

Property Prices Forecast
What's Ahead 2008, 2009, 2010
by John V. Kamin

The prices have been sliding for homes, second homes and condos, all last year. Foreclosures are up mainly on homes that have little or no equity. If you bought an overpriced home or condo in 2006, with 0% to 5% down, it's no surprise that many of the outstanding loans are now "under water" (where the total loans due are higher than the 2008 value of the home, which leads to "walk-aways" and foreclosures). There is an excess of supply in most metro marketplaces, for homes and condos, during 2008.

Surprises

What startles shoppers is that prices of commercial buildings have not dropped much, if at all. In many hot new building areas, prices for commercial buildings are still going up. Forecast: We expect commercial buildings to stay strong 2008 well into 2009, assuming no sudden depression.

More Surprises

What has surprised even more people is that rents are going higher, occupancy rates are staying high, for renters, owners of apartment buildings.

Those who thought they'd "rent for a while" instead of buying are finding themselves in a situation of escalating rents, which many did not anticipate during 2008.

Example: San Diego fires destroyed some 1,600 homes, so those folks now have to find another place to live. Many are taking the large insurance checks and renting for a while; which adds to rental demand. A number are relocating to different areas with their money, those who had substantial equity above the mortgages. They hope to buy elsewhere, cheaper.

Added Surprising 2008-2010 New Trends

Replacement costs for new homes, remodeling and rebuilding, are rising sharply.

Forecast: Many raw material prices can be expected to keep increasing sharply, adding to replacement costs. Copper is up from 68¢ lb. to \$3.80 lb. just since 2003. Iron ore to make steel was just boosted 65% in 2008 compared to last year's (2007) contracts.

Present building owners know that repair costs are going up. The \$55 plumbing call for 2005-2006 now is \$115 to \$185.

Higher minimum wages for 2008 have also increased costs for "grunt work", often done by temp workers - legal and illegal.

Prediction: Workers Compensation insurance premiums are rising and will continue soaring.

We won't even mention rising energy costs, or oil prices in excess of \$101 barrel. Rising oil prices add to the cost of roofing, asphalt, grinding cement, plastics, and transport of everything.

Summary: Replacement costs for building and rebuilding are rising sharply; even as new housing starts weaken, even in a 2008 glutted homes-for-sale market.

Many price declines (and foreclosures) are taking place on second and third homes, speculations, where people didn't intend to live full time: Miami condos, Las Vegas high-rise condos not quite built and others in formerly overheated markets such as Phoenix.

Forecast: As 2008-2009 replacement costs keep rising, as increased houses for sale listings diminish due to slowly-increasing demand at lower prices, where these two lines intersect on a supply/demand chart (remember your charts from Econ. 103) is where the market in metro area homes will reach equilibrium 2010-2012.

Past Example: 1971-1974 real estate prices in a troubled market just stagnated for several years. Buyers were unwilling to become aggressive bidders, but sellers were reluctant to cut prices any further. Vets returning from Vietnam 1973-1974 and later, all wanted homes with GI loans. By 1975 to 1979, home prices were increasing at 2% per month nationwide.

Prediction: It will take time, but eventually equilibrium will be reached between supply and demand.

Money Wars: Excess Liquidity vs. Lending Crunch

Conflicting opposing forces are warring, but invisible to the average American.

On the one side the government is doing everything it can to create extra money and push interest rates down to encourage responsible borrowing by people who will pay back the money. Money supply (M3) has risen an estimated 42% over the last year, according to one source. Currency in Circulation (CIC) is jumping, though the statistics are not published weekly, as before.

On the other side, the line-up is different. Congress is pushing to reduce lenders' access to collateral on delinquent loans. During 2004-2006, Congress was urging lenders to make loans and increase access to loans especially for marginal borrowers. Dr. Alan Greenspan in August of 2004 told Bankers Convention in Texas, "Bad loans are made during good times", an observant prophecy.

Today, bankruptcy judges debate whether to change the terms of home loan repayments and access to collateral (by lenders) to avoid repossessions. No one asks, "Who will lend on collateralized loans if lenders can't have access to the collateral when the loans are not repaid as promised?"

Clearly, in recent years, many mortgage loans were made to people who couldn't or wouldn't repay. "No-doc" loans were provided without documentation of income (for repayment). Adjustable Rate Loans (ARMs) have turned out to be a two-sided knife

blade without a handle, resulting in the subprime mess. Borrowers were glad to sign up for cheap ARMs at less than 5% interest, but now that lenders are tightening, borrowers don't like the "resets" at higher payments.

A 2008 glut of unsold new and used homes further discourages lenders from making new loans, or refinancing for shaky borrowers. New loans are now going under the lenders' microscope, where previously they were scrutinized loosely through rose-colored foggy glasses!

Question: Should lenders be required by law to lend to people whose ability and willingness to repay is questionable? Should loans be made again with 0% to 5% down? How about loans to people with no income? In falling markets, any tiny equity suddenly vanishes, and the home becomes unresalable for the full amount owed upon it!

Winners and Losers

Who will win the monetary war? As the Central Bank (FOMC) pushes interest rates down to below 2% on short-term money, savers, retirees, and the frugal who depend upon interest earnings, are being brutalized.

Fed leaders tell us they're pushing interest rates down now, so troubled borrowers can get out of trouble. But if the lenders won't lend to delinquent borrowers, nor refinance, or do so only with great reluctance and onerous conditions, adding further liquidity and pushing interest rates down further. It's like pushing on a string. You can throw a "borrowing party" but suppose those invited don't show up?

Historical Research

Around 1980 a credit crunch occurred as President Carter was exiting office. Short-term interest rates such as the prime rate soared to 16%. T-bill rates hit double digits. Mortgage rates ranged from 10% to 23%. (Today's parallel: credit card interest rates are up to 30% if you miss a timely payment!) Back then, one factory building owner consulted told me the only loan he could find was a 10-year loan at 10%. But when things improved under President Reagan a couple of years later, the factory owner went to pay off his 10% loan (to save the interest). Then lenders simply told him, "No." A borrower could pay off the principal early, but he'd have to pay the full 10 years interest he'd signed up for!

"Do Something, Anything!" Sound Familiar?

The point is Congress is clamoring for new laws and regulations to force lenders to lend and re-lend to those who have delinquent loans. But as lenders retreat, jumbo loans (over \$417,000 on larger homes, or even smaller homes in California) are costing 7½% to 9% interest, no matter how far the FOMC slams down interest rates to bankers (near 1%) August 2007.

Banking spreads have widened. Wouldn't you like to borrow money at a 1% to 2% interest cost and charge up to 30% interest by loaning it out on credit cards or other fees and devices?

In February of 2008, Dr. Ben Bernanke testified before the Senate Banking Committee in response to a question that, yes, he expects bank failures, and yes, there will be bank failures. In fact, the FDIC is running want ads to hire experienced bank liquidators who had retired since the early 1990s glut when the Resolution Trust Corporation was active in disposing of repossessed real estate.

Summary: No one is winning the liquidity war. Savers, retirees, and others, who see their interest earnings cut are punished. Lenders are drawing back under the giant microscope. Delinquent borrowers, who speculated on flipping condos, houses, and other overpriced areas, are still delinquent.

Those without income, who were questionable risks when the loans were first made, are becoming “walk-aways” during foreclosure. Many who bought houses with 0% to 5% down now have seen their small equity vanish as prices dropped.

Tax authorities tell them that they cannot deduct income tax losses on their home if they sell their home at a loss. FMAC and FNMA will not make jumbo loans to bring down mortgage rates, even under pressure.

Slow Adjustments

Marketplace adjustments are taking place, but at a very slow rate that satisfies no one. It is like the Iraq war, interminable with no clear exit in sight.

Prediction: Marketplace adjustments could go on for two or three years or more, before home prices begin to rise again; before the glut of unsold homes is worked off and before the contractors start getting super busy again. Remember when contractors wouldn't even return calls or show up to give an estimate?

Prediction: Inflation is proceeding, so replacement costs to build or remodel are rising sharply. Steel, copper, plastics and other building components are being boosted by higher oil costs, higher transport costs, and the prospect of increased taxes with a new president next year in 2009.

The U.S. dollar is being devalued against other currencies to “boost exports” but punishing anyone who has saved dollars, owns insurance, as college savings plans underway, etc., as loss of purchasing power steadily creeps onward.

A weak currency and creeping dollar devaluation are not good for the USA. A strong currency is necessary to slow down inflation. Assets that are increasing (besides building materials) are mainly hard assets such as gold and silver, rare coins, commercial buildings, and even rental properties as rents are in a rising trend.

Don't miss more strategic suggestions in upcoming articles.

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