

PULSE OF THE MARKET ©



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Changing the World

Pulse 47

Introduction

Though we can't see the future, we certainly can influence it. If you buy this thesis, then I ask you to buy the next one – we can indeed change the world. This may seem touchy - feely, but here's my point. I ask you to join with me in viewing the world as follows - everything that the world is, is actually unfolding at any given instant, always changing and becoming. If that's so, then when you or I do an unselfish favor for someone, we have enhanced the harmony of the world, and thus changed the world. The opposite action would also be true.

So what's this have to do with real estate? There are certain individuals and companies within our midst who are not waiting to see what happens in the future. They are taking action, influencing the future, creating it and thus changing the world. "Build it and they will come."

Let's Talk About Bloomingdales

According to their Web site, they have 37 stores in 12 states. The Manhattan flagship is located at 59th Street and Lexington Avenue. On September 28, 2006, Bloomingdales opened their largest store outside of Manhattan as part of the 1.5 million square foot Westfield San Francisco Centre (what we common folks call a shopping mall) at Mission and 5th Street. Folks, San Francisco is a teeny-weeny village compared to Los Angeles, Chicago, Atlanta, Dallas, Miami, Boston, San Jose, etc. and yet Bloomingdales decided to put their second largest store here. And by the way, upscale Neiman Marcus and Saks Fifth Avenue recently spent major renovation dollars on their San Francisco stores as well.



According to Mayor Gavin Newsom, this new Centre expects 25 million visitors a year and \$600 million in annual mall revenues. Bloomingdales and Westfield are influencing the future and in the process are changing the world. They are transforming the mid-market corridor of San Francisco. They are betting a lot of money, and they are smart people, not gamblers.

Buyer Dollars

According to the San Francisco Association of Realtors MLS, there were 2,917 condominium re-sales in the City in 2005, not counting new product sales. At an average sales price of \$835,236, this translates to \$2.4 billion in spending by condominium buyers. I don't yet have an accurate number for new product sales in 2005 (I'm working on it), but a good ballpark is probably 1,200 units, representing another \$1 billion in buyer dollars.

Over the next three years – 2007 to 2009, there are expected to be approximately 6,000 new units delivered, all in the SOMA/North Beach/Rincon Hill neighborhoods, and this represents about 2,000 new units per year and probably \$2 billion in annual buyer dollars.

Some of my clients and real estate associates are concerned that (1) the overall real estate market is soft or softening (I agree), and (2) there will be a condominium glut in San Francisco that will significantly depress prices (I don't think so).

There are several developers who are building towers south of Market Street, and they are national developers (including Tishman Speyer, Millennium Partners, Peebles, Fifield, and Turnberry), with multi-market experience, deep pockets, and the power and intention to change the world. Like Westfield and Bloomingdales, they are bent on influencing the future, and I think they will.

I don't know, nor do I think anyone does, whether the condominium demand in San Francisco is 1,000, 2,000 or 5,000 units per year. In my humble opinion, that's not the critical issue. The issue is creating a product that appeals to the needs and wants of a buying public. These condominium developers are not asking how big is demand. They are intent on creating it.

You can buy a 4,000 square foot single-family home in Tulsa, Oklahoma for \$200,000! And you can buy a 1,000 square foot condominium in San Francisco for \$1 million. What's wrong with this picture? I am convinced, though I readily admit that I do not have the facts to back me up, that a significant number of people come through (or learn about) San Francisco and say, "honey, if we ever can, let's live and own a place in San Francisco." They don't typically say that when visiting Tulsa (not that there's anything wrong with Tulsa).

A Dissenting View

I have a client, Ivan, a very financially sophisticated, single guy who has been renting on Telegraph Hill for as many years as I have known him, which is 3+. He has substantial funds, and he has very specific purchase requirements - one or two units in the Marina.

Our typical process is that we meet and visit a property, and he leaves with a goodbye that includes, "I'll run it through my spreadsheet." I have never asked to see the spreadsheet. He continues his search. He is sure that prices of condominiums in SOMA will decline over the next several years, and they will impact the prices of condominiums throughout the City, including the Marina.

Here's the proposition I made to Ivan and I make to you. I bet a dinner that the average price of a condominium in the Marina at December 31, 2009 is higher than the average for the 10-month period ended October 31, 2006, which was \$1,044,000. As a point of reference, the average sales price for the year ended December 31, 2003 was \$800,000*. There will be a surge of new condominiums coming to the market in 2008 and 2009, and we will see whether it has an impact on prices across town and in the Marina as an example. And as I have said in prior *Pulses*, buying wisely, i.e. a property that has unique features, will further mitigate concerns about future possible competition. Nonetheless, let me know if you would like to make this wager with me.

Ivan is trying to time the market and fears that he will overpay for a property if he buys now. This is not an uncommon concern among many, but certainly not all buyers. He also admits that if he falls in love with a property he will buy now. Hmmm, love trumps fear.

Market Psychology

It is in most everyone's best interest that prices appreciate – individuals who want to sell so they can obtain a good sale price for reinvestment of funds, even buyers so they can feel good about (and profit later from) their buy-decision, and new product developers so that they can cover their cost of construction and make a profit. While low interest rates help everyone, it is individuals' psychology, however, that has the major impact on prices and markets. When prices rise, everyone gets excited, and buyers chase after properties. When prices soften, the herd pulls in its horns and retreats, much like the stock market. The market is soft in San Francisco and elsewhere. But for how long? Answer – until the psychology changes. After all, many savvy buyers are out there taking advantage of this very same soft market. Different perspective, different actions and results. Different worlds.

For buyers like Ivan, I say look beyond the market softness today. Wesfield, Bloomingdales, and the south of market developers are looking to and creating the future. Ask a realtor when was it the best time to buy in San Francisco, and they will tell you – five years ago. And they would be right. Of course you can only know what any "best" decision was, after the fact. There is no other way of knowing what is best until after it happens.

The good news for would-be buyers in the south of market neighborhoods is that the developers ARE aware of a very competitive landscape. They can't afford to gamble on luck or guesswork. And they are not in the business of waiting. They don't know whether there is demand for 1,000 or 5,000 units, so they intend to provide the very best products at the best possible prices. They don't win if buyers don't win.

*If you had put down 20% (\$160,000) on the \$800,000 Marina unit, three years later you would have realized a 30% gain (\$244,000) in property value and a gain of 150% on your down payment (cash investment). Do I expect this same increase over the next three years? Probably not, but I do expect a gain.

Summing Up

On the subject of changing the world, I think of Cirque du Soleil. They are a company that redefined the circus business by creating demand that didn't exist. Are they a circus? Are they theater? They invented who they are. They changed the world.

My sense is that Ivan will still be looking for a property in 2010: it's part of his predisposition. If you require certainty, your future will likely always resemble your past. If one day Ivan does, for some reason, change his mind about that, he may very well change his world. Others with different intentions about their futures – empty-nesters, young couples/individuals who work in the Financial District or northern Silicon Valley, pied a terre buyers, investors who want to own a piece of San Francisco residential real estate, or collectors of third/fourth homes, will have make decisions and invest buyer dollars in San Francisco and perhaps in the newly developed south of Market neighborhoods before Ivan acts, unless, of course, he falls in love.

I remember some 15 years ago when I lived in Los Angeles and was in my car on the freeway. I was listening to the radio and a report by the Orange County Transportation chief. His words still ring in my ears – “however bad your commute was this morning, it is the best that it will ever be for the rest of your life.” I am sure that people who live and work in Petaluma, Tracy, Alamo, etc. experience this every day. For me however, that was not as good as it would ever get. I live here now, minutes from work. I changed my mind and changed my world.

Re-urbanization is occurring in virtually every major metropolitan area in the country. Being able to work and live in San Francisco is a quality of life issue. Yes, I know we have some (other) issues here, but commuter traffic is not one of them. While living and working in San Francisco is a major plus, a negative issue is that it is very expensive, and therefore difficult for companies to attract and retain talent when the cost of property is so much less in other locations. Somehow, it seems to work out for many many people. Maybe each city or market attracts it's missing pieces? Give me a ring any time. I'm glad to help with any residential issue. My contact information is below. Next *Pulse* after the holidays.

Some recent issues of *Pulse of the Market*:

- Pulse 46* - Art of Selling - Revisited
- Pulse 45* - Being Big Has Its Issues
- Pulse 44* - Lessons from New York
- Pulse 43* - Diamonds & Champagne

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