Making overseas investments

Investing in US property has never been better. Many good opportunities are available if you know how and where to look, says Dr Paul Hanks

Why would you invest in real estate in the US?

Not only have you probably read that the US housing market is set for a bust, but it’s a long way from the UK. Many investors like the ‘touch and feel’ approach to investing—buying homes where they can drive buy and see them. However, despite what headlines you have read, investing in US real estate has never been better and the exchange rate at over US$2 to £1 screams buy dollars.

Though a few weeks ago you could find voices claiming that the worst was over for the US housing market, it is harder now what with tightening credit and a glut of housing supply. So is a good time to invest in the US?

How problems began

James Fryer at economist.com reported that ‘homebuyers and lenders are reaping the consequences of loose monetary policy. When the Federal Reserve cut interest rates after the tech bubble burst, it inflated another, in housing, that is. By mid-2004, it was in the subprime mortgage market, which lends to people whose income is too low, or whose credit history too patchy, to qualify for an ordinary mortgage. 50% of America’s subprime lenders have closed their doors in the past three months and according to the Mortgage Bankers Association, 15 per cent of subprime borrowers were behind on their payments.

Most argue that the problems in the mortgage industry will not spread. The number of shadow mortgages at risk is too small for defaults to threaten everyone else and even if a fifth of the US$850 billion of adjustable-rate subprime loans went bad, that would be insignificant in the US$440 trillion market for debt. Despite two-thirds of mortgage borrowers being low risk—enjoying good credit, fixed interest rates, and with home values remaining far higher than their borrowings and are little risk—a growing minority of loans have weak borrowers, adjustable rates and little, or no, cushion of home equity. The fastest growth in America’s mortgage market has come with subprime borrowers. They now account for one in five new mortgages and 75 per cent of all US subprime debt, thanks to the expansion of mortgage-backed securities. America’s residential mortgage market consists of some US$10 trillion worth of loans, of which 15 per cent is re-packaged into securities, mainly by the government-sponsored mortgage giants, Fannie Mae and Freddie Mac.

The greatest difficulties threaten borrowers whose house is worth less than their mortgage. At the end of December 2006, negative equity affected seven per cent of all American homeowners compared to 18 per cent now.

A dramatic drop in national house prices this year is possible, but not yet probable. Unlike share prices, house prices rarely plunge in nominal terms. Unless repossession/home sales, homeowners prefer to sit tight when markets are weak. House prices stagnate, consumption may suffer a little, but not too much, so long as jobs stay plentiful and wages grow. If so, the mortgage crunch will be a grinding drag on America’s economy; one that unfolds over several years, hitting some people and some regions hard, but not, in itself, a macro-economic disaster.

Are falling prices good?

Economists are reporting slight increases in home prices nationwide in 2007, though foreclosures are forecast to rise and housing starts are expected to decline. According to the National Association of Realtors, sales of existing homes dropped 5.8 per cent nationwide in June 2007 compared to the same period in 2006, the slowest pace in four and one-half years. Interesting though is that one in five new homes purchased in the second quarter of 2007 were built and sold to first-time buyers.

Experts say that when the mortgage crunch is over, a lot of the problems will be over. Home prices will be negative at the end of the year at 4.5 to 4.8 per cent.

Charles Gallo at Arturius.com, a real estate advisory company exclusive to clinicians, reports that ‘homebuyers are certainly receiving mixed signals, especially with media pundit throwing on the dire consequences associated with sub-prime lending and expected tightening of lending standards’. In addition, many economists have stated publicly that housing is contracting at an accelerated pace as demonstrated by a larger than previously forecast in inventories of unsold homes.

Home prices will be negatively affected by a glut of unsold homes. Areas such as California and Florida, which had a disproportionate share of riskier loans, are at risk. House prices have already been falling in parts of both states, as they have in Midwestern states, such as Michigan, where the real estate industry has shed jobs in recent years.

Smart and informed investors understand that in certain parts of the nation there are great investment opportunities.

• Economic fundamentals are in good shape. The GDP growth for 2007 is forecast in the three per cent range, inflation is in check and unemployment is on track to end the year at 4.5 to 4.8 per cent.

• Housing starts in 2005, 2006, and 2007 (forecast) are 1.7 million, 1.5 million and 1.5 million, respectively according to the National Association of Home Builders.

• According to the US Census Bureau, population growth is on track to increase by almost five million each year between 2007 and 2010, which will require 2.2 new housing units each year, for example, demand for housing is higher than supply.

• The age of the existing stock of housing has reached a record 73 years, suggesting that approximately 1000 housing units per year will require replacement between 2007 and 2014.

• According to the US Census Bureau and the National Association of Realtors represent 26 per cent of the population, Generation X (those born between 1965 and 1980) represent 22 per cent and Generation Y (1981 and 1999) represent 27 per cent of the population.

• It is not just Utah that is showing price appreciation. Other states include Idaho at 12.27 per cent, Montana at 11.68 per cent, Wyoming at 11.67 per cent, Washington at 11.61 per cent and New Mexico at 11 per cent.

• Utah is the real estate market in which homebuyers have the highest opportunity to invest.

• Savvy UK investors, and those seeking second homes in other states, are attuned to the 15 per cent positive appreciation in the US, which can easily beat the 10 per cent average in the UK.

What about international investors?

Many UK investors tend to invest in Florida. The reason is simple—the most British invest if they invest in the US. Financing is relatively straightforward and Florida is accessible for holidays. However, as an investment, maybe Florida is not what it used to be. Certainly there is an over-supply of condominiums and single family homes. Very much like Spain, too much supply causes prices to drop and inventory to stay on the market for longer.

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