

# PULSE <sup>OF</sup> THE MARKET <sup>©</sup>



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## 2006 and Beyond

### *Pulse 48*

#### **Introduction**

In looking back at 2006, my sense is that the year was pretty darn good for both buyers and sellers, particularly in the face of unending media drumbeating that the bubble was bursting and the sky was falling: not here in San Francisco. But, it was a selective market; some did well and others did not so well. In addition, as we close out 2006, the table is set for 2007 - a transitional year in my opinion, when savvy people will capitalize on these currents and others will do just so-so or not well at all. The differences will be determined by how each approaches the market. If sellers approach the market casually and just call up their best friend (who happens to be a Realtor) then they are likely to experience a sinking feeling as their list price gets sliced every 30 days; something akin to a piece of salami. If buyers continue to wait on the sidelines or only seek bargains they will likely find the real opportunities only in hindsight. But if as buyers or sellers they approach the process as a major financial transaction and put the best man or woman on the job, then they are more likely to end up with a very satisfying experience. Guess where I put my money?

#### **Looking Back at 2006**

If you re-read my *Pulse 38* from October 2005, "*The Soufflé Has Arrived*," 15 months ago, you will note that I thought the San Francisco residential market would settle down post-Katrina rather than witness a bursting bubble. It was reasonable to assume, I thought, that market appreciation would likely catch its breath before marching forward once again after experiencing two year-to-year double-digit average price gains. The attached tables of historical average price changes are worth a glance.

If you had asked me about the state of the market in general any time during 2006, I would most likely have given you the very same answer throughout the year; it was great for some, and not for others. Some homes were receiving 5 to 10 offers while others were languishing on the market and experiencing multiple price reductions before finally going into contract.

Buyers were choosy, taking their time, and doing extensive homework and research. The sellers who won the game were those who picked a professional agent who orchestrated a first rate marketing program, staged the property, and made sure that the property was priced just below competitive product. There were plenty of buyers out in force throughout the year. They were just looking for a property positioned as attractive.

## **Behind the Numbers**

There is an existing inventory of approximately 100,000 single-family homes in the City, and to state the obvious, no more are being built. If you look at the attached 20-year table going back to 1987, as few as 2,511 properties have sold in a given year (1995), and a peak of 3,858 (in 1990). The year just ended saw a total of 2,614 properties change hands. While this number is on the low end of the range, lower than 14% of unit sales in 2005, and off 14.5% from the 20-year average of 3,058, I don't think it means anything in terms of predicting future price softness, as some have reasoned. It just is. As a percentage of the available 100,000 inventory, it means that 2.6% of the housing stock changed hands in 2006, versus 3.1% of the housing stock in an average year. As for prices, average prices across the City were up 3.2% in 2006. Not a great year for appreciation, but not bad either. And when you factor in leverage, still pretty for the investor.

Condominiums are a bit more difficult to decipher because of the new construction taking place below Market Street, and I trust their publicly available numbers much less.

According to the MLS, there were 2,429 condominium properties that changed hands in 2006, down about 17% from the 2,917 total that sold in 2005. This is similar to the 17% slide in unit sales that 2001 experienced compared to 2000, which was then followed by a 50% unit increase in the following 2002.

If I look at the average of condominium units sold in the 10-year period from 1997 to 2006, the number is 2,374, so relatively speaking, 2006 was not a lackluster year but one that was actually a touch above average for this most recent 10-year period. Then there is the new product activity south of Market. If I can accept that both One Rincon and The Infinity were at least 90% sold out, then there were another 700 units that were "bought," bringing the total for the year to over 3,100. And this doesn't include unit sales at The Palms, Ritz-Carlton, The Beacon, etc. It pays to look behind the published numbers.

## **2007 and Forward**

I find that my buyers fall into at least five categories. First, there are those who are first-time buyers. They have been renting for a few years and are now ready to make their first home investment. Second, there are those who are either moving up or are relocating to the city, both having purchased property before. Third, there are the baby-boomers (maybe empty nesters), who are relocating from the surrounding areas, downsizing, and relocating to the city. Fourth, there are those who want a place in the city, a pied a terre, which they will use only occasionally, and fifth, there are those who are home-collectors who wish to place some of their financial resources in different cities throughout the world.

There are also two sub-categories; those who want to buy in the next 30/60 days, and those who are in “no rush.” This latter category may be going through an educational process so that they can more accurately determine their specific wants and needs. Meanwhile the marketplace and conditions are in constant flux.

I attended a First Republic Bank-hosted luncheon in mid-December where Rich Karlgaard, Publisher of Forbes Magazine, was the featured speaker. Rich has a very perceptive column in every issue, and I am a big fan of his. He was forthcoming about his not being very knowledgeable about the real estate industry, but only compared to his great experience and knowledge about Silicon Valley and the equity markets. However, I thought his comments about the baby boomers were very interesting and worth sharing. His take is that this generation probably has made way more money than they ever expected from their home equity, and way less money from their 401K's and other retirement accounts (another testament to the attractive relative investment value of real estate). Consequently, he reasoned, many were planning to sell their 2,500+ square foot single-family homes, downsize to 1,000+ square foot condominiums in the City, and invest the difference in income-generating equities and bonds, so that they had the wherewithal to continue to fund their lifestyles. This makes a lot of sense to me, and I continue to get phone calls from just such people.

For buyers who may not be quite ready to move but who are able to purchase now, the challenge is to choose wisely among the multitude of new building options, some of which have not yet been built or completed. To make a sound decision and really understand the market as it continues to change over the next 5 to 10 years, a sophisticated buyer probably needs a very good simulation model of the future. I'm not aware that it exists, so I thought I would take a crack at creating it. But that's another story.

Surely an investment now in One Rincon, The Palms, The Infinity, or one of the many other developments currently under construction or already approved by the City, will be impacted if the 1,000+ foot Transbay Tower gets built, the 600+ foot Palace Hotel Tower gets built, and on and on. It's important to see and understand what you can't yet see. This is not a zero-sum game, but future values for specific condominiums and specific buildings will most likely vary widely in the next 10 years.

For those buyers who are ready to make a move now, it's a matter of making their best choice with the best available information at hand today. For my clients, I always try to project three to five years out when they might want to sell, so that we have an exit strategy\* in hand when we are making the purchase. Despite real estate's proven investment performance, it is also known as not being a liquid investment. Hence the importance of being strategic from the onset. Buyers today are sellers tomorrow, and the changing competitive landscape needs to be taken into consideration, whether it be south of Market, The Marina, or any other neighborhood in the City.

For buyers and sellers of single-family homes, the competitive landscape is much less complex. While this type of property is the favored home ownership in the City for a host of reasons, it is not appropriate for everyone, and as noted countless times before, no more are being built. By the way, note the difference in average appreciation since 1987 between single-family homes (8.7%) and condominiums (7.4%) in the accompanying tables. Both are pretty decent, not to mention the leverage. Also be aware, that these are averages and not everyone realized the average.

\*Then there are friends who put down a 5% non-refundable deposit on a \$2 million unit at The Infinity – without calling me – and then call me after the fact and ask me to “get them out.” They changed their mind. Hmmm.

## Summing Up

My crystal ball says that 2007 is going to be a good year for residential real estate in San Francisco. While the soufflé came out of the oven in mid-2005, I think that before long it is ready to be reheated once again.

I also think that the psychology of the market has already changed to the positive. With the recent November election in hand, there is a much less of a likelihood that we will be in Iraq for a long period of time. Come what may, I bet we will be out of there sooner rather than later. I also think that the media have pretty much shot their wad on the housing drama, and will shortly be off to some other issue about which to beat their drums, leaving people to make their buy and sell decisions without hearing that the sky is falling.

Lastly, for the condominium buyer and seller, I think the dumb (easy) money (read, south of Market investors/speculators) has been made in the last five years, and in order to make money in the future, buyers and sellers need expert advice and execution just like they need it when they undertake any other financial transaction.

Let me know if I can help. Happy New Year!

Some recent issues of *Pulse of the Market*:

- Pulse 47* - Changing the World
- 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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I am looking for clients who appreciate an agent who cares deeply about their needs and provides impeccable information, expert negotiation, and thorough execution. I refer you to my web site, [www.Sfpulseofthemarket.com](http://www.Sfpulseofthemarket.com), where you can see recent issues of *Pulse of the Market*© and learn more about me. I invite your comments, suggestions, and questions. I also invite your business.

## AVERAGE SALE PRICE - SINGLE FAMILY DWELLINGS

### SAN FRANCISCO

| YEAR | #SALES | AVG. PRICE | % Chg. |
|------|--------|------------|--------|
| 1987 | 2730   | 247,901    |        |
| 1988 | 3039   | 313,230    | 26.4%  |
| 1989 | 2766   | 362,438    | 15.7%  |
| 1990 | 3858   | 361,772    | -0.2%  |
| 1991 | 3454   | 345,520    | -4.5%  |
| 1992 | 2718   | 338,346    | -2.1%  |
| 1993 | 2786   | 329,087    | -2.7%  |
| 1994 | 2894   | 328,748    | -0.1%  |
| 1995 | 2511   | 343,006    | 4.3%   |
| 1996 | 3027   | 365,276    | 6.5%   |
| 1997 | 3319   | 394,354    | 8.0%   |
| 1998 | 3372   | 476,793    | 20.9%  |
| 1999 | 3458   | 561,176    | 17.7%  |
| 2000 | 3106   | 729,749    | 30.0%  |
| 2001 | 2694   | 751,361    | 3.0%   |
| 2002 | 3098   | 751,211    | 0.0%   |
| 2003 | 3393   | 810,998    | 8.0%   |
| 2004 | 3305   | 948,260    | 16.9%  |
| 2005 | 3027   | 1,088,166  | 14.7%  |
| 2006 | 2614   | 1,125,719  | 3.4%   |

Annual Average: 8.7%

Source: SFAR

**AVERAGE SALE PRICE - CONDOMINIUMS**

**SAN FRANCISCO**

| YEAR | #SALES | AVG. PRICE | % Chg. |
|------|--------|------------|--------|
| 1987 | 899    | 235,379    |        |
| 1988 | 1169   | 248,581    | 5.60%  |
| 1989 | 1088   | 295,371    | 18.80% |
| 1990 | 1643   | 318,322    | 7.80%  |
| 1991 | 1454   | 308,344    | -3.10% |
| 1992 | 1075   | 305,437    | -0.90% |
| 1993 | 1120   | 289,245    | -5.30% |
| 1994 | 1287   | 306,490    | 6.00%  |
| 1995 | 1161   | 313,776    | 2.40%  |
| 1996 | 1665   | 315,050    | 0.40%  |
| 1997 | 2031   | 343,011    | 8.90%  |
| 1998 | 1986   | 415,213    | 21.00% |
| 1999 | 2255   | 493,977    | 19.00% |
| 2000 | 1959   | 652,364    | 32.10% |
| 2001 | 1637   | 620,778    | -4.9%  |
| 2002 | 2462   | 612,777    | -1.3%  |
| 2003 | 2886   | 612,823    | --     |
| 2004 | 3184   | 714,201    | 16.5%  |
| 2005 | 2917   | 835,236    | 16.9%  |
| 2006 | 2429   | 841,178    | 0.7%   |

Annual Average: 7.4%

Source: SFAR