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Recovery?

One must find the source for the real estate recovery news surfacing in the headlines. Why are people talking about a real estate recovery while others are focused on an impending recession? Is this hypothetical recession, a macro event triggered by the fiscal cliff, and the real estate recovery sector specific? Overall, optimism surrounding the economy in 2013 is steady amongst the analyst community.

We are set in our mind when it comes to analyzing a company or a specific investment security for its' investment merit. However, we don't have a strong grasp, and honestly, even an inkling of an idea, when gauging the economic barometer. Our due diligence consists of aggregating news clips from a variety of sources, so we can't see the full, true picture. To us, in our gut, news of economic recovery doesn't sit well. How can the recovery be in place, when the system is defunct? Does recovery mean YoY improvement, but turning course on a dime from bad news in Europe, or is it a full-flung recovery, a flushed system, a full removal of 2008 gunk? The losses held by the private banks were transferred to the FED and the FED printed more money, so the burden has now shifted on the U.S. taxpayers. This is the spiel regurgitated by bloggers and columnists on the internet. Is this true? Sadly, we have more questions than concrete answers.

On the foreclosure front, filings have declined YoY as housing price improvements have lowered LTV figures, and some underwater mortgages are now in the black, providing incentive for mortgagees to keep current on mortgages. A recent survey completed by renters reveals they are inclined to purchase a property in 2 years, propping forecast estimates on the demand side, and another reason for current owners to remain current on the mortgages. As the distressed inventory sells off, and housing prices continue to climb in the single digit, we believe investors will allocate capital away from equities into real estate. Employment figures need to improve dramatically to set a firm footing for real estate related securities.

One columnist suggests 1) QE3, FED money and 2) mortgage banks holding real estate properties off the market to constrict the supply of for-sale properties, is contributing data points which signal improvement. QE3, where the FED would purchase mortgage backed securities, drove up the prices for these securities, lowering the yield. This affects the MREITs, which are REITS that purchase the MBS, and depend on the yield from the MBS to pay out dividends. MREITs typically finance the MBS purchases from repo financing, which have near 1% interest costs. With yields compressing on the MBS, MREITs are facing slimmer margins, placing some MREITS on the chopping board for short investors who are expecting dividend cuts.

Recovery for short term? Yes. In 2013? Yes. Full recovery, meaning home sale price improvement including shadow inventory? Not sure, and remain skeptical. We feel it is premature to participate in the real estate market right now, although it may be a great investment in the big scheme of things. Revert, always revert means things have a tendency to switch back to the mean, or the norm. Is the real estate norm the prices we saw in the run up to 2007? We think not. We think the norm is our current level, but anticipate investor frustration to fuel another bull rally in single-residential properties in 2013. In summary, short term 2013 rally, but not a fundamental, full recovery.