Real Estate Digest

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5 Real Estate Trends to Watch for 2017

As real estate magnate Donald Trump begins his term as president in 2017, there are likely to be some big changes on the horizon for the U.S. housing industry. Over the past year, housing markets across the country saw healthy increases in home values, thanks to low interest rates, lower gas prices, stronger wage growth, and millennials beginning to enter the market.

Although there are some clear trends for the upcoming year, future economic conditions could create uncertainty in some areas. Here are five real estate trends to watch for 2017.

1 Drones

Drones, officially known as unmanned aerial vehicles (UAVs), have been cleared for commercial use in the United States. The use of drones by the real estate industry is expected to increase dramatically over the course of the year, according to several analysts. In addition, home buyers and sellers will be permitted to use them with a few additional restrictions, according to the Federal Aviation Administration (FAA).

2 Not 'mixed-use' but 'surban'

As suburban-style living continues its decline, the rise of the 'surban' communities will continue. These communities are marked by a number of different housing arrangements, including town houses, apartments and single-family homes in a single neighborhood. John Burns Consulting expects nearly 80 percent of residential growth to occur in suburban communities over the next 10 years — up 71 percent from 2010 to 2015 — compared to just 15 percent for "urban" areas through 2025.

3 Millennials will skip the starter home

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More millennials are expected to buy a first home in 2017. These buyers are looking to purchase something more than a condo or starter home, thanks to having saved enough to spend on down payments.

However, student debt is still considered one of the top factors that will influence whether or not millennials buy homes. According to the National Association of Realtors, 44 percent of Generation Y buyers have student-loan debt of at least $25,000.

4 **Trump's win could affect real estate markets in unexpected ways**

Despite the fact that the Federal Reserve 's December 2016 interest rate increase was expected, there is still concern that Trump's win could affect the real estate market in some unexpected ways. Some observers fear that a recession is on the horizon, given Trump's plans to cut government spending dramatically during his first year as president. However, many analysts still believe that a Trump presidency could have a positive effect on the housing and mortgage markets in the long term, with home purchases remaining strong through 2017.

5 **Generation Z**

The millennial generation is currently dominating headlines. However, it won't be long before Generation Z joins them in the housing market. They are almost at the age of being able to buy homes, with the first Gen Z-ers celebrating their 18th birthdays in 2017. According to the National Association of Realtors, they are a lot different from the millennial generation, who experienced a recession, war, terrorism and a stock-market collapse.

Generation Z can expect low interest rates and better job prospects to help them cushion the high costs of college education, according to one analyst.

"It might sound a little traditional, especially when compared to what we've seen with millennials, but this is a generation that values homeownership," said Sherry Chris, chief executive of Parsippany–Troy Hills, N.J.–based Better Homes and Gardens Real Estate.

Five Signs Your Local Real Estate Market May Be in a Bubble

Since 2008, when the last housing bubble burst, homebuyers have been worried about getting into the housing market again, especially if they are concerned that their local areas are experiencing housing bubbles.

Those who buy during a bubble overpay for their homes. They might also have to stay in the home longer than they had planned in order to build up enough equity to sell. If homebuyers are looking for the right time to buy, they should watch out for these five signs of a real estate bubble.

1 **Risky Loans Are Common**

Subprime lending is not a sound practice, as exemplified by the 2008 recession. However, the U.S. government still backs loans that might be considered risky, especially those that require only a 3.5 percent down payment that are offered by the Federal Housing Administration (FHA). Although these loan products have higher underwriting standards than subprime low-down-payment products, they are still risky.

2 **Too Much Leverage**

"A bubble means lots of leverage," says Jonathan Miller, CRE, CRP, and president of Miller Samuel Inc., a New York, NY, real estate appraisal company. "And this [current] cycle has been remarkably devoid of leverage." Miller cites New York City as an example.

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Areas where there are more people financing their homes with low-down payment mortgages than buying with cash are at greater risk of a housing bubble.

3 Home Prices Increase Faster Than Salaries
When home prices rise faster than salaries, homebuyers often have to choose between buying homes they can barely afford or continuing to rent. If you believe that the housing market is in a bubble, it may be a better option to wait to buy or buy in the suburbs instead of a property in a pricey market.

4 Foreign Demand Slows Down
When foreign national buyer demand slows down in an international city, it is a sign that the local market may be experiencing a bubble.

5 Interest Rates Increase
Rising interest rates can decrease demand for housing because interest rate increases are often enough to convince some homebuyers, who were already on the fence about buying a home, to wait.

Of course, it is easy to think that a local housing market is experiencing a bubble when it actually isn't. Housing bubbles are unpredictable because they are not directly tied to rapid price appreciation. They actually are the result of unsustainable rapid price appreciation because the fundamentals of the market do not support the appreciation.

As a result, homebuyers should avoid purchasing homes that will put them under financial strain because they will be on the road to ruin if the market does not perform according to their expectations. Instead, buyers should purchase homes that not only meet their needs, but will also be affordable to them over the long term, even if real estate prices decline significantly.

Commercial Real Estate Is Facing Some Significant Challenges

Challenging conditions are ahead for the commercial real estate sector in 2017. According to Moody's Investors Service, as reported by the *Wall Street Journal*, the current 60-day delinquency rate on commercial real estate mortgages that have been packaged into securities is 5.6 percent, an increase of 1 full percentage point from the beginning of 2016. The U.S. commercial real estate sector is worth $11 trillion and there is approximately $390 billion in commercial real estate loans.

The delinquency rate is expected to worsen in the coming years because many loans taken out just before the financial crisis are about to come due, given that many commercial property loans have 10-year maturity dates. Morningstar Credit Ratings LLC expects that 40 percent of these commercial mortgage-backed securities (CMBS) loans that will mature in 2017 will not be paid off in 2017.

Attempting to refinance these loans will come with increased borrowing costs due to regulations mandated by the Dodd-Frank Act. These require CMBS issuers to maintain a minimum of 5 percent of the securities that they create on their own balance sheets as of December 2016. Increases in borrowing costs due to higher interest rates are making commercial real estate less attractive.

What Caused a Recent Spike in Foreclosures?

Foreclosures were previously falling at a steady pace to low levels not seen in nine years. However, October 2016 marked the first sign of a crack in the housing recovery when foreclosures spiked. The number of properties with a foreclosure filing, including default

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notices, scheduled auctions and bank repossessions, increased 27 percent in October 2016 compared with September 2016, according to a new report from Attom Data Solutions.

Although this is still a decrease of 8 percent from a year ago, year-over-year foreclosure rates had been dropping at double-digit rates throughout 2016 until October. These newer foreclosures are mostly due to government-insured FHA loans.

"While some states are still slogging through the remnants of the last housing crisis, the foreclosure activity increases in states such as Arizona, Colorado and Georgia are more heavily tied to loans originated since 2009 — after most of the risky lending fueling the last housing boom had stopped," said Daren Blomquist, senior vice president at Attom Data Solutions.

The spike could be due to a dynamic resulting from the recovery itself. When the mortgage market crashed and private capital fled entirely, the government stepped in. Government-insured FHA loans increased from roughly 3 percent of mortgage originations in 2005 to as high as 18 percent in 2010, according to *Inside Mortgage Finance*.

Given that these loans require just a 3.5 percent down payment, they are inherently riskier. Borrowers who use FHA loans, which require mortgage insurance, are doing so because they don't have the income to afford mortgages that require higher down payments.

Homeownership Recovers From 50-Year Low

After falling to its lowest level in 50 years, the U.S. homeownership rate began to increase slightly in the third quarter of 2016. At 63.5 percent, it is still much lower than it was at the height of the last housing boom.

Household formation, which is the number of newly occupied housing units (both rented and owned), increased by just over 1.1 million. Although most of the housing formation has been on the renter side, just under 50 percent of new households formed in the third quarter of 2016 were owners.

Rental demand continues to outpace housing demand, given that younger buyers are still struggling with high levels of student loan debt, higher home prices, weak income growth, and tighter credit conditions.

Millennials have also been taking longer to get married and have children, which are the two main drivers of homeownership. However, the dynamics are starting to change as millennials enter into their 30s. In addition, the number of available homes for sale continues to decline.

"The number of homes for sale declined more in October than at any other point this summer, leaving us with 11 percent fewer active listings than a year earlier and the largest monthly inventory drop since July 2015," said Jonathan Smoke, chief economist at Realtor.com.

Mortgage Rates See Increase After Presidential Election

Following the presidential election, the average rate of a 30-year-fixed-rate mortgage increased to 3.94 percent. This higher rate means that the monthly payment on a $250,000 home loan with a 20 percent down payment would be $948, which is an increase of $42 in just a week. At the same time in 2015, a 30-year mortgage was 3.97 percent.

In addition, the 10-year Treasury note closed at 1.85 percent on Election Day. One week later, it was 2.24 percent. Higher yields make borrowing more expensive. Although tight inventory levels have

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helped to push up housing prices in markets across the country, the low interest rates were helping buyers deal with the higher prices.

However, the prospect of higher rates is starting to affect mortgage applications, with mortgage applications dropping and the Refinance Index taking a hit. Analysts are paying attention to the language that the Federal Reserve uses to get an idea of future policy, which could mean that markets reposition on the next interest rate increase if the central bank takes a more hawkish tone rather than a soothing one with its message.

"It is always important to keep perspective: If you look back, rates are only as bad as when we began 2016," says Keith Gumbinger, vice president of HSH.com.

New Residential Construction Starts Jump 25 Percent

After months of record-low housing inventory, which has had a major impact on affordability across the country, there may be some good news on the horizon for homebuyers, according to the numbers reported by the U.S. Department of Housing and Urban Development.

In October 2016, privately owned housing permits were at a seasonally adjusted rate of 1,229,000, representing a 0.3 percent increase from September 2016 and a 4.6 percent year-over-year increase when compared to October 2015's estimate of 1,175,000.

Single-family housing permits reached 762,000, with new construction starts for privately owned housing experiencing a 25.5 percent month-over-month increase and a 14.4 percent year-over-year increase. Single-family housing starts increased to 869,000, representing a 10.7 percent month-over-month increase in October 2016 over September's 785,000.

"President-Elect Trump could implement a number of policies to help push the number of starts toward their historical average, but there's a long way to go. Though Mr. Trump has discussed demand-side policies that would ease mortgage lending, such as Dodd-Frank reform, we encourage the President-Elect to also focus on supply-side policies given inventory shortages across the country," said Ralph McLaughlin, chief economist at Trulia.

Trump's Tax Plans Could Affect Real Estate Market

Trump's tax-change plans, along with ideas that have already been proposed on Capitol Hill, could have significant effects on many people. His first plan to substantially increase the standard deduction ($30,000 for joint filers and $15,000 for single filers) could make it less attractive for homeowners to file mortgage-interest or property-tax write-offs.

Robert Dietz, chief economist of the National Association of Home Builders, estimates that the number of itemizers might drop from the current 25 percent of taxpayers to 10 percent or even just 5 percent.

In addition, Evan M. Liddiard, senior federal tax policy representative for the National Association of Realtors, believes that if you raise the standard deduction dramatically, "itemized deductions will become less relevant" and previously valuable and distinctive "tax incentives [for] homeownership evaporate even while taxes are not necessarily being reduced." This gives people less incentive to own a home rather than rent.

None of this has happened yet, given that the president's term is just starting. We expect to see months of committee hearings, debates, and lobbying before any tax plan gets sent to the president's desk. However, if tax reform becomes reality, the removal of these incentives to buy a home could result in homeownership levels declining in the United States.

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Useful Information From the 2016 Homebuyer Survey

The 2016 Profile of Home Buyers and Sellers conducted by National Association of REALTORS®(NAR) provided some useful insights into how buyers are searching for homes. The results of the survey revealed

that technology is becoming an increasingly important aspect of the home search process for buyers.

This year, 86 percent of buyers reported that they had used the internet frequently during the home search process. In 2015, 54 percent of buyers said that they frequently used a mobile or a tablet application.

Although 71 percent of buyers said that they frequently relied on a real estate agent for information, only 17 percent said that they had contacted a real estate agent first, with 44 percent of buyers using the internet as the first step of the home search process.

In general, buyers used multiple sources of information to find homes, with online websites (95 percent) and real estate agents (92 percent) ranking as the most-used sources. Mobile and tablet applications came in at 72 percent as the third most-used source of information.

However, 49 percent of buyers still used yard signs as one of their sources of information. Only 16 percent of buyers used newspaper ads as an information source. Just 3 percent used television as an information source.

Agents' Corner

What Today's Student Debt Means for Tomorrow's Housing Market

Americans collectively owe $1.2 trillion in student loan debt. This

debt continues to burden college graduates for years, especially when they are trying to buy a home. The more money buyers owe on student loans means the less they have available for a down payment and monthly mortgage remittances.

With too much debt, prospective homebuyers with student loan debt will have borrowed themselves out of their ability to purchase a home, given that even the most generous lenders will refuse applications with debt to income ratios of greater than 43 percent.

"Debt service can damage the eligibility of college graduates even when they consistently make their monthly payments," says Mikkie Mills, writer at Adam's Homes, a homebuilder serving the Southeastern United States. "Sometimes, though, the demands of re-payment and the lack of adequate employment opportunities create the perfect storm for default."

Defaulting can lower the potential homebuyer's credit score significantly, hurting job prospects and mortgage applications. In addition, property insurance premiums are rising after having been low for a long period of time, making it even more expensive for potential homeowners to obtain insurance on their homes.

Property insurance premiums also affect mortgage underwriting, given that property insurance premiums impact the PITI, which stands for principal, interest, taxes and insurance, of a mortgage.

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"There is always room to improve for the customer. At TitleSmart we're obsessed with all of the little things that make up a great customer experience."

Co-Founder and President Cindy Koebele