FINANCIAL SENSE UNIVERSITY
In Search of Truth

The Housing Bubble and Me

Part Deux

by David B. Moore | March 19, 2009

I wrote a piece for Financial Sense in September 2003, "The Housing Bubble and Me – A Financial Odyssey", in which I related my experience selling a condominium that I had purchased just three years earlier. For those who don't want to bother reading the prior piece, suffice it to say that I penciled out the rental economics of my condominium, decided that real estate prices at the time made no sense whatsoever, and sold my condo. Toward the end of the piece I commented:

> For my part, I think we're clearly in a housing bubble. The fact that so few agree with me is, in a way, further evidence of the bubble. After all, bubbles form because the masses are consistently and heavily on one side of a trade. The bubble is a reflection of the masses' opinion. The bubble begins to deflate only when the marginal buyer decides that prices have gone too far, which is hard to predict. But, once prices start to decline, most buyers step back, thinking, "Hey, let's see how far they fall." And they fall and fall and fall…until the marginal buyer thinks prices have gone too far in the other direction. History has taught us that the final value to which prices decline in these situations is often well below that which a rational investor would consider an "equilibrium value." Which is just another way of saying that values before and after a bubble tend to be somewhat symmetrical – overvaluation on the upside is almost always followed by undervaluation on the downside. In the final analysis, where the housing market is concerned, the music appears to have stopped, but there are a lot of people still dancing. I, for one, plan to sit out the next few numbers. Eventually, after all, the principal is going to show up, take away the spiked punch, and shut the dance down for good. And by that time there won't be many seats left. To be sure, hangovers will ensue.

Well, I sat out for more than just a few numbers as that party lasted for another two years. The condo that I sold in August 2003 (the transaction closed in October) for $306,000 – a price I considered absurd at the time – eventually sold again for $400,000 in March 2005. In case you're wondering, yes, I felt like every bit the ignoramus for a few years. (The Market Timing Gods have never fully embraced me.)

Eventually, however, we all know what happened next – housing came apart at the seams. Specifically, I noticed recently that the very unit I had sold back in 2003, and which subsequently sold again in 2005, changed hands a couple of months ago for yet a fourth time this decade. This time the price was a more reasonable $226,500, down a whopping 43% from its peak valuation three-and-a-half years prior.

David B. Moore is the Managing Partner of Marathon Financial Ventures I, LP, a private equity fund specializing in bank and thrift investments

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[As the piece above was extensively edited by Financial Sense I've provided the original unedited piece below.]

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All things considered, the most recent buyer probably didn't get a bad deal. Since I purchased the condo in October 2000, its price has increased by just 13.3%, versus rents which have increased by 45% over the same period. In fact, adjusting for taxes, it's now considerably cheaper (from a monthly payment perspective) to buy my former condo (using traditional financing) than to rent it.

So, what have I done in the interim? (Not that you care, but in the interest of bringing things full circle.) Well, I rented for a few years and purchased another condo (this time downtown) in November 2006 in a bizarre (by all accounts) transaction in which the seller left $150,000 of equity in the condo, which I would have to repay in three years time in the event that the appraised value of the unit stayed above a certain level. (I won't bore you with the details; it was a bit complicated.) Suffice it to say that the transaction's structure protected me from a 45% decline in the value of the condo. (This seller was a True Believer in San Diego real estate.) Just this month my seller acknowledged the slim likelihood of his equity having any value so I paid him a paltry sum to settle the contract and remove the second lien, thus enabling me to refinance.

Unfortunately, it's highly unlikely that my 45% downside protection will prove to be enough. Given the current environment I'll be surprised if my unit doesn't decline in value by another 10%-15% or more, despite the fact that my after-tax monthly payment (including property taxes and HOA dues) is less than what it would rent for. But, you see, that's the story of my life: buy too early, sell too early.

At this point I'd like to buy a distressed property down in Baja. But I'm in no hurry. Although we're three and a half years in at this point, this meltdown clearly hasn't run its course yet.

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