Getting Real

A decade after the real estate sector imploded, observers see varied signals in the market.

BY CALVIN HENNICK

What is the current state of the real estate market? It depends on which headline you read.

Some warn of red flags that indicate a market set to crash, or a second housing bubble that could burst at any moment. Others paint the opposite picture, talking about sizzling markets causing bidding wars in new locations, with no signs of cooling on the horizon.

"I think there are mixed signals. For the most part, economic fundamentals are strong. The economy is growing at a good pace. Unemployment is low, job growth has been consistent, and consumer confidence and business sentiment have been high," said Andrew T. Piekarski '87CBA, a Real Estate Director at Wafra Investment Advisory Group, who is also a St. John's alumnus and teaches an undergraduate course on real estate finance at the University.

"All of these point to a continuing demand for space and the potential to increase rents. There are some offsetting factors, though, which contribute to some uncertainty. Supply has been increasing, interest rates have been trending up, and there is growing unease with the potential impact from trade disputes and ongoing political turmoil," continued Mr. Piekarski. "So, despite strong fundamentals, there are other forces at work and they are being recognized in the market. Real estate pricing is already high compared to historic pricing. Even with strong fundamentals, it is hard to see much upside in prices. I expect that you will see pricing moderate."

With the 2008 real estate crash still fresh in most people's minds, some potential investors are understandably skittish about entering a market that has experienced several straight years of solid growth. While no crystal ball can guarantee positive returns, experts like Mr. Piekarski stress the importance of understanding the underlying factors that are putting both upward and downward pressure on property prices.

Economic Indicators

"Everything is ultimately interconnected with the economy," said Mr. Piekarski. "Where there is uncertainty, that tends to dissuade businesses from taking on additional obligations, including expanding space."

Mr. Piekarski notes that current economic markers, such as growth and employment, are largely positive, but adds that any number of developments—such as a further deterioration of relationships between the US and its trade partners, or domestic political turmoil—could cause a shock to the economy that would have a negative impact on real estate.

Stephen Melman, Director of Economic Services for the National Association of Home Builders, said the current economic recovery is "getting to be long in the tooth." However, Mr. Melman notes that duration alone is not a reason to think that conditions will soon sour.

"An expansion does not end because of age. There has to be a reason for it," he said. "It appears like there is going to be growth. Gross domestic product looks like it is going to grow, and the expansion is going to continue."

Taxes, Tariffs, and Interest Rates

Interest rates and tariffs on building materials are two in-flux factors that could have dramatic impacts on the real estate market, and the impacts of the Tax Cuts and Jobs Act of 2017 are still making themselves known.

"In recent market surveys I have looked at, the number-one risk factor to the industry cited by market participants tends to be interest rate uncertainty," said Robert J. Sein, Esq., Director of the Mattone Family Institute for Real Estate Law at St. John's University School of Law. "As interest rates increase, this exerts downward pressure on asset prices, all other things being equal. It has a dramatic effect throughout the industry. From the perspective of the individual homeowner, the question will be, to what extent does an increase in interest rates compress home prices? There is not a perfect correlation there, but it is a big factor."

Mr. Piekarski said that tariffs are "too new and raw" to have had a clear impact on the real estate market yet. "But it is clearly a risk," he said. "While the potential impact from tariffs is still uncertain, it could negatively impact business decisions over the near term."

Exactly how the Tax Cuts and Jobs Act of 2017 will influence the real estate market is still unclear. While lower taxes for many businesses and individuals could spur economic growth and investment, there are also components of the law that could have an adverse impact on the real estate industry. For example, the increase in the standard deduction for individuals means that fewer people are likely to itemize their deductions, effectively eliminating the mortgage interest deduction for some homeowners. Furthermore, the cap on deductions for state and local taxes may make some homeowners less likely to upgrade, as many of them will no longer receive an income tax benefit to offset increased property taxes.

The cap on mortgage deductions could even de-incentivize home upgrades, according to Laura Lee Mannino, J.D., LL.M., Associate Professor, Accounting and Taxation, at St. John's.

"The good news is that the new law does not place a cap on the deductibility of property taxes that are paid or incurred in connection with a real estate business," she said. "It is difficult to see the long-term effects of these changes because the limit on the state and local tax deduction will sunset at the end of 2025."

"It is a mixed bag, with both advantages and detriments," added Paul Bishop, Vice President of Research for the National Association of Realtors. "For the commercial real estate industry, there are benefits. But for many homeowners in expensive markets, it is a problem. One of the impacts of tax reform is that it made home ownership more expensive."

Strong Demand, Short Supply

"There are too few homes available, given the number of buyers out there," said Mr. Bishop. "If you go back to the financial crisis, there were plenty of homes on the market, and now we really have a housing shortage. That is probably the most important factor that determines what else is going on in the real estate market."

As of June, Mr. Bishop said, there was a 4.3 month supply of homes on the market—well short of the six-month supply that would create a balanced market.

"We are a long way, if you use that measure, from seeing any excessive number of homes on the market that would cause prices to decline in any significant way," said Mr. Bishop. "One big difference today, versus what we experienced a decade ago, is that the reason prices are rising is because of pent-up demand, as opposed to people speculating."

Mr. Melman adds that home builders are struggling to meet the demand for housing for a number of reasons, including rising lumber prices—even before new tariffs—and a lack of available lots in desirable communities.

"There are a lot of things working against builders right now," said Mr. Bishop. "I do not know a builder who would not put a shovel in the ground if they could do it. There are a lot of constraints. I do not see any crash in prices because there are too many people and too much demand."

Ordinarily, one might expect prices to continue to rise until demand is met. However, in some markets, prospective buyers have begun to sit out because there is simply nothing available in a price range that they can afford.

"Prices have been increasing at a steady clip for several years," said Mr. Bishop. "If you are in the market to buy a home, especially for first-time buyers, that can be a real challenge. We have seen prices for existing homes rising by about six percent a year. You look at that relative to average income increases, and they are nowhere near that quick. The squeeze is getting tighter and tighter. It is not just a matter of too few houses."

"FOR THE MOST PART, ECONOMIC FUNDAMENTALS ARE STRONG. THE ECONOMY IS GROWING AT A GOOD PACE."

—Andrew T. Piekarski '87CBA, a Real Estate Director at Wafra Investment Advisory Group

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Andrew Piekarski, a Real Estate Director at Wafra Investment Advisory Group, who also teaches an undergraduate course on real estate finance at St. John's, said the location of the University gives St. John's students unique access to talented adjunct faculty members and hands-on experiences. "The pace and feel of being in New York is going to be different from the experience anywhere else," he said.

Robert J. Sein, Esq., Director of the Mattone Family Institute for Real Estate Law at St. John's University School of Law, calls New York "the world's best training ground" for real estate professionals. "It is hypercompetitive, and the deals are sophisticated and heavily negotiated," said Mr. Sein, who anticipates partnerships between the emerging M.B.A. programs and the Mattone Center. "If you can practice real estate law or succeed in the real estate business here, you can succeed anywhere."