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Does Recent Equity Build-Up Present An Opportunity

- Aug 4, 2015
- joelcone
- Real Estate Investing

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A long-time investor in rental properties, Lin He believes it's time for a change in his investment strategy. With as many as 50 southern California rental properties in his portfolio (condos and single family homes mostly in Orange County) He is switching things up.

Continued observation of local market trends has led He to decide that his properties have captured about as much appreciation as they are going to in the present economy. So, he has converted that built-up equity into cash flow and is moving into other investment opportunities – buying apartments in particular.

"The rapid appreciation of the price is pretty much over," said He, who is also a real estate broker and general contractor. "Basically, I'm moving from capturing appreciation in equity to capturing appreciation in cash flow which in turn will be translated into more equity."

A report released by RealtyTrac earlier this year revealed that the number of equity-rich homes declined between the fourth quarter of 2014 and the first quarter of 2015.

"The biggest change in the equity landscape nationwide was in the category of homeowners with between 20 and 50 percent equity, which saw a net decrease of nearly half a million between the end of the fourth quarter and the end of the first quarter," said Daren Blomquist, vice president at RealtyTrac. "Nationally, there's 625,000 fewer homeowners who have 20 percent equity or more."

Based on the data compiled in RealtyTrac's U.S. Home Equity & Underwater Report for the first quarter of 2015, Blomquist wondered whether other real estate investors – like He (or homeowners for that matter) – are starting to cash out, capturing their built-up equity and either holding out on the sidelines, or redirecting those funds into new investment or housing opportunities.

Top Equity Markets Are Overall Hot Markets

Not surprisingly, the five metro areas with the highest percentage of equity rich properties in the nation were in expensive housing markets with substantial appreciation since the Great Recession bottomed out.

Those equity rich markets include: San Jose, Calif. (43.7 percent), San Francisco, Calif. (38.6 percent), Honolulu, Hawaii (36.2 percent), Los Angeles, Calif. (32.2 percent) and New York City (31.0 percent).

Completing the nation's top 10 markets for equity rich properties were: Pittsburgh, Penn. (29.7 percent), Poughkeepsie, New York (28.3 percent), Oxnard, Calif. (27.7 percent), San Diego, Calif. (27.0 percent) and Buffalo, New York (25.5 percent).

Should Investors Consider a Change

Based on the data compiled for the report, Blomquist believes investors should be at least considering the possibility of cashing out of the market.

"It might be a very wise decision to do that," he said. "The reason is some markets have seen 20, 30, 40 and even 50 percent gains in home values over the last three years and that is unsustainable. We know that the best case scenario going forward is that home values are going to plateau. The worst case scenario is they are going to decline or crash. So investors would be wise to be thinking ahead and not expect the gains of the last few years to continue. You should always be thinking of your exit strategies."

However, there are lots of reasons to think that the best case scenario will be realized, he added.

According to the RealtyTrac report, the Denver, Colo., housing market ranked 30th among the nation's top equity-rich metro areas with 19.5 percent of its housing stock having a loan-to-value ratio (LTV) of at least 50 percent or lower at the end of the first quarter of the year.

Despite the built-up positive equity in his area though, lawyer, author and veteran real estate investor Bill Bronchick does not believe that investors are looking to cash out of the area in order to invest in other markets or property types.

"For the most part people are happy with what they have. Rents are skyrocketing and vacancies are zero and that's a great place to be," Bronchick said. "Even though equity is up, prices are up too. It's a downward spiral because they will have to pay top dollar for the next one."

Even in the Seattle, Wash., metro area which reportedly had 21.4 percent equity-rich properties in the first quarter, OB Jacobi, president of Windermere Real Estate, said it does not make sense for investors to cash out.

“I don’t know if there’s been a ton of equity recapture for investors because rents are rising so fast, said Jacobi. “Why would you do it? We’re not seeing a lot of investors disposing of their assets to make a move into other opportunities.”

If there is any significant cashing out of investment properties, Mark Hughes, chief operating officer of First Team Real Estate in Irvine, Calif., it is most likely on the part of the large institutional investors who spent millions after the Great Recession ended buying up the best distressed properties they could find around the country.

“They are not purchasing anymore. They are selling a few here and there that they would have held onto,” Hughes said. “Now they are looking to recoup their investment plus 15 to 20 percent appreciation. They’re feeling that holding on much longer is not going to improve that delta.”

The Homeowner Conundrum

Based on the belief that the average homeowner stays in their home between six and 10 years, RealtyTrac estimates that 13.2 million homeowners fit into that category, making them the most likely to sell or want to sell their homes.

However, this still presents a difficult problem for homeowners despite their desire and financial wherewithal to sell. Executing a purchase transaction is nearly impossible given the current set of market factors in many of the nation’s most desirable housing markets — particularly inventory shortages.

“When you sell what is there to buy,” said Bronchick. “Here in Colorado we are down 75 percent in inventory. You can sell for top dollar but good luck finding a replacement.”

In Seattle, Jacobi noted that the inventory level is down to half a month’s supply.

“That’s ridiculous,” said Jacobi. “It makes it very stressful for buyers. We’ve heard stories of sales for double the list price, which is incredible. I think there are people moving up much more now than since the recession happened obviously. They’re more comfortable about the economy and jobs and have cash in the bank. It’s just hard to find the right house.”

One possible alternative explanation for the decrease in the number of equity rich homes during the first quarter of 2015 could be the increase in homeowner applications to cash out their equity and refinance their homes.

The first quarter refinance report from Freddie Mac noted that 63 percent of single-family applications were refinances, taking advantage of low interest rates, according to the Mortgage Bankers Association. In all, the report estimates that a total $7.7 billion in net home equity was cashed out during refinances of conventional pre-credit home mortgages.

Additionally, the National Association of Realtors reported in March the largest monthly increase in sales since December 2010, and the sixth straight monthly year-over-year increase in sales. This trend could lead to the conclusion that homeowners with enough desire and equity to sell might have cashed out during the first quarter in order to purchase another property elsewhere.

“The combination of low interest rates and the ongoing stability in the job market is improving buyer confidence and finally releasing some of the sizeable pent-up demand that accumulated in recent years,” said Lawrence Yun, chief economist at NAR.

As with any economic cycle, there are no magic tea leaves or fortune teller who can accurately predict when the real estate cycle might top out once again and another bubble burst occur.

"Trying to 'time' a market is always a gamble, whether you're a trader on Wall Street, or a homeowner or investor trying to decide the exact right time to sell your property," said Rick Sharga, executive vice president at Auction.com, an online real estate marketplace. "One of the things we learned the hard way during the recent boom and bust cycle is that home prices don't always go up. Buying and selling at the wrong time can be a financial disaster for homeowners and investors alike. So anyone considering such a transaction should take advantage of all available market data in order to make an informed decision."

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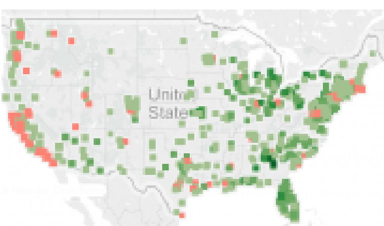
- 

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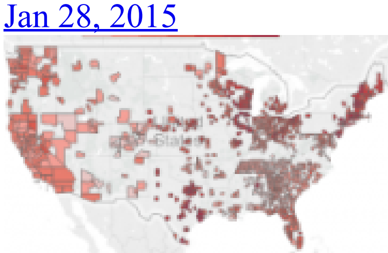
- 

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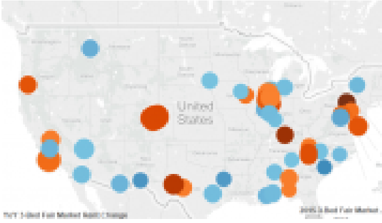
- 

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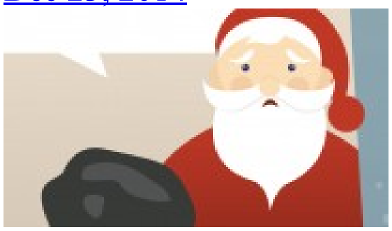
- 

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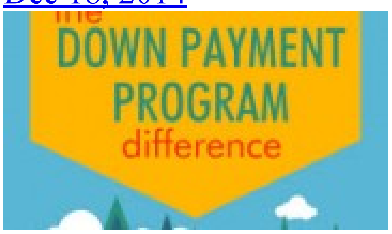
- 

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