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COLDWELL BANKER
RESIDENTIAL BROKERAGE

2007
The Real State
of
Real Estate

Seminar on 9/21/07
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The Bay Area

Brief History of Real Estate

We are in the 24th month of the current housing downturn. Historically, housing downturns average 27 months so we may be near the end. Although there has been a significant decline in sales volume, the Bay Area's home prices have continued to show small amounts of appreciation – excluding the Napa, Solano, and Sonoma areas. With the Fed cutting interest rates in the near future and the financial markets calming down, shortly money will begin to flow back into mortgage securities. It may be wise to give our client's a little historical perspective about real estate cycles.

1970 to 1980:

"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." - *Business Week - 1969*

- In 1972, interest rates were 7%, but these rates would not be seen again for over 24 years.
- In 1973, OPEC doubled the price of oil, banks had a run on deposits and, for approximately 8 months, there were no lenders who were in a position to make loans to any home buyers.
- By the late '70s, both interest rates and the inflation rate were exceeding double digit numbers.
- By the end of the decade, California home prices experienced a yearly return in excess of 11.5%!

"The median price of a home today is approaching $50,000 . . . housing experts predict price rises in the future won't be that great." – *National Business - 1977*

1980-1990

- In the early '80s, inflation hit 21.5% and home loans were reaching 18%!
- A recession was taking place and job losses were increasing – leading to home foreclosures.
- In 1984, California home prices had their first decline since the Depression – they declined 0.10%!

"The golden-age of risk free run-ups in home prices is gone." – *Money Magazine – 1985*

- The savings and loan scandal hit the financial markets but the government bailed them out in 1988.
- By the end of the decade, interest rates had decreased to single-digit (9.5%) rates.
- From '86 to '89, California home prices rose 46% and ended the decade with a yearly return of 7.95%!

1990 to 2000:

- On Nov.11, 1989 the Berlin Wall came down and, by January of 1990, Congress cut the defense budget.
- In a short period of time, a lot of highly-paid workers in defense and manufacturing had lost their jobs.
- California home prices declined from 1990 to 1996 by less than 2% annually, for a total of 12%.

"A home is where the bad investment is." *San Francisco Examiner - 1996*

- In the following 3 years, California home prices rose 19.7%, wiping out all the losses of the early '90s and ending the decade with a net gain of 9.35%.
- From 1995 to 1999, the Bay Area's median home prices rose a whooping 25%.
- The median price of a home in California has not declined since 1996, and the 38 year average rate of appreciation for homes in California is 7.75%!

Source: Researches by QTVN (regarding interest rates), U.S. Dept. of Commerce, CAR

The Media

Remember Y2K, Mad Cow Disease, West Nile Virus, Killer Bees, SARS, Bird Flu and now Housing? Today's media plays up bad economic news more than ever, which leads to misconceptions about economic realty. Our economy is *extremely* strong, with a 2nd Qtr. growth rate of 4%; corporate profits are *superb*; and personal income is growing more rapidly than spending - thus pushing up the personal savings rate! All the while, the world economy is *exploding.* However . . .

- ♦ The media says real estate is going down, yet July's prices for single-family homes in California were up 3.2% from last year. From August of last year, the Bay Area's median home prices rose 4%.
- ♦ The media reports that foreclosures have now exceed the 1996 peak in the Bay Area, but they fail to mention that more than 495,000 homes and condos have been built in the Bay Area since then!
- ♦ The media reported 53,942 *notices of default* for the 2nd Qtr - a near record high. They compare this figure to the 1st Qtr. of '96, when 61,541 *notices* were filed - but *fail to mention* that 2 million more homes have been built in California since then! (The lowest number was 12,417 - 3rd Qtr. of 2004.)
- ♦ The media and the financial markets have greatly over-reacted. There are only $70 billion of loans with late payments, yet the financial markets have lost over $1 trillion in value!

The Sub-Prime Market

The media will still report *massive* delinquencies and *huge* foreclosures in the sub-prime market, but those reports will not be accurate when you compare them to the total mortgage volume in the U.S.

It may surprise you to know that until 2003, all sub-prime lending made up less than 5% of the total loan volume. Since 2004, sub-prime loans make up 5% of the U.S. total loan market while Alt –A loans (those with credit better than sub-prime but less than prime) total only 8% of all loans. If you are wondering why the big banks made these sub-prime loans in the *trillions of dollars,* here is the answer:

- Bear Sterns 2nd quarter revenue was $2.512 billion – a new record!
- Merrill Lynch saw 2nd quarter profits rise 30.2%
- Morgan Stanley (holding $5.2 billion in sub-prime loans) had a 60% jump in earnings.
- Goldman Saks earned $2.33 billion in the past year.
- 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.

Sub-prime loans in California represent only 25.7% of the total residential loans in the state. From the summer of 2005 through all of 2006, 43% of all California loans funded were in both categories of these sub-prime loans. Today, most of the problems arise in just one type of these loans - the *Adjustable Rate Mortgages (ARMs).* How big is the problem? Not big at all! In the first quarter of 2007 in the U.S., 88.5% of borrowers with ARMs were not delinquent on their payments!

The media, knowing that they are losing viewers and subscribers, are well aware that *fear* helps to keep people tuned in or continuing to read. So they throw the big number of mortgage *delinquencies* in the headlines but fail to tell their viewers how few actually go through the entire foreclosure process!

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 only one month is missed, it is reported as a delinquency.

- In the 2nd quarter, the U.S. delinquency rate on all sub-prime loans was 14.5%. California's was 12.6%.
- The delinquency rate on Alt-A loans is only 3.7%, while prime loans in the U.S. are at 2.6%.
- Combining these rates with the total loan volume gives the U.S. a total delinquency rate of 5.12%. The media never asks, "What is the all-time low delinquency rate?" The answer is 4.0%!
- In California, prime adjustable rate loans are 1.9% while prime fixed-rate loans are only 1%.
- California's over-all delinquency rate (sub-prime, Alt-A, Arm & Fixed) is 3.25%.
- Jumbo mortgages (anything larger than $417,000) in the U.S. have a delinquency rate of only 0.37%.

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!

- Only 3.23% of all sub-prime loans have entered the foreclosure process – the experts had forecasted 7%.
- Only 0.65% of all prime loans have entered the foreclosure process.

Foreclosures

Foreclosures occur when the buyer has been unsuccessful in curing the debt, and either a lender or an investor has acquired the property.

- For sub-prime loans, 68% of the buyers are able to prevent the foreclosure by either refinancing the property or successfully selling their home.
- 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%!
- In California, 54.6% of homeowners in default emerge from the foreclosure process by bringing their payments current, refinancing, or selling the home and paying off what they owe.
- In the Bay Area, 79% of homeowners in default are successfully avoiding foreclosure, and compared to last year, foreclosures are up only 1.5% this year.
- Although California ranks # 1 in the number of foreclosures, if you divide the number of homes by the number of actual foreclosures, we would rank 4th in the nation.

Now you can see why the problem is greatly over-blown and why state-wide home prices have not crumbled. On a final note about foreclosures:

- The #1 reason they occurred was due to *fraud* and *speculation!*
  As of Aug 30th, California investors (those not living in the home) represented 21% of the loans in default. In Nevada, the number is 33%, Arizona is showing 26%, and Florida has 25%.
- In the U.S., the average for investor loans in foreclosure stands at 13%.
- The #3 reason – *loss of job.*
- The #4 reason was due to *medical problems*.

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 ever enter the work force, and they had the skills for our *changing* world. Their income from 1980 to 2004 exploded!

- The top 20% of incomes grew by 59%, while the bottom 20% of incomes grew by a measly 7%!
- The top 1% of incomes grew by 200% - earning more than the entire bottom 50% of wage earners!

Last year's rise in income was a 5-year high, and income rankings in the U.S. put California wage earners at #8!

- The number of taxpayers making more than $100,000 last year, grew by 3.4 million and accounted for more than two-thirds of the growth since 2000!
- Those making more than $1 million grew by 26% and numbered 303,817 in 2006! 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 one of 3 major buying waves, as 75% plan on moving to either the west or the south for warmth. Eighty percent 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. San Francisco rents have risen 7% each year, for the past 2 years. In the San Jose market, rents are up 17.8% for the past 2 years. 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% and the Bay Area is posting a 97% occupancy rate.

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: 2004/2006 Census, U.S. Bureau of Labor Statistics, IRS

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 *$56.2 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!
  (Boeing's "mobile mansions" are private wide-party jets being customized at $150 million each!)

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!
- ♦ The median price of homes purchased by foreigners is $70,000 higher than domestic buyers.
- ♦ Foreigners buy U.S. real estate for investment purposes 22% of the time, and for fun and frolic 47%.
- ♦ The falling dollar makes U.S. real estate a great buy for foreigners and immigrants.
- ♦ California, Texas, and Florida represent 52% of all purchases with California being #1.
- ♦ The Bay Area ranks in the top 5 U.S. areas for Asian immigrant growth.

Source: 2004/2006 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 of 2007, our economy grew at a 4% pace and is likely to produce a 2% to 3% growth rate for the year. Core inflation is down and the trade deficit is down. Since the mid-2005 housing cool-down, we have added over 4 million jobs and incomes have risen 7%, leading to a $1.35 trillion rise in the nation's income.

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).

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 the Bay Area, your job growth rate is 1.8%. It is one of the highest rates in both the state and the U.S. The unemployment rate in the Bay Area is 4.58%, which is well below the state's average of 5.3%.

4. Last year's increased tax revenues have helped to reduce the projected deficit of $325 billion to $240 billion. Our tax revenues are up 14.1% over last year, and the federal debt was reduced by 20.8%. The first quarter of the government's 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 historic 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. California is home to 36.5 million residents with a population growing over 800,000 last year. However, by 2050, our population will explode (nearly doubling) to 60 million people. With our large diversified economy, California will continue to prosper and the demand for housing will remain strong!

The Fed has pumped tens of billions of dollars into the financial system, sliced interest rates on bank loans and, may cut the Fed Rate for the first time in 4 years. The Chairman has stated that the central bank will act as needed to limit the impacts on the economy. Housing is just too important to the overall economy.

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, we will grow our way out of this downturn!

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

You Live and Work . . . Where?

Northern California

Around the 1850s, people began to arrive to California. Last year, the state population grew by 600,000 domestic and 200,000 legal immigrants. It took 155 years to grow from almost no one to over 37 million people who now call this State their home. In the next 20 years, the population is projected to *double* - reaching almost 60 million! It appears the State's *allure* has remained strong!

It is no wonder that with all these people, we employ 1 out of every 11 workers in the U.S. and produce 15% of the nation's GDP. In the past 12 months, the state has created 188,000 new jobs. The state's self-employed work force now exceeds 2.2 million! The Bay Area is home to over 20% of the state's entire diversified workforce serving the *Pacific Rim* through trade, a growing service sector, and expanding electronics and manufacturing. Add high-tech, the financial sector, bio-tech, construction, tourism, agriculture and government, and it is easy to see why northern California is a magnet for highly productive jobs.

In Northern Calif., most of companies employ fewer than 50 people! Today's technologies enable companies to become highly productive with fewer people, ending the *boom-bust* cycle and its massive lay-offs.

- The Bay Area's employment is growing at approximately 1.8% yearly, which adds 50,800 jobs.
- San Francisco ranks #2 in the nation as the most improved retail market. Oakland ranks #4 and San Jose comes in at #14.
- The Bay Area is one of the wealthiest areas in the world. Of California's top 10 counties for household income, 6 of these counties are in the Bay Area.
- The Silicon Valley continues to rank #1 for venture capital.
- The Bay Area's median home price is $665,000 for July, a new record. Another record is in Santa Clara, where the median price is $805,500.

Pent-Up Demand

More and more people are moving to California each year. The immigrants are coming from all over the world, the baby-boomers are relocating to our warmth and our resident population is growing. Since the 2005 downturn in housing, buyers have been sitting on the sidelines waiting to return. During this time, their incomes have grown. The job market has continued to expand and wealth continues to be created. The baby-boomers are not retiring and still investing in real estate while the parents of the baby-boomers are transferring their wealth to their grandchildren.

As the Fed lowers interest rates, buyers will once again begin to enter the market. They will be buying properties at excellent prices with almost historically low interest rates. For those that do, 2007 will give them ***"A Little Bit of Heaven"*** and for those wait into 2008, that year they . . . "***Should Not Hesitate"*** . . . in acquiring their home and/or investment properties.

Source: State of California, State EED, 2005 Census, U.S. Bureau of Labor Statistics, CAR.

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