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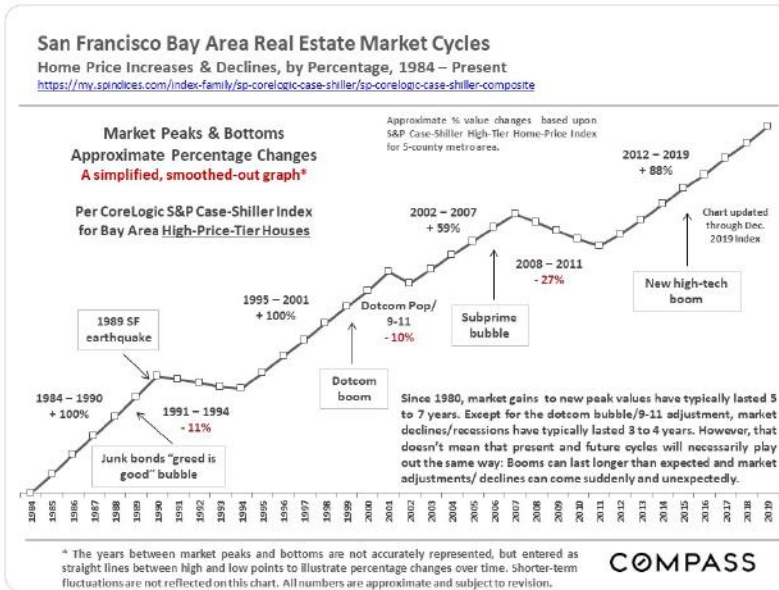


Market Cycles in Bay Area Real Estate

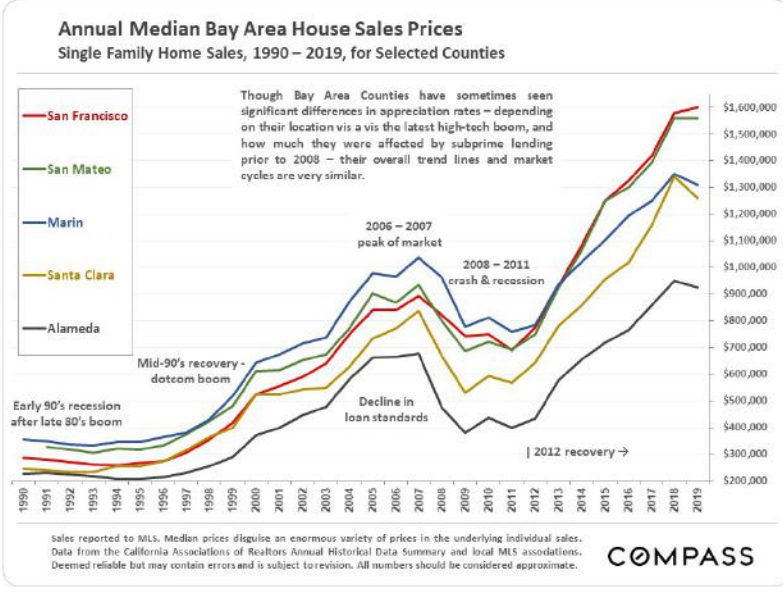
We realize there are much more important things than real estate right now, but since some of our clients are trying to make decisions about buying and selling, we will continue to try to provide useful information on market trends and conditions. At this point, we cannot know how the current crisis will play out.

This first chart is a very simplified, smoothed out look at Bay Area market cycles for higher-price-tier homes using data from the S&P CoreLogic Case-Shiller Home Price Index. It is a very approximate overview of hundreds of different neighborhood markets - whose

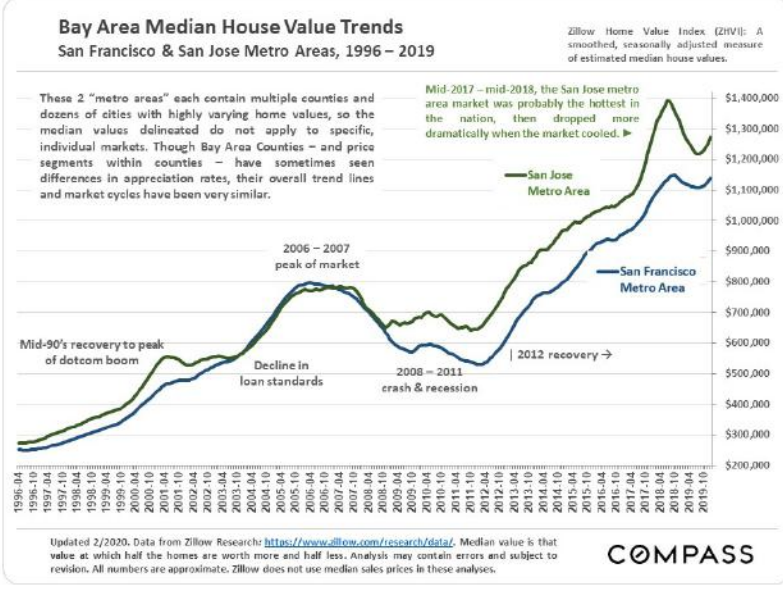
trends up and down were broadly similar, but whose details, such as specific appreciation percentages, varied.



The following chart uses the median house sales price trends of 5 Bay Area counties to illustrate a simple fact: The entire Bay Area generally follows the same broad trend lines in market cycles. Of course, there are differences by location, property type and price segment, but overall cycles are very similar. (We picked 5 counties as samples, because adding them all over-clutters the chart.)



This chart uses yet another market-value tracking algorithm looking at the 2 biggest, multi-county "metro areas" in the Bay Area. Since they reflect multiple counties of highly varying values, the prices themselves don't really reflect the prices of any specific market. The reason for the bigger drop post-2008 in the SF metro area is that portions of its 5-county area were more deeply impacted by the subprime lending crisis than the counties comprising the San Jose metro area.



Financial-market cycles have been around for hundreds of years, from the 1600's Dutch tulip mania through our recent speculative frenzy in crypto-currencies. Each market cycle has different characteristics in underlying causes and effects, and how it ultimately plays out in its specifics, but there are fundamental similarities in all of them, providing more context as to how the market works over time.

Human beings have always been worried about (or terrified of) the future, and we have constantly attempted to predict what it holds. However, whether using priests, oracles, astrologers, economists, analysts or media pundits, we show no aptitude as a species for having the ability to do so with any accuracy. In 2012, a Nobel-Prize-winning economist, famous for housing market analysis, said that the U.S. real estate market might not recover "in our lifetimes." In hindsight, we now know that the recovery had already begun in some markets such as San Francisco. In 2015, during a period of financial market fluctuations and a slowdown in our local high-tech boom, a well-respected Bay Area economist predicted that there would soon be "blood in the streets of San Francisco." Within cycle phases, there are often shorter-term periods of economic, ecological and political volatility which then pass. In 2016-2018, housing and stock markets soared higher and the high-tech boom strengthened again.

Our smartest experts can't get it right, much less the thousands of glib, confident forecasts by utterly unqualified individuals reported on in the media every month. We can't even remember the mistakes of the recent past – one reason why we don't seem to be able to escape the curse of recurring cycles – much less foretell what's going to happen tomorrow. Which leads to the next point.

It is extremely difficult to predict when different parts of a cycle will begin or end. There is no rule regarding how long the different parts of a market cycle will last. Boom times, even periods of "irrational exuberance," can go on much longer than expected, or get second winds, with huge jumps in values. On the other hand, negative shocks can appear with startling suddenness out of nowhere, often triggered by unexpected economic, political or even ecological events that hammer confidence, adversely affect a wide variety of market dominos, and then balloon into periods of decline and stagnation. These negative adjustments can be in the

nature of a bubble popping, the slow deflation of a punctured tire, or some combination of the two.

Going back many decades, all the major Bay Area recessions have been tied to national or international economic crises. Considering the fundamental strengths of the local economy, absent a major natural disaster, it is unlikely that a major downturn would occur due simply to local issues. However, local issues can exacerbate a cycle: The 1989 earthquake intensified the effects of the national recession in the early 1990's; our greater exposure to dotcom businesses produced a spike up and down with the NASDAQ bubble & 2000-2001 crash; and our current high-tech boom poured fuel on our up-cycle during the current recovery.

All bubbles are ultimately based on irrational exuberance, runaway greed, criminal behavior, or all three mashed up together. Whether exemplified by junk bonds, stock market hysteria, gorging on debt, a corporate Ponzi-scheme mentality, an abandonment of reasonable risk assessment, and/or incomprehensible and dishonest financial engineering, the bubble is relentlessly pumped bigger and tighter.

However, the 2008 crash was abnormal in its scale, and much greater than other downturns going back to the Great Depression. The 2005-2007 bubble was fueled by home buying and refinancing with exorbitant, unaffordable levels of debt, promoted by predatory lending practices such as deceptive teaser rates, no-down-payment loans and an abysmal decline in underwriting standards. The market adjustments of the early 1990's and early-2000's saw declines in Bay Area home values in the range of 10% to 11%, as compared to the terrible 2008 - 2011 declines of 20% to 60%. (Bay Area prices are now above their 2007 peaks.)

Whatever the phase of the cycle, many people think it will last forever. Going up: "The world is different now, profits don't matter, the rules don't apply anymore, and there's no reason why the upward trend can't continue indefinitely." Well, it turns out that the rules do still apply, and up-cycles always end sometime. And when the market turns: "Homeownership has always been a terrible investment and the market will not recover for decades." But the economy mends, the population grows, people start families, inflation accumulates over the years, and the repressed demand of those who want to own their own homes builds up. In the early eighties, mid-nineties and in 2012, after about 4 years of a recessionary housing market, this repressed

demand jumped back in – or "exploded" might be a better description – and home prices started to rise again. The nature of cycles is to keep turning.

As long as one doesn't have to sell during a down cycle, Bay Area homeownership has almost always been a good or even spectacular investment (though admittedly if one does have to sell at the bottom of the market, the results can be quite painful). This is due to the ability to finance one's purchase (and refinance when rates drop), certain tax benefits, the gradual pay-off of the mortgage (the "forced savings" effect), inflation, and long-term demographic and appreciation trends.

The best way to overcome cycles is to buy a home for the longer term, one whose monthly cost is readily affordable for you now, ideally using a long-term, fixed-rate loan (refinancing to lower rates when that option opens), while keeping an adequate financial reserve for emergencies - and then resisting the urge to use one's home as an ATM during times of significant appreciation. If one keeps to those rules, then it is usually true, quoting a NYT editorial, "Renting can make sense as a lifestyle choice... As a means to building wealth, however, there is no practical substitute for homeownership."

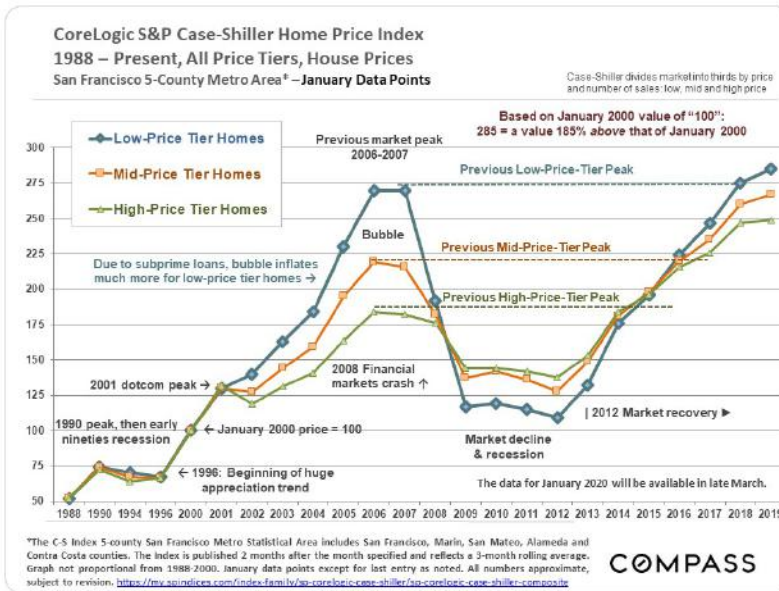
Market Changes & Home-Price Segments

The next chart, also based on S&P CoreLogic Case-Shiller Home Price index data, illustrates an important point about the last market bubble and crash: Different price segments experienced bubbles and crashes of vastly different magnitudes, mostly due to each segment's exposure to predatory subprime lending practices and the foreclosure crisis that followed. It was the lowest price segment that was most drastically affected by subprime lending: The blue line reveals its vastly bigger bubble and commensurately enormous crash. All Case-Shiller numbers refer to a January 2000 value for any home of "100." Thus a reading of 250 signifies appreciation of 150% since Jan. 2000.

The 2008 crash was an anomaly caused by the fact that tens of millions of Americans bought and refinanced homes with loans they could not afford on

day one. Happily, underwriting standards have recovered from the abysmal standards of the subprime bubble. That and low interest rates, so far, have kept mortgage debt well out of the danger zone.

It's also interesting to note on this chart that when the dotcom bubble popped, only the higher-price home segment was significantly affected (and that relatively briefly), because more affluent households have more assets invested in financial markets, and follow those changes most closely.

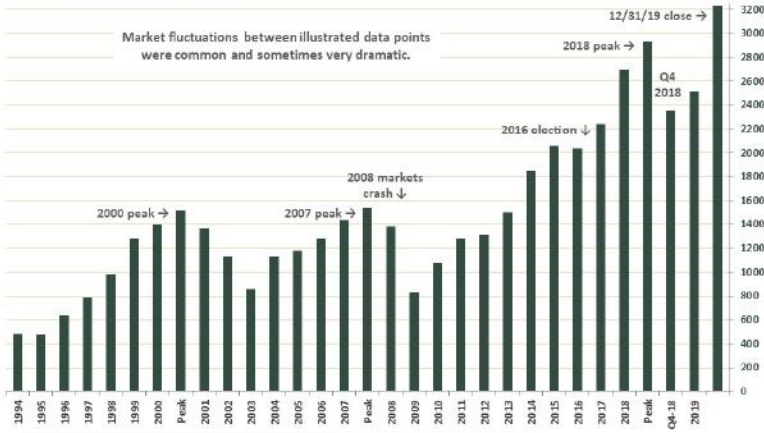


The Confluence of Economic Indicators

The 3 charts below show how real estate market cycles generally move in sync with other economic indicators such as - using 3 examples - financial markets, employment and consumer confidence. The S&P 500 chart goes through the end of 2019 and does not reflect the crazed volatility created by the coronavirus situation.

S&P 500 Stock Index, January 1994 – December 31, 2019

January Opening Values except as specified



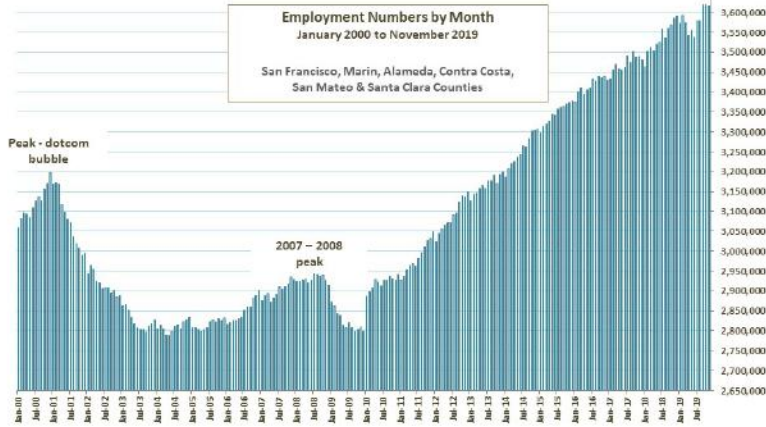
An approximate illustration only, January opening value data points except as noted in horizontal axis. Data from sources deemed reliable but may contain errors and subject to revision. Financial markets can be prone to significant volatility even on a short-term basis.

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San Francisco Bay Area Employment Trends

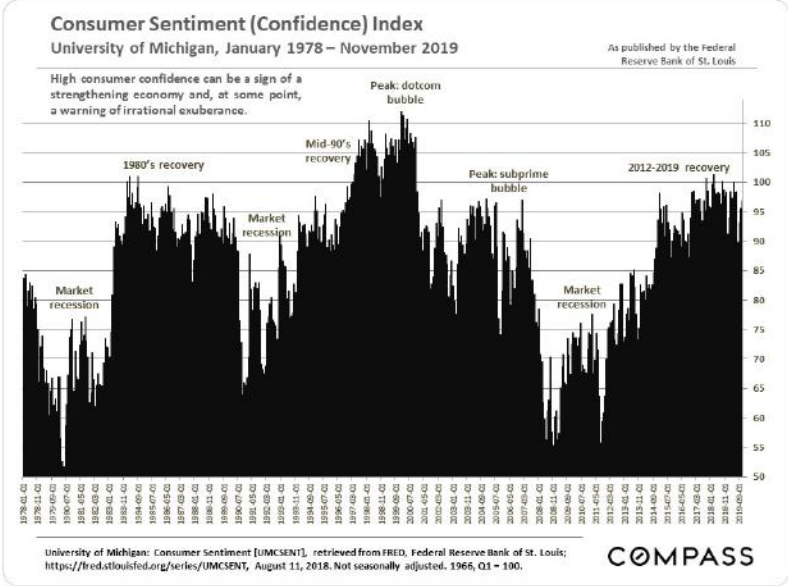
Number of Employed Residents since 2000

Per California Employment Development Dept. (EDD)



EDD data is Inner Bay Area Counties. Last month's data is labeled "preliminary" by EDD. EDD often goes back to revise past data releases. Data from sources deemed reliable but may contain errors and subject to revision.

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