The Wealth Report

THE REAL ESTATE MARKET IN 2021: CHALLENGES AND OPPORTUNITIES

Overview

In 2021, the real estate market features low housing inventory, continued price growth and higher expenses that have slowed the rate of new construction. It's a perfect storm for sellers — as long you have another place to live.

Yes, the pandemic has taken a toll on the economy. But unlike during the Great Recession, the economic decline has had much less of an impact on the residential market. First of all, the latest economic turmoil was not precipitated by a subprime lending crisis that plunged many homeowner mortgages underwater. Second, the government stepped in with stimulus-relief packages and a moratorium on foreclosures and evictions for homeowners and renters who lost their jobs. This, in fact, further reduced the number of houses that would normally be up for sale when homeowners experience financial difficulties.

Employed homeowners may well come out ahead post-pandemic. With higher savings and investment rates, many may now consider themselves both house-rich and cash-rich.

And finally, lockdowns and social distancing guidelines kept more homeowners at home. This sparked renovations and home improvement projects that not only incorporated better workspaces for employees working remotely but served to increase the value of their property as well.

Not that housing prices needed a boost; long before the pandemic began, there were more people looking to buy a home than people willing to sell, so low inventory sent prices soaring in many markets throughout the country. As of March this year, the median sale price of existing homes grew to a record high of $329,100.[1]

Buying

Millennials lead the demographic of eager homebuyers. Currently between 25 and 40 years old, they stumbled coming out the gate due to the last recession. But millions now have a foothold in their careers, have saved enough for a down payment and are eager to buy a home. Unfortunately, low inventory and high prices have converged to keep many still on the sidelines. This group has largely been squeezed out of the homebuying market by people who can make cash offers because they've moved out of more expensive markets and near-retirees downsizing or seeking second homes.

The coronavirus seems to have contributed to this fiercely competitive market of buyers. Some are looking to take advantage of the newly mainstreamed remote work model and move to rural areas for a more affordable lifestyle. Pre-retirees are reconsidering their plans to move to large metropolitan areas, or continuum of care retirement communities, where future outbreaks can spread more quickly.

spectrum advisors

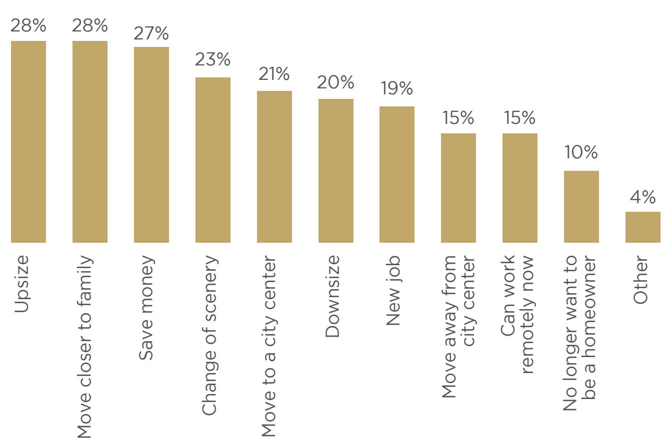
In recent years, there have been two popular reasons to move: work and taxes. One lesson we learned from the pandemic is that when people can work from anywhere, many choose to live elsewhere. Remote work opportunities, both now and moving forward, are expected to open up homebuying markets throughout the country, particularly in more rural locales.

Furthermore, a recent study by Goldman Sachs revealed that the Tax Cuts and Jobs Act of 2017 also plays a role in relocation goals. When the state and local tax (SALT) deduction cap caused taxes to increase for top earners in California and New York, this provided an incentive to relocate to other states. Between 2010 and 2020, only 9% of households that earned more than $150,000 relocated; they were the least likely to move. Yet during COVID-19, that number has jumped to 16%. In New York state alone, more than 6,000 people who earn more than $1 million relocated to states with no income tax like Florida, Texas, Tennessee and Nevada — largely due to SALT.[2]

Selling

Today's historically low mortgage rates serve to make the home seller's market more attractive. Sellers also benefit from a hot market that makes things like home repairs and staging unnecessary. Many of today's buyers are making offers sight unseen, as-is and above offer price. Sellers who can take their pick of multiple offers generally choose cash — which further locks young adults out of the market.

Why Sellers Are Putting Their Homes on the Market[3]



A recent survey by NerdWallet found that 17% of today's homeowners plan to put their home on the market within the next year and a half.[4] The problem with selling your home to cash in on home equity is that you still need a place to live. If you have multiple properties, that may not be a problem. But if you must go out and buy another home, you could overpay and be in the same competitive boat as all the other homebuyers.

"If you list your home in this market, there's little question of the outcome. Barring any significant defaults or dramatic overpricing, you'll sell your home. It will happen quickly, and you could receive multiple offers over listing price."[5]

Investing

If you've been thinking of investing in real estate, now may not be the best time. Remember, the fundamental tenet of investing is to buy when prices are low and sell when prices are high. Well right now, prices are high.

In general, investing in small rental properties is a viable way of generating current income while also building long-term equity. For those who already own properties, it may actually be a good time to sell them to capitalize on that equity.

Owning real estate is one way to diversify an equity portfolio largely composed of stocks. However, consider that property is less liquid than securities and it can take many years to build significant equity. It's important to invest in properties that generate enough income to cover taxes, insurance and maintenance so that investors aren't forced to pay those expenses out-of-pocket. It's also possible to buy and flip properties, but this is a less viable option when home prices are at their peak.

However, another way to participate in the real estate upswing is to invest in a real estate investment trust (REIT). This is a fixed-income vehicle that invests in residential or commercial properties, or mortgage-backed securities. REITs are publicly traded, so they are as liquid as stocks and bonds. Note that their value is tied to interest rates, so income may fall when rates increase.

Speaking of the commercial market, occupancy in large-scale corporate buildings continues to shrink in the wake of COVID-19, particularly in large cities such as Boston, Chicago, New York City, Washington D.C., Los Angeles and San Francisco. However, there are small markets in which occupancy has actually increased this year, thanks to cheaper rent and the trend to move business operations away from expensive metropolises. According to the National Association of Realtors, low rents in secondary cities offer strong incentives for more companies to relocate.[6]

Building

While the single-family homebuilding industry recovered from last year's economic decline pretty quickly, there are two challenges hindering this market. The first is the rising cost of building materials, which have increased by 12% compared to a year ago due to supply shortages of lumber and steel. Many builders also are having a hard time acquiring property and labor in various parts of the country.[7]

Higher building costs are another factor contributing to rising real estate prices. According to the National Association of Home Builders, the average new single-family home has increased by more than $35,000 within the last year.[8]

Final Thoughts

As people emerge from their lockdowns and the economy fully reopens, more homes will likely be put up for sale. This should help meet growing demand and curb the pace of price growth. However, the homebuying market is expected to continue among millennials and Gen Z for at least another decade.

As for the rest of 2021, the momentum for high prices is expected to continue, so it's likely a better time to sell rather than buy.

[1] Will Daniel. Business Insider. May 5, 2021. "Lumber prices top $1,600 for the first time ever as the ongoing homebuilding craze drains supply." https://markets.businessinsider.com/news/stocks/lumber-prices-top-1600-first-time-amid-homebuilding-boom-2021-5-1030392438. Accessed June 7, 2021.
[2] Les Shaver. GlobeSt.com. June 8, 2021. "Another Reason Why Wealthy Americans Are Moving." https://www.globest.com/2021/06/08/another-reason-why-wealthy-americans-are-moving/?amp=1. Accessed June 8, 2021.
[3] Elizabeth Renter. NerdWallet. April 21, 2021. "Listing Your Home in 2021? Here's What to Know." https://www.nerdwallet.com/article/mortgages/selling-your-home/2021-home-seller. Accessed June 7, 2021.
[4] Ibid.
[5] Ibid.
[6] Gay Cororaton. National Association of Realtors. June 1, 2021. "Cheaper Rents and Migration in Secondary Markets Boosting Demand for Tech, Finance, and Medical Office Space." https://www.nar.realtor/blogs/economists-outlook/cheaper-rents-and-migration-in-secondary-markets-boosting-demand-for-tech-finance-and-medical-office. Accessed June 7, 2021.
[7] Jacob Passy. MarketWatch. May 17, 2021. "Home-builder confidence remains strong, but buyers should expect rising prices." https://www.marketwatch.com/story/home-builder-confidence-remains-strong-but-buyers-should-expect-rising-prices-11621260739?mod=realtor. Accessed June 7, 2021.
[8] Will Daniel. Business Insider. May 5, 2021. "Lumber prices top $1,600 for the first time ever as the ongoing homebuilding craze drains supply." https://markets.businessinsider.com/news/stocks/lumber-prices-top-1600-first-time-amid-homebuilding-boom-2021-5-1030392438. Accessed June 7, 2021.

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