

Quality Asset Management

Grow Your Wealth with Peace of Mind

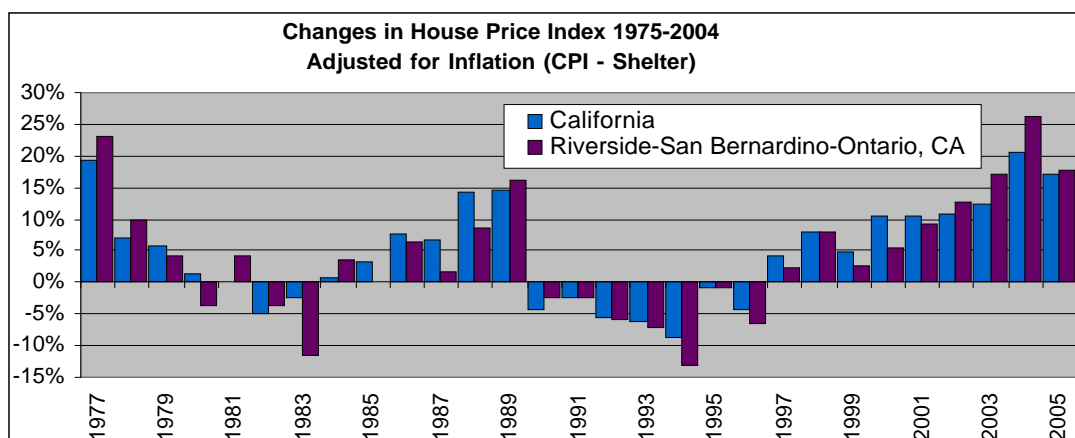
How should you deal with the Real Estate Slow Down?

By Gil Hanoch, November 11, 2006

Real estate markets throughout the U.S. are growing more slowly and in some cases are declining. This article provides some guidelines for dealing with this environment.

Statistics

First, let's put the recent growth of real estate in long-term perspective. The following graph shows the inflation-adjusted annual growth of two high growth areas from 1977 to 2005: California as a whole and a high growth area within California:



Source: Office of Federal Housing Enterprise Oversight (OFHEO)

The following table compares recent performance with the two recent cycles:

Annual Growth of Real Estate (adjusted for Inflation: CPI - Shelter)		
Period	California	Riverside-San Bernardino-Ontario
Last 5 years	14.2%	16.4%
Recent cycle (1990-2005)	3.8%	3.4%
Previous cycle (1980-1989)	3.9%	2.0%

Based on this data:

1. Growth since the beginning of the recent cycle was similar to the previous cycle. Therefore, there is no statistical reason to believe that *long-term* real estate values should adjust significantly downwards to make up for the recent excessive growth.
2. Recent growth of real estate was approximately quadruple the cycle average. Statistically, you can expect the next 5 years to have lower and possibly negative inflation-adjusted growth.

Please note that there is no guarantee that the future will behave similar to the past. These are just statistics that give you an idea of where we stand historically.

What should you do next?

This section provides ideas for dealing with the slow down in real estate, depending on your goals.

Speculator. If your goal is to make fast money on real estate, with the intention of buying and selling quickly, you are dealing with risky business, no matter when you do that. The risk increases as you borrow more of the cost. Statistically, you may lose money in the next few years, especially when considering inflation and the large transaction costs. This makes speculation at this point even riskier than at other times. Therefore, you should be inclined to avoid buying for short-term speculation and consider selling short-term speculative investments, or be prepared to hold on to them for many years.

Long-Term Investor. If your goal is to buy a property as a long-term investment, you may see a decline in your investment in the next few years. If history is any indication for the future, it may even take 10 or more years to see any profit. But in the long run (20+ years), you are likely to make money, regardless of the upcoming years. Given the recent history, you should be especially careful not to buy overvalued properties, but you do not have to avoid purchases altogether, and you do not need to rush to sell your long-term investments.

Buyer of personal residence. If you are buying a place to live, there are many benefits, both financial and non-financial. As long as you expect to keep owning a home for many years, you should outlive any potential decline period and enjoy the long-term growth of real estate. Even if you expect to move within 5-10 years to a place with similar growth patterns and of similar or greater value, you should be immune to short-term declines, or even benefit from them. The one caveat is that the high transaction costs may be prohibitive, if you expect to move in very few years.

On the move. If you are thinking of moving you should not necessarily hold off. Since you are selling one property in exchange for another one, you are staying in the real estate market. You should be careful not to upgrade to a much more expensive place that requires stretching your means or that is located in a market that recently increased significantly more than the market you currently live in.

Disclaimers

The guidelines above are general. Every transaction should be evaluated individually. There are many factors affecting each transaction. These include the value of the local real estate market in question and the specific property. At all times there are both overvalued properties and bargains.

In all cases you should consider transaction and maintenance costs and the risk of declines, repairs, extended periods of a vacant rental property and increasing interest rates on variable loans.

Sounds familiar?

This advice above is similar to the advice I would have given to stock investors in 2000. Since you don't know when the slowdown will end and how deep it will go, your best bet is to invest for the long run, or avoid the risk altogether.

One difference between real estate and diversified investments in the stock market is that real estate recessions tend to be significantly longer, transactions are much more expensive and the investment is less liquid (takes longer to sell). Globally diversified stock portfolios usually recover from recessions within less than 5 years, but real estate recessions may last 10 years or more. Therefore, think very carefully before speculating in real estate for short and even medium periods.

Past performance may not be indicative of future results. Simulated data was used for periods prior to the inception of mutual funds (see [Performance Data Disclosure](http://www.qualityasset.com/disclosure.htm) at <http://www.qualityasset.com/disclosure.htm>). Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this article, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Note that services are limited to investment advice and do not include financial planning and/or non-investment related consultation services. You should not assume that any discussion or information contained in this article serves as the receipt of, or as a substitute for, personalized investment advice from Quality Asset Management. If you have any questions regarding the applicability of any specific issue discussed above to your individual situation, you are encouraged to consult with the professional advisor of your choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.