises. These houses will take 2-5 years to work through the system and become available for investors to purchase.

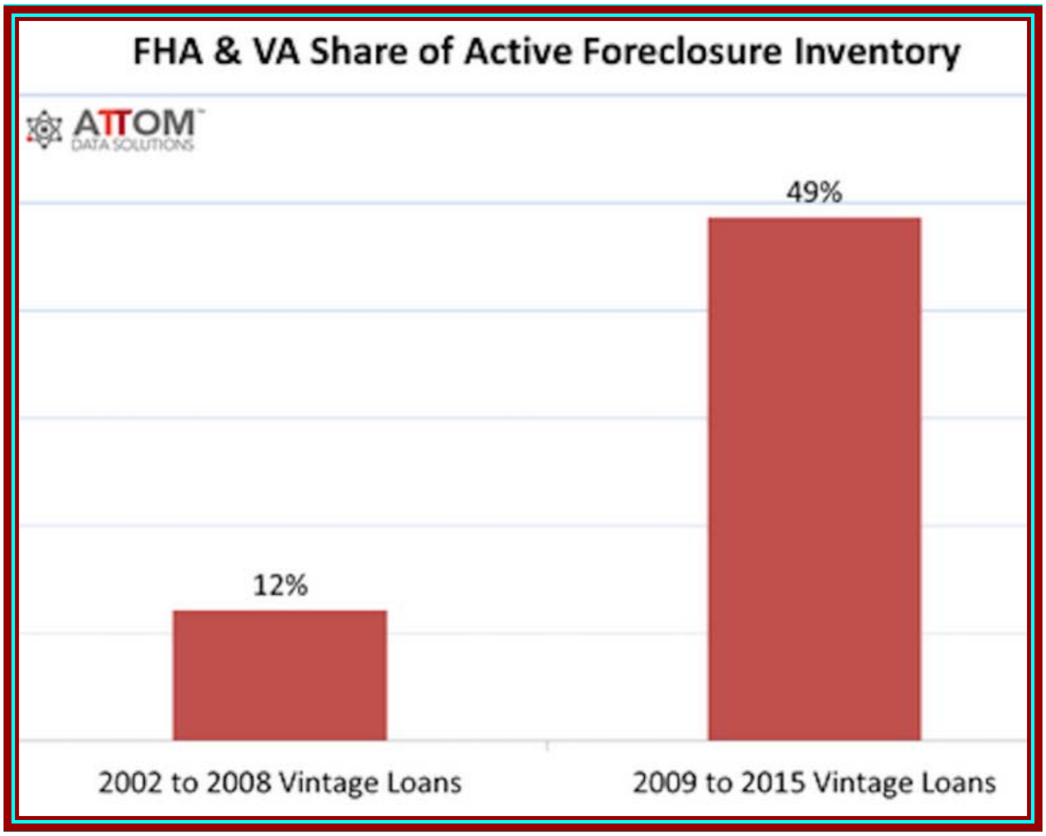

Figure 3 - Foreclosure Inventory

Central to the purchase of rental property is the need for good property management. Once the investor has purchased and renovated the property, he needs to turn it over to someone who will find a tenant and the manage the property for the investor. Since this inventory of foreclosed, vacant houses is all across the country, investors must have a reliable means of finding good property managers.

We believe the current business model for property management grew out of the need of Realtors in the 1970's to solve a major problem for some of their clients - those who had to move out-of-state before their house sold. Based solely as a convenience for these clients, Realtors started a new type of service designed to care for these properties until they sold. However, when the US economy declined and the housing market crashed, the need for this type of service expanded. Thus a whole new business entity known as *Property Managers* emerged.

Today the need for single-family property managers is again increasing, however, now it is for different reasons. All of these foreclosed homes need to be managed and eventually will end up back on the market and usually at discounted prices. This provides a great opportunity for prepared investors who have cash, are ready to buy and have a program in place to properly manage these properties. Current market estimates show that the need for good, reliable and safe rental properties will remain strong for the next ten years.

The Future of Rentals

Although the economy has started to turn around since the 2016 election, IRA accounts and pension funds are still causing concern. Recently, a new breed of investors has emerged, pulling funds out of the stock market and placing them in real estate where cash flow yields of 8 - 10%, or higher are possible. Generally these investors are more sophisticated and demand active roles in the management of their investments. This has caused problems for many property managers because they cannot meet the dynamic needs of this new breed of investors.

Since many of these investors pulled money out of the stock market and are looking for similar control and responsiveness over their investment, they want the "Charles Schwab" look & feel type of control they had in the stock market. Most property managers have issues with clients who take an active role in the management of their rental. Property managers like to collect the money, pay the bills, and send any residual money to the owner at the end of the month.

The typical property manager will maintain the investor's property if there are funds in the account to take care of issues as they arise. This leads to a management style where innovation and creativity are set aside for expediency and ease of solution. Very little, if any, problem solving is involved, the rule seems to be - *"Take the easy way out".* Don't get multiple bids for work, just go with your known contractors regardless of the price if the account funds can pay for the work. In other words, they manage the property to cover costs - *not* to make a profit!   ***(i.e. Cost Center Management)***

These new investors approach their real estate investments from a 'profit only' perspective. They are constantly looking to improve the bottom line of their investment portfolio each month. This includes having instant access to their accounts, records showing a variety of performance metrics on individual properties - such as major work projects, bids, contract awards, and close out task reports. They want to have quick responses to their questions and complete transparency on all monetary transactions.   ***(i.e. Profit Center Management)***

These new demands are hard for existing property managers to address. First, property managers have had a free hand for too long in managing their client's properties. They do not take input from their clients (the property owner) well. Second, they have out-dated management systems that basically are glorified accounting systems - they only report how they spent your money - not why. And third, their business systems have little if any *true* management functions. Their systems have no means of forecasting problems, reporting up coming issues to be resolved and almost certainly cannot answer investor questions in a timely fashion..

Finally, this new breed of investors is forcing property managers to change the way they have been doing business. These investors want true management functions added to their monthly reports. This would include topics such as future problems, approaches to solve these problems, pending work orders, status of current work orders, bid packages, etc.; items that are essential to making wise decisions on their property. The investor wants ***real control*** over his invested capital and the collected rents, because after all - ***It is his money***.

Gary Geist is a full-time Real Estate Investor with HomeReplay, LLC and winner of the coveted ARCHie Historical Renovation Award in Fort Wayne, IN. HomeReplay, LLC is based in the Midwest and provides tools and turn-key investment solutions to investors world-wide. For more information, visit **http://www.homereplay.com/**