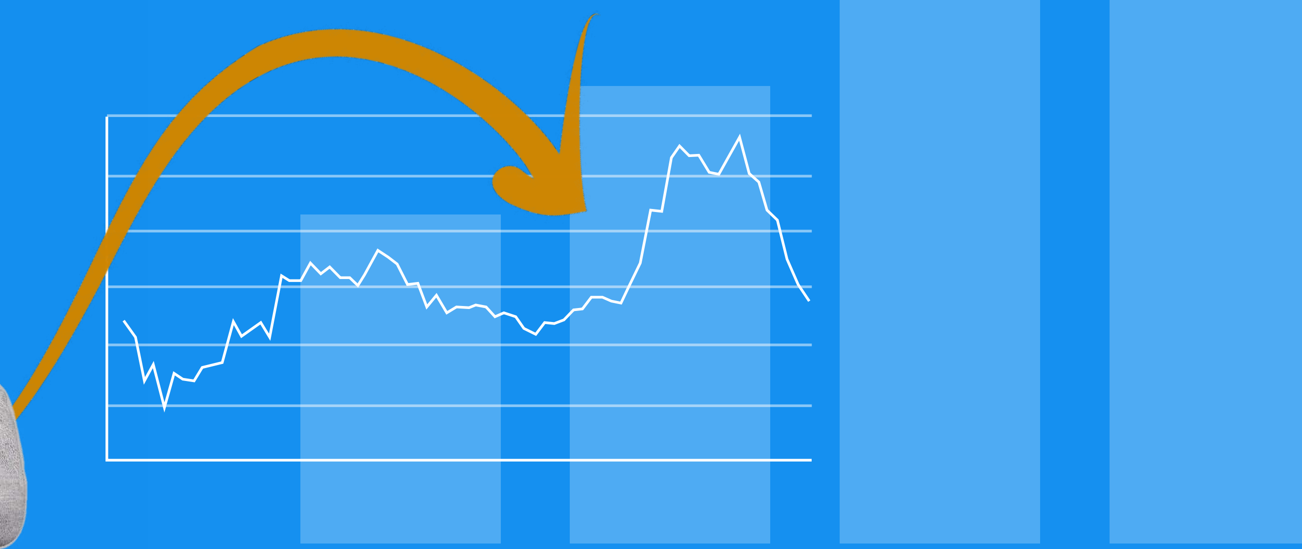
BiggerPockets®

THE STATE OF REAL ESTATE INVESTING

The 2023 market is poised for a correction:
Are you utilizing data to accurately
strategize your investments?



Introduction

After years of unprecedented growth, the housing market has shifted course and entered a correction. As mortgage rates rise and affordability reaches its lowest point in decades, investors can no longer rely on the property value growth seen since early 2020.

Yet with changing market conditions comes opportunity. The market is shifting from one where sellers have the power of price and terms to one where buyers are in control. As such, real estate investors are poised to see a greater volume of deals—and more potential for discounts—than has been possible in the last three years.

To take full advantage of these conditions and to properly mitigate market risk, real estate investors need to have a thorough grasp of the housing market cycle we're in and what strategies work in such an environment. As such, BiggerPockets has put together this 2023 *State of Real Estate Investing* guide to help aspiring and experienced investors make 2023 a year of progress and profit.

About the Author

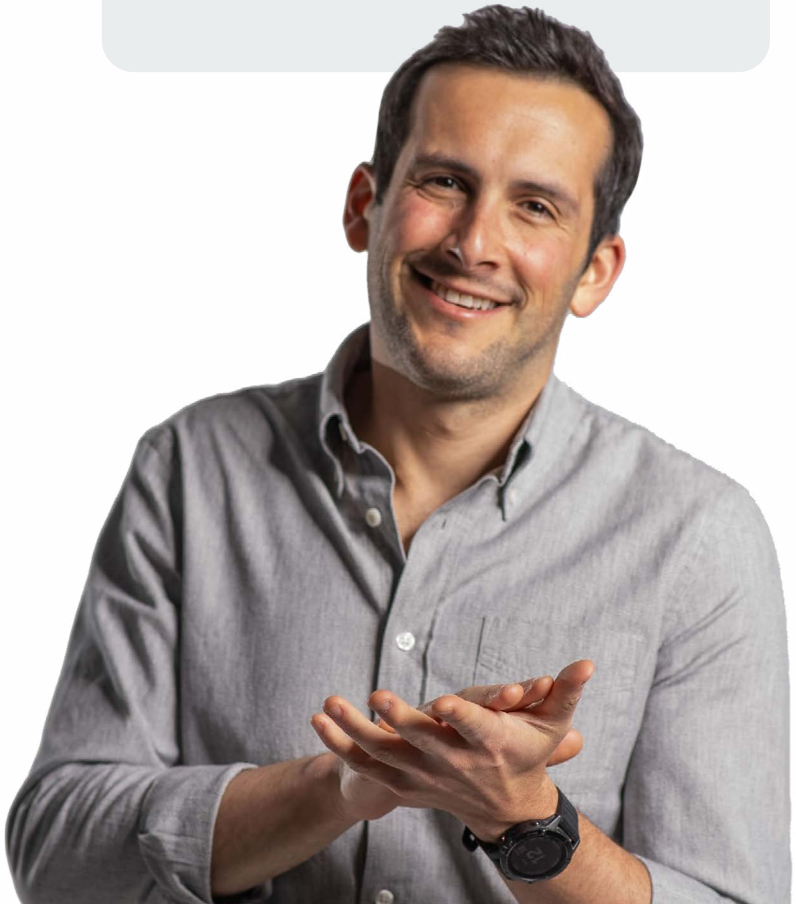
Dave Meyer is the Vice President of Data and Analytics at BiggerPockets. In this role, he is responsible for researching and reporting on current conditions impacting the real estate investing climate. Dave sources original datasets and conducts his own analyses to provide unique and unbiased information to real estate investors. He shares his insights regularly on BiggerPockets' blog, YouTube channel, Instagram account, webinars, and podcasts.

Dave has been investing in real estate since 2010, and he has experience with rental properties, short-term rentals, and multifamily investing. He is the coauthor of the best-selling book *Real Estate by the Numbers* and hosts the popular real estate news and economics podcast *On the Market*. Dave has a BA in political science from the University of Rochester and an MS in business analytics from the University of Colorado Denver.

Dave currently lives in Amsterdam and outside of work enjoys traveling, outdoor sports, and sandwiches.

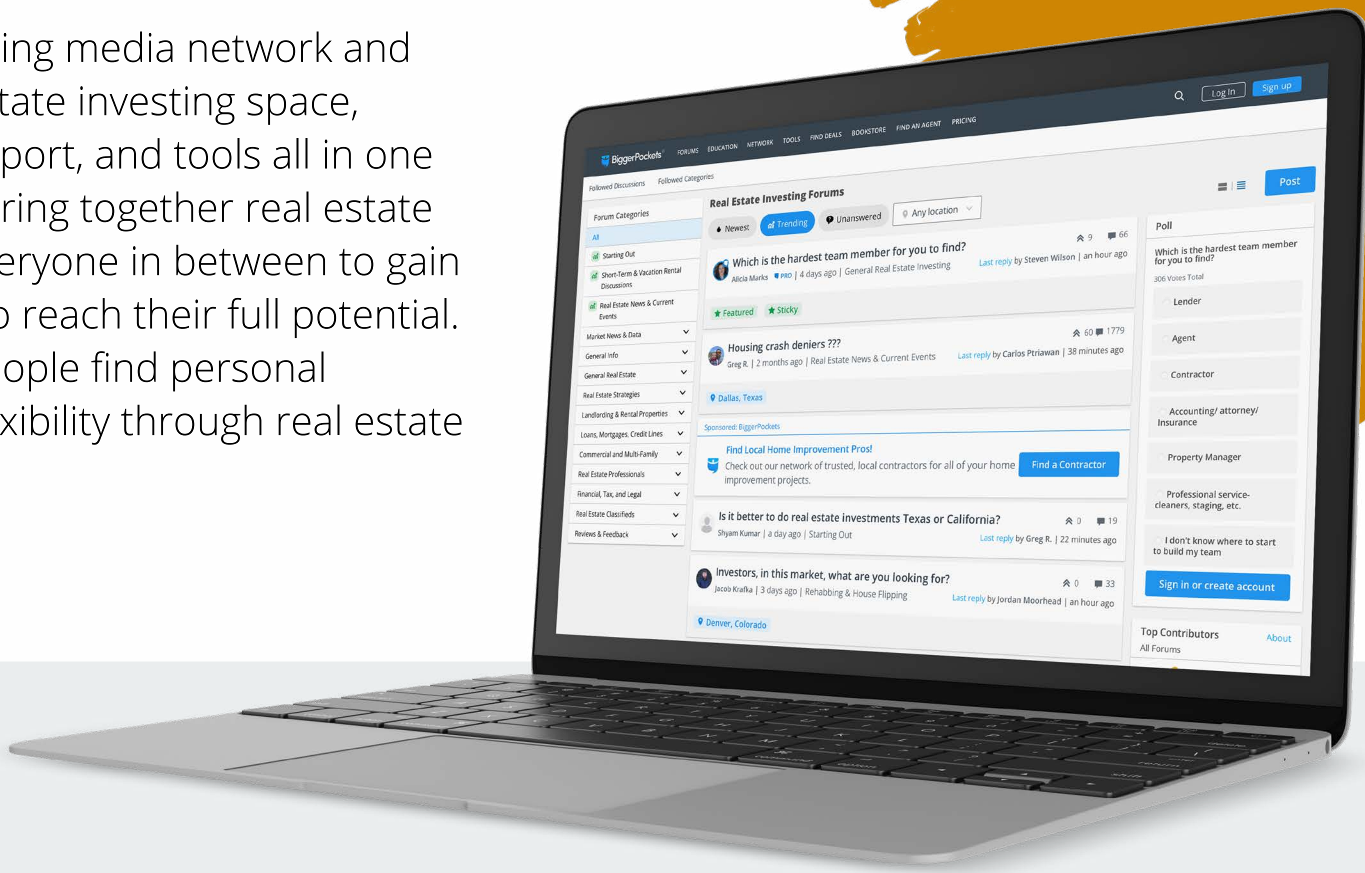
You can connect with him on BiggerPockets or on Instagram:

@THEDATADELI



About BiggerPockets

BiggerPockets is the leading media network and community in the real estate investing space, supplying education, support, and tools all in one place. We work hard to bring together real estate experts, newbies, and everyone in between to gain the knowledge needed to reach their full potential. Our mission is to help people find personal freedom and financial flexibility through real estate investing.



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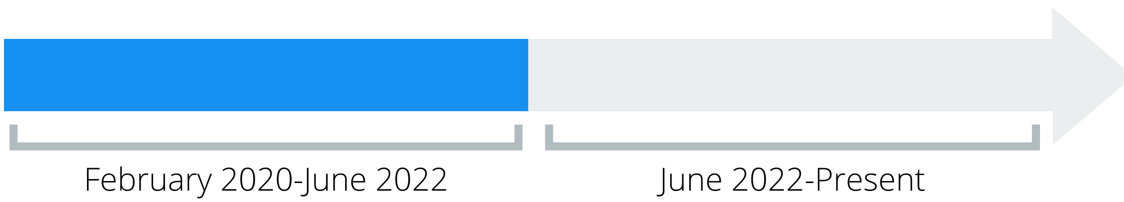
What's Going on in the Housing Market

As we enter a new year, it's often helpful to look back at the previous year to see what happened in the housing and rental markets. This provides context and clues about what might happen in the coming year. But, given that the last few years were anything but normal, we need to do a more thorough analysis. First, I'll examine the period of extreme growth and the variables that influenced the housing market from the outset of the COVID-19 pandemic in early 2020 through the middle of 2022. Then, I'll look at what's happened since the middle of 2022 as the market began to shift.

Extreme Growth	Market Shift
February 2020-June 2022	June 2022-Present

February 2020–June 2022

The period of February 2020 through June 2022 was one of the fastest-growing periods on record. While it may seem like this is a classic bubble, full of irrational behavior, there were actually many sound economic reasons why prices accelerated in the way they did.



Why Housing Prices Exploded

Housing prices are influenced by several key variables that combine and interact with each other in a complex way. Some factors are more influential than others, but no one factor dictates housing prices. Furthermore, there is really not a single housing market. Rather, every regional market behaves in its own unique way.

I will provide a summary of conditions in the housing market over the last several years, but keep in mind that aggregating data on a national level, as I have done below, does not account for every complex dynamic and regional difference in the housing market. That said, there is a lot we can learn from this analysis.

As with any market, prices in the housing market are dictated by supply and demand. But both supply and demand, in the context of the housing market, are influenced by broad macroeconomic variables such as housing supply (how many total homes exist in the United States), inventory (how many homes are for sale at a given time), demographics (how many new households are created), mortgage rates, affordability, inflation and monetary supply, and even the performance of other asset classes like the stock, bond, and crypto markets. There are many variables that influence housing prices, and we'll review them one by one below.

And as we examine each of these, you'll see that over the last several years, every single variable was nudging housing prices in one direction: up.

> **Over the last several years, every single variable was nudging housing prices in one direction: up.**

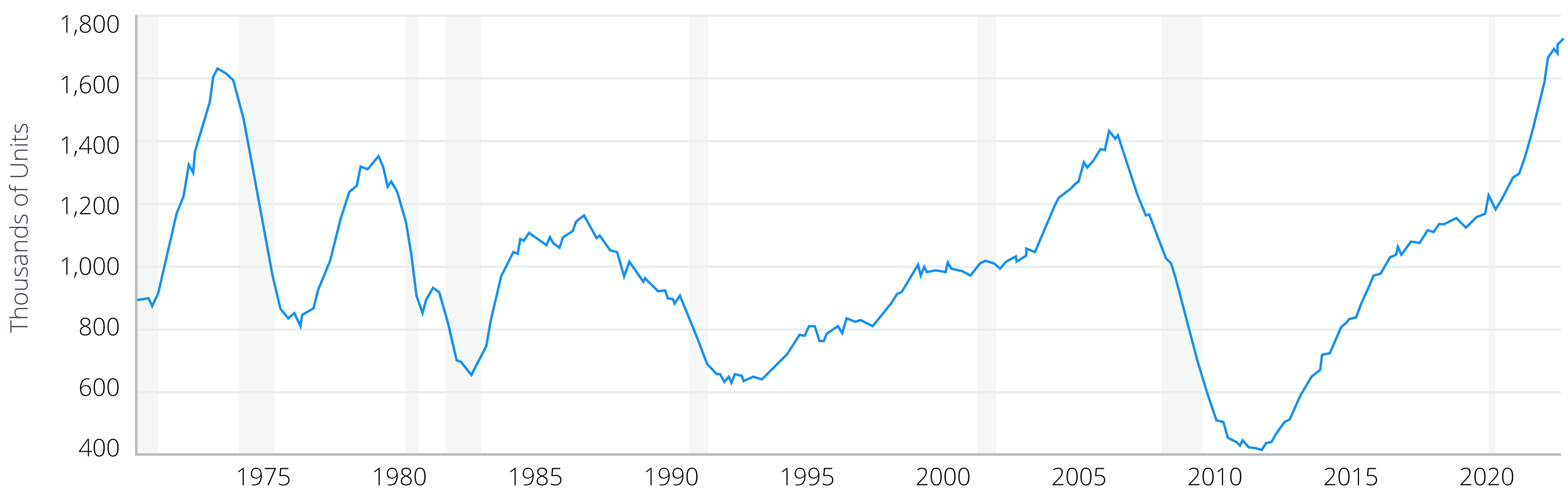
Let's explore the variables that influence housing prices:

1. Supply
2. Inventory
3. Demand
4. Mortgage Rates and Affordability
5. Inflation
6. Other Asset Classes

1 Supply

In the context of the housing market, supply is a measure of the total amount of homes in the United States. And, by pretty much all measures, the U.S. is facing a housing shortage. Following the Great Recession (2007–2009)—which was the worst collapse in housing prices since the Great Depression (1929–1939)—many home builders went out of business. It took decades for construction volume to pick back up, as seen in the graph below.

New Privately-Owned Housing Units Under Construction: Total Units



Shaded areas indicate U.S. recessions

Source: fred.stlouisfed.org

As a result, the U.S. is short somewhere between 3 and 7 million homes (Freddie Mac estimates a shortage of 3.8 million homes; National Association of Realtors estimates up to 6.8 million). Construction has picked up dramatically since 2020, but for most of the last decade, not enough supply was being created. Even with high levels of completed units in recent years (and likely for the next year at least), there is still a deficit. This is a trend that existed well before the pandemic started but remained an important factor in price growth over recent years.

3-7 Million

The U.S. shortage of homes

2 Inventory

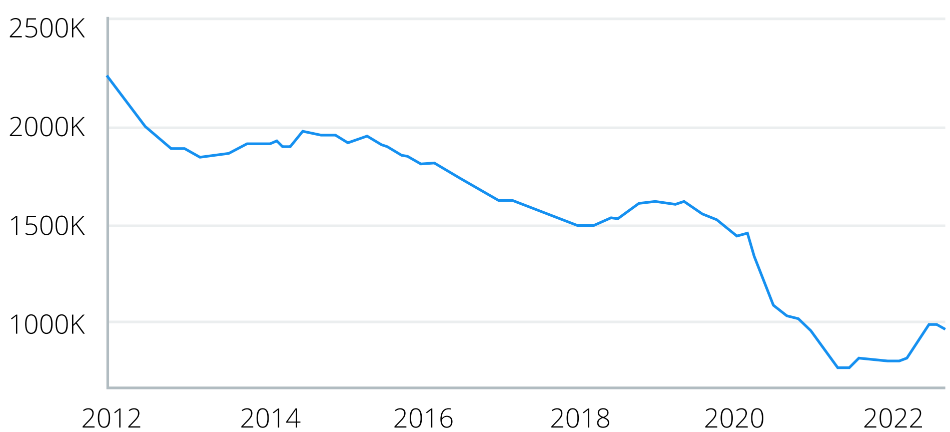
The housing shortage represents a lack of total housing units in the U.S., and it is a crucial long-term measure of supply. Inventory, which is defined as the total number of houses for sale at any given time, is a short-term measure of supply, and plays a very crucial role in short-term pricing for houses.

Inventory is a function of both new listings and demand. New listings measure how many new homes hit the market in a given month, but to calculate inventory, you need to know how quickly those listings are being put under contract. This is why it's such a useful metric—it shows the balance of supply and demand.

When inventory is low and few houses are on the market, it creates competition among buyers and pushes up housing prices. We call this a seller's market. When inventory is high, sellers are competing for buyers, and prices stay flat or fall. We call this a buyer's market.

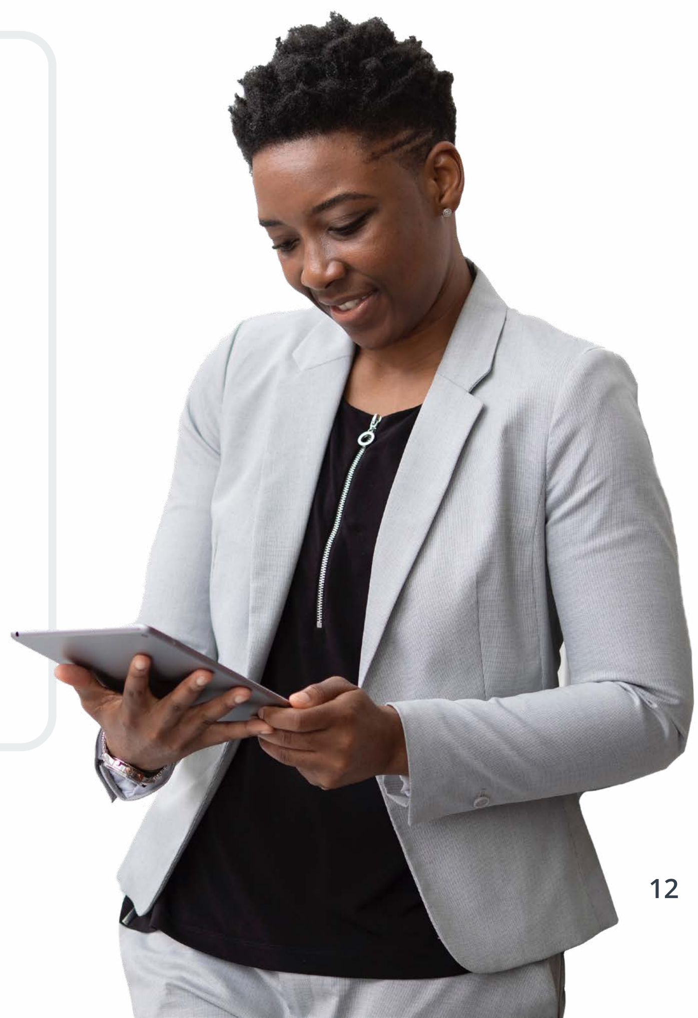
From the beginning of the pandemic until midway through 2022, we saw an extreme seller's market. New listings were not actually very low, but the extreme demand led to low inventory for years—and although inventory is rising, it remains low in a historical context to this day.

All Homes for Sale



National, residential homes

Source: Redfin



Notice in the chart how low inventory was from mid-2020 through June 2022. It's some of the lowest inventory ever measured—giving sellers all the pricing power. This was a major factor in price increases during that window.

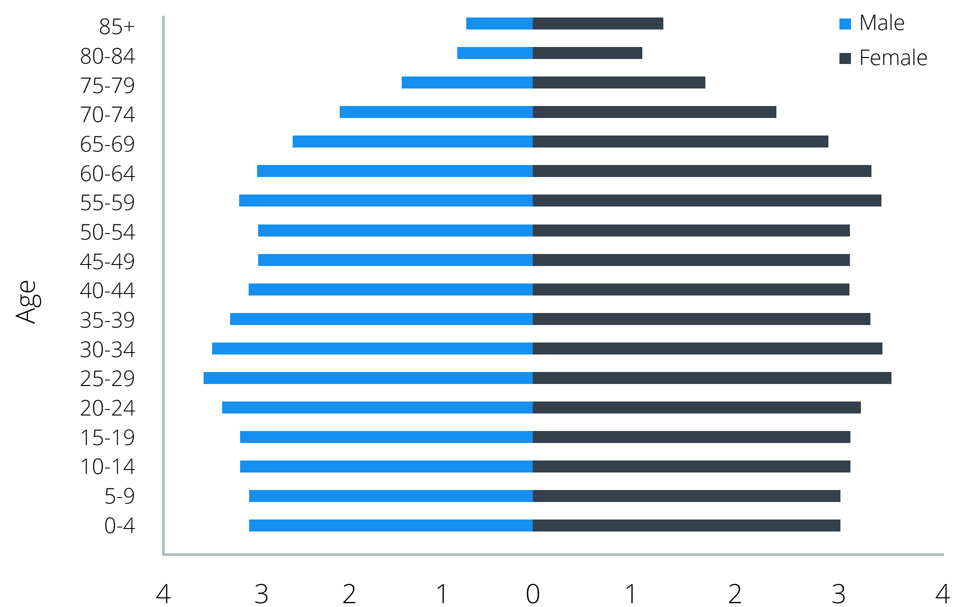
As you can see, two measures of supply—the total number of houses in the U.S. and the inventory—were constrained in recent years. The principle of supply and demand states that when supply is constrained, prices will go up, presuming demand stays constant. But what happens when supply is constrained and demand rises at the same time?

> **It's some of the lowest inventory ever measured—giving sellers all the pricing power. This was a major factor in price increases.**

3 Demand

Demand in the housing market is a measurement of how many people want to buy homes. This is composed primarily of people buying their primary residence (about 70 percent), but it also includes investors and second-home buyers.

Demand is a complicated thing, because it's not just who wants to buy a home but also who *can* buy a home. It's a combination of both desire and ability. We'll get into more specific factors that drive demand, but first let's look at one of the most powerful forces: good old-fashioned demographics.



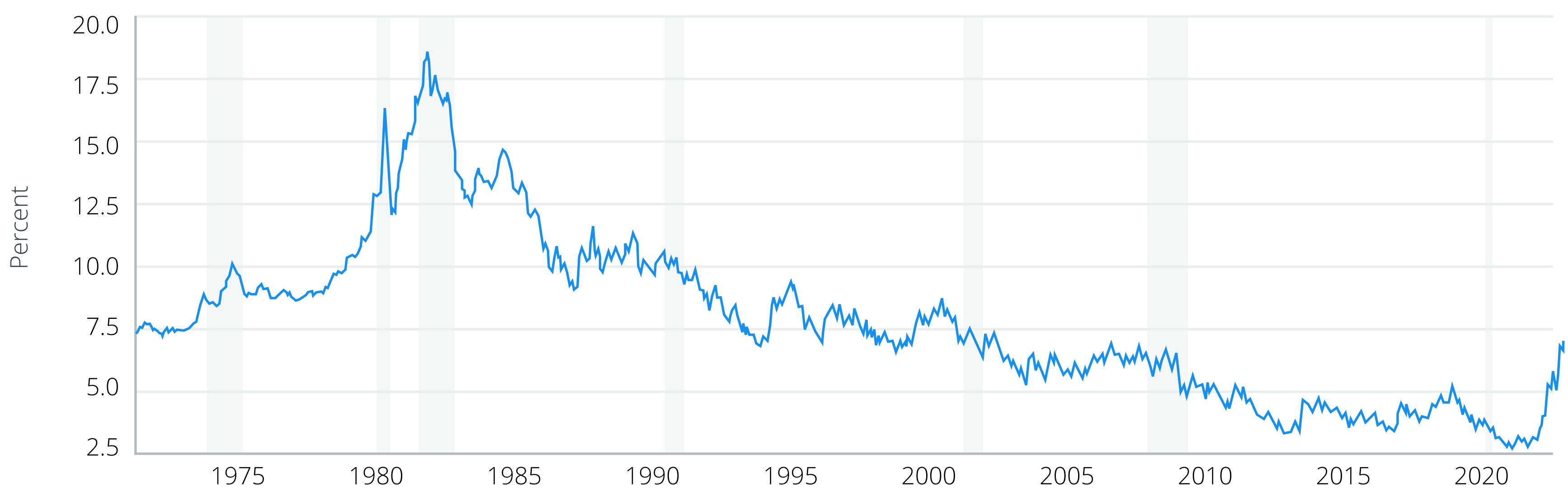
Source: 2020 Population Connection

As seen in the chart above, the largest cohort of Americans is aged 25–29 (as measured by the U.S. Census in 2020). The second largest group is 30–34, and the third largest is 20–24. Basically, millennials are now the largest generation in the U.S., and this is important for housing demand. The peak age for buying a home is between 30 and 33, meaning that the largest cohort of Americans has started to reach peak home-buying age over the last several years, pushing up demand. When demand goes up, prices rise.

4 Mortgage Rates and Affordability

As mentioned earlier, demand is not just how many people want to buy a home—it's also who can afford it. Since an estimated 90 percent of people purchase a home with a loan, the cost of that loan (as measured by mortgage rates) plays a large role in who can afford to buy a home.

30 Year Fixed Rate Mortgage Average in the United States



Shaded areas indicate U.S. recessions

[Source: fred.stlouisfed.org]

Since an estimated 90 percent of people purchase a home with a loan, the cost of that loan (as measured by mortgage rates) plays a large role in who can afford to buy a home.

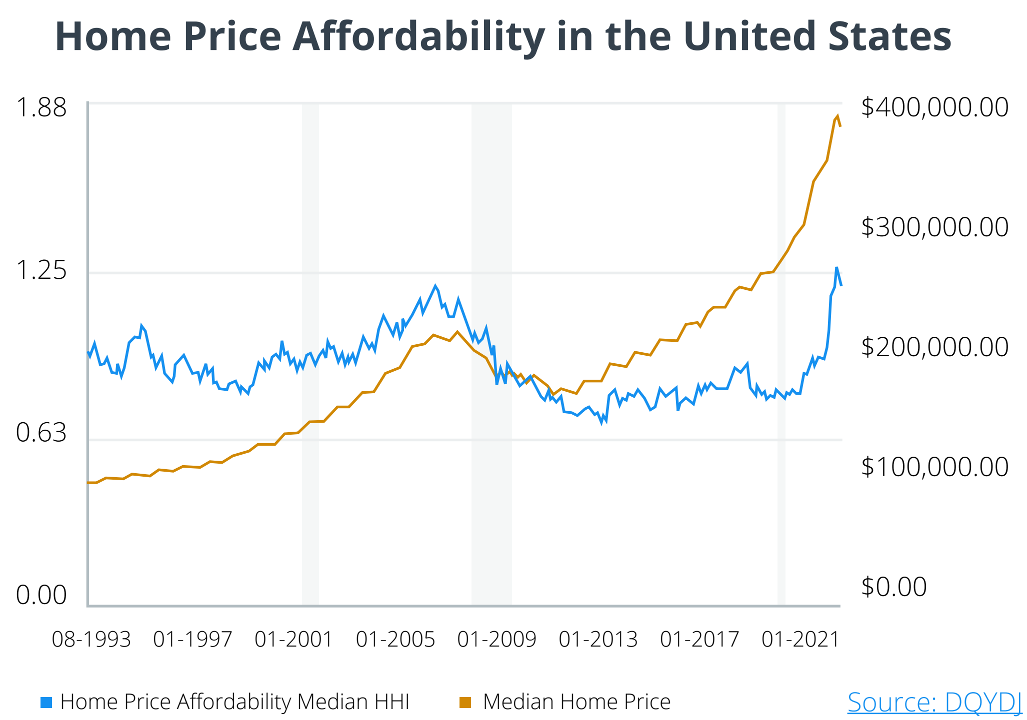
There are different tools that measure housing affordability, but I like this one.

TRY IT OUT

At the beginning of 2020, in response to the pandemic, the Federal Reserve cut the federal funds rate to near zero, and mortgage rates followed suit. From 2020 to the beginning of 2022, we saw the longest sustained period of low mortgage rates on record. Rates were often below 3 percent, which had been essentially unheard of prior to the pandemic. This made it much easier for the average American to afford a home, which drove up demand. And as we know, when demand rises, prices go up.

To further explain this point, because it's incredibly important, let's look at housing affordability. Affordability is a measurement of how easily the average American can afford the average-priced home in the U.S. Affordability is an excellent metric because it combines three important economic variables into one: median income, the median home price, and mortgage rates. When you factor these three variables together, you get a very clear picture of demand in the U.S.

As you can see, for the American family with a median household income, affordability was great from about 2009 to early 2022 (the higher the number, the less affordable housing is). This is notable, because despite rising home prices, affordability remained very low up until early 2022 (more on that later). Basically, low interest rates offset rising home prices and allowed Americans to continue buying homes.



[Source: DQYDJ]

To give you a sense of just how impactful all of this is, consider a family looking to purchase a $400,000 house, putting 20 percent down. Before the pandemic, mortgage rates were roughly 5 percent, and it would have cost this family about $1,717 per month in mortgage costs.

Once the mortgage dropped to 3 percent, that same family could now purchase a home for $510,000 and keep their mortgage payment about the same. Put another way, this family could spend *$110,000 more* on a home and make roughly the same payment each month. This huge increase in affordability creates demand and puts upward pressure on housing prices.

5 Inflation

Inflation is often described as “too much money chasing too few goods.” Essentially, when there is too much demand and not enough supply, we get inflation. And as everyone knows, we’ve seen high inflation for the last several years.

The current inflation issue has been caused by several factors, but in the context of the housing market, there are two that play the biggest role: supply constraints and monetary supply.

Let’s begin with monetary supply—which is just a formal term for how much money is circulating in an economy. There are many ways to measure monetary supply, but one of the most reliable is known as the M2. [You can find the definition here](), but it’s basically a measure of money in the U.S. economy.

Rob Abasolo and David Greene discuss inflation on the *BiggerPockets Real Estate Podcast*

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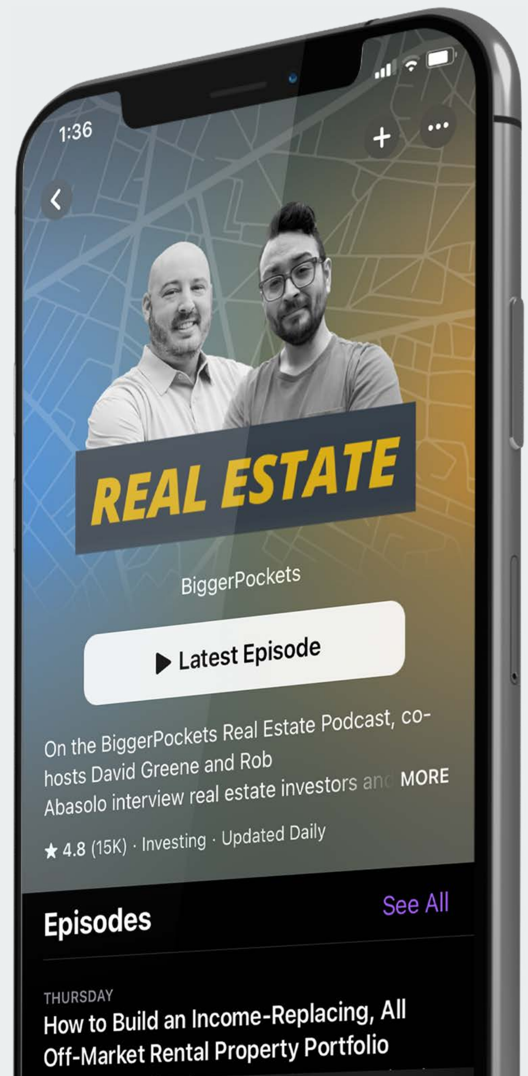
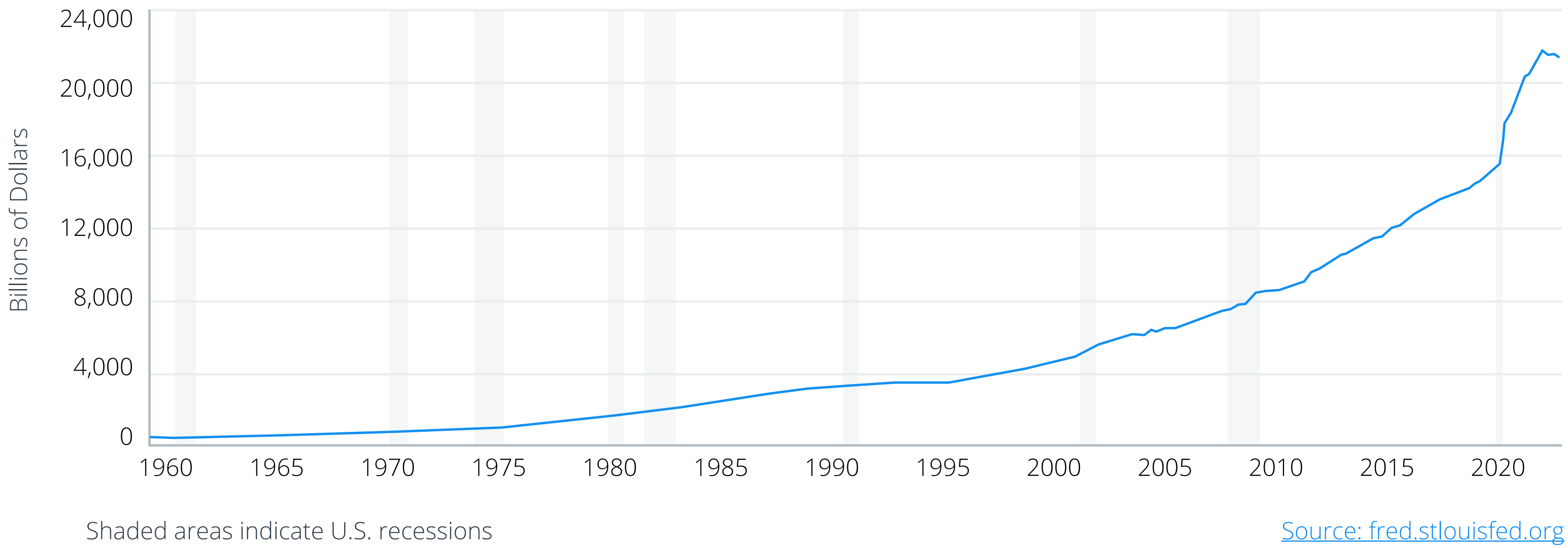


M2



Historically, the M2 has gone up relatively slowly. The rate of growth picked up during the Great Recession, but it shot up incredibly quickly during the pandemic due to three federal stimulus packages from both the Trump and Biden administrations, as well as a resumption of quantitative easing. When monetary supply increases, inflation tends to follow, meaning that prices generally go up. This is the "too much money" part of the "too much money chasing too few goods" equation and has contributed to rising home prices over the last several years.

The second inflationary pressure has been supply constraints. This is the "too few goods" part of the equation, and it has two primary causes. First was COVID-19 disrupting supply chains and shutting down manufacturing across the globe. The second was Russia's invasion of Ukraine, which has effectively removed Russian and Ukrainian goods from the global market, further constraining supply.

These supply shocks have contributed to inflationary pressure across the economy, but it hit the housing market particularly hard. The cost of all sorts of goods—from lumber to appliances, windows, doors, paint, and almost every other building supply—has dramatically increased in price.

Lumber Prices

[Source: www.macrotrends.net](https://www.macrotrends.net)

These supply costs, in addition to rising labor costs, have forced the cost of construction up significantly—which pushes up prices for buyers. [According to CBRE](), "Based on the Producer Price Index (PPI) basket of all goods used in construction (excluding energy), prices were up 41% in March 2022 from March 2020."

41%

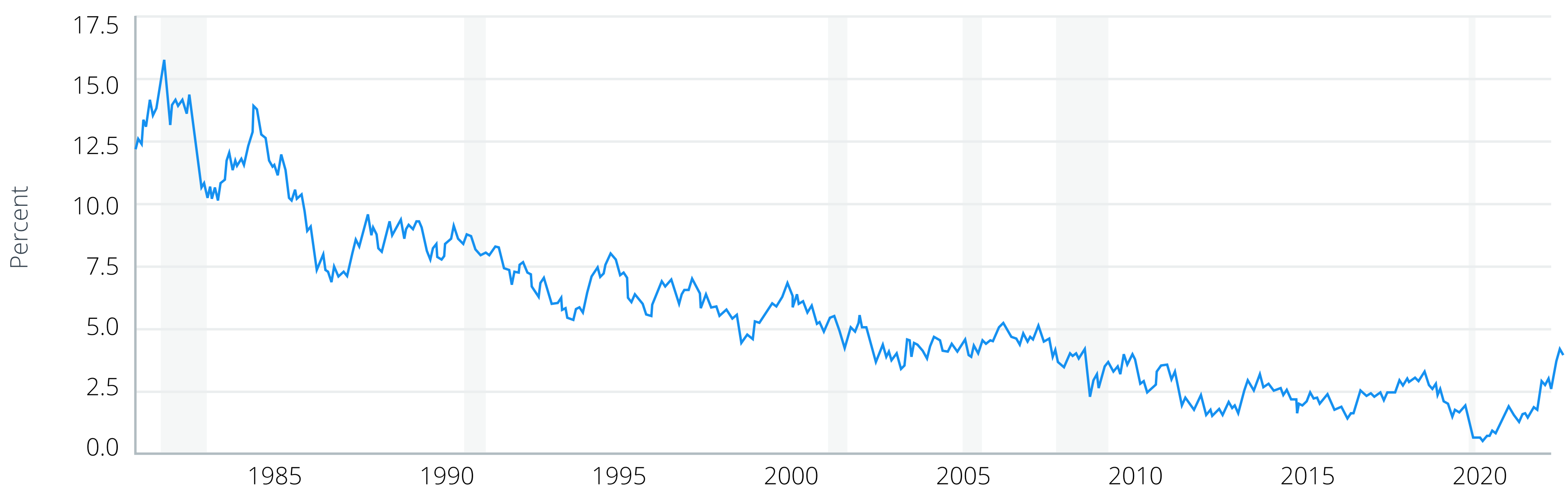
Construction goods price increase in March 2022 from March 2020

6 Other Asset Classes

While this report is focused on the state of the housing market, the dynamics of other asset classes play an important role in this market as well. No major asset class, like U.S. housing, operates in a silo—everything is interconnected.

While there are many complex interconnections between the housing market and other asset classes, the most important ones in explaining recent housing market activity are low bond yields and huge gains in the stock and crypto markets.

Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis



Shaded areas indicate U.S. recessions

[Source: fred.stlouisfed.org]

Bonds are largely seen as safe investments that offer predictable returns. However, for the last several years, those predictable returns (which are called yields) were very low. Bond yields have been trending downward for years, but they hit record lows during the pandemic.

For most of the last several years, investors could expect bonds to return less than 2 percent for a ten-year bond. Not exactly an inspiring investment, even on a risk-adjusted basis. When yields are this low, investors tend to look for higher returns in riskier assets like the stock or crypto markets.

For those who invested early in the pandemic, their net worth swelled, and they had huge amounts of excess cash. Many chose to take some of that extra cash and put it into real estate.

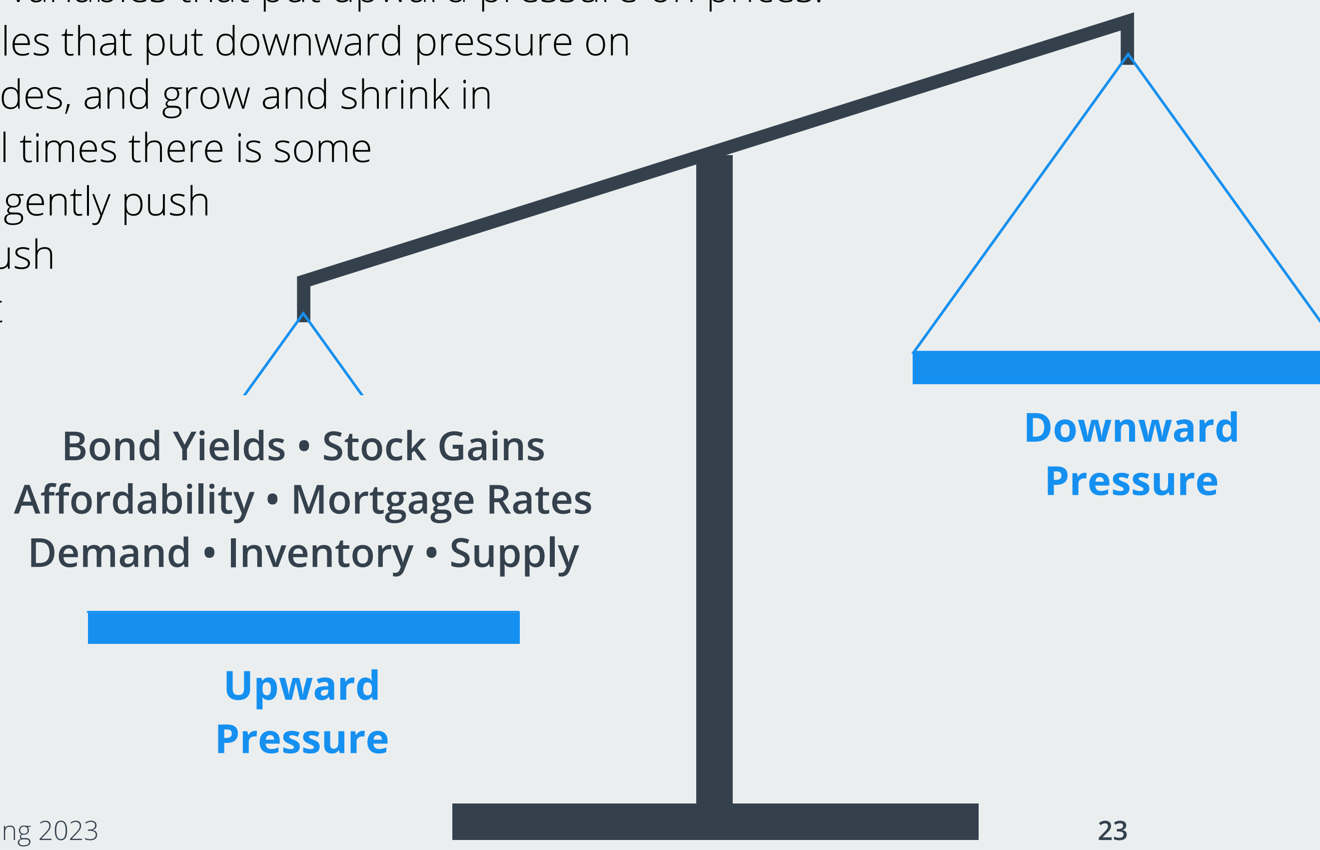
From 2020 through the beginning of 2022, huge amounts of money poured into stocks and crypto, rapidly increasing asset values. For those who invested early in the pandemic, their net worth swelled, and they had huge amounts of excess cash. Many chose to take some of that extra cash and put it into real estate, as demonstrated by the huge surge in second home demand.

Other investors, seeing low yields on bonds, chose to instead invest in another stable long-term asset: real estate. The share of homes purchased by investors surged during the pandemic, which increased demand across the housing market.

Housing Market Summary 2020–2022

As you can see, early 2020 to the middle of 2022 presented a perfect scenario for housing prices to rise. Supply was low, demand was high, and inflation pushed prices up throughout the economy. Every single variable that plays a major role in housing prices was putting upward pressure on the cost of housing.

I often like to think of complex markets, like the housing market, as a scale. On one side of the scale, we have variables that put upward pressure on prices. On the other side, we have variables that put downward pressure on prices. The variables can switch sides, and grow and shrink in relative importance, but in normal times there is some sense of balance. Some variables gently push prices up, while other variables push down on the scale, with the result typically being modestly rising prices. The average appreciation rate in the U.S. is historically between 2 percent and 4 percent—just above the rate of inflation.

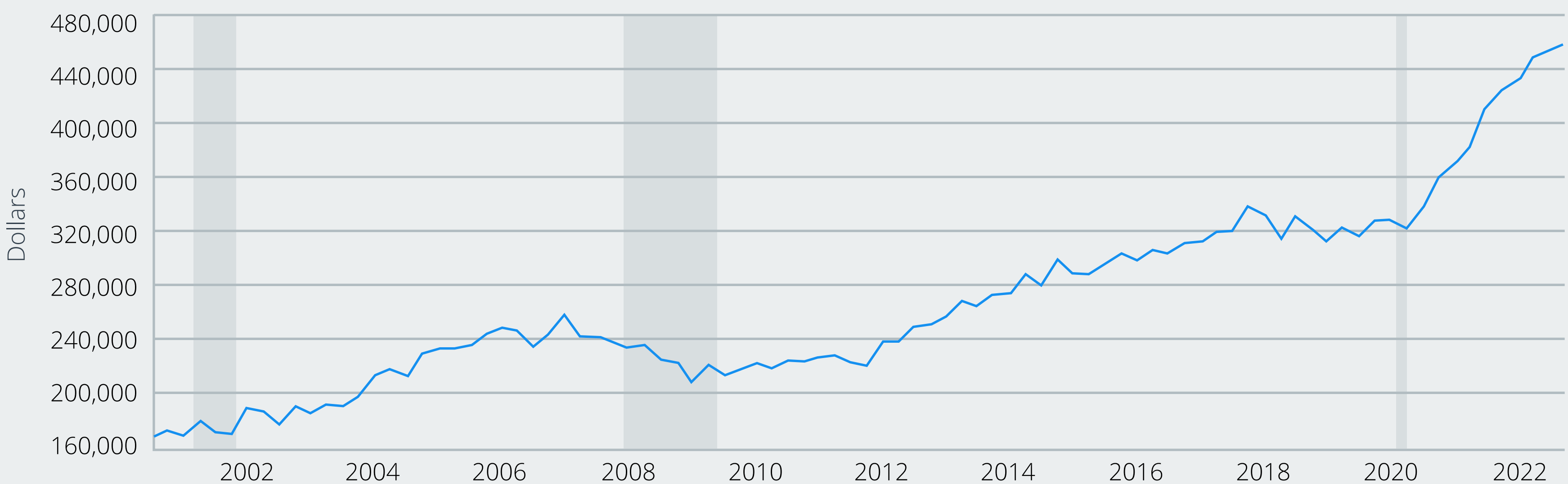


But from 2019 to June 2022, the scale was completely unbalanced. Every important variable jumped to the "upward pressure" side of the scale, and there was almost nothing keeping housing prices in check. It created the perfect conditions for prices to explode, and they did. From February 2020 to June 2022, the median home price in the United States rose 46 percent, according to Redfin.

46%

From February 2020 to June 2022, the median home price in the United States rose 46%

Median Sales Price of Houses Sold for the United States



Shaded areas indicate U.S. recessions

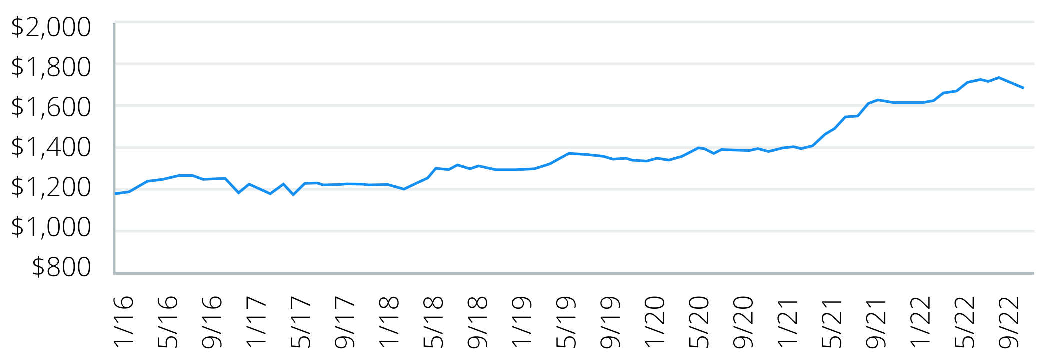
Source: fred.stlouisfed.org

The Rental Market, 2020–2022

Many of the variables that pushed housing prices up for most of the last few years also impacted the rental market. The national shortage of housing stock, demographic demand, and inflation likely played the biggest roles.

Just like with the housing market, demographics have been favoring rent growth. Again, millennials are now the biggest generation in the U.S., and they are reaching their peak household formation years. "Household formation" essentially means when a person, or couple, goes off to live on their own (rather than with family or a roommate). This creates another independent "household" in the country. For every household that is created, demand for housing goes up—not just for home purchases, but also for rental units. And when demand goes up, so do prices.

Median Rent | United States

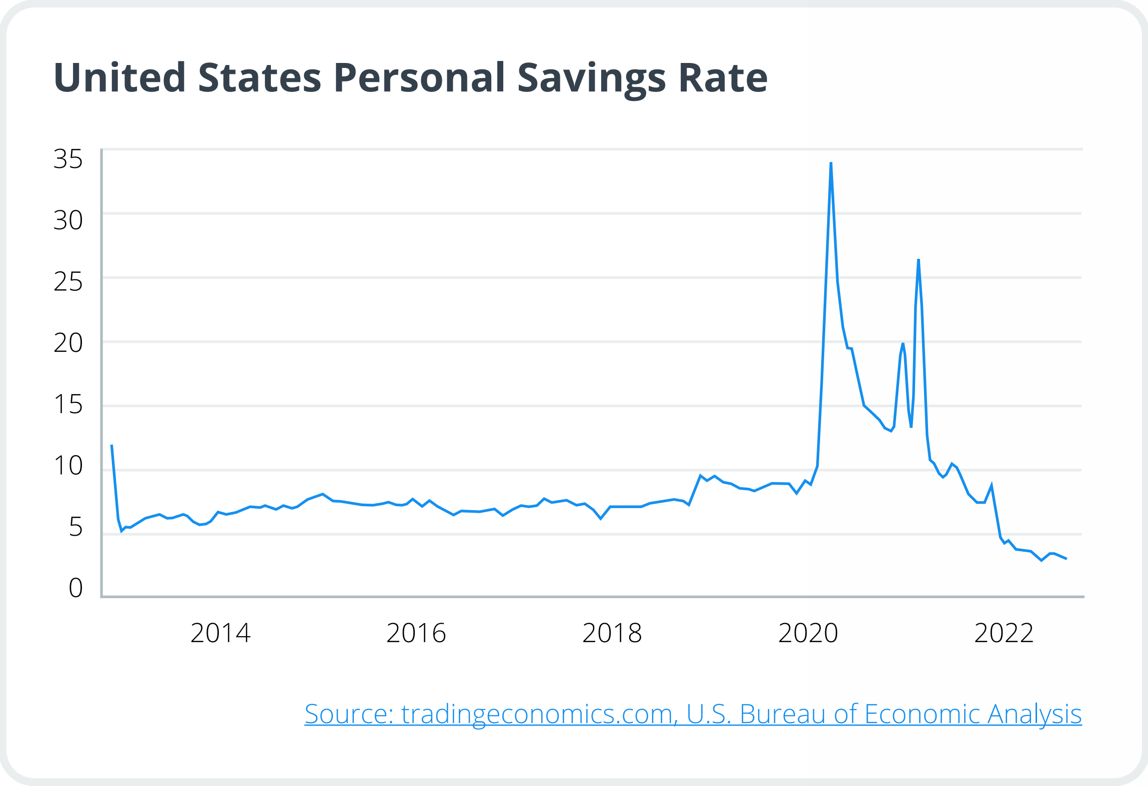


Source: BiggerPockets Data

> **For every household that is created, demand for housing goes up—not just for home purchases, but also for rental units. And when demand goes up, so do prices.**

Similarly, the national housing shortage hasn't just impacted homeowners, but renters as well. A too-limited supply of rental units combined with rising demand created competition for rental units, which drove the average market rent higher.

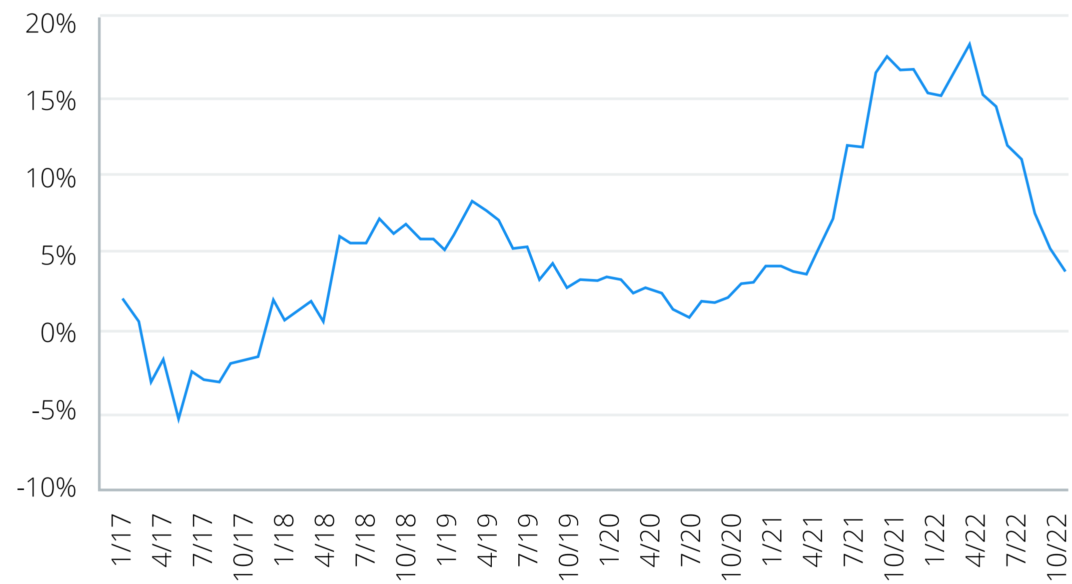
Lastly, Americans had relatively high levels of cash on hand (as measured by the personal savings rate) during the pandemic, as a result of several federal stimulus packages and growth in the stock and cryptocurrency markets. High demand with a high ability to pay leads to higher market rents.



These factors combined led to rental growth rates in the U.S. far above typical levels.

Good rent data is difficult to come by prior to the mid-2010s, but BiggerPockets does have strong rent data back to 2017. As you can see in this chart, during normal years, rent grows between 3 percent and 5 percent; but during the pandemic, we saw national rents grow more than 15 percent year-over-year (YoY) for a prolonged period. Growth rates have come back down to earth during the second half of 2022, which we'll address later.

Median Rent | United States | Year-Over-Year



Source: BiggerPockets Data

3-5%

Year-over-year rent growth in normal years

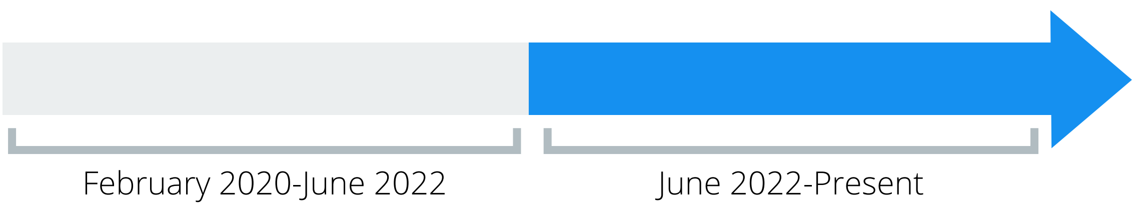
15%

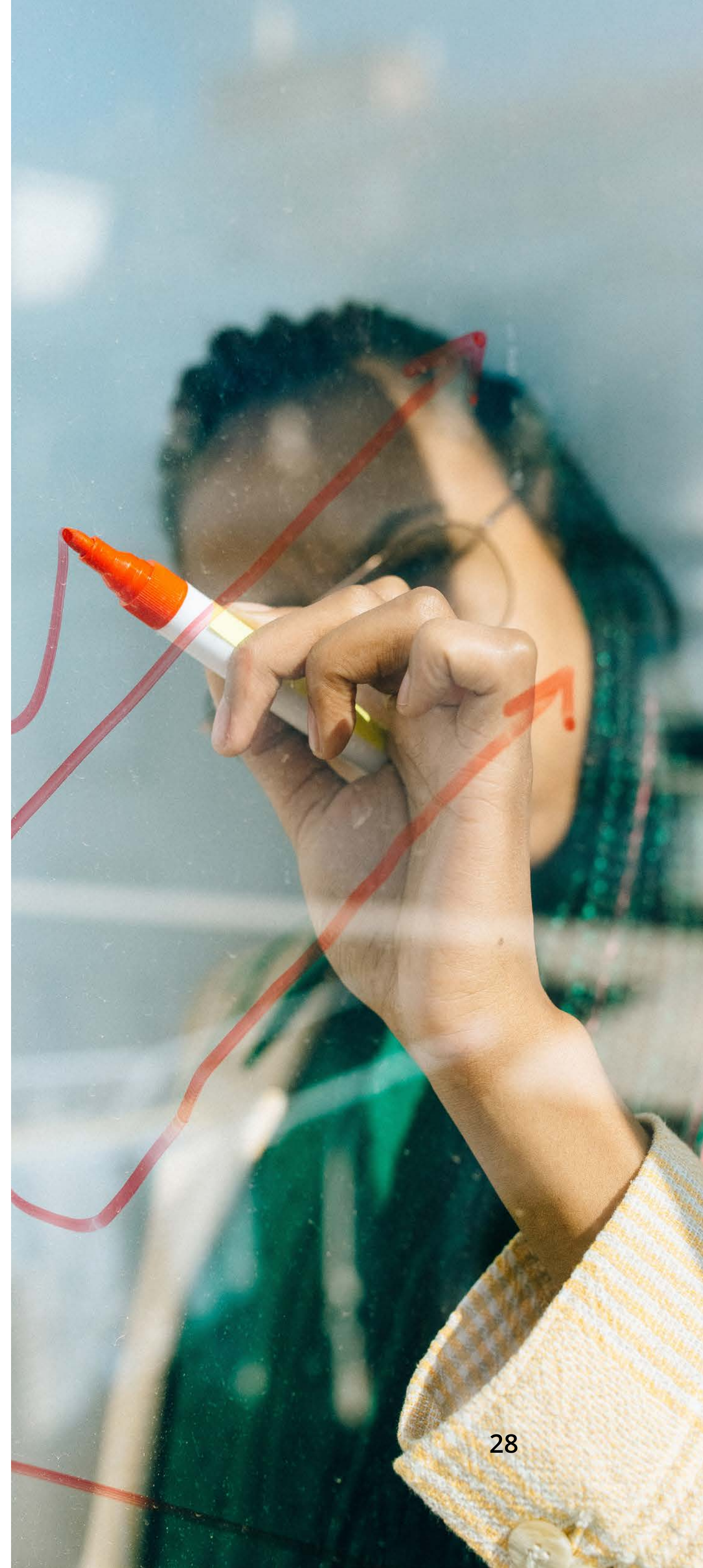
Year-over-year rent growth during the pandemic

The Correction Begins: June 2022–Present

Since the middle of 2022, the housing and rental markets have started changing course, and we've entered a new phase of a normal economic cycle—what I'd call a "correction."

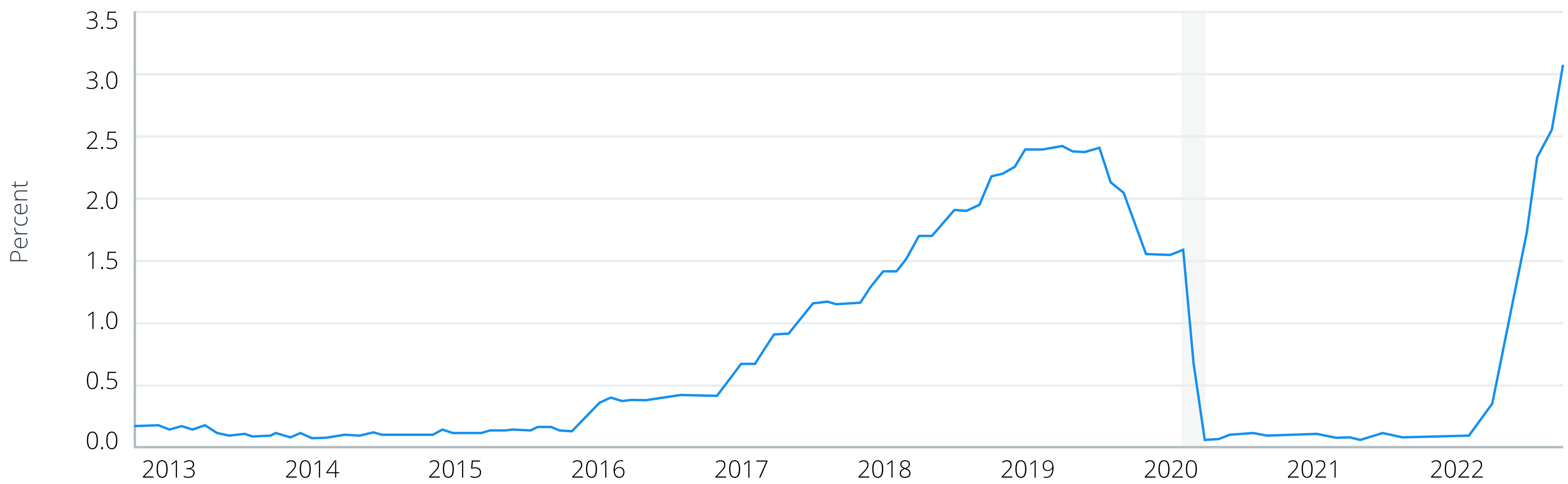
The primary cause of this change has been the Federal Reserve's decision to raise their federal funds rate (FFR) to combat persistently high inflation. They announced this policy change in late 2021 and began implementation in March of 2022.





Over the course of 2022, the Fed raised the FFR from near zero to over 4 percent—one of the most rapid paces of increase on record. The FFR is the only interest rate the Fed controls, and it sets the minimum rate at which banks can borrow from one another. The FFR doesn't dictate mortgage rates or credit card rates, but it essentially sets the lowest interest rate across the economy.

Federal Funds Effective Rate

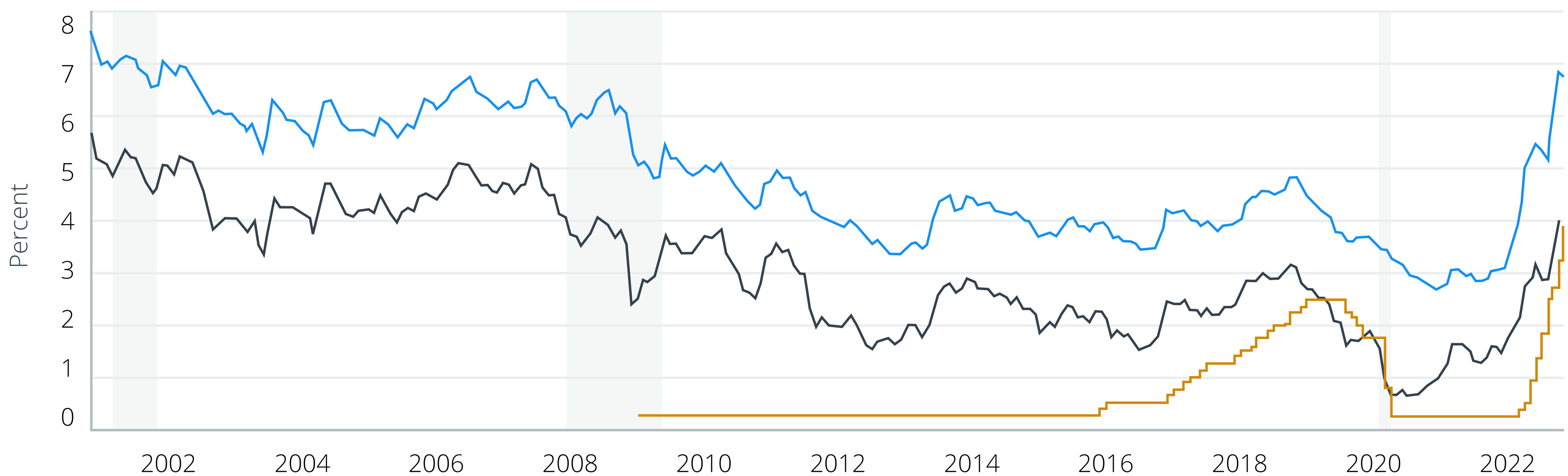


Shaded areas indicate U.S. recessions

[Source: fred.stlouisfed.org]

Although the FFR does not directly dictate mortgage rates, the two rates are related. Generally speaking, when the FFR goes up, it pushes up bond yields, which are correlated to mortgage rates, and mortgage rates rise as well. When bond yields rise, so do mortgage rates—and that is exactly what we've seen.

FFR against Mortgage Rates and Bond Yields



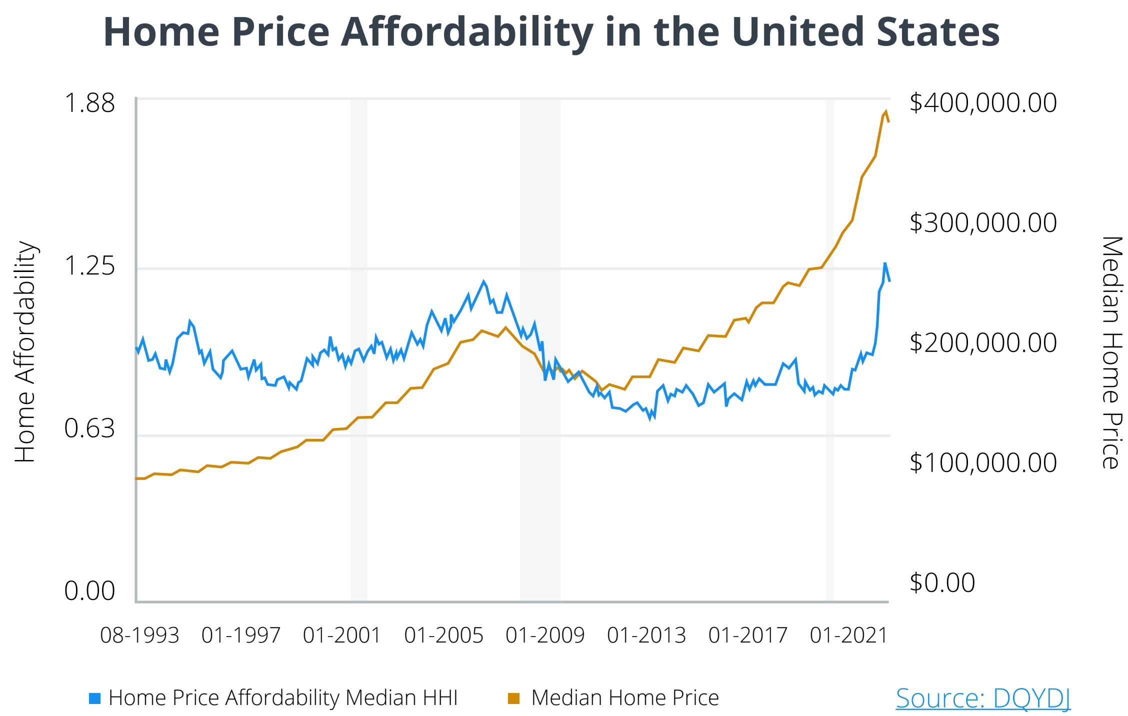
Shaded areas indicate U.S. recessions

Source: fred.stlouisfed.org

- 30-Year Fixed Rate Mortgage Average in the United States
- Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis
- Federal Funds Target Range - Upper Limit

This rapid change in mortgage rates has dramatically impacted housing affordability, which in turn has altered the dynamics of the housing market.

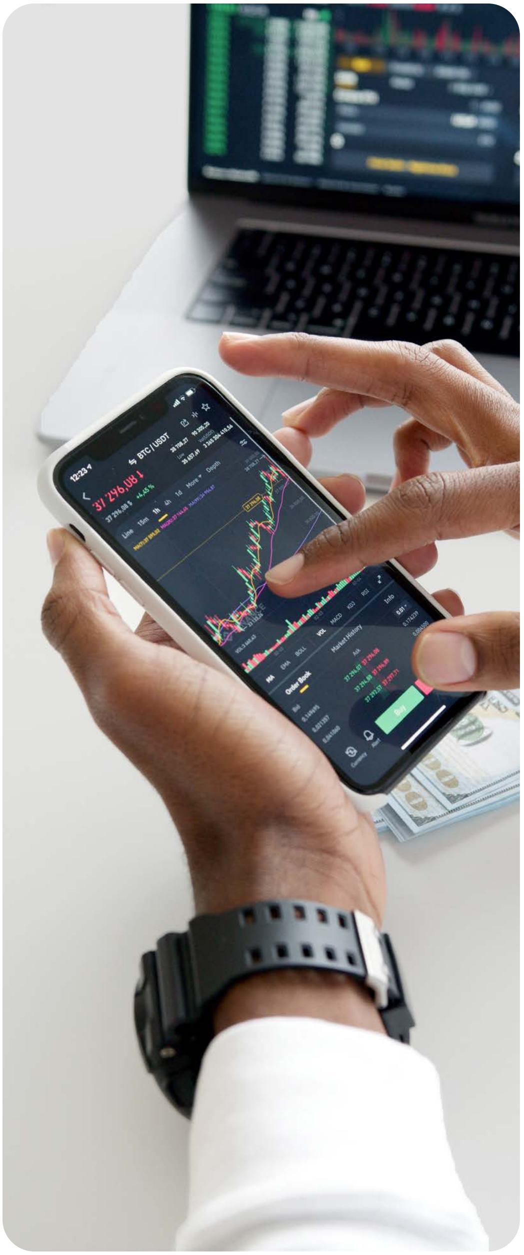
> **Once mortgage rates started to rise, the combined effects of costlier debt and record-high housing prices led to evaporating affordability. Now, at the end of 2022, housing affordability is the lowest it's been in over thirty years.**



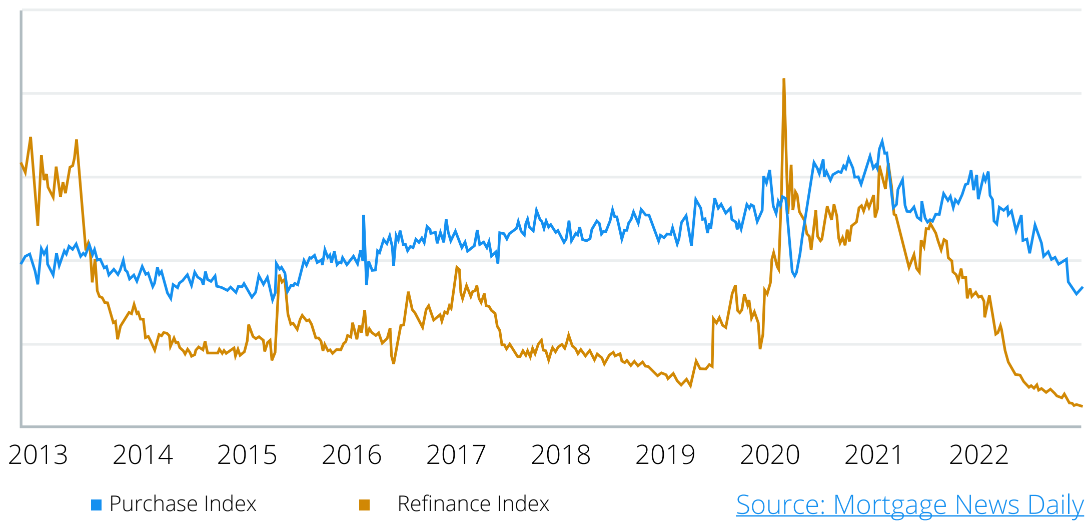
Source: DQYDJ

Recall that lower mortgage rates were helping to preserve affordability, even as housing prices rose across the country. But once mortgage rates started to rise, the combined effects of costlier debt and record-high housing prices led to evaporating affordability. Now, at the end of 2022, housing affordability is the lowest it's been in over thirty years.

With sinking affordability, demand has fallen off. For most Americans, it's simply too expensive to buy a home right now. You can see this clearly in the decline of mortgage applications and home sales volume. As of November 2022, mortgage purchase applications are down 41 percent YoY, and refinance applications are down a staggering 86 percent YoY.



Purchase vs. Refinance Index

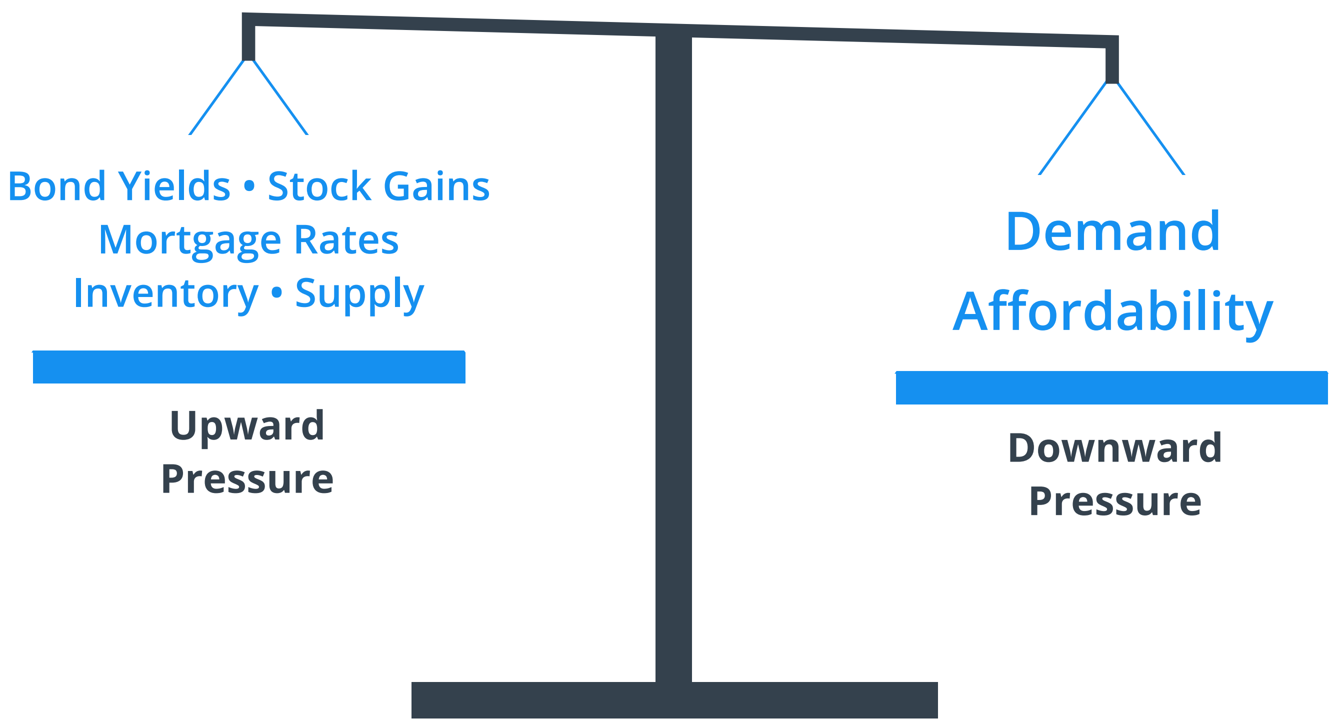


Source: Mortgage News Daily

Existing Home Sales

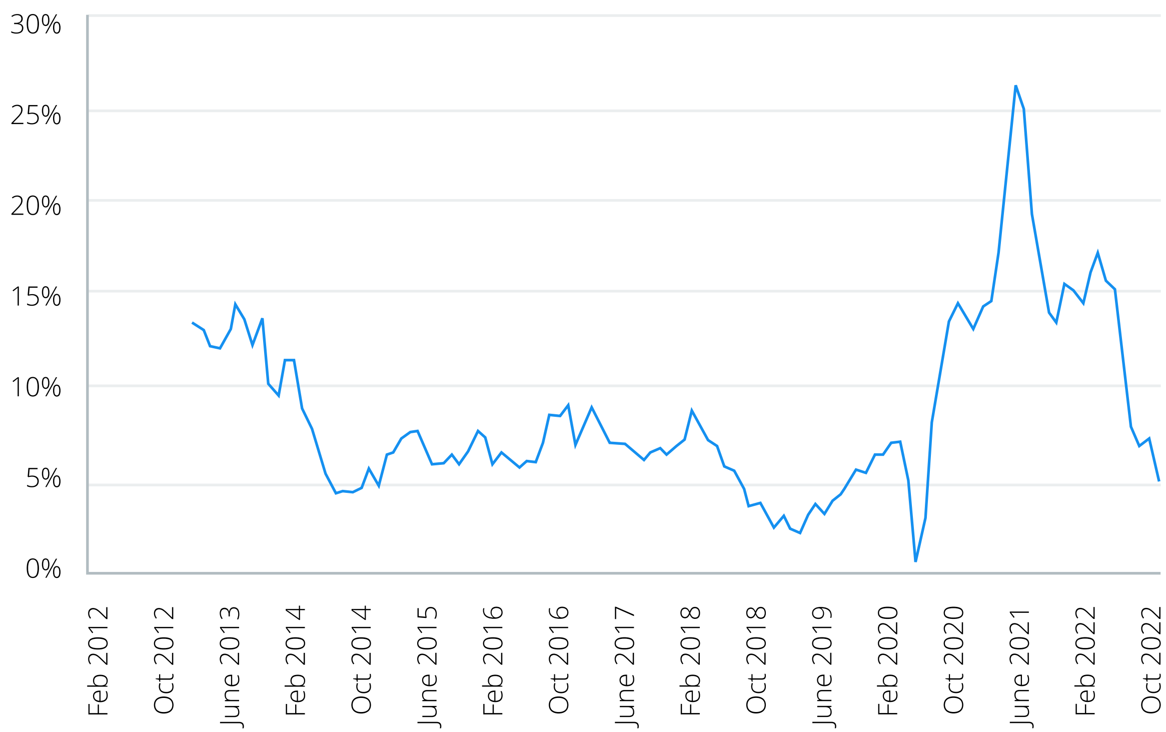
Source: tradingeconomics.com | National Association of Realtors

These shifting dynamics have rebalanced the housing market scale in a significant way. From March 2020 through mid-2022, all of the major factors that influence housing prices supported price growth. Since the middle of 2022, however, affordability and demand are now putting downward pressure on housing prices and have become the dominant variables influencing the market.



As such, home price trends have changed course rapidly. Housing prices are best measured in YoY terms, due to the seasonal nature of the housing market. Prices have yet to turn negative on a YoY basis (as of this writing), but the change in trajectory is dramatic.

Median Sales Price | United States | Year-Over-Year



From August 2020 to June 2022, the housing market averaged over 10 percent YoY growth rates, peaking above 25 percent. Now, in late 2022, when this is being written, YoY growth rates are about 5 percent, and are expected to fall further. During typical economic periods, a 5 percent YoY growth rate would be rapid, but given how quickly appreciation is decelerating, this represents a major correction in housing prices.

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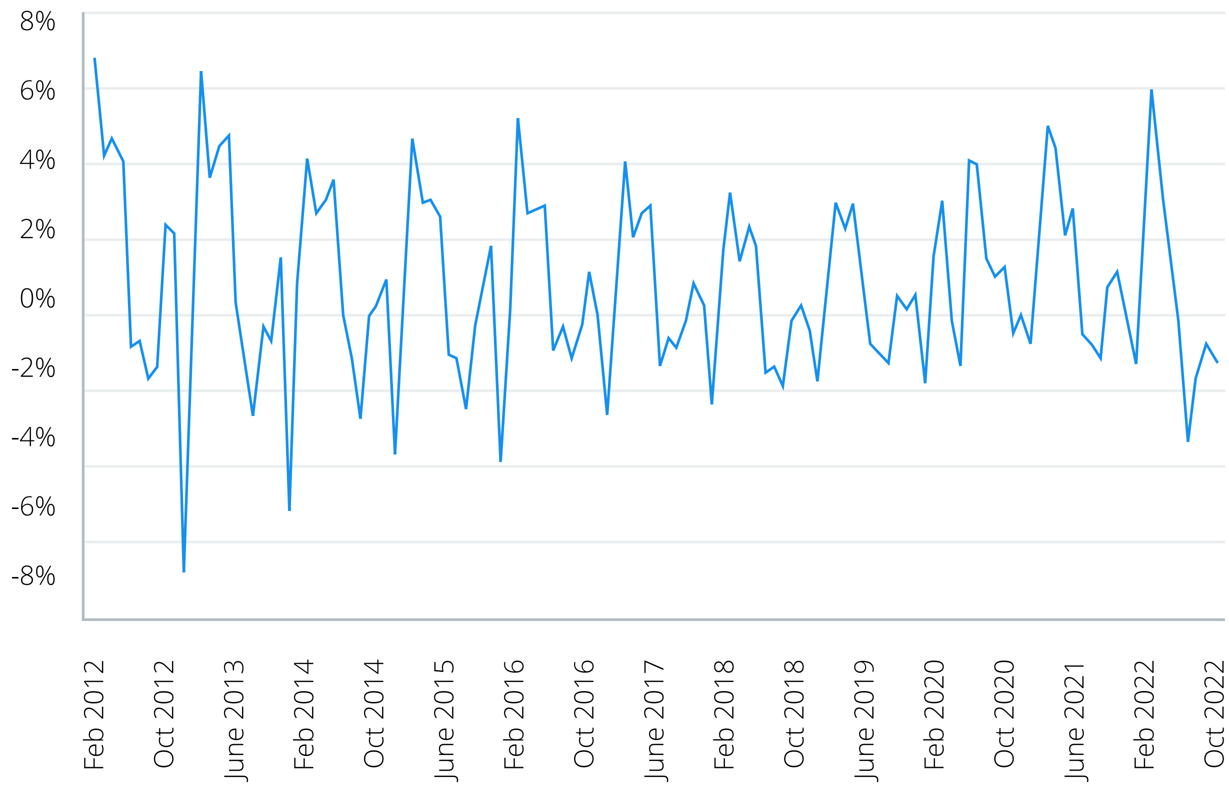
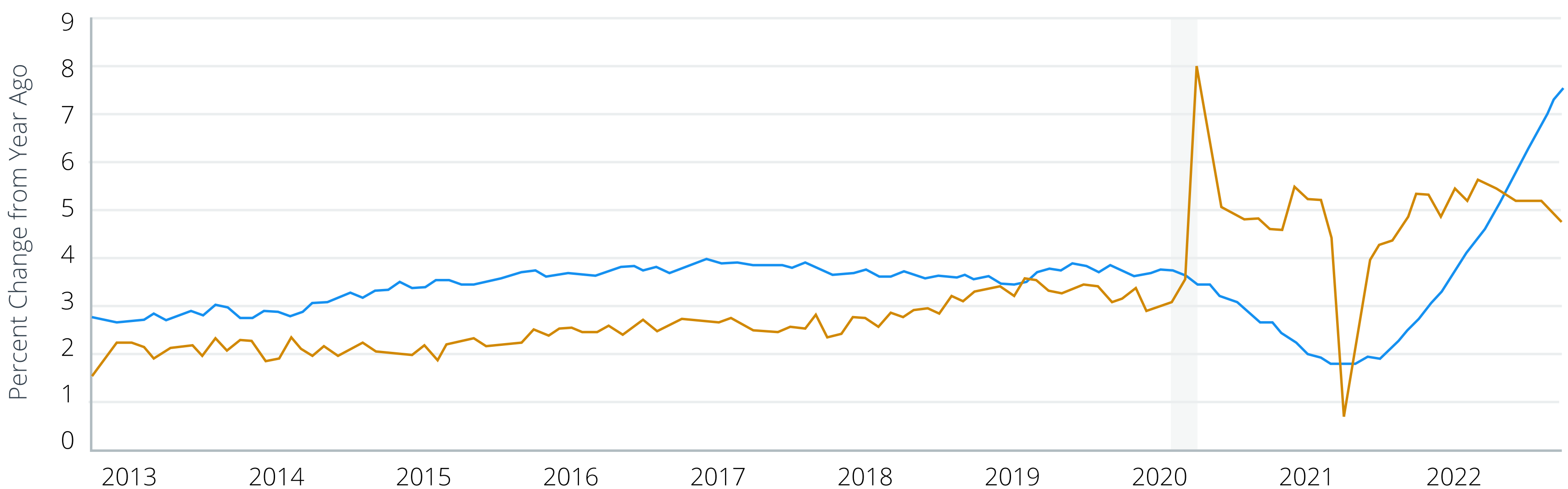
Median Sales Price | United States | Month-Over-Month



As I mentioned, YoY data is the best way to measure the housing market, but during a correction, monthly dynamics can be helpful. As seen in the chart on p. 35, housing prices peaked in absolute terms back in June 2022 and have been falling since. Due to the seasonality of the housing market, it's normal for prices to fall after the summer, but this year the downturn is sharper and more prolonged than it's been in at least five years.

The rental market has seen similar dynamics at play since summer 2022. Although rent growth accelerated dramatically starting in 2021, wage growth was keeping pace for a while until mid-2022, at which point rent growth started to outpace wage growth, thus making rent less affordable.

Rent and Wage Growth



Shaded areas indicate U.S. recessions

Source: fred.stlouisfed.org

■ Consumer Price Index for All Urban Consumers: Rent of Primary Residence in U.S. City Average

■ Average Hourly Earning of All Employees, Total Private

As it does in the housing market, declining affordability in the rental market puts downward pressure on rents. This, combined with an uncertain economic picture, where layoffs are becoming more frequent and wage growth is stalling, has dramatically slowed rent growth.

As seen in the chart below, the median asking rent in the U.S. has fallen from 17.5 percent YoY in October 2021 to just 4.1 percent in November 2022.

The periods of high rent and home price appreciation have ended, at least for this market cycle. The question is, how big will the correction be, and what will happen in 2023?

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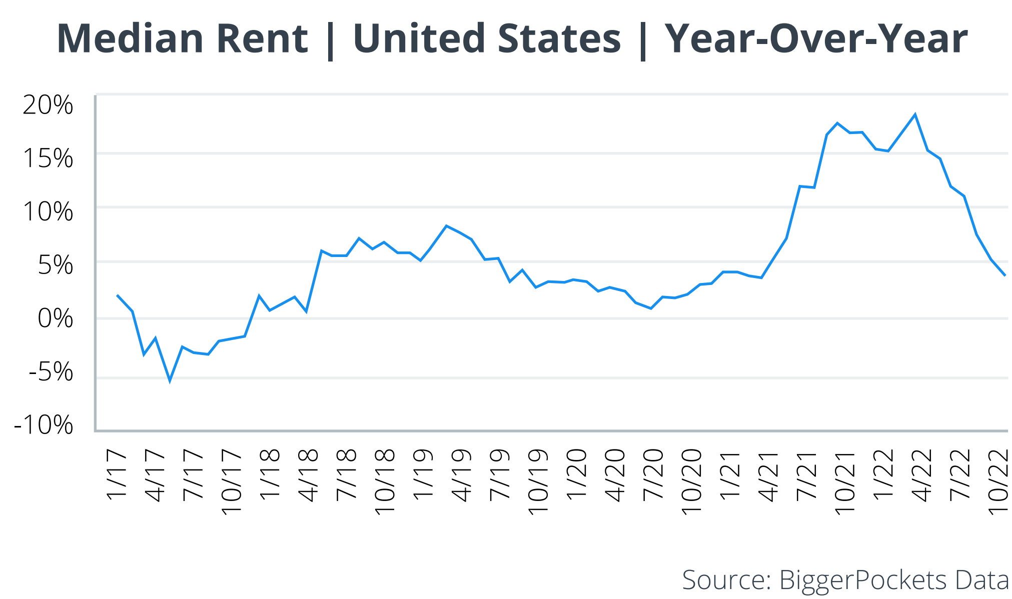

2023 Outlook

2023 Outlook

Of course, no one knows what's going to happen in the housing market. The global economic climate is very uncertain, and the U.S. real estate market is no different. However, we can extrapolate a bit from the data shown above to explore the most likely scenarios.

In my view, the housing market on a national level will likely see prices decline on a year-over-year basis in 2023. Of all the variables in play, I believe it comes down to affordability. It is simply too expensive for most Americans to buy a home right now. Combine that with the potential for a global recession and rising unemployment in 2023, and it's not a very enticing market for home buyers. These factors combined should keep demand suppressed for most, if not all, of 2023 and drive prices down. Remember, this is on a national level; each regional market will behave differently.

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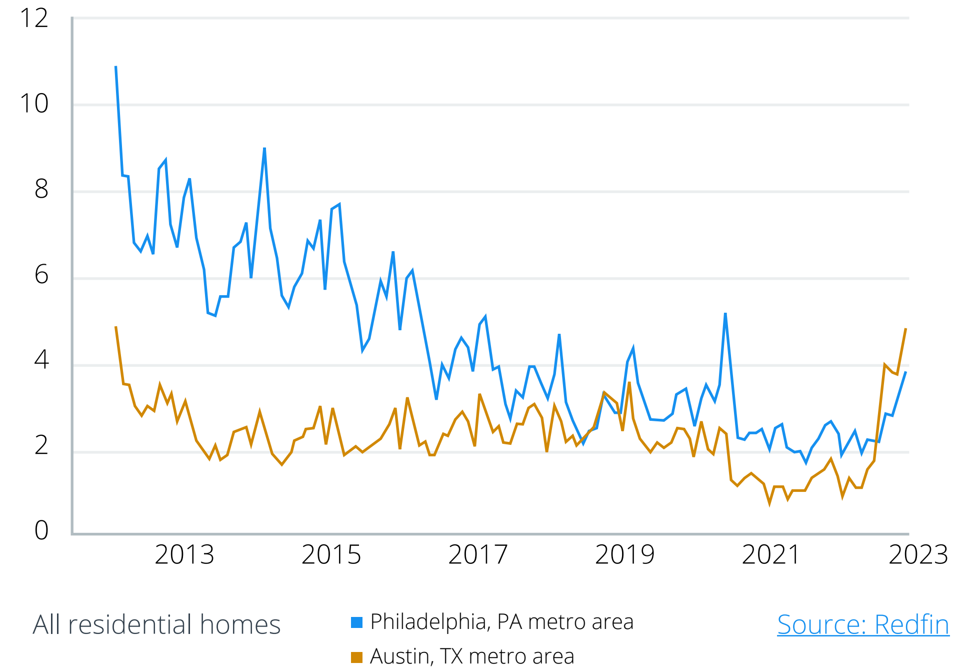
Of all the variables in play, I believe it comes down to affordability. It is simply too expensive for most Americans to buy a home right now.

As of late 2022, we're already starting to see regional housing market dynamics diverging. For example, consider inventory levels (as measured by months of supply) for Philadelphia, Pennsylvania and for Austin, Texas.

Both cities have seen their inventory levels rise from their pandemic lows in the second half of 2022. However, Philadelphia inventory remains below pre-pandemic levels, indicating it is still in a relatively strong (but dissipating) seller's market. Austin, on the other hand, has seen inventory skyrocket well past pre-pandemic levels, indicating a full-fledged shift to a buyer's market.

This is just a solitary example, but I expect the variance between regional housing markets to increase in 2023. Some markets will likely stay relatively flat or see modest declines, while others will see more significant drops in pricing.

Months of Supply Philadelphia vs. Austin



The size of the correction in the housing market remains unclear, with forecasters producing a wide variety of predictions. Moody's Analytics has called for national declines in the realm of 10 percent to 15 percent in 2023, with some markets seeing declines of over 20 percent. Meanwhile, Freddie Mac is calling for much more modest declines of only 0.2 percent in 2023. There is no consensus about the national market, but there are some emerging themes in forecasts.

Market Trends

- Markets that saw the largest increases from 2020–2022 have the highest probability of decline in 2023—think markets like Boise, Reno, Las Vegas, and Austin.
- Markets with low affordability are poised for the largest drops. Cities like Denver, Seattle, and San Francisco—all with a history of low affordability—are vulnerable to the biggest price corrections. Moody's Analytics believes some of these cities could see a drop of 20 percent to 30 percent in the worst-case scenario.
- Markets that seem the best insulated against declines are in the Midwest, Northeast, and Southeast. These markets (like Indianapolis, New York, and Dallas) saw more modest appreciation in 2020–2022 and are therefore less susceptible to declines.

These are broad, generalized trends, and it's very important for any home buyer or real estate investor to understand the dynamics of their specific market. That said, I believe the country as a whole is likely to see a broad price correction in 2023 due to low affordability.

Affordability has tanked due to the combination of rising mortgage rates and years of rapid price appreciation. Declining housing prices could help improve affordability, but it doesn't address the other part of the equation: mortgage rates. With interest rates continuing to rise, it's unlikely housing price declines alone will restore affordability to a reasonable level in the coming year. In my view, the housing correction will likely persist as long as mortgage rates continue to rise.

The question then becomes: When will rates stabilize, or potentially fall?

As of late 2022, the Federal Reserve has shown no sign of stopping rate hikes. In their most recent Summary of Economic Projections, the Fed forecast continuing to raise the FFR into 2023, albeit at a much slower pace than they raised rates in 2022. Inflation remains very high, so I don't expect the Fed to reverse course and lower rates in at least the first half of 2023. However, the inflation rate does seem to have peaked and is coming down slowly, which means the pace of rate hikes will likely come down as well.

While the Federal Reserve isn't likely to provide relief for mortgage rates anytime soon, the Fed doesn't control mortgage rates, as I mentioned earlier. They certainly influence mortgage rates, but there are more important variables than Fed policy. Specifically, mortgage rates are highly correlated with the yield on the ten-year treasury bills. When bond yields rise, so do mortgage rates. When yields fall, mortgage rates follow suit.

Bond yields are a complex topic, but in the context of the mortgage rates, it's most important to know that yields tend to fall during a recession and take mortgage rates down with them. Basically, bonds are safe investments, and during a recession, investors look to park their money in low-risk assets. This increase in demand for bonds pushes down the yield and takes mortgage rates with it. This can happen even as the Federal Reserve raises the FFR.

> **Because the prospect of a global recession remains high, there exists a strong chance that mortgage rates will at least stop rising, and perhaps even fall, in 2023.**

Because the prospect of a global recession remains high, there exists a strong chance that mortgage rates will at least stop rising, and perhaps even fall, in 2023. Lawrence Yun of the National Association of Realtors believes, "The new normal for mortgage rates looks to be near 7% for the 30-year fixed rate," while ATTOM's executive vice president of market intelligence, Rick Sharga, predicts rates to fall to 5.5 percent to 6 percent in 2023. Very few prominent economists are expecting mortgage rates to go much above 7.5 percent, if at all.

The leveling off or even the decline of mortgage rates in 2023 could provide a backstop for the housing correction and prevent a full-fledged crash. Of course, we don't know what will happen, but keep an eye on bond yields and mortgage rates, as they will be the most important lead indicators for the housing market in 2023. If mortgage rates level off or even fall, I expect a modest housing correction (probably single-digit declines nationally). If mortgages go above 8 percent, I believe prices will drop well into the double digits on a national level.

Despite the prospect of declining prices, there are still strong opportunities to invest in real estate. You simply must adjust your strategy to the phase of the economic cycle we're currently in.

How to Invest in an Uncertain Market

How to Invest in an Uncertain Market

Despite uncertainty in the housing market and the broader economy, there are strong opportunities for real estate investors. As noted earlier, the housing market has shifted from a seller's market, where pricing power belongs to property owners, to a buyer's market. This creates an environment where opportunities become more abundant for investors, but risk of short-term price declines is higher. Most experienced investors remain active, or even increase activity, in this type of market and still profit by using some or all of the following strategies.

Let's explore these strategies for investing in an uncertain market:

1. Buy Deep
2. Invest in "Hybrid Cities"
3. House Hacking
4. Flip with Caution
5. Short-Term Rental Risk
6. Explore Creative Financing Options
7. Hold On to What You've Got
8. Use Cash If You Can
9. Become a Private Lender
10. Time the Market If You Have a Crystal Ball

1 Buy Deep

"Buying deep" is an industry term for buying below asking price, and it is the best strategy for investors in an uncertain market. Of course, buying under list price is ideal in any market conditions, but it becomes essential during corrections.

During the strong seller's market of the last few years, it was nearly impossible to buy below list price. In fact, above-asking offers and waived contingencies became the norm. Now, sellers have lost their pricing power and are either more willing, or are forced, to negotiate with buyers if they want to sell their property.

This strategy helps mitigate risk of price declines. For example, if you believe your market is likely to experience 5 percent declines, try to negotiate a price about 5 percent below asking. This way, if the market does decline, you'll still have bought at an appropriate price.

Buying deep is a numbers game. Not all sellers are going to agree to a below-asking offer. But if you're operating in a buyer's market and do this enough, it tends to work.

"

If you believe your market is likely to experience 5 percent declines, try to negotiate a price about 5 percent below asking. This way, if the market does decline, you'll still have bought at an appropriate price.

2 Invest in “Hybrid Cities”

Over the course of the pandemic, nearly every regional housing market in the country saw rapid appreciation. Normally, it doesn’t work that way. From the period of 2010–2020, there was significant trade-off between markets that saw strong appreciation versus markets that offered strong cash flow. A few markets, however, offered some of both: solid (but not amazing) appreciation and solid (but not amazing) cash flow.

These “hybrid” markets pose less risk than other markets because they are less volatile and offer investors multiple ways to make money. Hybrid cities tend to be smaller, less well-known cities. Cities like Austin, Boise, and Las Vegas have all seen tremendous appreciation over the last few years but now face a high probability of significant price declines. Cities like Detroit and Milwaukee offer strong cash flow but have declining populations and could see below-average appreciation in the coming years. Instead of these cities, look for more boring and predictable cities like Birmingham, Alabama; Philadelphia, Pennsylvania; or Madison, Wisconsin.

3 House Hacking

House hacking is an owner-occupied investing strategy and offers good benefits in almost any market conditions. House hacking entails an investor living in the property that they buy. Most often, the investor buys a single-family home, lives in one bedroom, and rents out the others, or the investor buys a two- to four-unit property, lives in one unit, and rents out the remaining units.

This strategy is effective for several reasons. First, it allows the investor to access residential and owner-occupied financing, which means one can put as little as 3.5 percent down and can often get a lower interest rate than an investor loan.

Second, house hacking returns are calculated a bit differently than a "typical" rental. For a house hack to be successful, it doesn't necessarily need to have cash flow. It just needs to significantly lower the investor's cost of housing. For example, consider an investor is paying $1,200/month in rent before house hacking. If that same person completes a house hack and now pays just $200/month in living expenses (because her tenants are paying all other expenses), she is saving $1,000/month. This isn't cash flowing, but it still improves the investor's financial position considerably by saving her $12,000/year, which she can then reinvest.

4 Flip with Caution

Flipping houses is a popular real estate investing strategy, and for good reason: It can be very lucrative. However, it is also one of the riskiest strategies—particularly in a correcting market. The business of flipping houses entails buying a property in need of rehabilitation, fixing it up, and then selling it for a profit. When the market is appreciating, it adds cushion and potentially some bonus upside for flippers. In a correcting market, houses sit on the market longer, which adds to the flipper's holding costs and could eat into the profit. Experienced flippers will do very well in this type of environment because there will be deep discounts on properties in need of repair, but novice flippers should be extra conservative when underwriting prospective deals.

5 Short-Term-Rental Risk

Short-term rentals (STRs) are a great investing strategy and often generate some of the best cash-on-cash returns. The challenge with short-term rentals in the short run, however, is twofold. First, supply has exploded. AirDNA has reported a 17 percent increase in listings in just one year. Even though demand for domestic vacations is strong and shouldn't get hit too hard even in a recession, I doubt it will grow very much. Increasing supply even with modestly declining demand could decrease revenue for hosts.

> **Increasing supply even with modestly declining demand could decrease revenue for [short-term rental] hosts.**

Second, I think high-priced vacation rental markets, like ski towns in Colorado or beach destinations in Florida, are going to get hit the hardest in terms of price corrections. During the pandemic, demand for second homes skyrocketed alongside interest from short-term rental investors. That demand (not prices) has come crashing back down to earth (I don't use those words lightly). I worry that some STR investors bought at a bad time and there could be some forced selling if revenue slows. I never root for anyone to lose their shirt on a home or any other investment, but if that does come to pass, it could present buying opportunities.

6 Explore Creative Financing Options

Consider creative financing options, like Subject To (SubTo) and seller financing. These financing strategies offer the opportunity to buy real estate at lower rates than conventional mortgages and can help boost your spending power. SubTo is when an investor assumes the existing mortgage from the sellers (ideally at a lower-than-market interest rate). Seller financing is when a seller owns a property free and clear, and essentially serves as the bank for the investor's mortgage. Because these scenarios are simply buyers and sellers negotiating, it means investors can often get more favorable terms than if they financed through a bank at current market rates.

7 Hold On to What You've Got

If you bought property within the last ten years with low-interest debt, stay calm and carry on. You may give back some recent appreciation, but if your property cash flows, rent growth is improving your

cash flow and might continue to do so into the future—making it a solid long-term investment. It may sound boring, but deciding to hold a property that cash flows, has a low rate, and could see increased income is a good move in this market! The alternatives, such as a cash-out refinance, 1031 exchange, or selling and paying taxes, will likely yield worse returns than just holding on. Panicking when prices decline and then selling is pretty much always the worst possible outcome.

8 Use Cash If You Can

If you have the means, consider buying with all cash since debt is currently expensive. If prices are coming down in 2023, then investing in real estate using high-interest-rate debt may be dilutive to your returns compared with buying in all cash in the near term. If you buy a property generating income at a 4 percent cap rate, and assume 2 percent appreciation next year, then 6 percent to 7 percent interest rate debt will likely make your returns worse than if you buy all cash.

Don't believe me?

Try it out on the BiggerPockets Rental Property Calculator for yourself. Depending on your appreciation assumption, financing with debt may actually make your returns worse than buying in all cash. Not many people have this option, but if you do, it's worth exploring.

CHECK IT OUT

9 Become a Private Lender

As rates continue to rise, it could be a great time to shift at least part of your real estate strategy to the lending side. Returns on private lending can be as high as 10 percent to 14 percent in the current market, and demand for private loans is likely to rise significantly in the coming months. Your worst-case scenario as a lender is that you become an equity holder in the real estate property you are lending to. If researched and executed carefully, lending may produce much higher returns than equity investments over the next twelve months, with a dramatically lower risk profile.

Learn how to create financial freedom and passive income in real estate as a private money lender.

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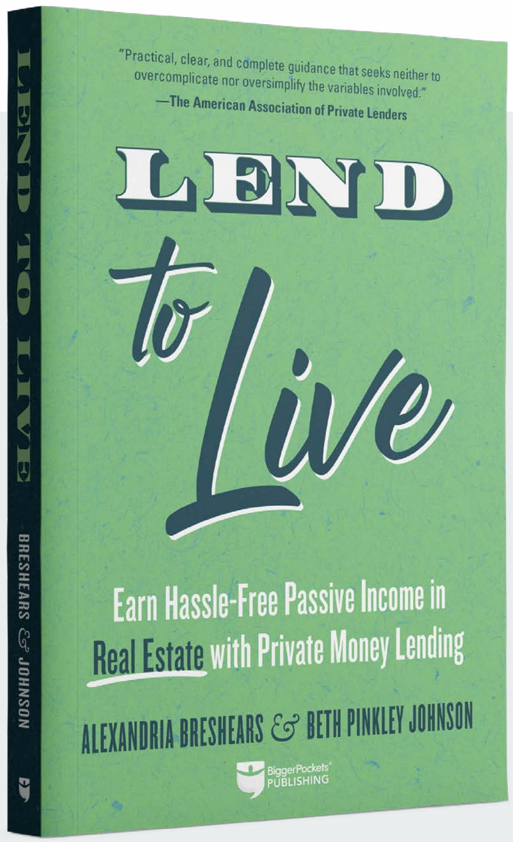
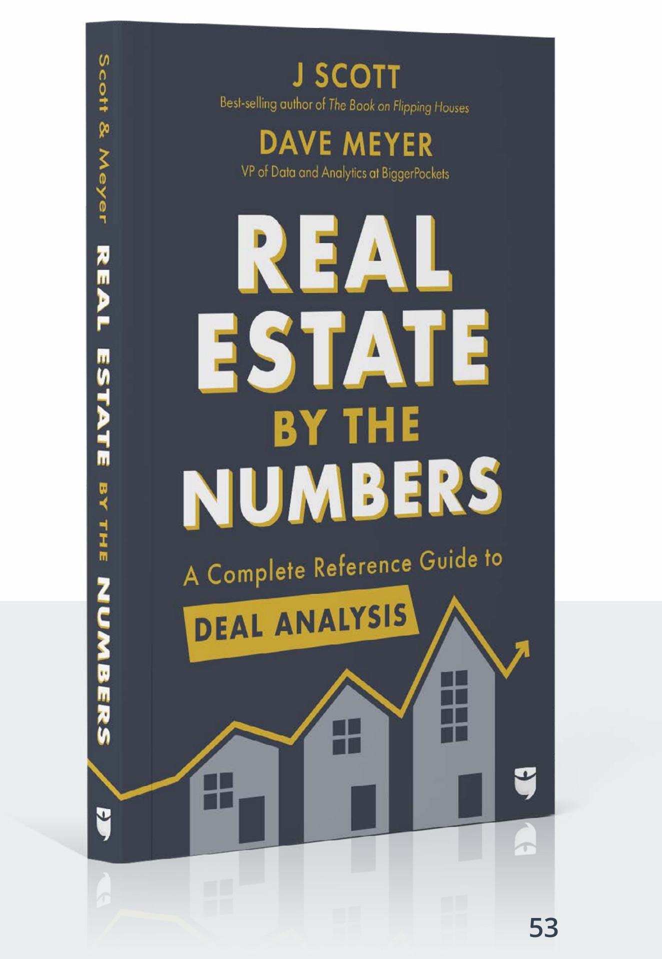


10 Time the Market If You Have a Crystal Ball

Last, you could try to time the market, but that is notoriously difficult and something I would not recommend. Instead, stick to the basics and look for good long-term opportunities. Remember, property values are not the only way you make money with rental property investing. You could try to time the market, but in the meantime, you'll miss out on cash flow, loan paydown, and tax benefits.

I'm not saying you should buy just anything, but you need to factor in variables other than property prices when deciding where to allocate your capital. If you want to learn how to analyze deals with all of these metrics, you can check out my new book, *Real Estate by the Numbers*, which I co-authored with BiggerPockets legend J Scott. You can also tap into BiggerPockets' many investment calculators, which are an invaluable resource to analyze deals and understand the numbers behind investments.



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What to Watch For

What to Watch For

I've provided my best analysis of current housing market trends above, but there are a lot of outstanding questions that will play a major role in the 2023 real estate investing landscape. I wish I had answers to these questions, but since I don't, I'll simply pose some thoughts about important topics to monitor throughout 2023.

Let's explore these topics:

1. Will There Be a Recession?
2. Mortgage Rates
3. Commercial Real Estate
4. Geopolitical Conditions
5. What Is the Future of Wall Street in Real Estate?

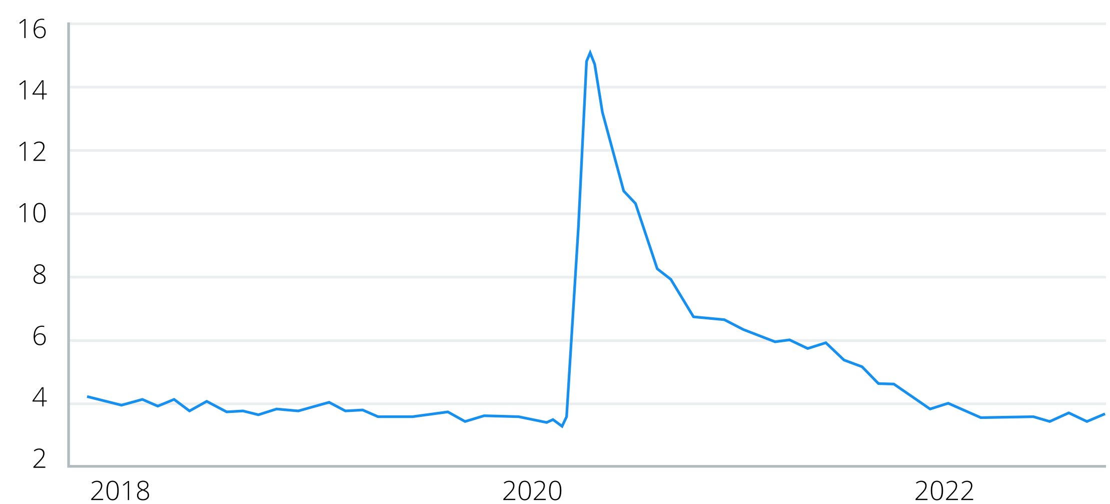
1 Will There Be a Recession?

2022 was a very strange economic year with high inflation, rising interest rates, and no real gross domestic product (GDP) growth in the first and second quarters. Two consecutive quarters of GDP declines is a common definition of recession, but since the official designation of recession happens in retrospect from the National Bureau of Economic Research, we don't know if we've been in a recession or not. To further complicate the question, GDP grew in the third quarter.

Regardless of whether a recession is officially designated, most Americans (and people across the globe) have a gloomy economic outlook. Inflation is eating away at spending power in most countries across the world, and wage growth peaked back in February 2022 and has been coming down slowly.

The labor market has remained surprisingly resilient in the face of interest rate hikes, but as of early December 2022, there are signs that could be changing. The data still shows strong labor conditions, but anecdotal evidence is pointing to more high-profile layoffs and more fear in the labor force.

United States Unemployment Rate



Source: tradingeconomics.com | U.S. Bureau of Labor Statistics

Recessions come in all shapes and sizes, and their impact on housing is variable. In four of the last six recessions, prices went up, but of course we all remember the Great Recession where housing prices declined over 20 percent nationally and took years to bottom out. Rents, on the other hand, tend to be quite sticky—even during recessions, they rarely go down more than a few percentage points.

All that said, a recession is going to change the economic landscape in ways we can't currently foresee. I will be keeping a close eye on the labor market, wage growth, and GDP to gauge how a potential recession would impact my expectations for the housing market.

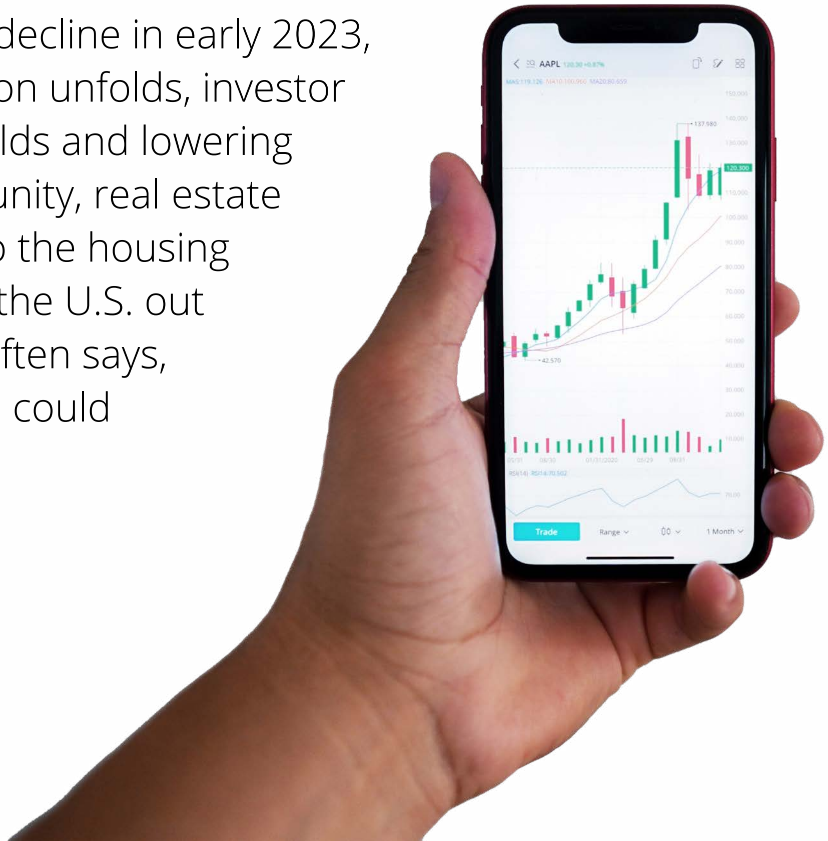
2 Mortgage Rates

As discussed above, mortgage rates are a real toss-up in 2023. If there is a global recession and investors flock to the safety of U.S. treasuries, it could push down mortgage rates and raise demand in the housing market. This would provide a backstop for falling home prices and probably limit price declines to single digits on a national level.

However, if the Fed succeeds in raising interest rates while avoiding a recession, bond yields could continue to rise, taking mortgage rates somewhere near 8 percent. If this happens, the housing market is going to face very significant demand destruction and will likely see prices drop by double digits nationally.

I can envision a scenario where housing prices decline in early 2023, leading the U.S. into a recession. As the recession unfolds, investor dollars flock to the U.S., pushing down bond yields and lowering mortgage rates. Then, sensing a buying opportunity, real estate investors and home buyers alike jump back into the housing market, spurring economic activity and leading the U.S. out of the recession. As Lance Lambert of *Fortune* often says, housing is “first in, first out” in a recession, and I could definitely see that happening in 2023–2024.

Keep an eye on bond yields!



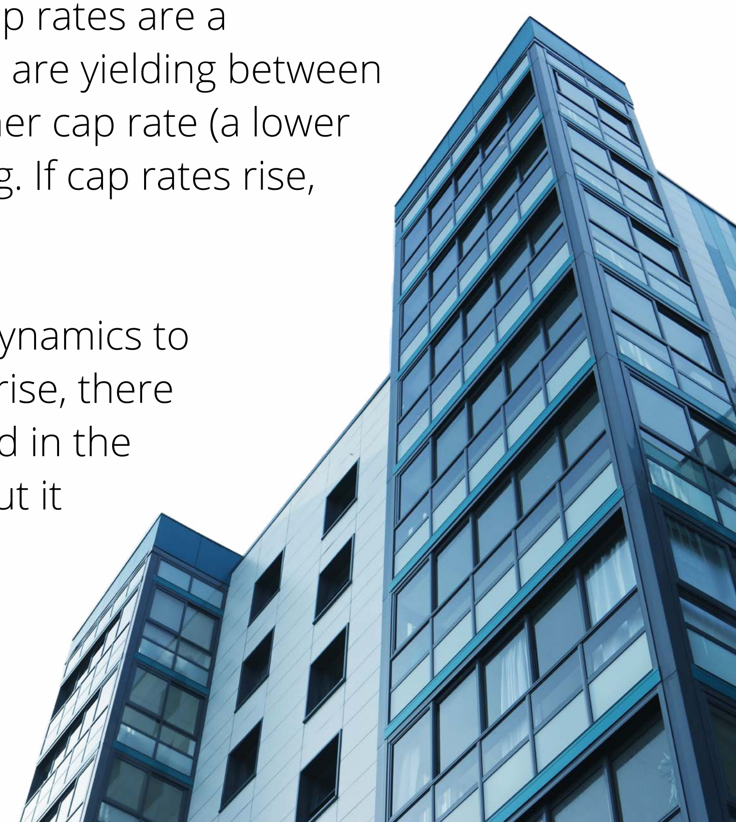
3 Commercial Real Estate

The majority of this report has focused on the residential real estate market, which includes multifamily properties up to four units. The commercial real estate market has different dynamics than residential real estate, and it faces unique risks entering 2023.

First, unlike residential real estate, where thirty-year fixed rate loans are common, commercial loans often have shorter maturity periods, sometimes with variable interest rates. This makes commercial real estate more vulnerable to rising interest rates. Commercial operators whose loans are adjusting or who have their loan coming due in 2023 will face much steeper debt costs. Will those rising debt costs lead to decreased cash flows, or perhaps even defaults?

Second, rising interest rates put upward pressure on cap rates. Cap rates are a complicated topic, but the important thing to know is that if bonds are yielding between 3 and 4 percent, multifamily buyers could demand to buy at a higher cap rate (a lower price) to justify the increased risk of real estate over bond investing. If cap rates rise, multifamily prices will decline.

It's unclear how this all will play out, but these are two important dynamics to watch for in 2023. If there is an increase in defaults and cap rates rise, there could be significant declines in asset values above what is expected in the residential market. This, of course, would hurt current investors, but it could create strong buying opportunities for those with cash.



4 Geopolitical Conditions

At the outset of 2022, most economists were expecting inflation to start cooling due to easing of the supply chain issues brought on by COVID-19. Then, Russia invaded Ukraine and wreaked havoc on global trade. Not many people saw that coming. What other geopolitical events could happen in 2023 that change the United States' economic picture and housing market?

There's obviously no way to know for sure, but the war in Ukraine is ongoing and there is always the possibility that it will escalate. There are major protests in Iran, and now in China. Europe is facing high inflation and an energy crisis.

These events may seem distantly connected from the U.S. housing market, but if the last few years has taught us anything, it's that we live in a global and interconnected world. If something major happens with one, or several, of the world's large economies, it will likely have an impact on the U.S. economy—for better or worse.

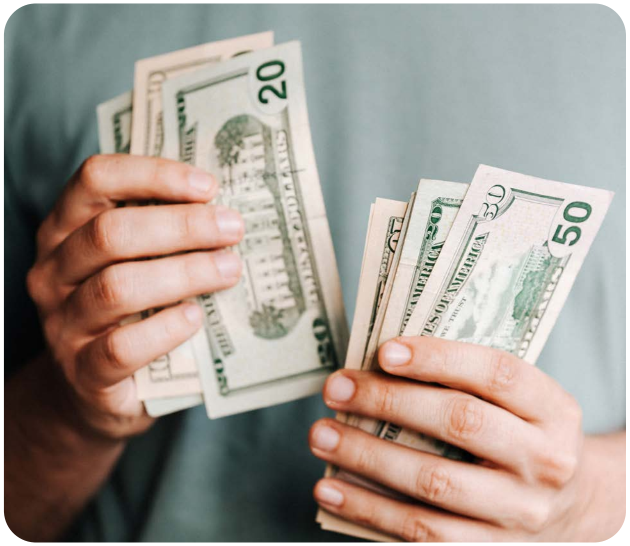
5 What Is the Future of Wall Street in Real Estate?

There has been a lot of attention paid of late to an increase in investor activity in the housing market. While major Wall Street firms aren't yet taking over residential real estate, given that John Burns Real Estate Consulting believes that only about 2 percent of homes are purchased by companies with over 100 units, it will be interesting to see what happens next. If institutional investors get more involved in the housing market, it could make housing and rent even less affordable than it already is. If price declines spook institutional investors and they start to sell, it could force prices down even further.

I don't think either is likely. These large institutional investors tend to play the long game well, and I don't expect major changes in their behavior in 2023, but it will be something worth paying attention to.

Since the Great Recession, there has been a great proliferation of real estate technology. In particular, major publicly traded companies like Zillow, Redfin, Offerpad, and Opendoor created businesses offering sellers the convenience of selling to a big company sight unseen (called iBuying). But iBuyers have had a lot of trouble of late with Zillow and Redfin exiting the space, and Opendoor posting major losses. Will iBuying survive in 2023? Will something else come up and take its place? Big Tech will not be exiting the real estate space—it's too large a market—but it's possible that a downturn will force a lot of the current players out of business and we'll see a new slew of technology companies emerge in the next expansion.

If institutional investors get more involved in the housing market, it could make housing and rent even less affordable than it already is. If price declines spook institutional investors and they start to sell, it could force prices down even further.



Conclusion

Conclusion

For real estate investors, 2023 will be a market of both opportunity and risk. There is a risk of recession and price declines in most major metro areas. This is a threat to profits that needs to be taken seriously.

But at the same time, opportunities are emerging at a rate not seen since the aftermath of the Great Recession.

While it can be scary to invest in this type of market, especially for newbies, recessions and downturns are often when profit potential is the highest. As Warren Buffet famously said, “Be greedy when others are fearful, and fearful when others are greedy.” The same is true in real estate.

3 Key Steps for Investing in 2023

1. **Understand your local market dynamics.**
2. **Employ an investing strategy that works during a correction.**
3. **Stay on top of shifting macroeconomic conditions.**

That does not mean you should go out and buy just anything. In this type of market, it is particularly important that you understand your local market dynamics, employ an investing strategy that works during a correction, and stay on top of shifting macroeconomic conditions. If you do those three things, there should be ample opportunities to invest in 2023.

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