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# The Anatomy of a Market Turn

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Recently I have met with quite a few prospective customers who are planning to sell in the near future. They are anxious because they don't want to miss the opportunity that currently exists with high sales prices. Not being quite ready to sell, they are asking me, if they don't sell for 3-6 months will it still be a good market?

After we thoroughly discuss the dynamics of the Real Estate market, they are relieved to find out that 3-6 months is not enough time for a good market to turn bad.

Let me explain. The Real Estate market does not react with the speed of the stock market, where billions of dollars can change hands at click of a mouse and prices continuously update in real time. Real Estate is a slower moving animal. Real Estate's lack of liquidity keeps volatility down. Consider selling a home. Usually the decision takes several months, another couple months to prepare the home for sale, and yet another couple for marketing and escrow. Quite the opposite of the stock market, where one can log on, click to sell, and receive confirmation within minutes.

So knowing that the Real Estate market does not change significantly over a 3-6 month window, is it possible to look into the future and predict what lies ahead? Yes and no. My crystal ball is absolutely worthless 1 year or more out. But for shorter time frames it is actually quite good. How is it that I feel quite able to predict the future only 3-6 months out? There are two factors that aid in these predictions. First, as I mentioned, Real Estate is a slow moving animal, so it is usually fair to say that the current trend will not usually do a complete 180. It takes a couple of years for a trend to reverse direction. But here is the most important bit of information, **THE CURRENT INVENTORY OF HOMES WILL BE YOUR FUTURE COMPETITION.**

An appraiser tells you what it is worth. But constrained to using closed sales, what he really means is "this is what your home WAS worth". He has based his data upon homes that close escrow up to 6 months ago. With a 60 day escrow, this sale could have been negotiated up to 8 months ago. Appraisers are arriving at valuations based upon what they see in their rear view mirror.

More timely data can be obtained by using the "pending sales" (homes currently in escrow). These sales have been negotiated as recently as yesterday, and rarely more than 45-60 days ago. So these transactions give you a closer look at recent valuations. But appraisers are not allowed to look out their side window for value. They can only look out the rear view mirror at what has closed escrow.

The future lies in what is for sale, because this will be your future competition and future sales. A lot of relevant information can be gained from sizing up your future competition. This is the basis for making reasonable predictions about the future 3-6 months out.

It is as simple as looking at the recent sales, the current inventory, and determining how many months supply there is based upon the current sales rates. During these strong last several years, inventory has been almost non-existent. When meeting with sellers, we would compile all of the activity in their area. There might be 20-30 sales, 10 pending sales, and less than 5 homes for sale, sometimes none. Diving further into the homes currently for sale we would notice that some were on busy streets, some were already sold (but just not updated yet), or were at very high list prices. In either case, these homes would not be competition. The data was showing us that there was demand in this particular marketplace for about 5 or more homes per month and there was essentially no inventory.

The good news is that this condition still exists, inventory is still extremely low.

If the market does change, what will it look like, and how long might it take to change. As I mentioned before, should the market change directions, it will not do so overnight. It may even take years.

The last peak in the market occurred in late 89 early 90. Buyers simply were priced out of the market. There were few buyers left with either the down payment or income to qualify. Then in June of 90, I remember with vivid horror and mild confusion that my phone simply stopped ringing, buyers threw in the towel. Sellers didn't respond right away, they had been conditioned to believe that they

where holding on to something more valuable than gold and for only a dear price would they part. "Next year it will be better" was the typical cry I heard from most sellers unable to sell. Well next year (1991) rolled around and it wasn't any better. Seven years of constantly rising prices create an optimistic atmosphere that is not easily countered in one. "Next year will be better" was still the viewpoint of most home sellers. But 1992 did not bring about a recovery. It did however bring about an awareness that things were not going to get any better, and "if I want to retire out of the area like I have been planning to for the last several years, I might as well bite the bullet and lower my expectations and price". Only then, two years after the peak of the market, did we really experience a significant decline in prices.

Compared to the bull market of the last several years, this 1992-1994 market looked quite different. There might have been 10 closed sales, 3 pending sales, and 30 homes for a buyer to choose from. Some of these 30 homes were listed for less than the lowest closed or pending sales. So if you were a home seller at that time there were several very important truths to swallow if you were going to be successful in selling your home. First, if there were 30 homes to choose from and only 3 were going to sell in the next 30-60 days, your home had to be better than the rest of the competition. Second, even though your neighbor's identical home sold for \$300,000 three months ago, there were 10 similar homes on the market in your area with list prices of \$299,000 or less. So it was inevitable that the next round of sales prices would be \$290,000. It did not take a rocket scientist to deduce that prices in the future would be lower.

But investment and home ownership is an emotional game. Not all home sellers adapted, and many agents were unable to communicate the nature of the market. If these truths were not swallowed, then it was likely that a home seller would be caught in a vicious cycle of "chasing the market down", dropping the list price several months too late, and always just a little above the market.

But the good news is that none of these conditions exist. Just yesterday I ran comparable sales for a homeowner, and again there was close to no inventory for a prospective buyer to choose from. Good news for the home seller.

During January the market has again shown a continued push upward in prices. There simply isn't enough supply to feed the demand. So at this point, I don't see the market changing. But being old enough to have been through market cycles, I also know that trees don't grow to the sky. So while there is no indication that the market is slowing. Many homesellers remain guarded.

While the market is already powering forward this year, it would also be realistic for the market to slow and price

increases to level off. What might cause this? The only obvious issue is interest rates. The good news is that the general consensus is that they will remain low through the year with the looming Presidential election. Interest rates are very critical because dropping interest rates were an important component to the last wave of price increases. Buyers have strained to afford current prices after 20%+ price increases 3 years running, while buyers incomes have only risen 4% per year. Price increases have greatly outstripped a buyer's ability to pay. Interest rates have certainly softened the blow. But it is also the general consensus that rates will not drop further from here and all bets are off after the election.

Beyond interest rates, what might change and give Real Estate a reprieve? In economic circles, it is always the unexpected that causes a problem. If a problem was anticipated, the market would already have taken that problem into consideration and priced it into the market. Looking back on history, what have been recent unexpected events? The last bear market in Real Estate was exacerbated by an end to the cold war with Russia. If in 1985 during the Reagan defense buildup (which we know SoCal greatly benefited), I told you that Russia would no longer exist as we know it, and the Cold War would end, you might have consider me crazy. If in early 2001, I told you that jumbo jets would fly into the World Trade Towers and topple them, you also might consider it the makings of a good Hollywood thriller, but certainly not reality. But these unexpected events are what can bring down a market with high valuation.

What might cause Real Estate problems in the future? Certainly a spike in interest rates could create a precarious market. Beyond this obvious scenario, nothing comes to mind. But this is all just speculation, for which I mentioned my crystal ball broke many years ago. What is certain is that the market is still *HOT*, with low inventory, high demand and very appealing interest rates. This bodes very well for the market in the next 3-6 months.

Should you be considering the sale of a home during 2004, know that Real Estate does not change overnight, and current conditions are very favorable. Should market conditions change, a build up in inventory will foretell before lower prices are even seen in the marketplace. Like appraisers, the economic community reports what has already happened. But with years of savvy investment analysis experience, both you and I together can see storm clouds on the horizon before even a drop of rain is felt.

We invite questions regarding any future plans. Our consultation is always free and having information about your future plans can make the decision process smoother and clearer.