

Hold the Presses.

By Armand Lucarelli, CPA CTP

'Hard Landing' on the Coasts Jolts Those Who Must Sell; Ms. Guth Tries an Auction 'We're Preparing for the Worst'¹

Vincent has written a great article on "stagflation" that is superseded by today's news in the Wall Street Journal. About two weeks ago there was an article in the WSJ predicting that the slow down in real estate would impact GDP by .75%. Today Allen Sinai predicts a 1% drop in GDP because of the housing slow down. Just how big is the impact going to be. We are not economist nor do we have access to data but the news on the street is not good.

A client has his boat up for sale. Hits on the brokers web site are down 70%, a local dealer with four stores sold one boat in July vs. multiple units a year ago, rentals in Wellfleet on Cape Cod are down substantially, restaurants have tables available, sales of paintings are down substantially at galleries on Cape Cod, and bankers are finally telling us they have cracks in their portfolios.

During a recent sales trip to Miami Florida to launch our new office we observed condo's sprouting like rabbits, yet customers have disappeared. When the dust settles what happens to the construction workers building the condo's, the realtors who have made millions satisfying what was thought to be a boundless appetite, lawyers with an endless supply of real estate closing, or mortgage brokers who have been writing 1% adjustable rate weapons of destruction? Economists are now predicting a bumpy landing for real estate vs. a soft landing. It is not the bumpy landing of the real estate market in itself that is troubling, but the side impact on the service and the construction industries leading to a slowdown in retail that could flow into manufacturing.

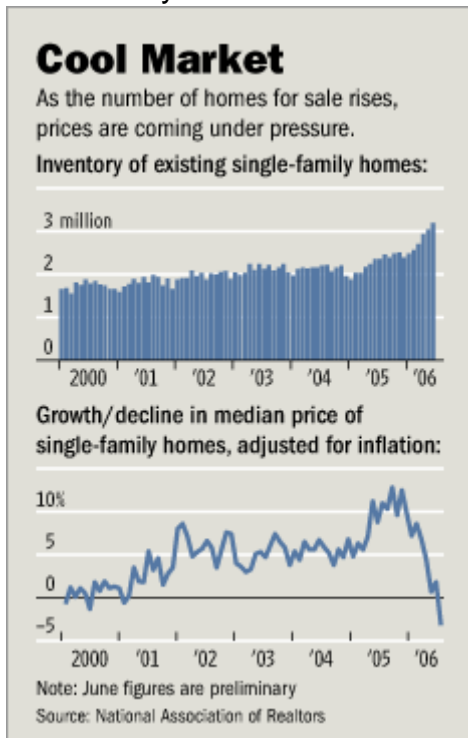
Allen Sinai, chief economist at Decision Economics Inc., a New York research firm, contends that housing is poised for something "harder than a soft landing but softer than a hard landing." The weaker market will hurt the economy by eliminating jobs in construction and other housing-related fields and by reducing the ability of consumers to finance spending by borrowing against their home equity. Mr. Sinai predicts these factors could shave as much as a percentage point off economic growth over the next year or so. Taking that into account, he expects the economy to grow at a relatively sluggish annual rate of 2.5% to 2.75% in 2007, compared with 2.5% in this year's second quarter and 5.6% in the first quarter.²

¹ By JAMES R. HAGERTY and MICHAEL CORKERY
August 23, 2006; Wall Street Journal

² By JAMES R. HAGERTY and MICHAEL CORKERY
August 23, 2006; Wall Street Journal

What is most interesting are the true stories in the article regarding the real drop in value taking place if one needs to move a piece of real estate. Sellers are turning into landlords to avoid taking a loss, auctions drawing two potential buyers and no bids sufficient to sell, buyers making the tough call to loose deposits or carry two homes. While the medium price of real estate has not softened it may not be a true indicator of what is really going on in the market as it is several months behind. The following are some of the highlights that caught my attention.

The inventory of unsold homes has increased by over 1 million units since early '05. The medium price is now less than in 2000.



Meanwhile, high house prices and rising interest rates have pushed even more homes out of reach of the typical buyer. The housing-affordability index fell to a record low in the second quarter, with just 40.6% of the new and existing homes sold in the second quarter considered to be affordable for a family earning the median national income of \$59,000, according to a third release from the home builders.

In the condo market, developers see supplies rising and new construction falling. A vast majority of developers -- 82% -- report more resistance from buyers to their prices. Three-fourths of developers are offering nonprice incentives, such as free upgrades or help in paying closing costs. A sizable number of builders have cut selling prices, with the average

reduction of 9%.

Half the builders are using brokers and agents to help sell condos, up from 20% a year ago.³

Some interesting excerpts from the article;

- In his 40 years as a home builder, Mr. Toll says, he has never seen a slump unfold like the current one.⁴ Mr. Toll is CEO of Toll Brothers.

³ REX NUTTING
MarketWatch
August 22, 2006 3 Wall Street Journal

⁴ By JAMES R. HAGERTY and MICHAEL CORKERY
August 23, 2006; Wall Street Journal

- "Every time we've gone into a downturn in the home-building industry, they've always been longer and deeper than we've all imagined," Mr. Tomnitz, CEO of EB Horton the countries largest developer in units, told analysts in a July 20 conference call. "So we're preparing for the worst, and we think this one will be longer and deeper than just the last six months."
- Joan Guth is one homeowner who was taken by surprise. Last September, she put her stately five-bedroom home in Herndon, Va., on the market for about \$1.1 million. She was confident she would get something near that price, and planned to use the proceeds to buy a retirement home in Florida. But her home in the Washington suburbs attracted few serious lookers, and in March, she cut her asking price to \$899,900. Still there were no takers. Finally, on the advice of her broker, she called in an auction firm, beginning a process that would eventually reveal to her just how weak the Northern Virginia market had become.⁵
- Over the past year, the number of previously occupied homes listed for sale nationwide has risen nearly 40%. In some metropolitan areas, including Orlando and Phoenix, the supply has quadrupled.⁶
- Ms. Guth, whose home in Herndon, Va., had failed to attract a buyer after months on the market, eventually turned to Tranzon Fox, an auction firm based in Burke, Va. Ms. Guth had based her initial \$1.1 million asking price on a 2005 appraisal of her home, which now appeared far off the mark. She and her family decided they would accept the highest bid of at least \$675,000.⁷ This is a 61% decline from asking price. No matter how inflated the asking price this is a staggering drop in pricing.

While some of these stories may be extremes the underlying issues will have far reaching impact on the economy. We anticipate an impact on the service and construction sector that supports building and finishing of real estate. The world is still awash in cash and many articles note excess capacity around the world. Money always finds the next tech craze, housing boom, or tulip bulb investment to ride to riches. The good news is that there is a limited supply of land and a growing world population. The bad news is that it may take some time for the excess to filter through the economy.

⁵ By JAMES R. HAGERTY and MICHAEL CORKERY
August 23, 2006; Wall Street Journal

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As with most things in life when you over indulge it takes time and pain to return to normal.