US Real Estate Investment mid-2016 Snapshot – The Big Picture

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After what seems like a good 4-5 years of sustained growth in real estate values, investors may be left wondering whether or not the timing is right to continue to invest in US real estate? This article will examine the fundamentals underlying supply and demand in the US, and argue that there are very good reasons to continue to be bullish on residential single family rentals as one the most desirable investment opportunities today. Here are the top 5 reasons:

DEMOGRAPHICS: Household formation data is based on demographic analysis and grounded in fact; the only forecast variables depend on net migration patterns and at what age a young person or couple move into their own home, and that home is whether rented or owned. Research from the Harvard Joint Center for Housing Studies estimates that overall household creation in the US will be at minimum 1.3m per year for the next decade.

The Mortgage Broker's Association (MBA) released a survey in July 2015 forecasting how demographic shifts in Baby Boomers and Millennials will impact housing requirements over the next 10 years. The survey excluded migration or other factors and kept homeownership ratios at current levels; it concluded demographic shifts alone will account for a net increase in demand for housing of at least 1.3m per year.

The millennial generation is the single largest in the history of this nation, larger than the baby boomers, and the oldest of the millennials are just now buying their first homes. This generation also is the single largest cohort of the labor force according to Pew research and, at 83 million strong, will drive housing demand for the next decade at levels not seen since the early 1980s.

HOUSING INVENTORIES: There are a number of variables affecting the lack of entry level, affordable housing stock, but the fact is that the new supply simply cannot keep pace with current demand, and the lack of affordable and available housing amidst this demographics-driven demand produces the truth behind the core economic theory of supply and demand. Coming out of the recession and housing crisis, the nation's homeownership rate is down six percentage points from its peak, creating almost six million more households that are now renting. This supply/demand imbalance has driven vacancy rates down and rents up. With the demand side clearly here for the next decade-plus, the drivers that are keeping real estate prices and rentals high will continue to present attractive investment opportunities.

HOUSEHOLD FORMATION VERSUS RENTER DEMAND: Recent announcements, from both private companies and government agencies, indicate that opportunities for entry-level buyers, particularly those who can't make a 20 percent down payment will improve. This will bring much needed liquidity into the market. And while the demand for homeownership may correct itself from current depressed levels, the demand for rental housing, is expected to remain strong.

More than 11 million households, a record, spend more than 50% of their income just on rent. Some 21 million households, another record, pay in excess of 30%. The median rent for newly constructed rental units now stands at $1,372 per month, more than half the median monthly household income in America. While rentals continue to take such a large part of disposable income, it makes saving for a down payment challenging. Moreover, Millennials are burdened not only with a high rent to disposable income ratios but with burgeoning student debt, which means that the option of renting for the Millennial demographic will continue to remain the preferred, indeed in some cases the only option, over home ownership.

INTEREST RATES: Current low rates of mortgage interest are as good for homeowners as they are for investors. The cost of a home is not just the price the borrower pays and the home's maintenance over time. It also includes a much higher cost for most buyers: the mortgage interest a homebuyer will pay over the term of the loan. The difference in interest expense between a 4.5 percent rate and a 6 percent rate on a $200,000 mortgage is about $60,000 over 30 years. Investing in a home at these rates, at the beginning of what will be a prolonged demand cycle, is an opportunity that should not be discounted. Furthermore, conditions are delicately balanced so as not to warrant further significant rate hikes, ensuring that rates will likely remain low for the foreseeable future.

TAX BENEFITS: The mortgage interest deduction is a mechanism that allows borrowers to deduct the mortgage interest paid (with a variety of limits that you should consult a tax professional about) from their taxes. It is particularly effective for investors because the way mortgages are written, a larger part of what you pay in the early years of your mortgage is interest, allowing a greater deduction at the outset of the investment cycle.

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