SPONSOR SPOTLIGHT

REAL ESTATE: TWO MARKETS EMERGE

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Probably the most common, single investment we make during our lives is buying a home. The strengths and weaknesses of the real estate marketplace have always been reflected in our economy. Or, is it the other way around? It does not really matter. As one crashes, rebounds, or thrives, so does the other. And no topics have so completely dominated our headlines for the last several years as the housing crash, signs of recovery, and our resulting—or underlying—economy.

In a May 27, 2016, *Fiscal Times* article titled, "The Housing Market Horror Story Isn't Over Yet," author David Dayen observes that, "We don't have a housing market, we have two: one for the rich and one for the rest." His research showed that in April of this year, the average selling price of a home was $379,000, a new record—though, accounting for inflation, this reflects only 50% of the last housing bubble.

He goes on to point out two very interesting, supporting facts reflected in market trends for 2013-2015: 1) sales of homes priced at $200,000 and below are falling; and 2) sales of homes priced at $400,000 and above are rising. This decreasing inventory/market for lower priced homes was confirmed by Bill McBride of Calculated Risk. He reports that in 2002, 30% of new home sales were priced well below $150,000. However, by this past April, that percentage had dropped to 2%. Dayen says: "The conventional wisdom on this topic is that lower-income homeowners with subpar credit scores were being pushed out of the housing market by gun-shy lenders wary of new government regulations." He supports this statement with statistics from The Urban Institute, which reflect that in 2014, 1.2 million borrowers were denied credit. But Dayen offers another possible reason for this trend. He cites Archana Pradhan, an economist with market research firm CoreLogic. Pradhan says the data shows that the issue is not a constricted supply of mortgage credit, but less demand by those buyers usually in the market for lower priced housing. He posits that potential buyers with subpar credit are preemptively removing themselves from the market, assuming that they will be denied a mortgage.

Two other trends should be considered as possible explanations for this. First of all, wages have been relatively stagnant for years, and so, when considered along with the uptick in home prices, one can assume that home-buying ability is declining. Secondly, an estimated 6.2 million families have lost their homes to foreclosure since September 2008 according to CoreLogic. Almost every middle class household has experienced, or knows someone who has experienced, a default, loan modification, eviction, a home underwater, etc.

It is not hard to see why these trends would discourage new buyers, especially at the lower end of the market. One domino effect of this trend is that developers are catering to those without credit issues and with the money for luxury homes, where prices continue to rise–further dividing the haves from the have-nots.

Meanwhile, the banks still have a large inventory of delinquent and non-performing notes as well as foreclosed homes with which to contend. This creates a real estate marketplace that is ripe with opportunities for shrewd financial experts.

Many banks and other lenders sell foreclosed properties in bulk at a fraction of their real value in order to quickly recoup some of their losses. The majority of REOs (Real Estate Owned) are located in inner city and rural settings, and many are in need of some repair. Companies like Stonecrest buy these REOs on behalf of their investors who finance the purchases through a fund. Our REO fund diversifies risk among many homes located across the country. The homes are then sold to qualified purchasers at wholesale and retail levels. Stonecrest targets properties with the potential to achieve a pretax total fund annualized return of 20%-25%. At the end of the portfolio's term, the portfolio's assets are liquidated and distributed to investors. But, investors are not the only winners in this scenario. The foreclosed homes are often then sold to buyers who ordinarily could not qualify for or purchase a home—perhaps some of the same buyers who have taken themselves out of the running for mortgage loans, as mentioned above. These people become property owners with little money down, paying reasonable interest rates, and with mortgage payments at or below rental levels for the same neighborhood. So everyone wins. The banks recoup some of their losses, investors get a stable and attractive return, and the retail purchaser gets a home he/she could not have previously afforded.

Another opportunity presented by this marketplace is in the area of private money loans. It has become increasingly difficult to get bank loans secured by real estate. The delays and nearly impossible conditions necessary to qualify have locked liquidity contained in real estate assets away from owners. Stonecrest and others have designed private money funds to address this market opportunity. By restricting loans to closely vetted borrowers, establishing attractive (for investors) yet affordable (for borrowers) interest rates, and by maintaining conservative loan-to-value ratios, private money loans can offer stable returns and diversified, manageable risk.

It is important to get the underlying story—the real story in real estate. Finding opportunities for investors is one way to balance the darker side of the story and generate some badly needed returns.

Christina Gray has been an active board member of the FPA of San Francisco for five years as the sponsorship chair. Through Stonecrest's Alternative Real Estate Investments, she strategically works with RIA advisors and individual investors to achieve higher yields, diversification, and steady income.