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Real estate values: Past, present and future

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In 2007 I was interviewed on the radio regarding the active real estate market. There was much sales activity and refinancing. But as I was speaking about how active the market was, it came to me to tell the story of something deeper. Low interest rates had a lot to do with it. Where do low interest rates come from? Monetary policy and to a smaller extent fiscal policy establishes low rates. In that interview, I stated that this policy could be harmful in the intermediate and long run. It costs substantial resources to keep interest rates low. The result of these monetary and fiscal policies produced over supply. This, along with bad credit loans, created the economic crisis that started in late 2008. Low interest rates still appear to be the driver of hot real estate markets in the last 11 years including the current market.

Many appraisers focus on the micro picture; especially sales, rentals, short-term supply/demand considerations, and current mortgage terms; not necessarily about longer term interest rates and longer term supply/demand considerations. Fiscal and monetary policy causes interest rates and economic activity to change. Fiscal policy is when the government spends money with direct government projects or tax cuts, tax credits, etc. Monetary policy is accomplished primarily by the Federal Reserve. The Federal Reserve is a type of bank which is not directly controlled by the government. It is essentially a private bank. It was formed in 1913. At that time there was no federal income tax either. Most of the federal government revenue came from tariffs. In the 1890's and then in 1907 was a serious federal cash crunch. Shortly after that the federal income tax was instituted along with the Federal Reserve Bank in 1913.

The Federal Reserve can set policies which can increase money supply such as "Quantitative Easing." The primary function of the Federal Reserve is to adjust the thermostat for the economy keeping inflation in check and at the same create economic activity. Because of inappropriate monetary and fiscal policy in the 1970's, interest rates for mortgages were as high as 18% by the late 1970's and early 1980's. Inflation was out of control. Then Congress enacted a major fiscal tool which was the Economic Recovery Tax Act of 1981 which started a boom in real estate which was unprecedented. President Reagan followed the advice of supply side economists Milt Friedman and Art Laffer. Monetary policy decreased interest rates but fiscal policies put capital in the hands of investors. The problem was that tax shelter deals put too much of the private sector resources into the real estate sector. The Tax Reform Act of 1986 removed some of the overzealous real estate shelter aspects, but also reduced certain tax rates. At the same time the plan was to shrink government spending but President Reagan never had control of the House of Representatives; then he lost control of the Senate in 1986. This interfered with the second part of the fiscal equation which was to eliminate fat in the federal bureaucracy.

In the early 1990's commercial real estate remained oversupplied. However, the Federal Reserve's low interest policies created a boom in residential market. The good news in the mid and later

1990's was the technology boom which was led by the Microsoft revolution. In the early 2000's some major tax cuts in post 9/11 along with Federal Reserve monetary policy created another real estate boom. At the time there was a lot of sales activity and refinancing because of low interest policies. Since 2009 we've had one of the slowest economic recoveries in history because of fiscal policy. By implementing this fiscal policy the national debt is almost $19 trillion. An economist out of Boston University recently stated that unfunded future federal liabilities are over $200 trillion. Yet, right now the real estate activity has been one of the most active in the last 30 years but due to costly monetary policy. The 1980's real estate boom was attributed to mainly fiscal policy. The current and to a lesser extent the 2006 real estate market was attributed to expensive monetary policy. Thus, the 1980's real estate value increases were predicated more on fiscal policies such as tax cuts. More recent real estate market successes are dependent upon monetary policy through the Federal Reserve.

My prediction is that future intermediate long-term real estate values will be bolstered by less monetary policy and more fiscal policy similar to the 1980's. Otherwise future real estate values will be at risk.

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