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To Buy or Not to Buy: That is the Question



Image courtesy of Markley Boyer/The Mannahatta Project and *The New York Times*

In September 1609, just 400 hundred years ago, Manhattan looked like the image above when Henry Hudson sailed his small wooden ship into the Muhheakantuck (later Hudson's) River. It was in 1626 that Peter Minuit bought the island from the locals in exchange for trade goods worth about 60 guilders. Rumor has it that he might have overpaid for what is now New York City. I doubt that there were multiple offers, and thankfully the monthly S&P/Case-Shiller Home Price Index did not yet exist to create short-term concerns, but who knows.

In any event, someone on Minuit's team had a long-term time horizon, something that many people seem to forget when they talk about residential real estate. Renting was not an option then, and thus Mr. Minuit bought. And he wasn't expecting to do a quick flip to another sailor passing by. Good move!

I've heard a lot of grumbling lately that it is no time to buy; better to rent. My rental buddies go through an exercise of comparing the cost of renting versus the cost to buy and own. For the short-term, they may be right.

It's all about time horizon, tying up a good chunk of money and buying well. The latter includes using leverage that maximizes your return on investment – unless, of course, the leverage works against you in a down market, but that brings us back to time horizon.

Up until a year ago, had you told me that you planned to be in San Francisco for more than three years, I would have recommended buying over renting. Now I would suggest a minimum of five years before pulling the trigger.

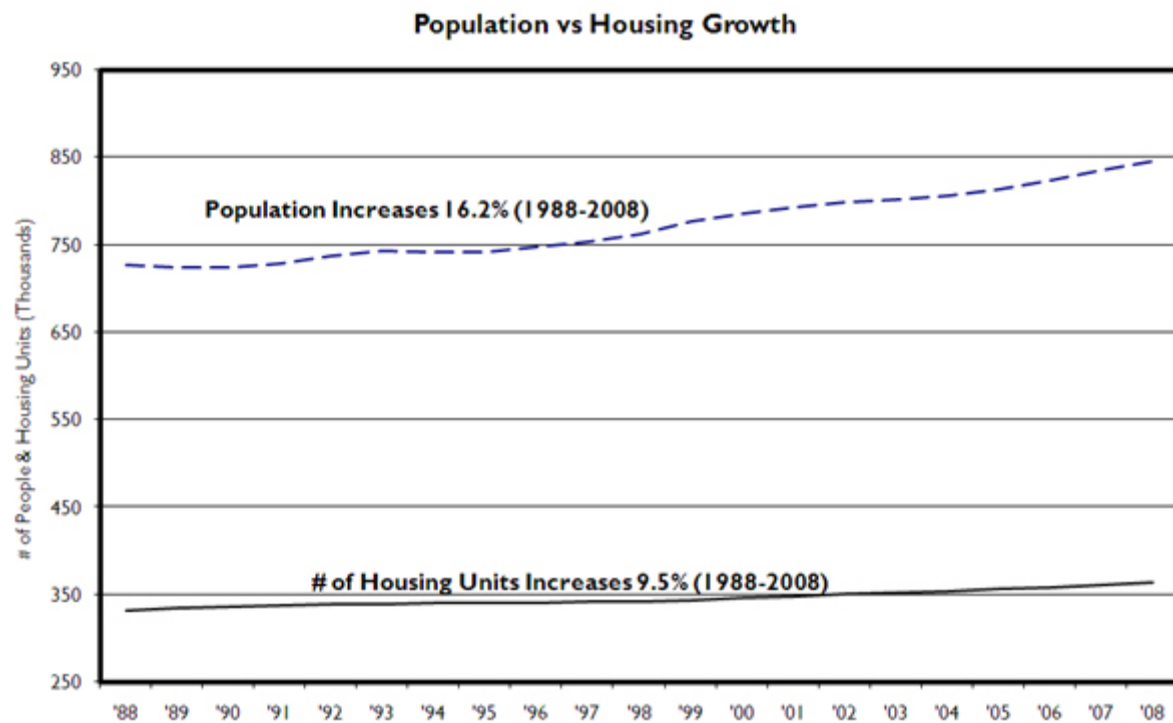
The added years are an adjustment for uncertainty; not only because of unstable market prices, but because of general economic and financial flux in the marketplace – not to mention job uncertainties that exist throughout the land.

The fact that buyers must put 20% or more down now, rather than 5% or 10%, does mean that there are fewer people who can qualify for a mortgage today. Of course, it was not too long ago that 20% down was the norm, but that was before the party started and lenders and buyers forgot why having an equity stake was important in the first place.

Fortunately, historically low interest rates mitigate some tighter qualifications. Nonetheless, times have changed and there are fewer people who are able to make all-cash offers, since many have had their portfolios ravaged. Fewer buyers equates to lesser demand and lesser appreciation.

But these are short-term issues, aren't they? Let's take a look at some long-term trends.

According to the San Francisco Planning Departments' April 2009 report, as of 2008 there were 363,662 dwelling units, 31% (112,000) of which were single-family homes. The balance was rental and condominium buildings. Here are two charts, courtesy of [Liberty Hill Development LLC](#). The first chart compares the growth in housing stock versus population growth.



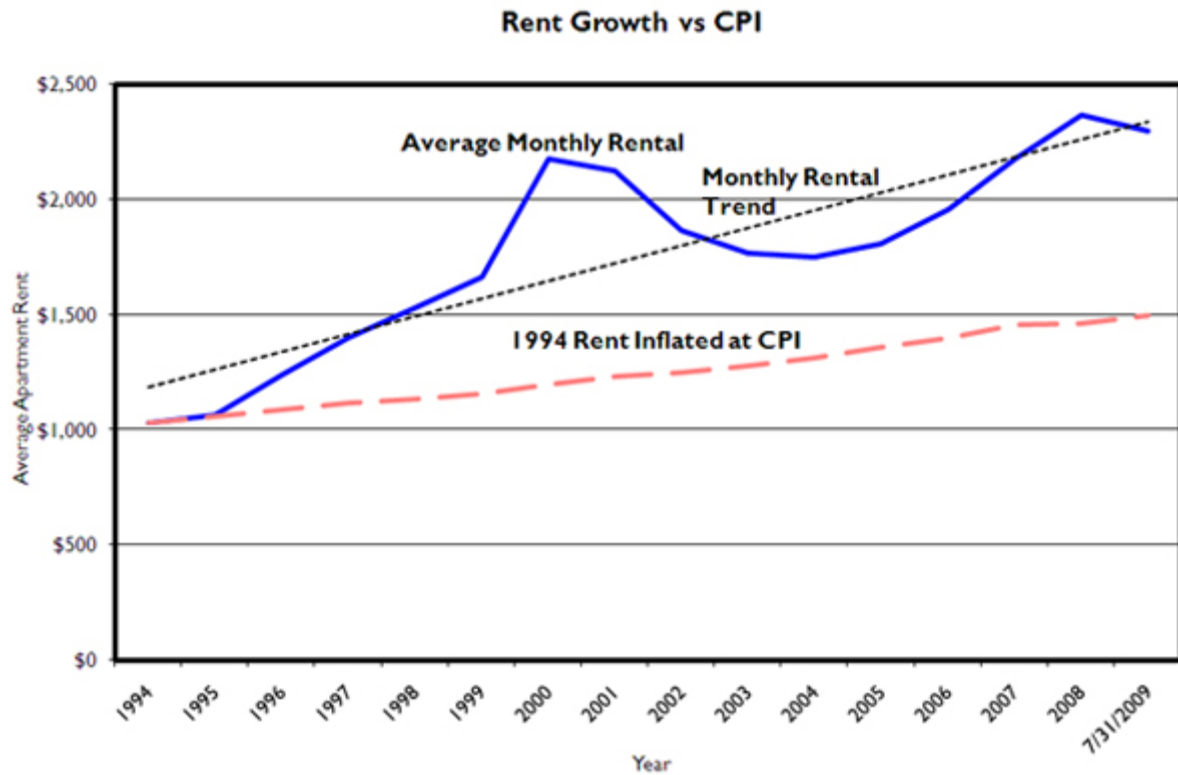
With San Francisco's population growing faster than the housing stock, the trend of rising rental rates and housing prices will continue over time.

Given the difficulty that developers have getting the green light for new condominium and rental projects in the City, it's a fairly safe bet that we are not going to see much growth in the housing stock in future years.

This is a prime reason why San Francisco housing is, has been, and probably will remain so expensive.

Do I need to mention that people find the quality of life here pretty good? That's another factor that increases housing demand.

The (long-term) trend in rental rates exceeds the Consumer Price Index, as shown in the second chart.



If I am a condominium developer, I like this economic picture. On the one hand, demand is increasing, and on the other, the cost of competing rental units is also increasing. By thinking long term, we can probably make a number of mistakes and still come out ahead. It's when we think short term, e.g. expecting to buy and flip, that we tend to get into a lot of trouble. Markets have a tendency to shift more quickly than we anticipate.

There's no need to be in a state of paralysis when it comes to buying versus renting decisions. It's more a matter of asking the right questions and evaluating the right information. Doing nothing is also a decision, and even that has consequences. Best to look at the big picture. So Peter Minuit was a pretty cool cat. You can be one too.

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