



The Changed Home Buyer

Market Forces Have Changed the Game for Today's Home Buyers.

Market forces have changed considerably over the recent years in many crucial areas that affect home buyers and how they purchase and finance a personal residence in the San Francisco Bay Area. Our primary claim in this paper is that the consumer has had to adapt to these changed forces and the providers of services have not yet made the necessary changes to effectively serve this market.

The first major driver is housing prices. The price of housing in the Bay Area is the largest driver of change for the home buyer. In 1999, a typical 3 bedroom, 2 bath home in Palo Alto sold for \$700,000. Today, that same home sells for approximately \$1,500,000. This is a dramatic shift in price and in mortgage obligation borne by the consumer, not to mention the increased property tax obligation.

Incomes have not kept pace with housing prices. This means that other life obligations are threatened. The three major obligations that are threatened are retirement savings, children's college savings and current lifestyle costs.

Another driver that has changed is the death of pensions and the looming insolvency of Social Security that is taking away the retirement underpinnings that was there for prior generations. When asked, most 40 year old and younger Americans will respond that they do not expect to ever see a check from Social Security.

Compounding this financial challenge is the incredible surge in life expectancies. For a married couple who both achieve 65 years of age, there is a 63% chance that one of them will live to be 90 years old. This means that a married couple must plan on at least one of them paying for 25 years of retirement to be funded on capital accumulated throughout their working lives. The amount that must be accumulated will change if a large inheritance is expected or if their children can assume some of the burden of their care.

The Big Three Life Obligations

To cement for the reader the new challenges the home buyer faces, we will show the three major life obligations and examine what is required and how these are threatened by the dramatic increase in housing prices over the recent years.

Retirement

Let's accept that for many home buyers, Social Security does not factor into their retirement planning. It falls under the category of "that would be nice to have but I'm not counting on it." Most buyers in the Bay Area are not counting on a pension. Even those that have pensions are rightfully questioning the solvency of the program (see United Airlines).

The rule of thumb that we use for retirement income is to have \$1,000,000 in capital at work for every \$40,000 of gross income to be replaced at retirement. So, if one wishes to replace \$200,000 in gross income, this requires capital at work of \$5,000,000. The challenge facing buyers today is how to accumulate this amount of money

by age 65. For a 30 year old couple to accumulate this amount of capital at work through savings, they would need to save \$29,000 per year and have an average return of 8% per year on those assets.

Children's College Savings and Current Education Costs

The average tuition at a four-year private college is approximately \$22,000 per year in today's dollars. Tuition costs have been increasing by 6-9% annually, a clip that is two to three times inflation. A homebuyer with a newborn would need to save \$6,675 per year for the next 18 years to be ready for their child's college tuition costs. This is an obligation that not all parents will assume, but for those who do, they will be concerned for this cost.

Current Lifestyle Costs

These are the more mundane costs of groceries, gas, house repairs and utilities to the more extravagant and life experience costs such as Hawaiian vacations, Disneyland, a new Mercedes and summer camps for the kids. Life experiences with family, children and friends are what we look back on in our old age and relish with satisfaction. These are not frivolous expenses, they are what bring value and meaning to people's lives. Of course, these costs are individual to each family and need to be planned and budgeted.

Threats to Obligations

Mortgage amounts are larger and mortgage payments are larger. Property tax obligations have risen at the same pace as home prices for people buying a house. These new higher payments are required for home buyers to provide an appropriate house for their family and these now pose a threat to the three obligations detailed above.

What Is The New Challenge?

The home buying consumer is faced with a new set of challenges for which many are not prepared. They must have an effective strategy to satisfy their retirement savings, their children's college costs (if they accept this as an obligation) and their current lifestyle costs. And, this strategy must include the purchase and maintenance of the family home in the Bay Area.

New concerns have emerged in this new environment; they are large, sweeping changes that will ripple through the Bay Area as home buyers seek to satisfy these concerns.

Home buyers will seek out more professional financial help as the consequences of their actions have become clearer and more consequential. Service providers who do not acknowledge the financial concerns of their clients and who do not offer help in this domain will lose power with their customers. Mortgage providers who only offer their usual great service, great products, great rates, great people and great technology will be passed over as they are not addressing any of the financial concerns of the client. Financial advisors will be sought out who can provide strategies for coping with these new concerns.

What Matters Now?

Transparency. Financial Knowledge. Costs. Returns. Relationship (holding concerns long after the transaction). Fiduciary responsibility.



Old strategies and actions will no longer work as these were designed for a different time under different circumstances. This new challenge will be handled by consumers demanding a different set of offers from Realtors®, mortgage providers and financial advisors. Let's explore this new relationship a bit.

A home buying client has lifestyle concerns of neighborhood, schools, proximity to work, along with house configuration and activities, etc. They have financial concerns such as financing their home, resale value, upkeep and future transaction costs, allocation strategies for their holdings, investments, money management, trusts and wills. There are also tax consequences now and into the future along with the financial planning and guidance to maximize investments and minimize taxes.

The home buyer will look for a team to provide them with powerful solutions for these challenges. The most powerful advice will be provided by teams who have expertise and knowledge in these areas and who work well together to coordinate the management of these complex issues for today's home buyer. Service providers have not yet caught up to these new realities, but they will be forced to as their clients require that they address these new demands.

Case Study

Tammy and Tom are 35 years old and have a 2 year old child and want to purchase a home for approximately \$1,000,000. Their current gross income is \$225,000 per year. They have \$75,000 in retirement and \$125,000 in liquid savings in a mix of cash, stocks and bonds. They expect their income to increase every year by 3-5%. They have some life insurance and disability insurance from their jobs. They are currently renting after moving to the Bay Area from Chicago.

They selected a Realtor® who was referred by a friend of theirs. This Realtor® had a conversation with Tammy and Tom about their lifestyle ambitions for their new home. They talked of the neighborhoods they were interested in, the configuration of the house, school quality, negotiation strategies and resale value expectations of various neighborhoods. The Realtor® also expressed that this was a very important financial decision and must be well thought out so they can purchase their home satisfied that they can manage their other financial obligations.

When Tammy and Tom met with Opes, we completed an extensive client profile to understand their current situation. We reviewed their aspirations for their future and we helped them calculate the financial costs of these. We worked with them to devise a strategy that includes retirement and college education concerns, as well as a lifestyle cost and a housing cost plan.

For their down payment, we helped them avoid paying unnecessary short term capital gains on stock holdings which also allowed them to stay fully invested. We changed the allocation of some of their investments to improve their risk/return profile and we established savings targets that will allow them to reach their objectives.

By working with Tammy and Tom on their financial forecast, Opes designed a mortgage that supported their efforts and allowed them to purchase their home with peace and dignity, not fear and concern.