

Brief History of Real Estate

Historically, housing downturns average 27 months. We are in the 23rd month of the current downturn, so once we are past this financial *over-reaction*, things should improve. The median price of a resale home is 3.4% higher than a year ago and the pending sales index is moving back up. There may just be some light beginning to shine at the end of this tunnel!

1970 to 1980:

Prior to my entering real estate in 1971, a quote appeared in **Business Week** (late 1969) due to an increase in housing prices:

“The goal of owning a home seems to be getting beyond the reach of more and more Americans. The typical new house today costs about \$28,000.”

In 1972, interest rates were 7% and it would take over 24 years before a home buyer would be able to obtain those low rates once again – today, we are in the low 6’s. In 1973, banks had a run on deposits and for a period of approximately 8 months there were no lenders who were in a position to make loans to home buyers. This should have caused a collapse in the real estate market, but home prices continued to rise. In 1977, the **National Business** magazine stated:

“The median price of a home today is approaching \$50,000 . . . housing experts predict price rises in the future won’t be that great.”

1980-1990

At the end of the ‘70s and into the ‘80s, inflation hit 21.5% and home loans were reaching 18%! This was followed by a *crash* (and later bail out) of the savings & loans industry in America. Although large job losses were creating foreclosures, home prices continued to rise. By 1985, **Money Magazine** made this prediction about home prices:

“The golden-age of risk free run-ups in home prices is gone.”

With a build-up in defense spending and huge growth in manufacturing sector in the late 1980s, increased job creation led to a boom in home construction and home prices continued to rise. Then on November 11, 1989, a dramatic event took place: the Berlin Wall came down! With the *Evil Empire* (the Soviet Union) breaking up, things were going to change around the world and change quickly!

1990 to 2000:

In early 1990, Congress began slashing funds for defense spending. Within a very short period of time, a lot of highly paid workers in both defense and manufacturing had lost their jobs. California home prices declined about 12% by 1996 when the **San Francisco Examiner** said:

“A home is where the bad investment is.”

In the following 3 years, California home prices rose 19.7% wiping out all the losses of the early ‘90’s and ended the decade with a net gain of 9.35%. The median price in California has not declined since 1996.

The Media

Today's media plays up bad economic news now more than ever, which leads to misconceptions about economic reality. Our economy is *extremely* strong, profits are *superb* and the world economy is *exploding*.

- ◆ All you read and hear is that real estate is going down, yet last month, prices in the U.S. rose 3.4% from a year ago and California is up almost 1%. The Bay Area prices have gained 4.1% over last year and southern California median price is up 3.7%.
- ◆ Foreclosures are suppose to be at a record high but last year 98.83% of mortgages did not go to foreclosure. Today, the Bay Area's foreclosure rate is up only 1.5% over last year while southern California's foreclosure rate is up 2%.
- ◆ The media reported 53,942 *notices of default* for the 2nd Quarter - a near record high. They are comparing it to the 1st Q. of '96 when 61,541 *notices* were filed but fail to mention that 2 million more homes have been built in California since then!
- ◆ What if the media's headlines read: **99.2% of Mortgages are Not in Foreclosure?**
- ◆ The media and the financial markets have greatly over-reacted, to the real problems that have been revealed in the lending marketplace, which is typical.

The Sub-Prime Market

It may surprise you to know that sub-prime loans make-up only 5% of the U.S. total loan market and Alt -A loans (those with credit better than sub-prime but less than prime) total only 8% of all loans in the U.S.!

1. These exotic loans became a major influence in the early 2000s, but anyone obtaining them up through 2004 had very few problems due to rapid equity growth. Many with no-money-down purchases soon found they had 20% (+) equity within a year or two!
2. Most of the problems with sub-prime loans originated in the summer of 2005 through 2006. In California, 43% of all loans funded during that time were sub-prime loans.
3. Sub-prime loan investors that needed to sell their loans were liquidating their paper for \$.96 on the dollar. There has been no current data on sales since August 5th, but with the current turmoil in the financial markets, I am sure they are being "dumped" for less.
4. Here is a financial report on some of the banks that provided the sub-prime money:
 - a. Bear Sterns 2nd quarter revenue was \$2.512 billion – a new record!
 - b. Merrill Lynch saw 2nd quarter profits rise 30.2%
 - c. Morgan Stanley (holding \$5.2 billion in sub-prime loans) had a 60% jump in earnings.
 - d. Goldman Saks earned \$2.33 billion in the past year.
 - e. Bank of America (#2 U.S. bank), after putting aside \$1.81 billion for potential credit losses, saw net income rise to \$5.76 billion - up from \$5.48 billion last year.

The media will still report about *massive* delinquencies and *huge* foreclosures in the sub-prime market, but those reports will not be accurate because they don't explain the difference between a delinquent payment, a notice of default or a foreclosure. They tell us . . . **"Foreclosures At Record High!"** but that is not accurate.

Source: Mortgage Bankers Association, National Homebuilders Association, Inside Mortgage Finance

Delinquencies vs. Notices of Default vs. Foreclosures

Delinquencies:

Delinquencies cover any missed payment – even if it is just for one month, it is reported as a delinquency.

1. The delinquency rate on sub-prime loans was running at 13.77%, which is up 13.44% from the previous year. In the last quarter, the delinquency rate dropped to 12.4%!
2. The delinquency rate on Alt-A loans is only 2.69%, while prime loans are at 2.57%.
3. Combining the three rates with the loan volume gives you a delinquency rate for all loans in the U.S. of only 4.84%. The record low is 4.0%.
4. On *jumbo mortgages* (anything larger than \$417,000) the delinquency rate is 0.37%
5. California's delinquency rate is only 3.25%.

Notices of Default

Notices of Default are filed when lenders' loans have been delinquent for a specific period of time. These loans begin the foreclosure process. The four states of California, Florida, Nevada and Arizona currently have the largest amount of loans in the foreclosure process. Yet, in the 1st Quarter, 24 states saw a *decline* in foreclosure starts and 36 states saw a decline in the 2nd quarter!

1. Only 3.23% of all sub-prime loans have entered the foreclosure process, with most of the defaults occurring on loans from Jan. 2005 to June 2006.
2. Only 1.28% of all prime loans have entered the foreclosure process.
3. In California, the last quarter saw 53,943 notices filed, with most filings being on loans from the summer of 2005 to the summer of 2006.
4. The lowest number was 12,417 in the 3rd Quarter of 2004..

Foreclosures

Foreclosures occur when the buyer has been unsuccessful in curing the debt, and either a lender or an investor has acquired the property. As of last month, there was 1 foreclosure filing for every 693 homes in America.

1. For sub-prime loans, 68% of the buyers are able to prevent the foreclosure by either refinancing the property or successfully selling their home.
2. For prime loans, the foreclosure rate is 0.86%. Last year, the U.S. saw a combined foreclosure rate of only 1.09% while California's rate was 1.17%!
3. California now ranks # 4 in the nation in foreclosures – down from #1!

The media will try to scare you with numbers like *\$1 trillion in loans* needs to be recast this year and that foreclosures could cost lenders as much as *\$2.3 billion dollars!* They never mention that there is *\$10.4 trillion of mortgages with \$56 trillion dollars* of equity in American households. Add to that the wealth of the U.S. at *\$70 trillion*, with the value of stocks between *\$15 and \$20 trillion*, while the *bond market* is even larger. So these losses (should they occur) should not have any great effect on home prices.

A final note about foreclosures: The #1 reason they occurred was due to *fraud*. The # 2 reason was *unethical lending*, followed by #3 - *loss of job*, and finally #4 was *medical reasons*. By the way, the mortgage insurers are in a good position to cover losses at these (high) levels.

Source: Mortgage Bankers Association, Federal Reserve, Federal Bureau of Investigation

Why The World Changed in 1979!

Baby Boomers' Impact

Never before in the history of the world has a generation accumulated so much wealth as the baby boomers. The Internal Revenue Service will tell you that from 1945 to 1979, incomes increased at the same rate for all tax brackets. By 1979, the early *baby boomers* had been in the workplace for over 10 years. They were the most educated generation to enter the work force, and they had the skills for our *changing* world. Today, the IRS tells us that, from 1979 to 2004, the median income in the U.S. rose 18%. From 2004 to 2005, incomes grew 5.8%!

- ◆ The number of taxpayers making more than \$100,000 grew by 3.4 million and accounted for more than two-thirds of the growth vs. 2000! *Half of Americans make less than \$30,000 and two-thirds make less than \$50,000.*
- ◆ Those making more than \$1 million grew by 26% and numbered 303,817 in 2005! These individuals, who constitute less than a quarter of 1 percent of all taxpayers, reaped almost 47 percent of the total income gains in 2005. .
- ◆ The top 85% of the nation's wealth resides with the richest 15% of Americans; the bottom 50% of Americans holds only 2.5% of the nation's wealth.

Over the next decade, there will be a 25% increase in the population over 50 years of age. They have more money than any preceding generation, due to having dual incomes, equity growth, and record inheritances (60% goes to the top 40%)! This age group is spending \$2 trillion dollars annually! Last year, 2.1 million boomers turned 60, with 25% planning on not retiring. They found a way to mix leisure with work and are not ready to fully retire – they have *money and income* and they are still investing in real estate.

They are part of a major buying wave, as 75% plan on moving to either the west or the south for warmth. Already, 80% own their own home with 25% of those owning additional property.

Those Who Own and Those Who Don't

1. We are the youngest of the home-building nations. History does repeat itself! Every country has gone through a cycle whereby it breaks into two parts: those who own a home and those who don't.
2. When this happens, rental rates begin to soar. We are in the beginning cycle of this event, as evidenced by the fact that the national rental rate increased 5.3% in the last 12 months. Since 2001, the rise in rental rates has easily outpaced inflation.
3. Obviously this becomes a great benefit to those who own homes and rental properties – especially when the U.S. occupancy rate is now at **96.2%**!
4. The United States is unique among developing countries – we are still growing! Last year our population surpassed the 300 million mark as we added another 2.9 million people. This makes us the 3rd most populous nation in the world, behind China and India. Since 2000, we have added 20 million individuals and by 2030, there will be 80 million more people living in America!

Source: 2004/2005 Census, U.S. Bureau of Labor Statistics

Just How Rich Are We...

There are now *2.9 million millionaires* in North America, holding *\$10.2 trillion in assets*. There are *317 billionaires* in the U.S. holding *\$1.1 trillion in assets*. California is home to *90 billionaires!*

The Federal Reserve reports:

- Consumers have *\$5 trillion dollars* in liquid cash sitting in banks and savings and loans!
- In 2006, households' net worth rose *7.4%* and now exceeds *\$55.6 trillion dollars!*
- Homeowners real estate equity is *\$10.9 trillion dollars* – representing a *59%* equity position!
- The value of individual stocks and mutual funds held by individuals grew to *\$10.4 trillion dollars!*
- Other assets held by individuals include:
 - \$ *3.2 trillion* in bonds and credit instruments - \$ *1.1 trillion* in insurance reserves
 - \$ *6.7 trillion* of equity in non-corporate businesses - \$*11.1 trillion* in pension funds
 - \$ *2.5 trillion* in 401K's – plus *\$10 billion* in loose change in homes and cars!
- The *rich* and *super-rich* saw their assets surge *11.2%* last year to *\$37.2 trillion dollars!*

What Are They Doing With This Wealth?

They or their parents are also in the process of *transferring their wealth* to their children and grandchildren. These *newest* home buyers make up the largest group of the 3 buying waves. They are presently 23 to 33 years of age, and will add *1.2 million* new households per year for the next decade! They are purchasing at a median age of 26, yet those purchasing under 25 years of age now represent *14%* of the *first time* home buyers market.

And let us not forget the wave of buyers that represent the *normal* buying market. This group is projected to grow at a rate of *1.17 million* per year for the next 7 years. They include *1st time* home buyers (median age 29) and those purchasing upscale homes (median age 45).

Impact of Immigration

Add to this the immigrants purchasing real estate and you can see that the U.S. home buying market will remain strong. From 1980 to 2000, over *6.2 million* minority households joined the ranks of middle-income earners, and they are purchasing housing.

- ◆ Immigrant children who arrived with their parents in the '80s and '90s, are now buying homes.
- ◆ These *2nd generation* Americans, if history repeats itself, will out-earn their parents.
- ◆ As *1st time* buyers, they represent *35%* of the *1st time* resale market.

Immigration of new buyers is largely due to a U.S. policy of *family reunification*. Today, there are *34 million* immigrants, making up *12%* of our total U.S. population and representing *28.4%* of all households.

- ◆ Presently, Latinos are the fastest growing segment of the U.S. housing market.
- ◆ Asians will become the fastest growing segment of the U.S. housing market over the next decade, largely concentrated on the West Coast. By 2015, China's *middle-class* will be larger than the entire U.S. population. By 2025, India's *middle-class* will reach those numbers!

Source: 2004/2005 Census, Federal Reserve, Internal Revenue Service, National Association of Realtors, World Wealth Report

Why Our Economy Will Continue To Do Well!

The National Economy

In the 2nd quarter, our economy grew at a 3% pace and is likely to end with the last two quarters producing a 2% to 3% growth rate. Core inflation is down, the trade deficit is down and the consumer is still spending. Our economy is doing just fine, especially when we look at the following numbers:

1. Since 2003, the U.S. has created over **4.5 million** new businesses and over **8.3 million** new salaried jobs. Add **16 million** self-employed and **25 million** part-time workers and one can see why we are generating a whole lot of tax revenue (\$167 billion vs. last year) as incomes continue to rise 6%.
2. California is home to 1 out of every 11 workers in the U.S. and produces 15% of the GDP in America.
3. Over the past 12 months, the U.S. has employed almost **2 million** new workers. Our unemployment rate of **4.6%** is at a 6-year record low, and since **3%** of the population won't work even if you give them a job, we are near *full employment*. In California, our rate is 5.2% with the Bay Area being the lowest at 4.77% while the Central Valley is the highest at 8.4%. In the Sacramento area, the rate is approximately 6.12% and southern California's six counties average 5.25%.
4. Last year's increased tax revenues have helped to reduce the projected deficit of \$325 billion down to \$240 billion. Our tax revenues are up **14.1%** over last year, and the federal debt was reduced by **20.8%**. The government's first quarter fiscal year saw a **32%** reduction in the deficit compared to the last year's 1st quarter – a 5 year low! The Treasury has announced the elimination of the 3-Year Note due to lower deficits.
5. Corporate profits have doubled in the past 5 years and 2nd quarter earnings showed that corporations are still going strong. Companies are buying back their stock (maybe as much as \$2 trillion) due to having so much cash in the bank! Corporate cash is still at a historical high of **\$2 trillion**.
6. Since 1980, the Gross Domestic Product has risen **70%** and is now at **\$13.3 trillion**, helping to shrink our federal deficit. Today, debt is only **1.8%** of the GDP, compared with **6.0%** in '83 and **4.7%** in '92.
7. With both business and consumer spending growing, these forces are propelling the economy upward with a "one-two punch". Our economy should continue to grow between **2.0%** and **3.0%**!
8. California is home to 36.5 million residents with a population growing over 800,000 last year. However, by 2026 our population will explode (nearly doubling) to 60 million people. With our large diversified economy, California will continue to prosper, the demand for housing will remain strong and as this housing downturn comes to an end, we will once again do very well!

During the past 20 years, global prosperity has created millions upon millions of wealthy individuals, as well as a billion or so new members of the middle class. This global development is lifting living standards around the world. Underpinning this expansion is the integration of half of the world's population into the global market economy! These expanding economies and populations will profoundly affect our economy in a most positive way . . . and once again, the media will have gotten it wrong!

Source: Federal Reserve, IRS, U.S. Bureau of Labor

**California Existing Single Family Home Annual Average Sales Price
1968 to 2005**

Year	Average Sales Price	Dollar Increase	Percent Change	Avg. Gain Yearly
1968	\$ 23,210.00			
1969	\$ 24,230.00	\$1,020.00	4.21%	
1970	\$ 24,640.00	410.00	1.66%	
1971	\$ 26,880.00	2,240.00	8.33%	
1972	\$ 28,810.00	1,930.00	6.70%	
1973	\$ 31,460.00	2,650.00	8.42%	
1974	\$ 34,610.00	3,150.00	9.10%	
1975	\$ 41,600.00	6,990.00	16.80%	
1976	\$ 48,630.00	7,030.00	14.46%	
1977	\$ 62,290.00	13,660.00	21.93%	
1978	\$ 70,890.00	8,600.00	12.13%	
1979	\$ 84,150.00	13,260.00	15.76%	10.86%
1980	\$ 99,550.00	15,400.00	15.47%	
1981	\$ 107,710.00	8,160.00	7.58%	
1982	\$ 111,800.00	4,090.00	3.66%	
1983	\$ 114,370.00	2,570.00	2.25%	
1984	\$ 114,260.00	(110.00)	-0.10%	
1985	\$ 119,860.00	5,600.00	4.67%	
1986	\$ 133,640.00	13,780.00	10.31%	
1987	\$ 142,060.00	8,420.00	5.93%	
1988	\$ 168,200.00	26,140.00	15.54%	
1989	\$ 196,120.00	27,920.00	14.24%	7.95%
1990	\$ 193,770.00	(2,350.00)	-1.21%	
1991	\$ 200,660.00	6,890.00	3.43%	
1992	\$ 197,030.00	(3,630.00)	-1.84%	
1993	\$ 188,240.00	(8,790.00)	-4.67%	
1994	\$ 185,101.00	(3,139.00)	-1.70%	
1995	\$ 178,160.00	(6,941.00)	-3.90%	
1996	\$ 177,270.00	(890.00)	-0.50%	
1997	\$ 186,490.00	9,220.00	4.94%	
1998	\$ 200,100.00	13,610.00	6.80%	
1999	\$ 217,510.00	17,410.00	8.00%	0.94%
2000	\$ 241,350.00	23,840.00	9.88%	
2001	\$ 252,350.00	11,000.00	4.36%	
2002	\$ 316,130.00	63,780.00	20.18%	
2003	\$ 371,520.00	55,390.00	14.91%	
2004	\$ 450,990.00	79,470.00	17.62%	
2005	\$ 548,200.00	97,210.00	17.73%	
2006	\$ 556,640.00	8,440.00	1.54%	12.29%

38 Year Average Appreciation	7.75%
-------------------------------------	--------------

Source: California Association of Realtors