

ECONOMICS AND REAL ESTATE

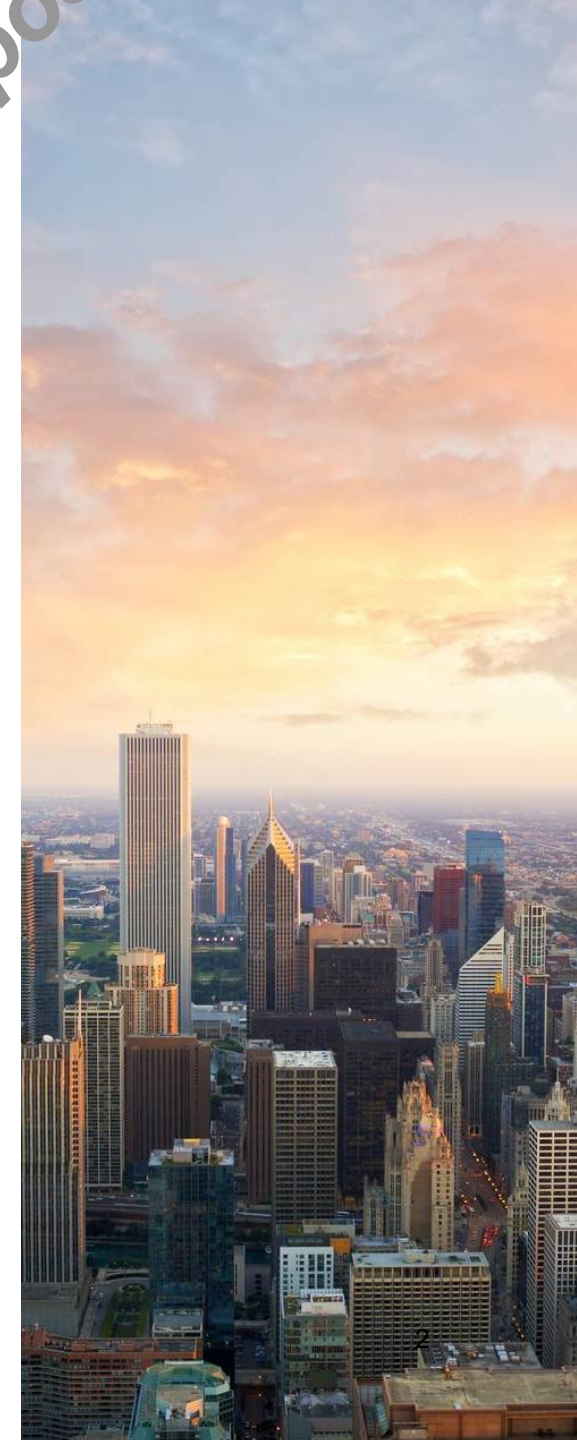


AGENDA
Discussion
of political
and
economic
history for
the last 100
years

A real estate CE
program by
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Economics

Sooner or later we all sit down
to a banquet of consequences.

Robert Louis Stevenson

 quote fancy

Why study Economics?



Business cycles influence value



Economics provides the 'big picture' for everyone in real estate



Knowing how cycles behave allows you to prepare for changes in your real estate market

Major Events

Great Depression

1973-1975 Recession

Double dip recessions of 1980, 1981-82

Great recession 2006-2012

Currently: inflation down; prices still up

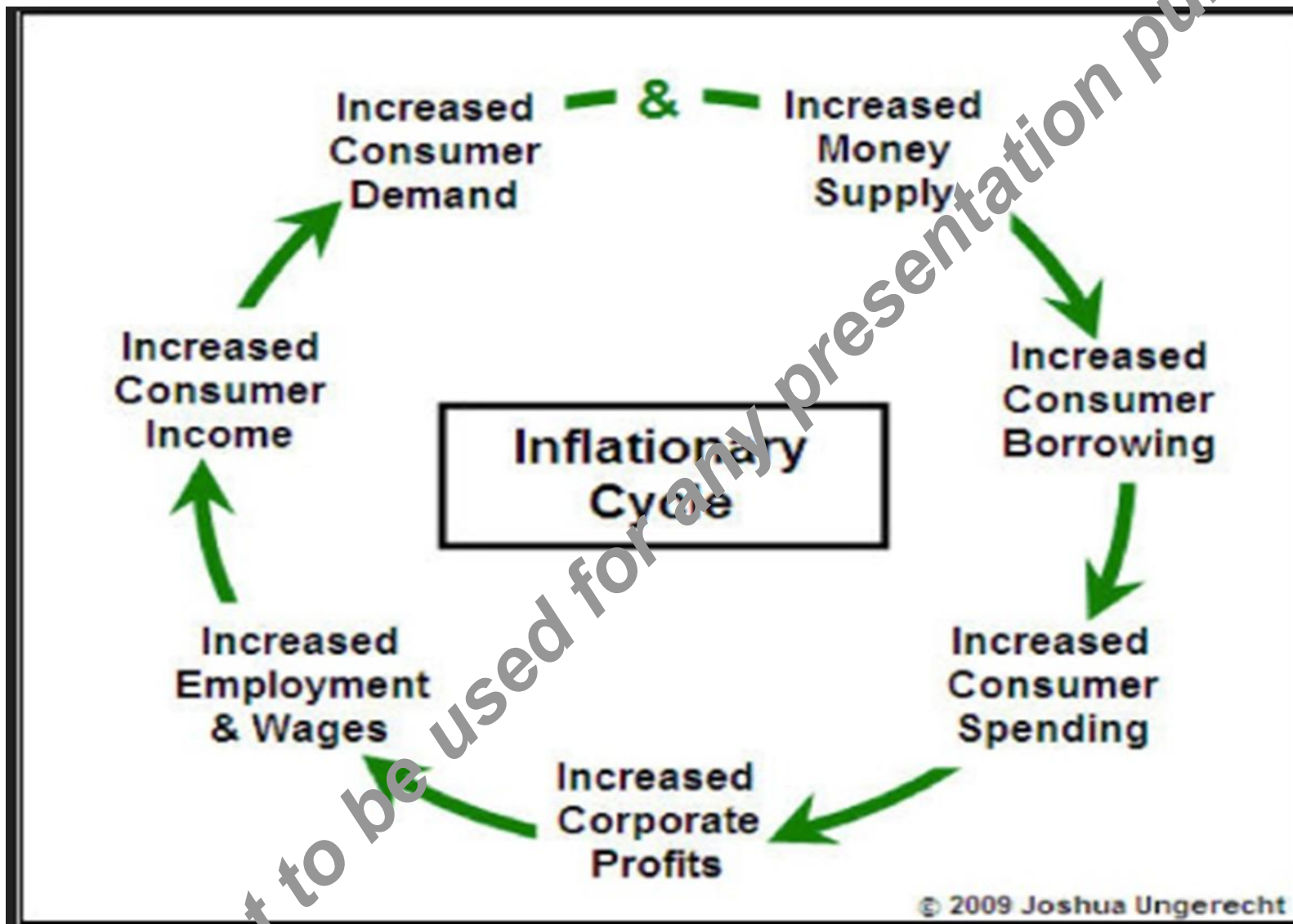
Real Estate in the US. . .

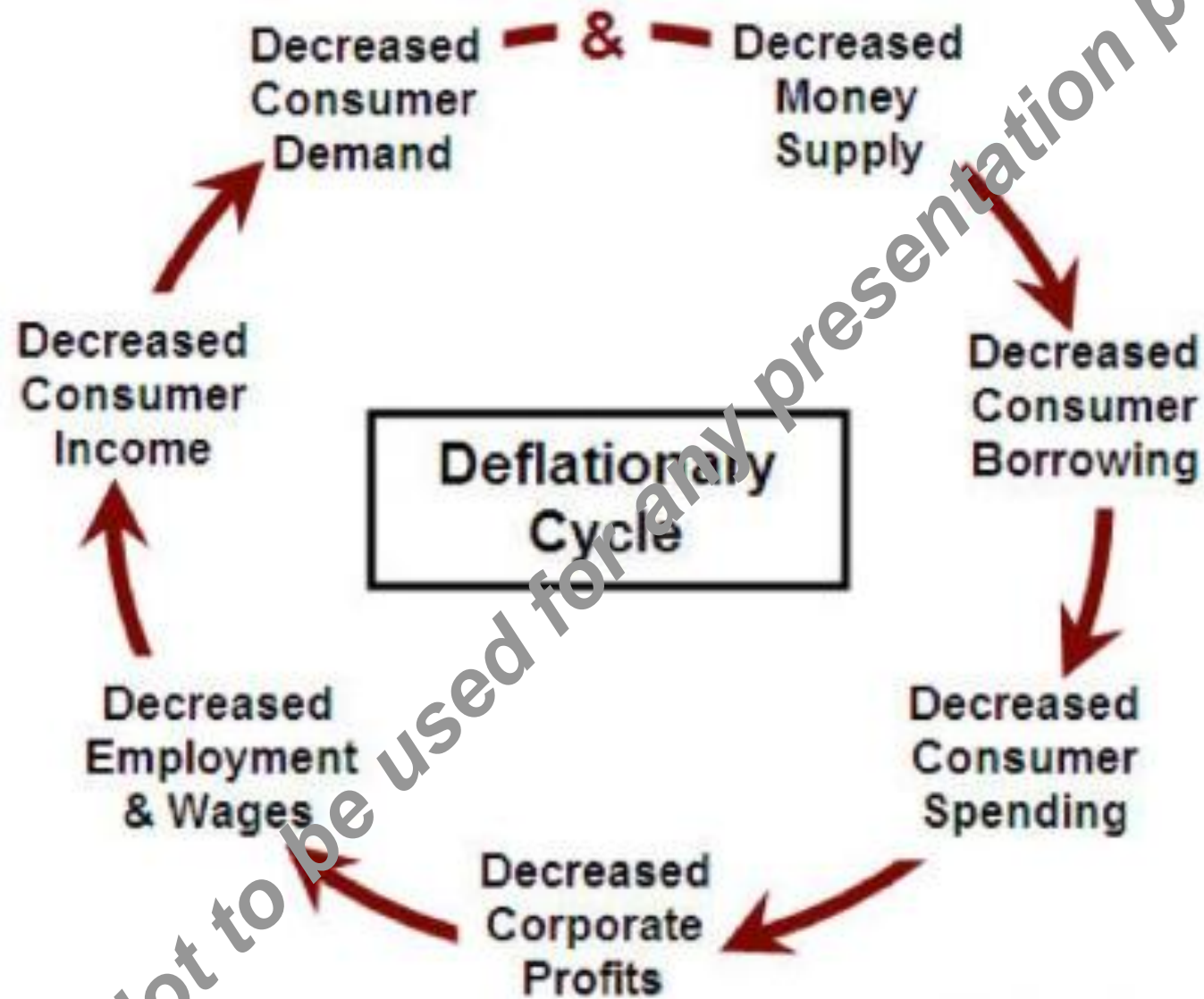


- From Homestead Acts
- To FNMA
- Real estate is a big part of our economy
- Public policy has encouraged home ownership

Private Land Ownership in US

- 60.1%





Deflationary Cycles

Great Depression

Can be when a “Bubble” bursts

Can be extremely localized

Affected by overbuilding, oversupply



Speaking of Taxes....circa 1913

**Federal Income Tax
made permanent
(had been in place
during previous
wars)**

**7 brackets—1% to
7%**

1913

1913

- Federal Reserve was created
- Following the “panic of 1907”
- By Congress
- “To make the American Banking system more stable”

What Does the Fed Do?

Regulates banks

Lender of 'last resort' to member institutions

Open market operations

Discount rate

Reserve

requirements

Reserve Requirements

How much banks
must keep in
reserve

Which means they
can't loan it out



Federal Reserve Sets Interest Rates

**On reserve
balances (IORB)**

**Overnight reverse
repurchase
agreement (ON
RRP) rate**

Discount rate

**These 3 influence
the Federal Funds
Rate, the Rate at
which banks loan
each other money
overnight**

Bond Rates are YIELD for Investors

Mortgages track the 10 year bond rate

There is usually a 'spread' between the two rates

Spread is historically around 1.5 to 2 percentage points to compensate investors for the higher risk of mortgages. So if the bond yield is 4%, mortgage rates might be around 5.5% to 6%.

Speaking of the Fed...

- "Regarding the Great Depression ... we did it. We're very sorry. ... We won't do it again."
- –Ben Bernanke, November 8, 2002, in a speech given at "A Conference to Honor Milton Friedman ... On the Occasion of His 90th Birthday."

Taxing Times



1916–1921

**Roaring 20's:
Top rate around 78%**



1929–1931

**Great Depression
DROPPED to about 20%**



1944

**W. W II
OVER 80%**



Currently

**Currently:
Under 40%**

Will Rogers:



“The difference between death and taxes is death doesn't get worse every time Congress meets.”

Roaring Taxes in the Roaring 20's!

1921

By 1921, Federal Income Tax had 56 brackets, from a low of 4% to a high of 74%

By 1924, the brackets “only” numbered 43, from 2% to 46%

1924

1920-1930 House Prices



**Average price in 1920
= \$6296**

**Average price in 1930
= \$7145**

**Up almost 14% in this
decade**

1920's

**Home Ownership
was limited to a
small percentage
of the population**

**Down payment
requirements
high—50% plus**

**Term very short—
5 years**

**Many people
bought with
cash**

**Housing increased
during mid 1920's---
until the crash; levels
in 1925 were 58.7%
higher than in 1929**

1930's

**Great
Depression and
New Deal**

**Significant
legislation:**

1933 FDIC

**1934 Federal
mortgage
insurance and
regulation of
housing standards**

**Housing declined by
91.9%; by 1933
housing was 12.9% of
the 1929 level and only
8.1% of the peak of
1925**

**Durable good
expenditures
declined 49.2%**

Not to be used for any presentation purposes

1932

**Federal Home
Loan Banks were
created**

**Federal National
Mortgage
Association
(Fannie Mae) begin
buying mortgages**

**Until 1968, Fannie
Mae was the sole
institution buying
mortgages**

Investment declined 68.6%

GNP declined 27.7%

Deflationary cycle

Mortgage terms increased to 20 years

FHA created

Stock market declined 89%

1930's



- Roosevelt suspended Gold Standard
- 1937: "Roosevelt Recession"
- 1940: wartime production began

\$4197.30 Ounce price 12/6/25



In 1933, FDR issued **Executive Order 6102**, making it **illegal** for U.S. citizens to own gold coins or bullion.

You to **turn it all in** to the government or **face 10 years in prison**. The government paid you **\$20.67 an ounce**. Once they had all the gold, they **immediately raised the price to \$35 an ounce**, **instantly devaluing** everyone's paper money and **making the government rich**. It was the **greatest wealth heist** in American history.

By Law:

**Gold at Fort Knox is
valued at \$42.22 per
ounce**

By law

**“Book value” around
\$11 billion**



Who was Henry Morgenthau?



- FDR Secretary of Treasury
He said: “Never in the history of the world has there been a situation so bad that the government can’t make it worse.”

Taxes in the 1930's

- Reached a peak of 59 brackets (1933)
- From 1935-1939, rates ranged from 4% to 79%

1930-1940 House Prices



\$7145 in 1930

\$2938 in 1940

**Lost almost 60% of
value**

1940's

WWII

Did WWII end the Great Depression?

Would the Great Depression have ended sooner without government interference?

Housing growth between 1945 and 2nd Quarter 1948 strongest of 20th century

Taxes in the 1940's

**1940 rates went
as high as 79%,
but in 1942-1943
hit an all time high
of 19% to 89%**

War is expensive

1940's

- Surge of housing construction 1947-1951
- Consumer Price Index increased by 2.9% between June 1946 and June 1948
- Truman took office April 12, 1945 following FDR's death
- Tried to reinstitute "New Deal" as "Fair Deal"
- Blocked by Republicans

Truman

- Price controls, inflation, unemployment
- Beginning of “benefits” (no raises)
- Taft-Hartley “Right to Work”
- Truman vetoed
- Congress passed over his veto
- Price controls ended post WWII

1940's--Truman



- Eventually lowered taxes: growth started
- Extended rent control for 15 months in June of 1950
- Home ownership rates at 43% by near end of decade

Harry Truman's Quote:

Give me a one-handed
economist! All my economists say,
On the one hand on the other.

Harry S. Truman

quotation

1940 to 1950 House Prices



\$2938 in 1940

\$7354 in 1950

Up 150%

1950's

1957 MGIC Corporation formed

Offered Private Mortgage Insurance which competed with FHA MIP

Home ownership rate increased to 55% by 1950

1950's

- 1953-1954 recession—
fourth largest of post war
era
- Substantial decline in
housing
- Korean War anticipated
to be another long war



1950's

Inflation came back

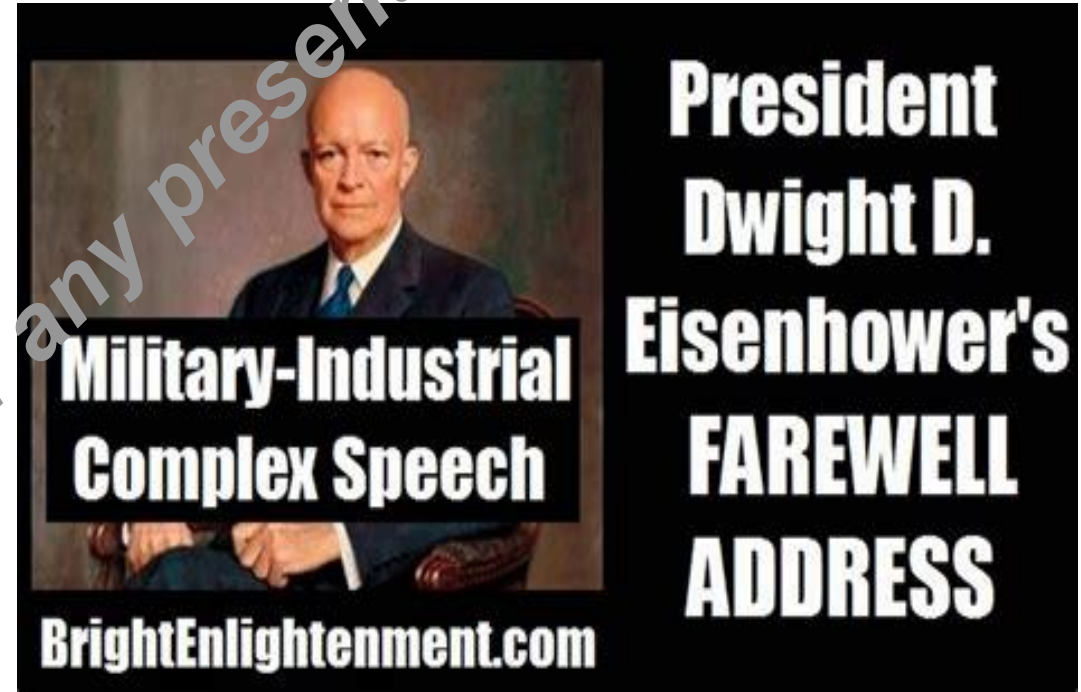
Fed increased reserve ratio

Wage & price controls were started in January of 1951

Housing increased rapidly in the middle of 1954, again leading economy out of recession.

1950's

- Truman did not run again
- Eisenhower elected twice
- "Peace Dividend"



Taxes in the 1950's

- Highest rates historically were 1952-1953, rates went from 22.2% to 92%

Arthur Oken American Economist



- **“High tax rates are followed by attempts of ingenious men to beat them as surely as snow is followed by little boys on sleds.”**

1950's



Eisenhower: Interstate highway system



Reduced Federal debt



Unemployment dropped to 4%



Virtually no inflation



Dow hit 400 in '54; closed at 679 on 12/31/59



“Military Industrial complex”

1960's

- JFK elected
- Youngest President
- First Catholic
- Unemployment at %
- State of the Union in 1963:
- “Cut taxes to increase jobs”



1960's



**Unemployment
dropped to around
4%**

**Minimum wage
\$1.25 in 1961**

**Stock market
724.71 on 1/2/62;
947.74 on 1/1/69**

1960's

JFK Assassination

Space Age

Johnson: "Great Society"

Social Security expanded to age 62

Home ownership levels hit 62%

Vietnam and "Guns v. Butter" (he tried to do both)

1960's



“New Frontier” Housing Act 1961



\$5 billion for urban renewal & new construction



Home ownership rates hit 62%

1960's



- Median price of a home in 1960 = \$16,500
- By 1970= \$26,600
- Up 61%

1960's Taxes



By 1964, top rate had dropped from 91% to 77%



1965 through 1981 rates remained from 14% to 70%, with a total of 15 tax brackets

1968

Fannie Mae was split into a private corporation and a publicly financed institution

To provide competition for Fannie (now private) and to increase funds for homeownership, Congress established Freddie Mac (Federal Home Loan Mortgage Corporation) through Emergency Home Finance Act of 1970

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Price Controls

Nixon elected 1968

**August 1971 90 day
freeze on prices
and wages**

**Which exacerbated
the oil crisis**



1970's=Inflationary Cycle

- Remember the '70's?
- Gas lines
- Inflation
- GREAT TIME to own real estate!



1970's



1971—lending limits changed, allowed S & Ls to make loans of 95% (formerly 90% LTV)



Limits on dollar amounts of mortgages raised



Decade ended with high interest rates—18% to 20%



ARMs introduced



Housing fell 20.2% during 1969-1970

1970's



Nixon took us off the Gold Standard



Nixon opened China; more trading



Recession 1973-1975



Housing declined for 2 quarters before the Arab oil embargo



50.6% decline in housing



Inflation surges from under 4% to 10%

1970's



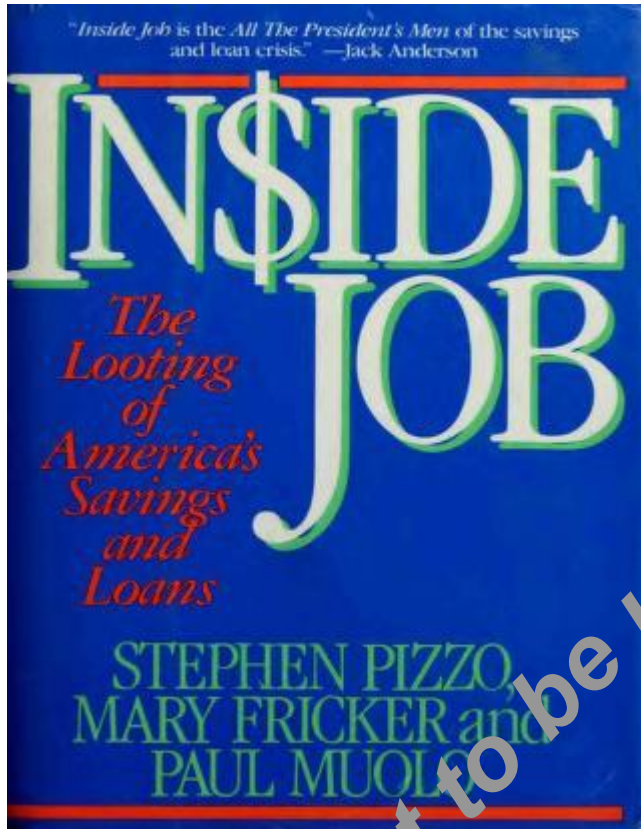
Housing again recovered first, after federal funds rate was reduced to the 1972 level

Nixon resigned; Ford took over

Stock market declined from Watergate to Nixon's resignation

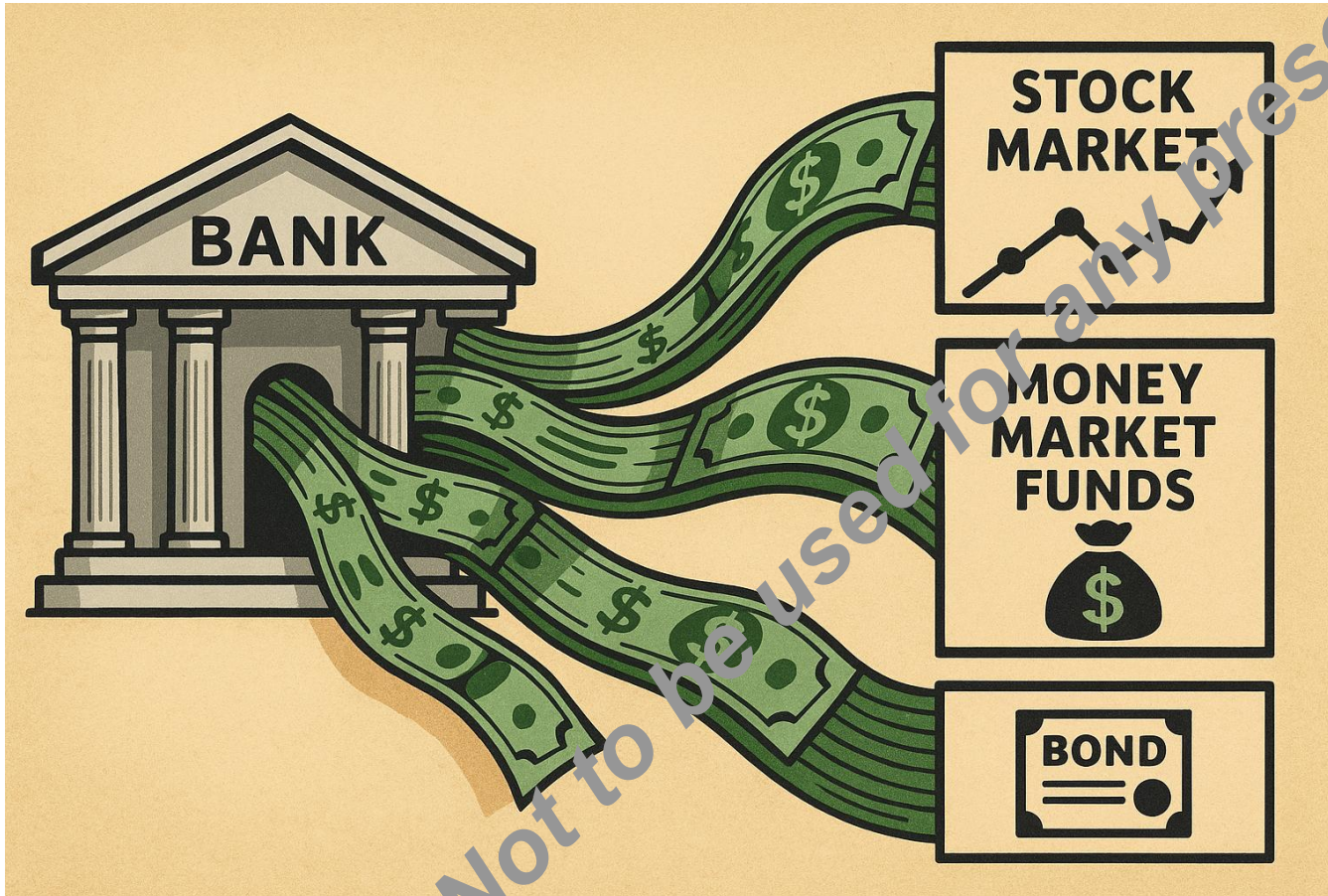
Carter elected 1976

1970's



- Began the loosening of requirements for S & L's
- Allowed them to expand into commercial loans, consumer loans etc.
- Government pushed this "reform"

Disintermediation



Flow of funds
from one entity to
another

Money market
funds

Siphoning off
bank and S & L
deposits

1970's



Dow crossed 1000 for first time



Disintermediation begins



Nixon: price, rent, wage controls



Ford: inflation at 7%; unemployment at 9%=

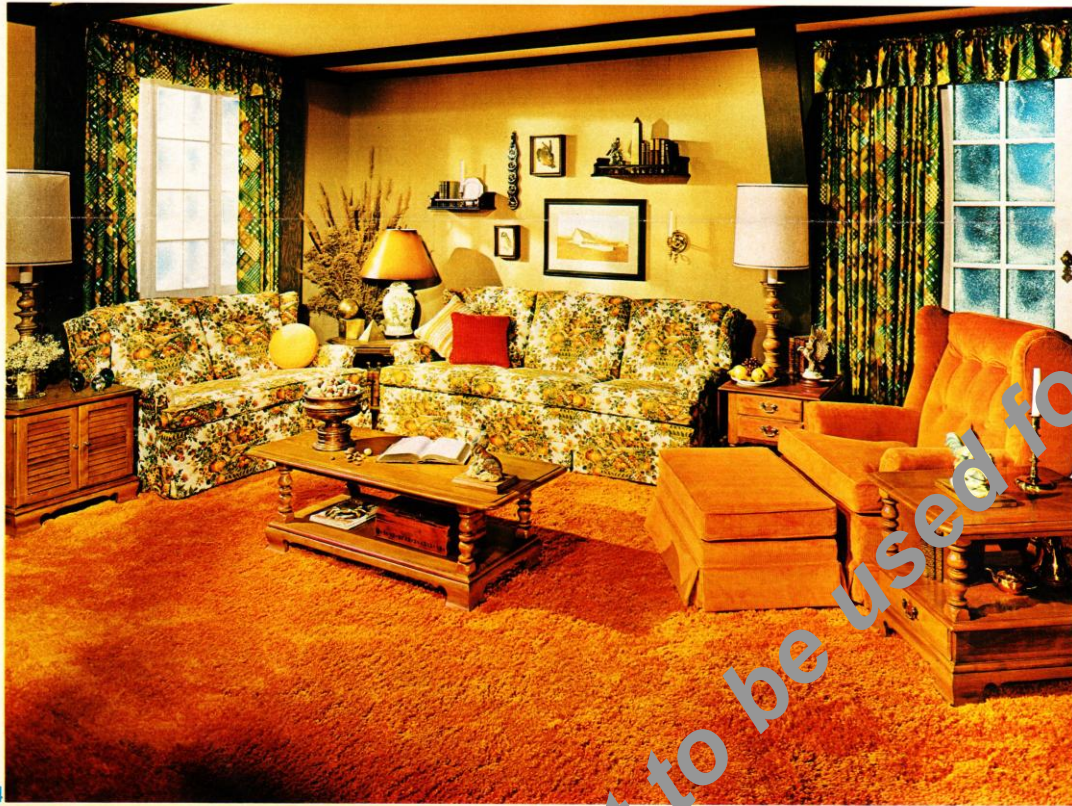


Stagflation



Carter elected 1976

The 70's were great because. . .



- Real estate was appreciating rapidly
- Borrowers were paying back their loans with dollars which were worth less

1970 to 1980 House Prices



**Average in 1970 =
\$23,400**

**Average in 1980 =
\$64,900**

**Appreciation rate =
177%**

Politics

- Nixon
- Price rent & wage controls
- Watergate
- Resignation
- Ford assumes office



Ford

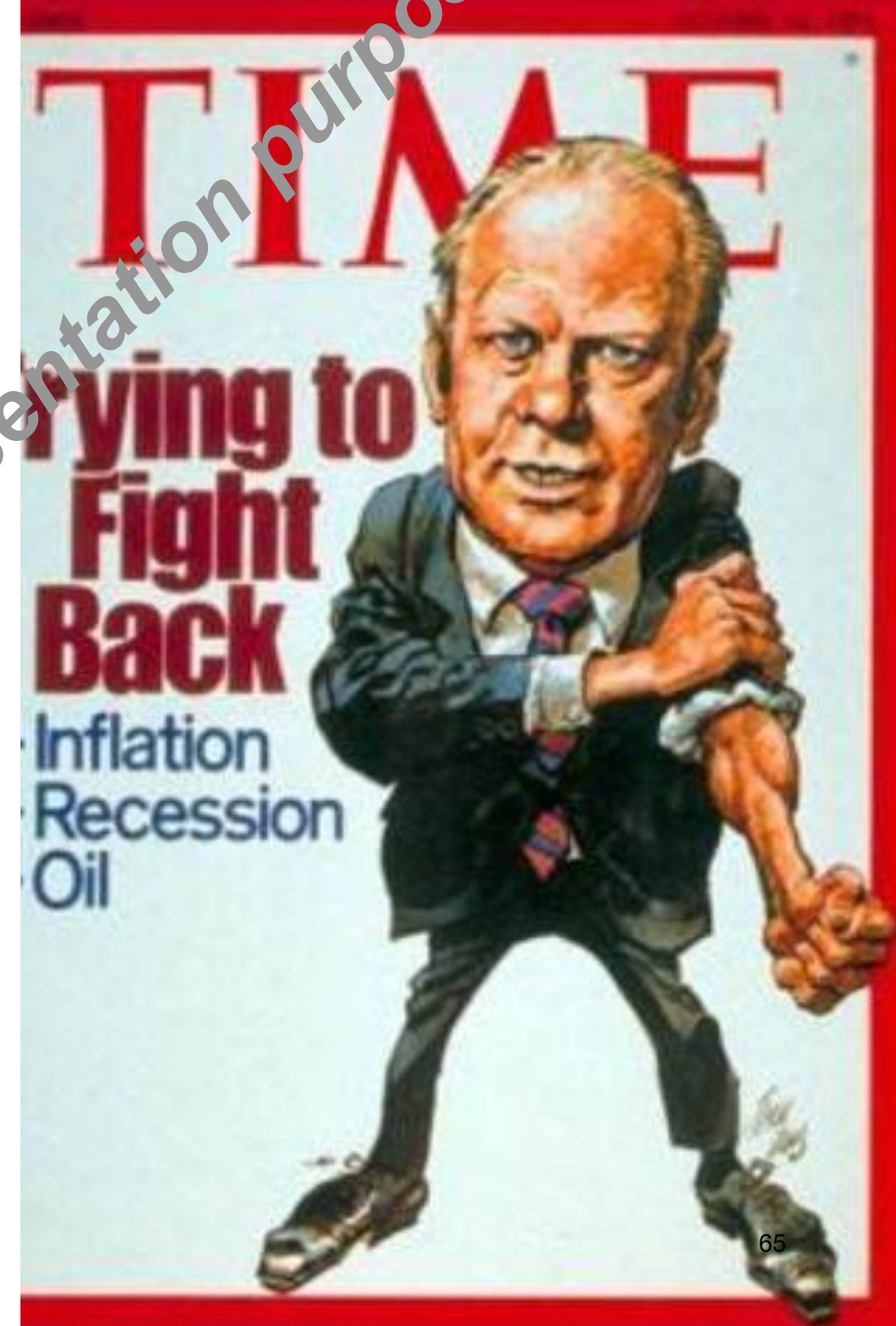
High inflation

High unemployment

“WIN” buttons

Pardoned Nixon

Not re-elected



1970's



Carter started Community Reinvestment Act



Covered all lenders insured by FDIC



Gave feds ability to “muscle” lenders

1970's

Carter did not cut taxes; vetoed his own spending plans

Volcker rates up 9% in 8 months

Reagan defeats Carter with: “Are you better off today than you were four years ago?”

1980's

- **S&L bailouts**
- **FIREEA legislation passed (leading to certification of all real estate appraisers)**
- **Interest rates decline**
- **Credit requirements relaxed**
- **Community Reinvestment pushed**

1980's



- 100% loans introduced
- 125% loans introduced
- Waves of refinancing
- Wall Street Collapse; 22% loss 10/19/1987
- Disintermediation continues

1980's



1981-1982 recession was second most severe of the post-war era



3rd Quarter 1978 to third quarter 1980 housing fell 40.6%



1st Quarter 1981 to 2nd quarter 1982 housing fell another 36%

Fed Chairs In This Era



William Miller's last 3 months registered a *13.521% annualized inflation rate*



He was replaced and Volcker beat inflation



Paul Volcker's last 3 months registered a *puny 2.220 % rate.*

Tax Changes—1980's



**Tax code changed—
taxpayers could no longer
deduct**

**Credit card interest
Car loan interest**



**What could they
deduct?**

Mortgage interest!

Taxes in the 1980's

- After cutting top rate in 1981 from 91% to 70%, Reagan kept cutting
- 1982-1986 rates were from 11% to 50%
- 1987: only 5 brackets, for the first time—11%, 15%, 28%, 35%, 38.5%
- 1988 True simplification: 2 rates: 15% and 28%

1980 to 1990 Average House Prices



\$64,900 in 1980

\$120,000 in 1990

84% + appreciation

1990's



- Average price of a house 1990:
\$120,000
- Average price in 2000:
\$171,100

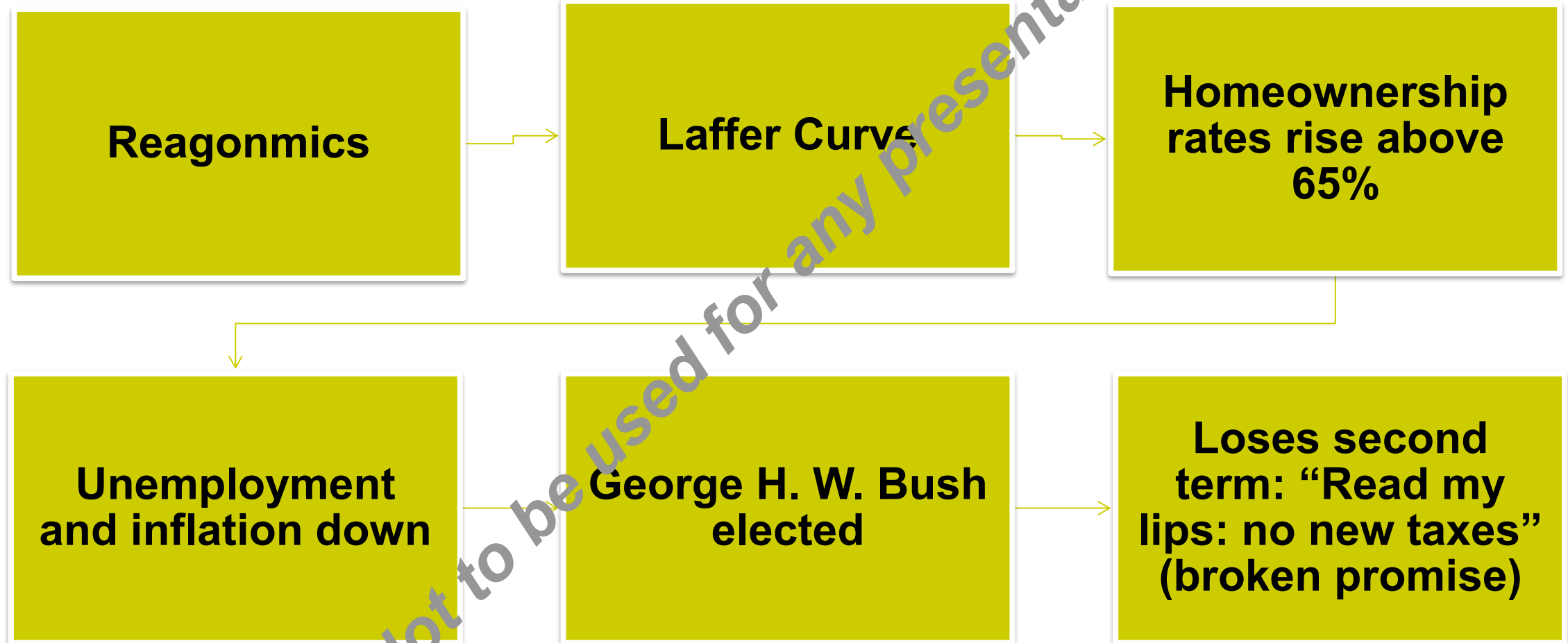
1990's

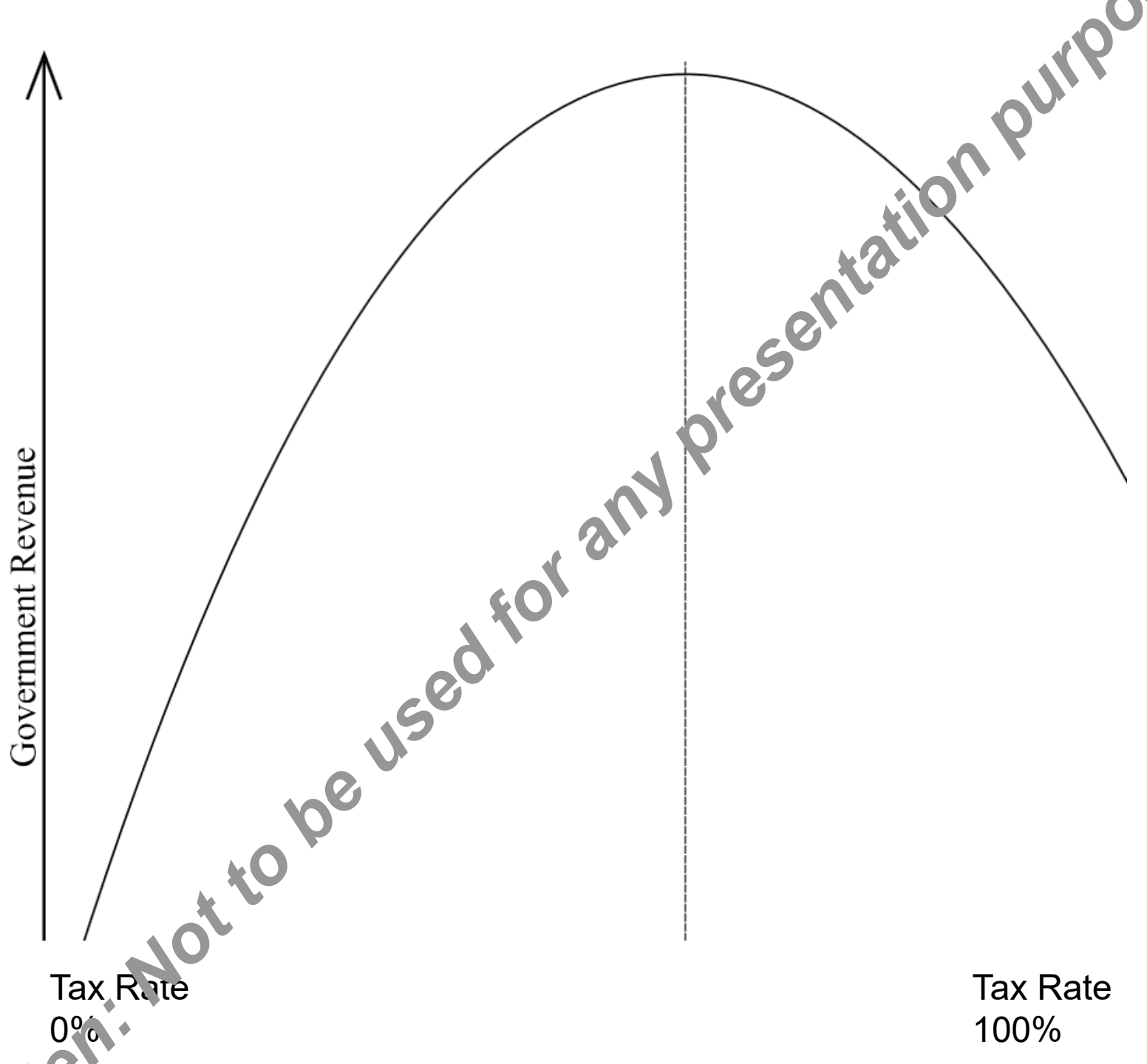
- More Community Reinvestment Act
- Hybrid loan products introduced
- Economy grew rapidly
- Stocks up –Dow hit 11,000
- Low unemployment

Political and Economic History

- Reagan's promises: lower taxes, decrease federal government & spending, increase domestic energy services; increase military; balance budget
- Did all BUT balance budget

1980's





1990's

"All the News That's Fit to Print"

The New York Times

Late Edition
New York. Today, limited sun, perhaps a shower late. High 62. Tonight, cooler. Low 40. Tomorrow, cloudy, a light shower. High 61. Wednesday, high 59, low 45. Details are on page 50B.

VOL. CXLI... No. 48,809 Copyright © 1991 The New York Times NEW YORK, MONDAY, DECEMBER 9, 1991 50 CENTS

DECLARING DEATH OF SOVIET UNION, RUSSIA AND 2 REPUBLICS FORM NEW COMMONWEALTH

Frantic Moves Came to Light In Days Before Maxwell Died

As the Empire Was Crumbling
A special report.



By STEVEN PROKESCH
Special to The New York Times
LONDON, Dec. 8 — At the time of his mysterious death on Nov. 5, Robert Maxwell almost certainly knew he was about to be caught. He had drained hundreds of millions of dollars from his two flagship public companies and from employee pension funds in a frantic attempt to keep his heavily indebted publishing empire afloat.

The auditors of the Maxwell empire, Coopers & Lybrand Deloitte, were to conduct their next regular audit of the pension funds in a couple of months. And Coopers would have quickly discovered the transactions, said a person very familiar with the details of a special financial examination of the empire conducted for the banks after Mr. Maxwell's death. He agreed to discuss the report only if his identity was not disclosed.

"Basically grabbing cash," the Coopers team also found evidence that some of the diverted money went to The Daily News in New York to cover its losses. That raises more doubts about the future of the newspaper, which Mr. Maxwell acquired in March.

The maneuvering by Mr. Maxwell to prop up the private companies that controlled his empire "was doomed to failure," the person familiar with the Coopers' report said.

"It wasn't a sophisticated fraud like BCCI," he said, referring to the scandal surrounding the Bank of Credit and Commerce International. "The guy was basically grabbing cash, and Coopers found it out within days of going in." The Coopers team was led by Richard Stone, the partner in charge of the accounting firm's corporate finance division.

That discovery led the man behind the collapse of the Maxwell empire to a dramatic end.

Robert Maxwell

West Europeans Gather to Seek A Tighter Union

By ALAN RIDING
Special to The New York Times
MAASTRICHT, the Netherlands, Dec. 8 — In an atmosphere of

The New and the Old



POPULATION
January 1990
Others 70.6 million
Belarus 8 million
Russia 146 million
Ukraine 51.8 million
Byelorussia 10.3 million

CONSUMER GOODS
Share of production
Others 28.2%
Belarus 0.6%
Russia 47.0%
Ukraine 16.4%
Byelorussia 1.5%

AGRICULTURE
Share of total output, 1988
Others 21.4%
Belarus 4.4%
Russia 46.7%
Ukraine 22.1%
Byelorussia 5.4%

"We, the republic of Byelorussia, the Russian Federation and Ukraine... state that the U.S.S.R. is a subject of international law and geopolitical reality, is ceasing its existence."
— Brest declaration, Dec. 8, 1991

The Union Is Buried: What's Being Born?

By LESTINE BOHLEN
Special to The New York Times
Dec. 8 — Ever since the collapse of the Soviet Union, the three co-founders of the new commonwealth — President Boris Y.

Gorbachev's Move

"The U.S.S.R. as a subject of international law and geopolitical reality is ceasing its existence," the leaders declared. [Text, page A8]

The action essentially stripped President Mikhail S. Gorbachev of his office and authority, and the immediate question was whether the tough and enigmatic Soviet leader would resist — and if he did, whether the military or other centers of power would support him.

The three co-founders of the new commonwealth — President Boris Y.

TAKE OVER A-ARMS

Newborn Bureaucracy Is Inheriting Functions of Old Authority

By SERGE SCHMEMANN
Special to The New York Times
MOSCOW, Dec. 8 — The leaders of Russia, Ukraine and Byelorussia declared today that the Soviet Union had ceased to exist and proclaimed a new "Commonwealth of Independent States" open to all members of the former union.

In a series of statements issued after a two-day meeting at a Byelorussian government retreat, the leaders of the three Slavic republics declared void all efforts to create a new union on the ruins of the old one. But they called for the creation of new "coordinating bodies" for defense, foreign affairs and the economy that would have their seat in Minsk, the capital of Byelorussia, and decided to maintain the ruble as the common currency.

They declared that the "norms" and activities of the former union ceased as of the moment of signing, and that the new commonwealth assumed all international obligations of the Soviet Union, as well as control over its nuclear arsenal.

1990-91 recession
housing fell 34.8%

Collapse of Soviet Union
= more markets for
capitalization & trade

Trade opportunities

Technological advances

1998 first budget surplus
in 30 years

1990's



**Clinton years 1992 Democrats
had control of all 3 branches**

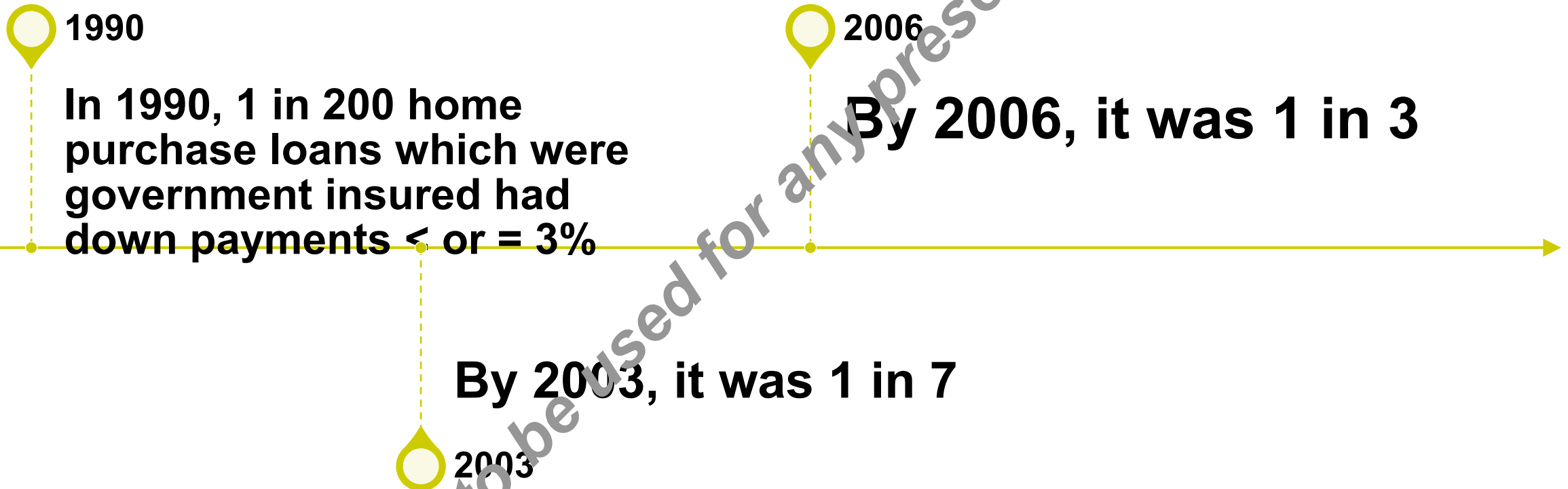
**1994: Republicans “Contract With
America”**

**1998 First Balanced Budget in 30
years**

**Good decade for stocks and real
estate**

DJIA hit 11,000

Compare:



1990's



**Congress pushed
“reform” for
Fannie & Freddie
Creating the sub
prime monster**

2000's



Early 2000's, market went up and up

Owners became speculators

Some markets had triple digit inflation

Huge demand for mortgage-backed securities; tranches and other exotic things introduced

2nd Quarter 2006, first decline

2000's



George W. Bush

9/11

Two wars in the mid east

Capital gains rate cut to lowest historical level

Home ownership hit almost 70%

2008 Barack Obama elected

Housing crisis kicks into full gear in 2006

Political and Economic History



Clinton & Republicans cut taxes & spending; balanced budget in 1997



First balanced budget in 3 decades



George W. Bush—tax cuts went into effect in 2003—followed by 46 consecutive months of growth

2000's



Foreclosures up

Fraud revealed

Wall Street collapse

Bail out of AIG

Collapse of many lenders

**Still reeling from
foreclosures**

Timeline

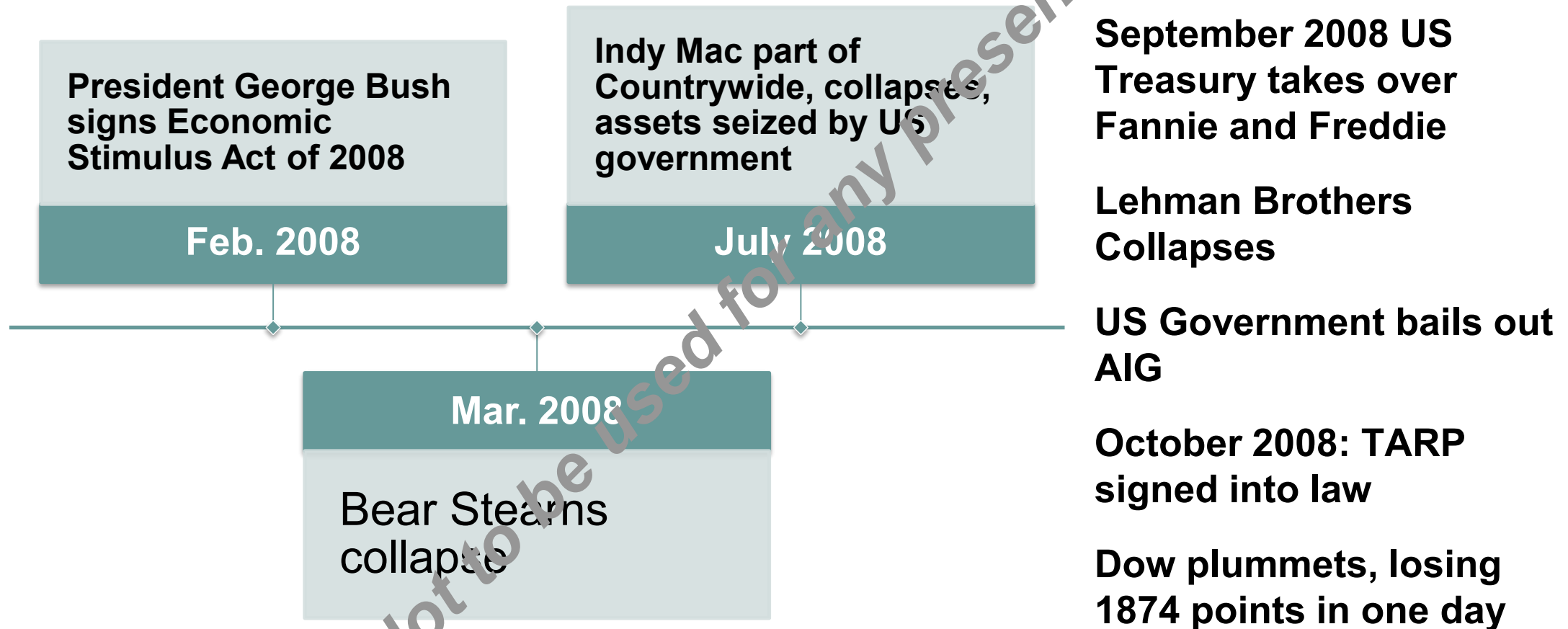
April 2007 New Century Financial declares Chapter 11 Bankruptcy (sub-prime lender)

October 2007 Dow hits 14,164

Jan 2008 Fed drops rate AGAIN to 3% (had been 5.25% in Sept 2007)



Timeline



Timeline

November 2008 US Government bails out Citigroup

December 2008 General Motors and Chrysler get \$80.7 BILLION TARP funds

Fed reduces interest rates to 0%: first time in US History

January 2009 Bank of America bailed out

New President Obama approves a \$787 billion stimulus package, contains some tax relief

Dow plunges to low of Great Recession, ending at 6547, more than half of October level

June 2009: National Bureau of Economic Research says “recession over”

“It ain’t over till the fat lady sings...”

**June 2009 GM files for
bankruptcy**

**October 2009 US
unemployment hits 10%
first time in quarter-
century**

**Foreclosures hit record
levels, 2.9 million in
2009 alone**



2000-2010 House Prices



- \$171,100 in 2000
- \$222,900 in 2010

Obama



Stock market up



Many new taxes



Unemployment down, but labor participation rate down (fewer people looking for work)

Obama



GDP 'sluggish' at best



Obamacare raised government spending and taxes



Real median income down



More financial regulations passed:

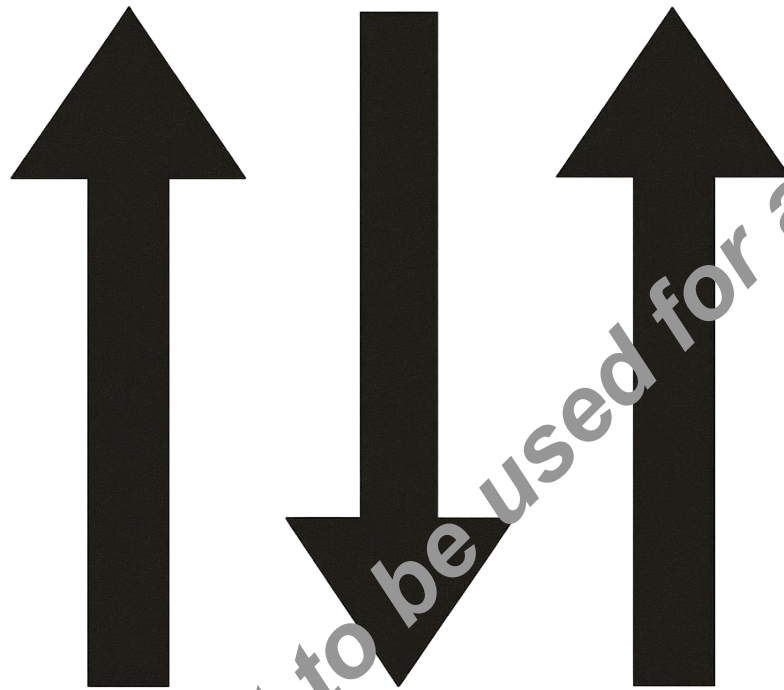


Dodd-Frank



CFPB changes real estate settlement procedures

Taxes



2001 top rate
39.1%

2002 top rate
38.6%

2013 top rate
39.6%

Trump followed Obama



US unemployment hit a 50-year low of 3.5 percent in December 2019

Black and other minority unemployment hit new lows

Black teenagers experienced more employment than at any other time

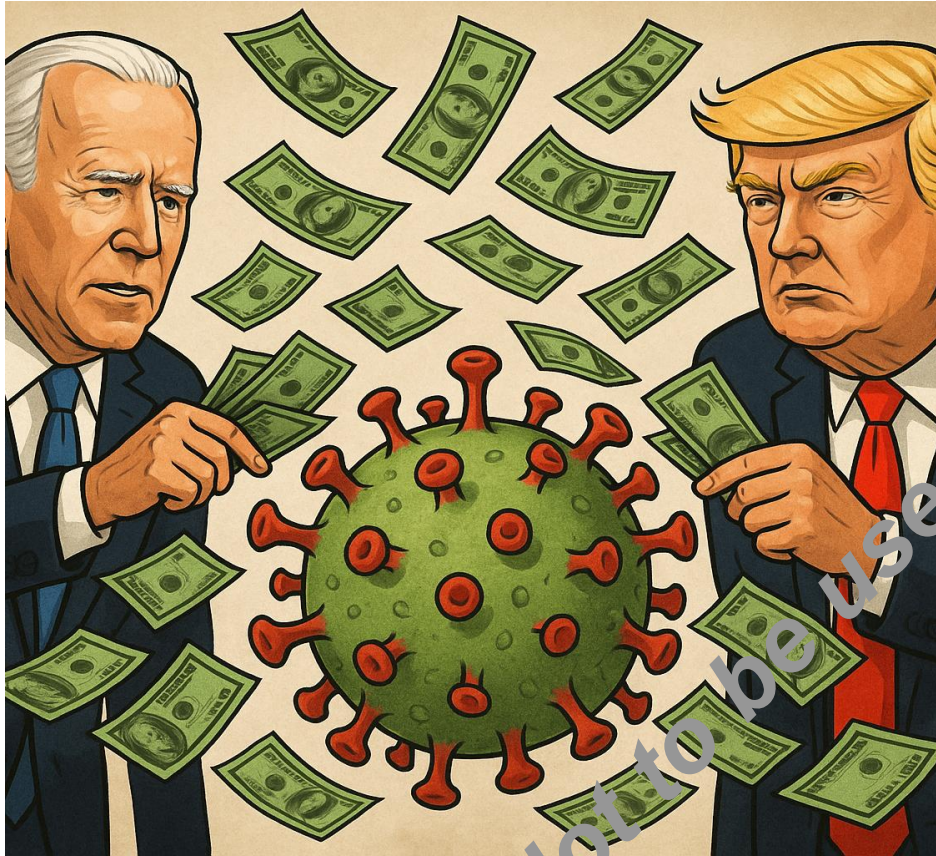
Corona Virus set all employment back

Then: Covid!



- Historic highs in stock market
- Up 111+% 2017-2021
- Tax cuts
- Coronavirus!

Coronavirus



Congress and Presidents Trump and Biden began throwing money at this problem

June of 2021 a trillion of this remained unspent

Biden



Tax and Spend bills

“Build Back Better”

Green initiatives

Record inflation

Stagnant employment gains

Recession: 2 quarters of declining GDP

Student loan forgiveness

2010 to 2020 House Prices



2010
\$222,900

2020
\$338,600

Up 51.9%

Government & Inflation



Which 'basket' are they using?

Summer of 2022
feds conveniently
left out food and
fuel CPI because
they are 'volatile'

Bank Failure: First Republic 2023



Made low interest mortgages to wealthy people

Paid high interest to clients

Many account balances exceeded FDIC coverage

First Republic Investments

**Heavy investments in
commercial real estate**

Invested in Silicon Valley Bank &

Signature Bank

Investors got worried

**Over \$100 billion of deposits
withdrawn in one week**



What Happened?

**FDIC seized First
Republic Bank**

**Sold to J P Morgan May
1, 2023**

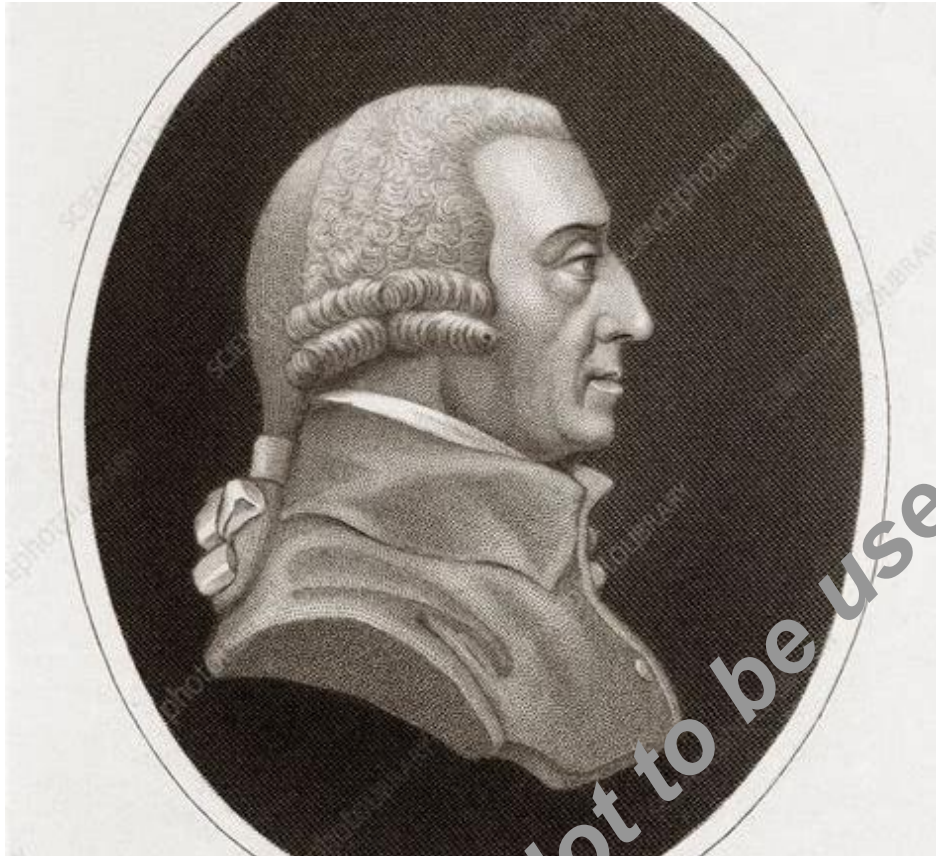
“Fire Sale”

To protect depositors

Keep panic at bay



Adam Smith



An Inquiry Into the Nature and Causes of the Wealth of Nations

Self interest will cause people to prosper

Limited government

Individuals would invest resources in the manner which would yield the highest return

Free market: supply & demand sets price

Adam Smith

- Quote: “It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner, but from their regard to their own interest.”

John Maynard Keynes



Father of Modern Economics

Governments can influence macro economics

Government intervention

Believed in a multiplier effect for government spending

Quote: "In the end, we're all dead."

Milton Friedman



Capitalism and Freedom published in 1962

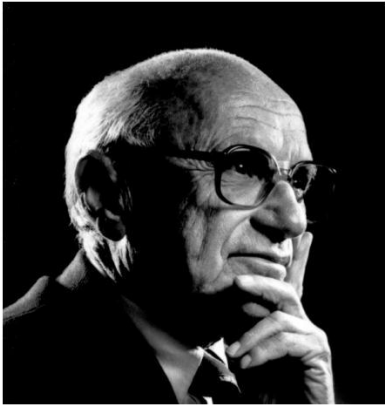
Political freedom & economic freedom go hand in hand

Believed we should go off gold standard

Demonstrated that government spending resulted in an equal change to GDP, not a multiplier (refuted Keynes)

Believed in flat taxes

Milton Friedman



Milton Friedman (Capitalism and Freedom)

“Underlying most arguments against the free market is a lack of belief in freedom itself.”

Argued that many government programs have “unintended consequences”

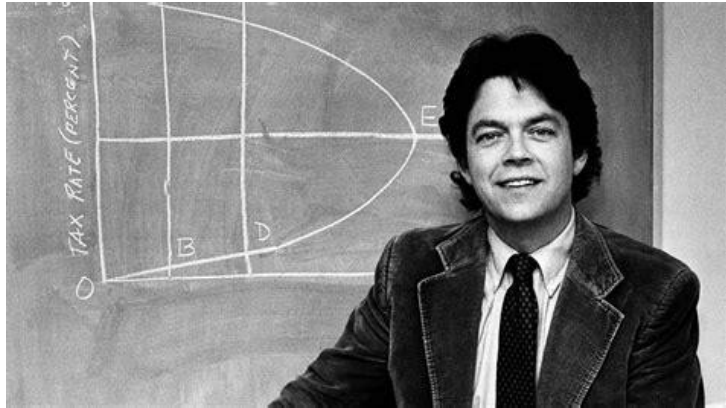
Quote: “There is nothing so permanent as a temporary government program.”



Arthur Laffer

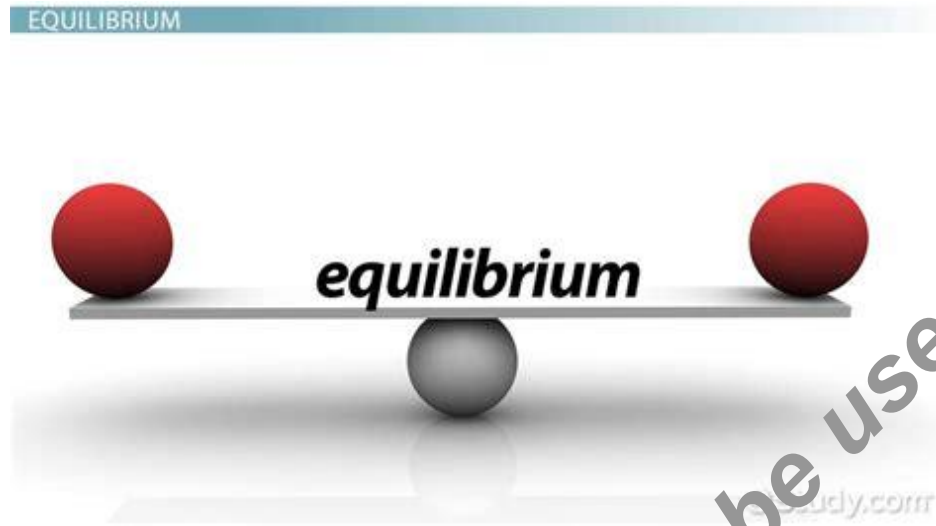
- **Laffer Curve: raising tax rates will eventually *lower* tax revenues because tax payers have no incentive to earn more money**
- **Supply side economics**
- **Remove barriers, reduce taxes, businesses will create jobs**

Arthur Laffer



Quote: “And you can’t have a prosperous economy when the government is way overspending, raising tax rates, printing too much money, overregulating and restricting free trade. It just can’t be done.”

Equilibrium



In economics, equilibrium is defined as when supply equals demand (they are in balance).

Real estate is an *imperfect market* (rarely in equilibrium)

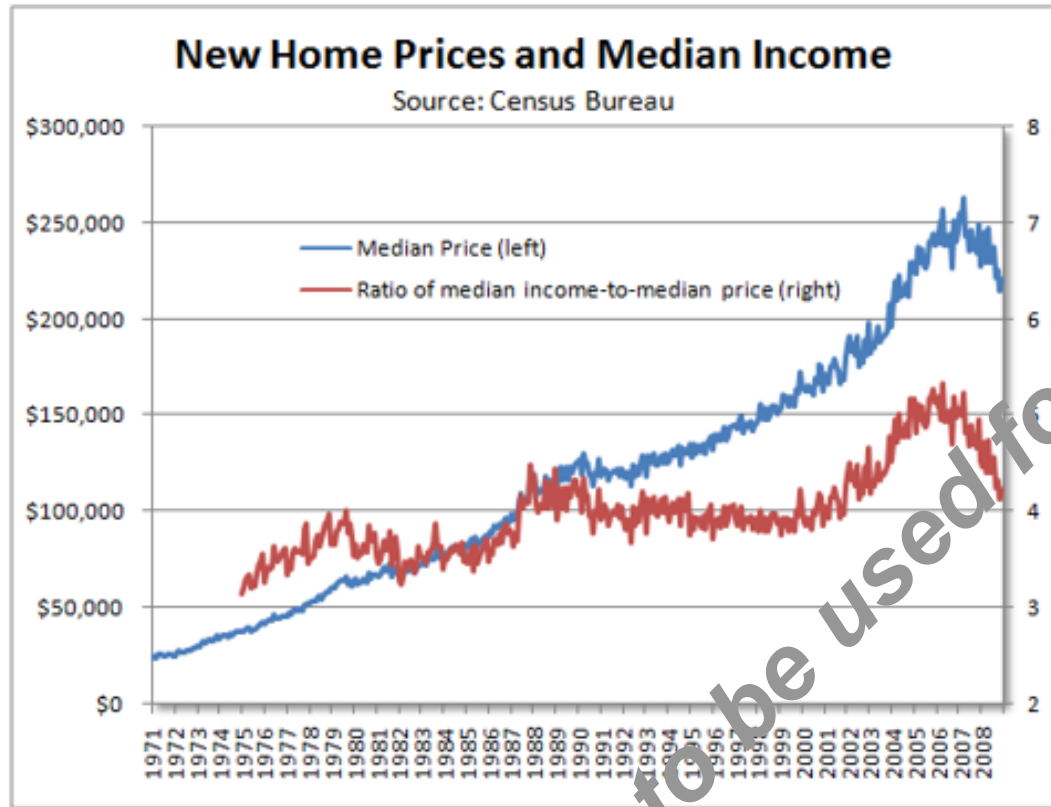
Why?

Equilibrium (Point & Price)

- In a free market, an equilibrium will be established at a price which will result in a supply that will satisfy the demand of buyers



Demand and Money



Housing has to correlate to median income

Relationship between rental rates and income; mortgage payments and income

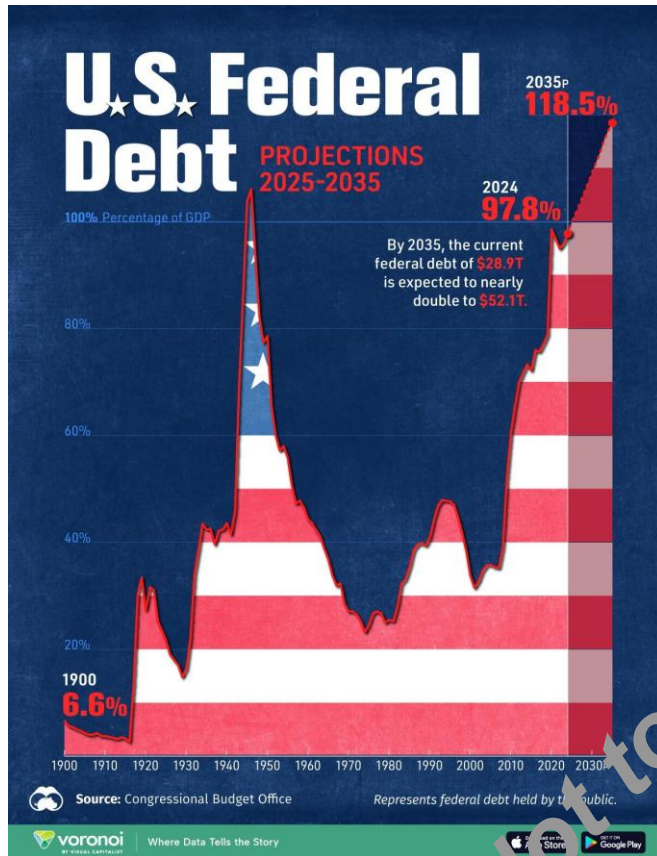
In many markets, median income earners can't afford houses

The Real Estate Market is Imperfect



- Real estate does not lend itself to perfect economic supply and demand models

Monetizing Debt



Government buys back
its own debt
Can lead to inflation
Can devalue the dollar

Beyond our control. . .

Interest rates

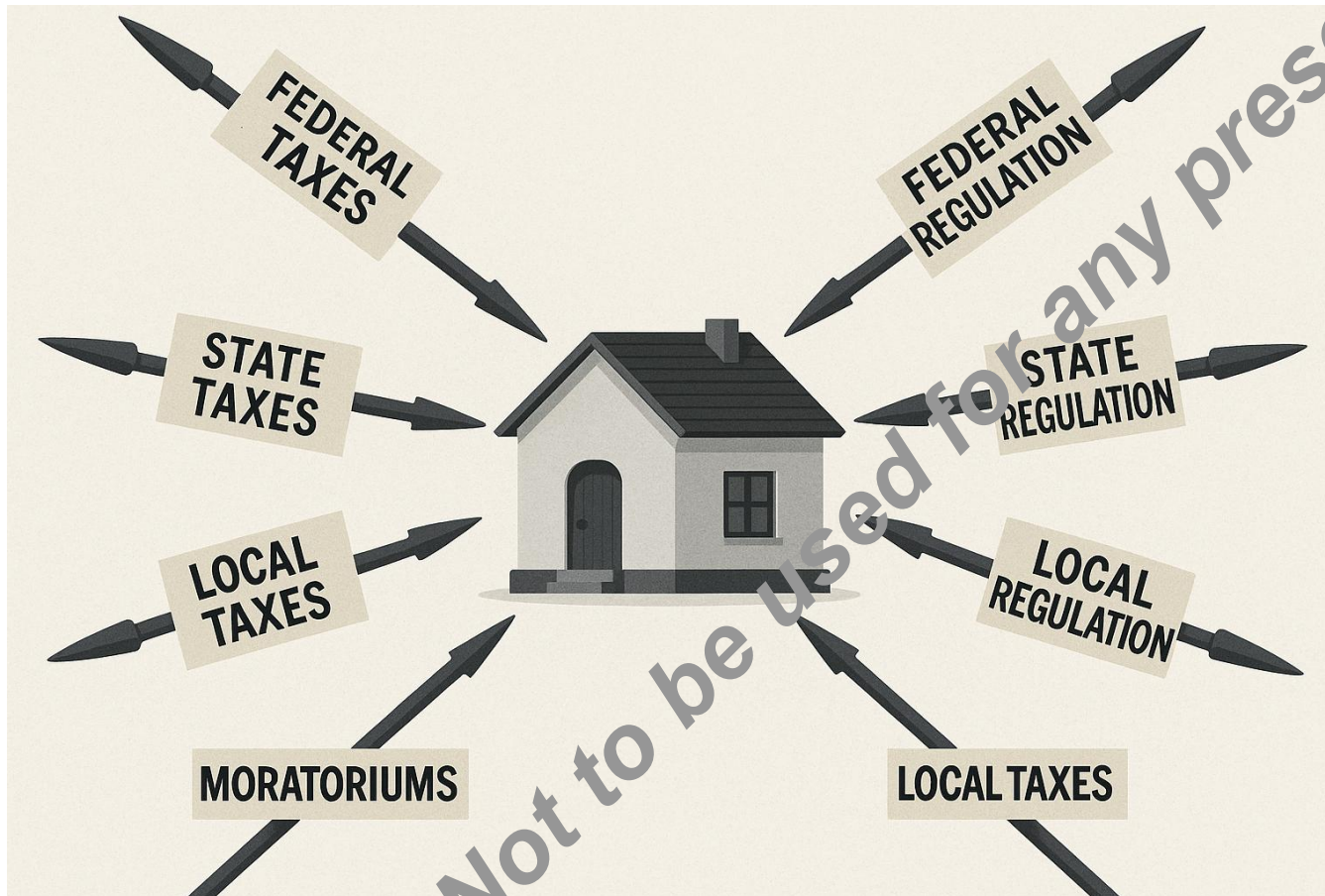
Supply

Demand

Unemployment rates

- Demographic changes
- Local moratoriums
- Negative external influences (new roads, etc.)

Real Estate Markets are influenced by...



Federal Laws & Policy
e.g. the Fed, interest rates

State Laws and Policy
e.g. state's economy, tax structure, how certain things are funded

Local e.g. local employment, local taxes, local moratoriums, etc.

Local Economy



Can have large variances within a region

Communities which rely in whole or part on one employer are vulnerable

Demographics can vary greatly within county or region

Tax structure, tap on fees, local moratoriums, all contribute to affecting this market

Other Factors:



- **Demographics:**

- **Age**

- **Educational levels**

- **Household formations**

- **Family size**

- **Income levels**

New Jobs Multiplier



- Dollars spent in a community are generally multiplied in effect by a factor between 2 and 3
- Net effect of \$1,000,000 per year payroll is 2 to 3 million

Summary



**Politicians make policy to
try to influence economy**

Doesn't always work

**Unintended
consequences abound**

Watch what is going on!

**THANKS FOR
COMING!
MELANIE MCLANE**

