VIEWPOINT

Local Housing Market May Cool, But Then Resume Upward Climb

By ANTHONY MARGULEAS
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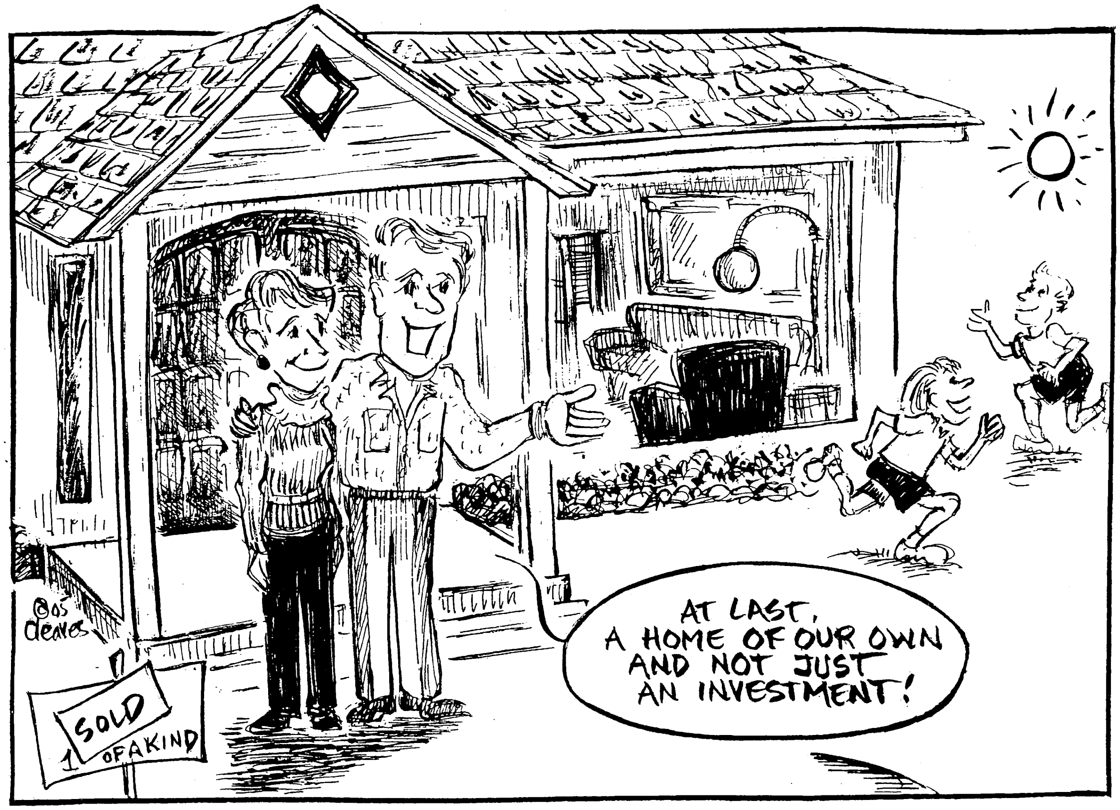

Most of the "experts" talking about a real estate bubble are economists and financial consultants with no experience selling real estate. The truth is, real estate isn't like the stock market and it doesn't crash, or burst like a bubble. The worst real estate recession in the past 30 years saw only a 5 percent annual depreciation—over a six-year period, approximately 20-30 percent in California. And that was in the early 1990s. Stocks, however, can lose 50 percent or more of their value overnight. The main reason people buy a home is because they want a place to live and/or raise a family; investment is of secondary interest for most home buyers.

The main issue driving prices up in Southern California, especially in Los Angeles, is supply and demand. Homes-for-sale inventories in Los Angeles County as of April were at a 2.6 month's supply. This means that if nothing new came on the market, then it would take 2.6 months for the inventory to run out. By way of comparison, the inventory levels in 1991 were at 27.9 months. In Pacific Palisades a year ago, inventory levels fell to an all-time low of 35 homes for sale vs. past inventory levels of 300. Since then, inventory has climbed to around 80.

The number of days a home is on the market before there is an accepted offer has dropped 50 percent too. A home that used to be on the market for 40 days now sells in 20 days, adding more pressure to the market.

Most buyers in higher-priced areas are moving from a home in which they already have a lot of equity and applying a large down payment from the sale of that home. When the housing market slows, it's more like a hot-air balloon drifting slowly down than a bubble bursting or a stock market crash.

I can see the market cooling a little, as we saw an appreciation of more than 20 percent in 2004, and we are on track for another double-digit appreciation in 2005. But once things cool, they invariably heat up again, and the balloon will start to rise.

Many people believe that low interest rates are keeping the market buoyant, not taking into account that only a few years ago the rates were significantly higher—closer to 7 and 8 percent—and home values still appreciated 20 percent a year. Even if rates go up by 2 or 3 percent in the coming year, I don't think it's going to have as much of an impact as some experts predict.

Two things that affect the low inventories in Los Angeles are capital gains and property taxes. Both of these discourage people from putting their homes on the market, so inventories stay low while demand remains very high. In a city with such high property values, being able to exclude only $250,000 per single and $500,000 per couple for capital gains means that homeowners at the upper end of the market are severely penalized when selling. With property taxes at 1.25 percent of value as well, these factors are deterring many from selling and moving up.

If a homeowner paid $1,000,000 for a home five years ago that is now worth $2,000,000, and they want to move into a $3,000,000 home, they would face an increase in property tax of approximately $2,000 a month. Thus, existing homeowners are increasingly opting to stay put and improve or expand what they have.

A major change in tax legislation here in Los Angeles and California is about the only thing that could significantly affect our market—and even then, prices would stabilize, not drop. These changes are not only highly unlikely, but would take years to materialize.

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