# The 2022 Real Estate Market: Bubble or Not?

I listed and sold Real Estate during the build-up to the crash of 2008. I contend that this market is NOT the same. Let me explain.

Google defines "bubble" as **a good or fortunate situation that is isolated from reality or unlikely to last.** *Good*? *Fortunate*? That depends on your perspective which makes the definition *vague*, allowing people to see both markets as more similar than they really are.

Whatever you think caused the crash in 2008, I will focus on *my experiences*. Starting around 2002, the specific months and years involved varied across the country, interest rates dropped <u>dramatically</u> to generate buyer interest. Interestingly enough, the rates that created that heated market were very much like what we see today which has many complaining about rising rates. How is that perspective?

In addition, and very troubling, lending standards <u>loosened</u> *dramatically*. The changes included a reduction in the minimum credit score required to "qualify" for a loan as well as increased ratios, meaning that prospective buyers could use more of their gross and net income to buy Real Estate. Ever hear the phrase "house poor"? Let me digress for a moment.

I have always asserted that the smartest people on the planet work in finance of some sort. Not to disparage other professions but it is impressive to see how financial people use data to make decisions. I wish "analytics" in sports were as good but the issues with them likely relate to who is using them.

Here is my point. Lenders are NOT in business to loan money. Nor are they in business to turn down "credit worthy" borrowers: there are no awards for "most *declined* business"! Lenders are in business to MAKE MONEY plain and simple and they do that by lending money to "credit worthy" borrowers. Many companies quickly sell their loans as investments in the borrowers using the Real Estate they "own" as collateral if the borrower defaults. They do NOT want to evict people to take ownership of Real Estate. Doing that, in addition to the emotion of displacing homeowners, is costly and time-consuming, perhaps costing them tens of thousands of dollars.

There are two major components to making loans. First, the prospective borrowers must demonstrate their "creditworthiness". Many joke that lenders will only lend money to people who can prove that they do not need the money. Anyway, lenders use "*metrics*" to assess how viable a prospect is. I do not know how they determine the "benchmarks" they use but do not believe that they intentionally discriminate although I am sure that some people let *personal bias* affect how they do business. Others may commit fraud to enrich themselves. I will focus on how things are *meant* to work. The standards are the same for ALL people as far as I know so, just because one group seems disadvantaged by the metrics, does NOT prove anything wrong happened. That is a lesson I think many need to learn.

The second component is an *appraisal* of the property to ensure that the lender is making a smart investment and, worst case, can recover their money should the borrower default. I have heard of issues where some allege that specific groups suffer bias with appraisals but think some of that may have to do with location, features and condition of the Real Estate rather than simply assuming that appraisal issues relate to the owners or prospects but that is a subject for another day.

During the years 2002 through 2008, it seemed like many borrowers with lower credit scores AND higher “ratios” than used historically were buying homes. The “ends seemed to justify the means” and helped sell a lot of houses, enriching many. It also seemed like every sale was a “new high” for the local market. Then, **the market hit a wall**. It was destined to happen regardless of what many thought. How many sellers turned down good offers, assuming others were coming? How many buyers thought they could delay buying? Delaying likely benefited buyers more than sellers unless the buyers were truly able to finance and own Real Estate.

Unfortunately, many borrowers were sold “adjustable” interest rate loans to “qualify” with little consideration about what would happen when their interest rates reset to higher fixed rates. OOPS! In addition to the revised lending standards proving problematic, this change led to many new owners being unable to continue making their monthly payments. The new phrase of the day was “*short sale*” where owners were allowed to sell their houses even though the proceeds were not sufficient to pay off their loan debt. It was preferable to “foreclosure” for owners and lenders.

As far as the effects on the Real Estate market, they happened in stages. Early on, many houses that had not sold earlier were now selling and many new buyers were able to achieve the American Dream, even if only for a short time. The initial reaction was a surge in buyers, clearing out our prospect “pipelines” as many who had been “waiting” to buy jumped off the fence.

Then the market shifted: the imbalance of new buyers and “For Sale” houses created stiff competition and drove prices up. It reached a point where the combination of historically low interest rates and historically high selling prices resulted in monthly payments similar to what would have occurred with “normal” interest rates and selling prices. However, the <u>major</u> difference was that you could refinance a high interest rate but NOT a high selling price. While sellers continued to achieve great results, buyers were being impacted. Once adjustable rates started to reset to higher fixed rates the market came to a screeching halt. If you look at statistics in my market for 2008 and 2009 you will see a precipitous drop in prices.

The “bottom line” is that the 2002-2008 market was leveraged with many instances of bad financing decisions resulting in the “bubble bursting”. The “irrational exuberance” of many buyers hurt them for many years to come. As recently as a few years ago I was still meeting sellers whose property values were well below what they had paid years before. Some refused to sell for less than what they paid even though they had a lot of equity while others had used their home’s equity like an ATM and simply owed too much to try selling. There were many lessons to be learned, but *did we*? I still hear talk about trying to get more groups involved in homeownership. That is great but the devil is in the details and the *end does not justify the means*! Instead of lowering lending standards, focus on why some people have issues with credit scores, managing debt and earning a good income. Raising the minimum wage was not a viable answer either and the effects are starting to become apparent!

The current market, while some may assume it meets the Google definition, has *some* similarities <u>but</u> a very different “cause” and likely a different outcome. The pandemic suppressed inventory levels. Some sellers did not want buyers coming into their homes. Some were financially affected by the lockdown and could not buy their “*next* home”. Many buyers were reluctant to visit homes or were also financially impacted. However, many buyers were still looking even though inventory levels were low. The imbalance created a serious buyers’ market resulting in intense competition and huge price surges. That being said, it “appears” that these buyers were financially qualified although I cannot state how valid appraisals are in a market like this as no one has a crystal ball. At some point pricing has to stop rising and perhaps start to decline, doesn’t it?

Assuming (and hoping) that the typical new owner is able to make their monthly payments, I wonder how many will suffer repercussions such as "buyer remorse" if they bought "sight unseen" and/ or without inspections? How will what they paid impact their future decision-making if they think about moving? A major difference between markets is that we are not seeing "short-sales" and "foreclosures" resulting from loose lending standards. While both outcomes will always occur, the current causes have more to do with the overall economy.

There is a lot more to what caused these two similar markets and it remains to be seen what evolves in the next few years. As far as whether the current market is a "bubble" or not depends on how you define the term. To me, there is quite a difference between lowering lending standards so more people can become homeowners and what is happening today when buyers "seem" financially qualified even if paying over the "asking price" and being extremely creative to gain a competitive advantage. Even if sales prices tumble, which they may as some owners enter the picture after the pipeline of buyers has dried up, to me that is more like a "stock market" correction and not a "bubble" based on faulty underpinnings.

Semantics? Perhaps but I have heard too many equating the two markets. While I respect and understand buyers expressing concern about buying Real Estate today, wondering if prices are sustainable, there is never a guarantee that Real Estate prices will appreciate in a straight line if at all. Look at the stock market regularly and you will see this in action. There is always risk in ANY "investment" but what are the alternatives? If you are renting, is that a more prudent bet than owning? You will never recover your rent payments and they continue for as long as you rent. If you have delayed your plans to move, what is the cost to your personal happiness and any other factors impacted by your staying put?

Buying and selling Real Estate are **personal decisions that deserve a lot of consideration**. This type of market does not typically offer time to decide. These are *emotional decisions justified with logic*. Planning and preparation are critical even if the time available is shortened. The time to plan and prepare is not after you find a house you think you like. Start before looking! Some lessons from the real "bubble" should be helpful.

Contact me in 5 or 10 years and we will have a clearer picture of what happened!

**There is no time for inexperience, empty promises *or* false expectations!**

**HIRE WISELY: We are not "*all the same*"?**