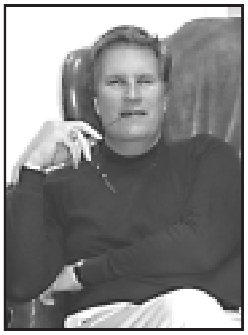
Bully Pulpit

By Bruce W. Cook



Why has the residential real estate market slowed? The experts claim that rising interest rates are partially to blame. An insecure world at the mercy of terror may be a factor. Yes, the Islamic Jihad is planning to blow up your three-bedroom Cape Cod with R.V. parking on the outskirts of Poughkeepsie.

The residential market has slowed because prices have risen to record levels. The psychology of investing has been altered. And don't kid yourself, it really is all about the perception of mortal humans on how much is just too much. Interest rates and world affairs and the price of crude do certainly affect the overall U.S. economy and the price of housing. However, the value of housing is predominately determined by investor psychology. In other words, what is it worth to you?

As summer 2006 witnesses a change in that psychological bent, homes are sitting on the market longer, inventory is up. Prices are still at all time record high levels. What may ultimately soften the price level is what happens when investors leave the market. For the past decade real estate has grabbed formerly committed stock market dollars. Double digit annual increases in real estate values have fueled this transition. Is it over?

Perhaps. At least to a degree. Again the psychology of the real estate buy was simple. Investors didn't care (to a degree) about the price of the property because they believed it would rise 20 to 30, even 100 percent in some cases, over a very short period of time—one to three years. This was true in many parts of the country—not all. If there was negative cash flow, or if the loan had negative amortization, so be it. It would all come out fine in the end with profit to spare.

This attitude or philosophy has changed literally overnight. As investors attempt to move inventory that has negative cash flow and no longer carries the promise, (whether psychological or real) of double digit annual increase in value, property prices will soften as market competition to sell widens. No brainer.

How does this affect the homeowner, who is certainly also an investor? Values may decline. Some areas may see more substantial declines than others. In the heat of the real estate passion, homes on super busy streets in prime areas that in a "normal" market took much longer to sell, will no doubt take much longer to sell once again. This is no revelation, just common sense.

Do homeowners need to worry? If you are a member of the refinance and spend club, you may have cause for concern. The cycle of easy refinance which has fueled consumer spending may put some homeowners in jeopardy of going upside down. In other words, if you have inflated mortgage debt on the psychological promise of continued value increases, that new Range Rover, the summer safari to Kenya, the kid's private school tuition and that deposit on five acres in Aspen may just have to be reconsidered.

Unfortunately, we humans tend to have a follow the herd mentality in both up and down markets. Of course, it's much easier to be among the herd on the way up.

The best strategy for real estate investing in the coming years is to be an individual, not a member of the herd. Do your homework, take nothing for granted, and seek opportunities. There are always opportunities, in any market. With investors on the fence, there will be more opportunities for owner-users. This is good. Houses, after all, are domiciles in which mortals find shelter, they are not just cash registers.

Does it make sense to you that the bottom of the residential single family housing market here in Southern California now rests at around half a million dollars? Forget what statistics tell you, try and find a half-way decent home for less. Do you realize how much you need to earn to comfortably pay for such a home, including taxes, insurance, maintenance and improvements?

Let's do the math. If you put 20% down on a $500,000 home you will have a mortgage of $400,000. At sensible fixed rates, not some very low variable, the homeowner would currently pay around 6.75% on the balance, or around $2,500 per month including some principal reduction. Add taxes, in California at around 1.3% that's $6,500 per year, or another $550 per month. Insurance will be another $150 per month. We're up to $3,200, not including repairs, maintenance, improvements, and services like an exterminator to trap the bats in your attic. After State and Federal taxes, you'd better be taking home $7,000 to $8,000 each month to support this debt. That's an income of more than $100,000 per year before taxes, just to support the least expensive single family home you can find.

For this reason, statistics do report that only some 11% of California citizens, not already owning a home, can afford to buy. This stat will change when property becomes more affordable. In the long run a top heavy market is not good for the overall health of the economy, or for the real estate industry. Balance is better than boom. The psychology of boom is often followed by bust.

I keep using the term "psychology" because in the end, to repeat, it is our own collective state of mind that will determine the strength or weakness of the real estate market. Do we believe in the economic vitality of real estate? Absolutely. Do we know that real estate, especially in California, has produced the greatest gain in individual investor wealth over a century of trading, despite corrections and reversals? Absolutely. Would we prefer to live anywhere else? Probably not.

The path is clear. Stay positive. Stay informed. Refute rumors on market conditions. Be realistic. Stay focused. Seek out opportunities and be honest with yourself about the short and long range possibilities

Above all, remember that the psychology of the real estate market is in your hands—that's everyone—agents and public alike. If we continue to believe in real estate, it will respond accordingly. This is not some fanciful uber-optimistic p.o.v., it is just simple logic. We manifest that which we truly believe.

So, manifest positive goals and watch what happens. GT

Bruce Cook is the creator of Grand Tour Magazine. He is a twice-weekly columnist for the Los Angeles Times/Daily Pilot, and serves as Editor of the prestigious Bay Window Magazine. Cook has been heard on San Diego radio for the past five years, and is an Emmy-nominated television writer and producer responsible for such programs as Entertainment Tonight.