

## CONCLUSIONS

for a paper submitted in partial fulfillment of the requirements for  
Real Estate Economics 215

## FORECASTING MARIN REAL ESTATE PRICES

by

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## THE ISSUES THAT WERE EXPLORED

The first in this series of papers proposed the topic of forecasting Marin County real prices. The second discussed the relevant research that had been done. This paper draws conclusions from this research.

**Topic 1: To what extent have government tax credits and low interest rates stimulated home purchases, and what will happen to demand when these programs end?**

The federal government's \$8,000 tax rebate program came to an end on April 30, 2010, but California instituted its own tax incentive program which took effect May 1, 2010. Interest rates remain low.

### **Conclusions:**

There is no argument that the federal program provided a tax benefit to more than 1.4 million taxpayers. No doubt, some first time homebuyers were drawn into the market due to the program. What will never be known, however, is how many of these would have bought anyway. My conclusion is that very few home buyers based a decision to purchase a home based on the \$8000 incentive. Other factors would be more compelling reasons to buy: a growing family that needs a larger home; renters who want to stop paying rent and build equity; a couple recently married; a job relocation, etc. However, many such potential buyers probably did *accelerate* their decision to

purchase based on the incentive. Until the funds run out, Realtors can continue to tout this incentive as a reason to “buy now”. I believe, however, that such programs do not stimulate demand in the long run, but just pull it forward, and I expect that if the economy remains sluggish, that there will be a proportionate decrease in demand once these programs end, since those that did accelerate their purchase decision have now been removed from what would have been the normal level of demand had these incentive programs not been offered. Over time, perhaps equivalent to the length that these programs were in effect, demand will return to its normal pre-stimulus level.

With respect to interest rates, it is widely believed that their only future direction is upward, due to the money “printed” and pumped into the economy. Rising interest rates make homes less affordable and the effect will be to moderate price increases that will come about as the economy improves.

**Topic 2: What is the magnitude of the “shadow inventory” of REOs ? Are they being kept off the market in an attempt to control supply? Or has the backlog simply built up because lenders have not had the capacity to process the influx of distress property inventory? Is this inventory increasing or decreasing and what developments might cause lenders to move this inventory quicker to market, and if they do so, what will be the impact on prices?**

**Conclusions:**

While there has been a great deal of discussion about this supposed “shadow inventory,” my research, and personal experience in dealing with short sales, is that there is NOT

much of a shadow inventory, if by this we mean foreclosed homes that are now REOs. And to the extent that there is such an inventory, it is not because the lenders are strategically holding them off the market, waiting for conditions to improve so that they can get higher prices. Instead, it is because of the bureaucratic inefficiencies built into the banks that are “too big to fail.” They are also too big to operate efficiently. Bank of America is a good example. They have 3 layers of “negotiators” in a short sale, none of whom actually talk with the listing agent to negotiate anything, each of which has 6 weeks to process the paperwork before passing it on to the next level, with 20 days in between each assignment!

The recently enacted Home Affordable Foreclosure Alternatives (HAFA) program, which went into effect on April 5, 2010, is expected to speed up the short sale process with participating lenders essentially “pre-approving” short sales. To the extent that happens, the REO inventory should shrink faster than it would have otherwise.

For those that define the “shadow inventory” as did Standard and Poors to include “all delinquent loans, not only those that are real estate owned [REO]” the latest reports are that the rate of home loans moving into foreclosure is slowing.

My conclusion is that, by either definition, the inventory is now or soon will be headed downward, with a corresponding decrease in supply and an increase in home prices.

**Topic 3: How long will the current psychology of the buying and selling public continue to keep them on the sidelines? And how long before job growth will increase in a way to positively change this psychology, resulting in greater demand and therefore home price increases?**

**Conclusions:**

A recent (May 13) Bloomberg Business Report in the San Francisco Chronicle includes the headlines “Macy’ posts a profit higher than forecast,” “Cisco’s earnings beat analysts’ estimates” and “Whole Food profit doubles.” These and similar stories and reports seem to confirm that we are indeed coming out of “the Great Recession.” In recent weeks, the stock market has made steady gains, with the Dow Jones Industrials passing the 11,000 mark for the first time since September 2008, and many companies are planning to add new hires in the remainder of 2010.

In the “Marin Real Estate Market Update” report that I issue each quarter, I note that Q1-2010 is the first time since Q2-2007 that home prices in Marin for both condos and single family homes increased not only over the previous quarter, but over the same quarter a year ago.

All of this indicates that the mass psychology regarding real estate is starting to swing back from the very negative toward at least a neutral if not a positive psychology.

**Topic 4:**

**To what extent is there a correlation between stock prices and Marin home prices? Does the recent recovery in the stock market portend a similar recovery and increase in prices of real estate?**

**Conclusions:**

There is a definite correlation between stock price and prices of Marin County home prices as indicated in the graph below which shows the change in median single family home prices since 1994 (red line) and the level of the Dow Jones Industrial Average over the same period (yellow line.) The level of the Dow increased by a factor of 2.7 and Marin housing prices increase by a factor of 2.2. In the past week, the Dow dropped an astounding 1000 points in a single trading session, gaining most of that back the same day. My belief is that, which fluctuations will not be nearly that dramatic, we are not yet to the point where we will see continuous price increases from quarter to quarter across all housing types and towns in Marin. Instead, the long run direction will be up, but there will be some down quarters in some segments of the market before we're back to a "bull market" in Marin real estate.

**Topic 5:**

**Would it be more accurate across all price ranges to use a price per square foot rather than median price as the standard measure of value?**

**Conclusion:**

A charting of price and price/sq.ft. for Marin single family homes from 2002-2009 showed that the two measures of value mirror each other very well, and since the median price is a metric that most homeowners can relate to far easier than price per square foot, I've concluded that there is no advantage to changing this standard metric.

**In discussing pricing trends, the author publishes a quarterly Marin pricing analysis. This breaks the market into a low end (under \$750,000), a mid-range (\$750,000 - \$1,750,000) and a high end (above \$1,750,000). With prices having come down, is this still a reasonable way to segment the market when discussing pricing trends? What percent of homes are on the market in each of these segments? How should these pricing tiers be adjusted to make for more meaningful reporting of pricing trends?**

**Conclusion:**

After experimenting with various pricing segmentations, for the most recent quarterly analysis, the long-standing pricing tiers were altered as follows. The percentage of sales in each tier is shown:

<b>Inventory</b>	<b># Active</b>	<b>Percent</b>
Homes < \$500,000	147	16%
Homes \$500,000 - \$1,000,000	386	41%
Homes > \$1,000,000	407	43%
Total	940	100%

In Marin, most condos will fall into the first tier, with most single family homes split between tiers 2 and 3.

## **Topic 6:**

**What is the current “inventory” of homes on the market, and how does that compare with historic volumes? It seems that inventory is down, but price is not going up, contrary to the basic tenet of supply and demand. Why is this and does it mean that we can no longer use the months of inventory as a prediction of future prices?**

### **Conclusion:**

The inventory at the end of Q1-2010 was 940 homes, compared with inventories in the previous 5 years that ranged from 392 to 1007. The absolute number of homes on the market at any point in time is the supply. The size of inventory itself does not directly tie into price levels, however, since it doesn't take into account the demand. When we look, though, at the number of months that it would take to sell that inventory – i.e. the rate of consumption – then there is a direct correlation. That “backlog” which was only 2.7 months at the beginning of 2007 grew to 10 months by the beginning of 2009, during which time we saw prices decline. By Q1-2010 that backlog had been reduced to 6 months and as expected, prices are starting to rise.

**And finally, to what extent does seasonality affect pricing? Should a Realtor advise a client to put their home on the market only in the spring, when they might maximize the sale price? Or do the increased number of competitive listings balance out any perceived increase in buyer demand during the peak home buying season?**

**Conclusion:**

Research showed that there is a consistent pattern indicating that Q2 prices (homes that close escrow in April-June) commanded higher prices than those that closed in January-March. Since closes lag contracts by 30-60 days, this would indicate that there generally is a bump in prices for homes that are listed in Q1 over those listed in Q4. The months of November-December are typically slow months due to the holidays, so this seems to support the theory that buyers who shop during that period, when there are few other active buyers, can get a better price; and that sellers would be well advised to wait until after the first of the year to list their homes. It's difficult to draw any similar conclusions about other months of the year and of course many home sellers will not have the luxury of attempting to maximize price by selecting the optimal month to place it on the market. More pressing issues, such as divorce, relocation, loss of job or other motivating factors will override any seasonal considerations.

**Final Conclusion:**

The most critical issue in attempting to predict the direction of prices for Marin homes for the remainder of 2010 and 2011 appears to be the state of the economic recovery from the "Great Recession." All indications are that, painful as it has been, and

continues to be for many, this economic downturn will follow the long established business cycles of prosperity, recession, depression and recovery. The downward slide, which is the period of recession, has been formally declared to be over by the economists that measure such things. Having hit the bottom of the slide, we are currently wallowing in the “depression” but recovery is sure to follow. In this case, because of the massive amount of federal stimulus, that recover will include rising interest rates. The rise in rates and the psychological scars from the bursting of the real estate bubble will cause home prices to rise more slowly than they have in the past, but rise they will.