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Recovery?

One thing is certain – single family residential pricing is climbing up in different metropolitan pockets in the US. Going back to the NYU Professor Damadoran's blog posts, value and pricing is different. The intrinsic value of houses, is roughly 10x annual rent income. So if a house can rent at $2,000/mo, or annually $24,000, then the house could sell for $250,000. This would be similar to a P/E multiple of 10x, a 10 handle, or a 10% yield on the investment, which is close to the 7-8% cap rate, on larger, commercial properties. Yet, we know that these properties are selling for 20 handles, which is where we can see the divergence between value, as stated above, and pricing, which is driven by supply/demand. Value is somewhat fixed, whereas pricing can sway into the fringe.

We are picking up more news related to pricing recovery in Los Angeles, Phoenix, Vegas in the West. These areas have large population growth and the demand is present for another recovery. We knew in our hearts that they would recover from the floor pricing, but it was a matter of time. We don't believe housing **prices** will return to the heydays, and if it does, it is not justified. Of course, flippers will ride the wave all the way to the top, before the poor investor at the top crashes with the market. And we know what happened to the global economy, when the market unraveled. We believe this could happen again in the future, seeing how 1) mortgages are still being securitized, albeit certain regulatory legislation is putting stricter controls on the underwriting process (robo mortgages), so the transfer of ownership, thus risk, is continuing to be spread to investors globally, but with less risky subcomponents 2) banks like Wells Fargo are ramping up their mortgage units, and we know greed begets greed, and we will soon see banks making risky, zero docs, or a differently named mortgage, available to the borrowers, with banks absorbing large non-provision losses on their books, and the list goes on.

In our capitalistic society, it is impossible to segregate greed and growth. Although we don't necessarily believe Greed is good, it does fuel the booms and catalyzes the bust, so greed will resurface from its' 5 year slumber. Has anything really changed? We believe patches have been placed, but no material overhaul.

Soon, real estate frenzy will take its place as excess liquidity from QE shifts from fixed income, to equity, to real estate. Banks are well capitalized and mortgage lending is becoming more lucrative. They will gradually lower requirements and sub-prime mortgages will pick up, opening up opportunities for new home owners to purchase homes, pushing up prices, and current homeowners getting out of negative waters. This will create more transactions, more headlines on the news, and a full blown real estate recovery will lead to job creation.

One thing is for sure: had the government not intervened 5 years ago with the bailouts, stimulus, and monetary policies, the market would have crashed and the economy would have collapsed. Today, the same follows suit.