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Prepare for the worst, hope for the best in our economy

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With every new economic report, the likelihood of a recession increases. From my perspective, we are definitely headed in that direction. I have come to this conclusion based on multiple factors including but not limited to declining auto sales, the 2007 national savings rate, the severe slowdown (if not cessation) of land sales, and, of course, the sub-prime debacle.

A slowdown in auto sales is one of the first signs of economic trouble. Auto sales for 2007 were disappointing in comparison to 2006 sales. January 2008 auto sales are forecast to be 2.9% lower than January 2007 sales and 23.8% lower than December 2007 sales. Not surprisingly, the sales of larger, less gas-efficient vehicles took the hardest hit during 2007. The biggest losers included sales of minivans (down 15.6%) and mid-size SUVs (down 12.6%). The biggest gainer in sales was the Toyota Prius, one of the most gas-efficient vehicles available, with sales increasing 69.4% during 2007 over 2006. With rising fuel prices, these statistics are no surprise.

A big surprise was seen in the 2007 national savings rate in that for the first time since 1933 (that is, the Great Depression) the rate was in negative territory at -0.5%. The Commerce Department calculates the savings rate by taking the difference between after-tax income and all expenditures, including housing, food and clothing and dividing the difference by the after-tax income. Basically, a negative national savings rate means that in general Americans are spending more than they are earning and going into debt as a result. For a number of years, with appreciating household real estate assets, the average U.S. household's net worth continued to increase. However, with falling real estate values, this net worth is losing ground. As reported in CNNMoney.com, many Americans were using the equity in their house like an ATM machine using home equity loans and refinancing to pull out cash to support a higher level of spending. This approach is just not viable any longer.

At the Maine Real Estate and Development Association's 2008 Annual Real Estate Forecast Conference, Michael Miller of NAI The Dunham Group gave a presentation on Southern Maine Industrial Market Review and Forecast in which he stated that industrial land sales are virtually non-existent. This slowdown/cessation of land sales is an indicator that no to very limited new development is going to take place in the immediate to near future.

The sub-prime debacle is the most serious crisis within the economy with global impact and, in my humble opinion, was totally avoidable if sound lending practices had been closely followed. The stated reason for creating the sub-prime mortgage was to allow persons who would otherwise be unable to partake in the American dream of home ownership to have the opportunity to jump on the housing spiral. This would work in theory if, and only if, housing prices continued to appreciate and if the system were not abused. Unfortunately, neither of these took place. We are all well aware that housing values have stalled in most areas and experienced depreciation in other areas with the number of foreclosures climbing daily. The abuses of the system are well known and have been discussed in prior articles.

The Commerce Department reported on January 28th that sales of new homes dropped by 26.4% last year to 774,000, the worst sales year on record, surpassing the old mark of a 23.1% plunge in 1980. This housing weakness has dragged down overall growth and sent shock waves through the rest of the economy particularly the financial sector, which is dealing with billions of dollars in losses in sub-prime mortgages. As a result of this fiasco and its ripple effect, many people will lose their jobs from mortgage brokers to builders to auto workers on throughout the economy.

The various measures to stop the recession such as lowering interest rates and the proposed federal \$150 billion economic stimulus package are unlikely to avert a recession. The problems run too deep for such easy fixes.

The current economic climate is a challenging one for appraisers as we must be very sensitive and responsive to the issues of the local environment in which our subject property is located. For more information on appraising under such conditions, turn to the Appraisal Institute at www.appraisalinstitute.org.

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