All Hail King Cash (for Now)

An influx of cash buyers and investors helps prop up home sales in a lagging market, but who will take its place when tight fiscal policy and investments with more equity sends these entrepreneurs packing? **By Ryan Schuette**

If cash is king in a buyer's market, Joe Goyne wouldn't know it. The way the easy-going president of the Dallas-based Pegasus Bank makes it sound, the recent army of cash buyers and investors is one driving off low sales and hordes of foreclosures in distant lands.

"We don't see them," he intones with a drawl, describing his portfolio—about half commercial real estate, half everything else—as one fortunately lacking in distressed properties. He vaguely recalls a number of "wealthy customers" he knows that find recently foreclosed homes and move in quickly to score a profit.

Even though Pegasus Bank passed on the sticky helping of foreclosures that still haunts other banks, Goyne acknowledges the simple truth analysts and economists around the country are now heralding: This cash purchase trend is more silver lining than bullet for the low-hanging sales cloud, but it boosts an uneven housing recovery, and the economy needs it.

The bottom line is that "any increased activity in property sales is stabilizing for the market," says Goyne. "That makes transactions occur. That's good for the market, that's good for the industry, and that should be good for the banks."

Reports from Capital Economics and the National Association of Realtors (NAR) concur readily, crowning cash buyers and investors for their role in propping up otherwise southerly home sales. According to second-quarter data released by Capital Economics, homebuyers pocketing properties with hard cash accounted for a princely 57 percent of existing home sales in 2011. That crests a 24-percent surge in the number of existing homes swept up by cash buyers since November 2009—a nearly two-and-a-half year arc trending upward.

A (Cheap) Kingdom for Sale

Economists agree that cash buyers and investors are good right now for three reasons: they're creating demand in a housing downturn, raising equity among all homebuyers, and taking expensive REOs off bank ledgers. But what's luring them?

"The housing market looks incredibly attractive from a valuation point of view," says Paul Dales, senior U.S. economist at Capital Economics. "It's a good deal. Cash buyers and investors are able to take advantage of that because other buyers have been constrained by limited access to credit."

Dales chalks up advances by cash buyers and investors to record-low home sales, dipping mortgage rates, and a climate that spurs sellers to wash their hands of a property as fast as possible, even if that means gutting prices. With the government borrowing 48 cents for every dollar it spends, overseas investors rush to pick up properties on the premise that a deflating dollar inversely raises their purchasing power.

Walter Molony, a spokesperson for NAR, attributed the rise of cash to "pent-up demand" in the market. He said that high unemployment and a weak credit supply continue to discourage first-time and repeat homebuyers.

According to NAR, only one in five people even possess the disposable income necessary to ink their good faith and credit to a mortgage note, thanks to a proposed risk-retention rule from Washington that threatens to top off down payments at 20 percent.

Not so with cash buyers and investors, Goyne says, whom he calls successful people with excess liquidity in search of a buck and "a good time." The bank president describes cash buy-ups and investments as "family endeavors" for the ones he knows, with siblings and parents scouring local listings, pooling their capital, scooping up distressed properties at bids and courthouse auctions, and then remodeling and casting the refurbished homes back onto the market.

That may not be far off the mark for national trends, says Molony, who reports hearing that a number of parents front homes with cash for their hard-hit students with shoddy or untested credit scores. "That's been a way for parents to help their children get a house and a get a better return on their money," he says.

Just who are these opportunists and entrepreneurs?

There is no clear answer. According to NAR, which began measuring month-over-month cash purchases and investments in October 2008, cash buys and investments now take up 30 percent and 35 percent of the market, respectively, with retirement homebuyers accounting for 7 percent of the market and international cash buyers averaging 3 percent. Dales says that unreliable data fails to accurately portray the identities of these faceless buyers and investors, leaving the subject open to debate.

Still, even if their identities are unknown, their value-adding place in the market is clear, and bankers and economists want them to stay.

Cash the Tyrant?

But not all news is good news when it comes to cash buyers and investors.

For some, especially banks and lenders, cash is a benign ruler that rings the registers, keeps the trains on schedule, and pushes back a menacing foreclosure invasion that robs from banks and competes with home construction. Sure, a cash buy removes mortgage lending and the loan officer from the process, but the benefits far outweigh the consequences.

For others—namely first-time and repeat homebuyers—cash is a hard-knuckled tyrant that steals credit from an already shallow pool of capital crimped by the national legal, financial, and political environment.

The reason: first-time and repeat homebuyers compete with cash buyers and investors for a bank's business and marked-down properties. These homebuyers depend on lenders to finance their mortgages, and analysts say cash buys and investments are locking them out of the market. Speaking truth to power, the NAR reported a startling 21-percent dearth in repeat buyers over May.

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"People who are competing with cash buyers or investors for these homes are probably having a tough time," says Dales. "The cash buyer holds all the good cards. First-time and repeat homebuyers—anybody who has to buy with some sort of credit or finance—are struggling to" acquire the financing needed for a mortgage note.

Offering clarity, Goyne describes a scenario in which a lender is approached by a cash buyer and a first-time homebuyer. "If you're offered a contract by somebody and it's subject to financing, more than likely . . . they still have a jumbo mortgage to" pay off and close down the house, he says. "If somebody offers you a contract and it lacks contingency planning, that's a much stronger contract."

The contract for a homebuyer may stipulate a 60-day financing window, while the contract for a cash buyer is hassle-free. In other words, get a signature, exchange the cash, and sell a property. Close the deal. These conditions make the contract for a cash buyer "much stronger" and more lucrative for a bank, he says.

It doesn't help that 23 percent of repeat buyers own a mortgage worth more than the actual property, and another 25 percent are more than 20 percent in the red with their positive equity, according to NAR.

Molony says that he doesn't "foresee first-time or repeat homebuyers jumping back into the market anytime soon," a widely held prediction that unnerves analysts and casts doubt on the ultimate sustainability of a cash buyer's market.

The Succession Issue

Without cash buyers and investors keeping watch, the housing market would trend less safely on the road to recovery. A report by Capital Economics estimates that cash buyers and investors are responsible for a 70 percent boost in sales since those figures hit rock bottom last year. Of those sales, first-time buyers clocked in at an eyebrow-raising 6 percent by comparison, begging the question: Who will succeed cash buyers and investors when they abdicate their place in the market?

"Right now houses are greatly undervalued and that's why we're seeing so many cash buyers," says Molony, going on to describe the potential for fallout from the recently proposed risk-retention rule, a provision in the Dodd-Frank Act that he says will scare away cash buyers and investors and leave in their place a considerable hole.

"Washington is throwing the baby out with the bathwater," he says. "If you kill the market with a higher down payment, the whole housing market falls out. That's why the new home market is historically low."

Dales sums up the problem with cash buyers and investors neatly: "The danger is once demand from cash buyers and investors have been exhausted, first-time and repeat homebuyers will be unable to fill the hole left."

A Capital Economics report bears weight on the issue, suggesting that the housing hole is made deeper by the prospect of a 20-percent down payment, low home equity among first-time and repeat homebuyers, and a "chronic lack of demand" that stifles home construction and household formation.

"We would be much more confident that the housing market had embarked on a sustainable recovery if first-time buyers had played more of a role," the report adds. "This is another reason to expect any further increases in home sales to be fairly muted."

Still, at least for the moment, cash reigns supreme in the housing market and the people—some of them, anyway—seem to be rejoicing.

"I think it's good for the market," says Goyne. "Any increased activity in property sales is stabilizing for the market, whether it's cash or not."