

# CIRIOS TRENDS

IN SEARCH OF REAL ESTATE OPPORTUNITIES.



## The State of the Markets

If someone were to wake up from a 5-year coma and ask about the state of our country's economy, the chart on the right of this page pretty much sums it up.

The past five years in the housing market, the financial market and the economy have been anything but boring.

With respect to the housing market, we are at a critical juncture. Pundits and so-called experts are lining up on opposing sides of the recovery debate. Optimists will point out that after historic price declines, affordability is at all-time highs and government support for the housing market has helped mitigate the negative effects of tightened credit and mounting foreclosures. The bottom, they say, is in.

Meanwhile, pessimists urge caution. Foreclosures continue to rise, more borrowers are falling behind and the government is considering removing some of the programs that have kept interest rates low.

Ultimately, both arguments have merit. But they both miss the point.

Take another look at the graph to the right. It's no coincidence that during the time of most uncertainty in the stock market (2008), the housing market experienced its steepest declines. It's also no accident that the recent bottom in stocks (March 2009) matches almost exactly with the turning point in housing.

The answer to the riddle is simple: Confidence.

In a new book called *This Time is Different*, economists Kenneth Rogoff and Carmen Reinhart dissect hundreds of years of financial crises and try to assess how societies keep getting themselves into the same mess over and over again.

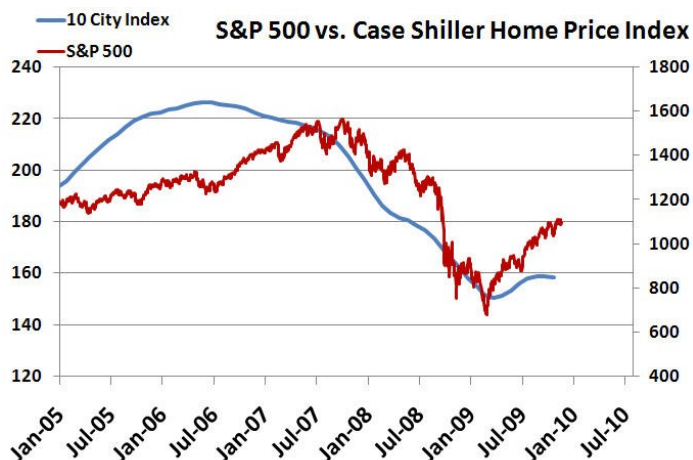
A common thread in the discussion, specifically surrounding debt crises like the one we experienced (and indeed are still experiencing), is the notion that confidence plays a far larger, and far less understood role in economic panics than most people think. According to Rogoff and Reinhart: *"Economists do not have a terribly good idea of what kinds of events shift confidence and how to concretely assess confidence vulnerability."*

Since most people equate the stock market with the economy, swoons on Wall Street send the message that all is not well with our economic future. Accumulate enough of these swoons and confidence gets punctured to the point where people start acting differently. As risk aversion grows, consumers delay purchases, businesses delay expansion and banks stop lending.

In March of last year, the housing market was beyond bleak. Liquidity dried up and buyers were terrified. Ditto on Wall Street. But as stocks recovered through the spring, hope emerged that maybe the worst was behind us.

Now, as the recent surge in stocks is tested, so too will the surge in home buying: The two are far more linked than most understand.

Chart of the Month  
Home Prices vs. Stock Prices



Source: Cirios Real Estate

**“As risk aversion grows, consumers delay purchases.”**

### Housing Data Still Mixed

- NOV. CASE-SHILLER HOME PRICE INDEX: -5.3% Y/Y (+0.2% M/M)
- DECEMBER EXISTING HOME SALES: -16.7% M/M
- DECEMBER NEW HOME SALES: -7.6% M/M
- SEPTEMBER HOMEBUILDER SENTIMENT INDEX: 15 (DOWN FROM 16)

### Inside This Issue

<b>THE STATE OF THE MARKETS:</b> FEBRUARY 2, 2010	<b>1</b>
<b>FEATURE:</b> REAL ESTATE INVESTING WITH YOUR IRA	<b>2</b>
<b>AROUND THE BAY:</b> LOCAL NEWS BITES	<b>3</b>
<b>ZIP CODE SPOTLIGHT:</b> SOUTH SAN FRANCISCO (94080)	<b>4-5</b>
<b>CIRIOS OPPORTUNITIES:</b> SWEET SALVATION IN SOUTH CITY	<b>6</b>
<b>TALKING CHARTS:</b> LOCAL MARKET ANALYSIS	<b>7-11</b>

**“Do, or do not. There is no ‘try’.” - Jedi Master Yoda**

**“The primary difference is that the owner, not the manager, calls the shots.”**

## Feature: Real Estate Investing with Your IRA

At cocktail parties and around the water cooler, the familiar refrain that “now is a great time to buy,” is piquing the interest of even the most casual real estate investor. For many, however, taking advantage of “distressed” real estate opportunities remains difficult, at best.

For some it’s a simple question of economics. Buying a distressed property often requires an all-cash purchase - a daunting task with high Bay Area home prices. And after the stock market’s swoon in 2008, it’s seemingly untenable recovery in 2009 and a recent blip downward to kick off 2010, many investors are just trying to get back to where they started.

However, for those with a desire to diversify away from the limited transparency afforded by investing in stocks, tax-protected retirement money can be used to invest in real estate.

It’s a well-kept secret that money held in IRA accounts can be invested at the owner’s discretion. Brokerages and money managers earn money from controlling IRA investments for their clients. This gives them little incentive to provide information on “self-directed IRAs,” which give investors the ability to diversify their retirement savings, while still retaining IRA tax protection.

Only tiny fraction of the trillions of dollars that are in IRA accounts are self-directed. And with cash-flush investors stepping back into the housing market, an increasing share of deals are being snatched up by buyers using tax-protected retirement funds at the closing table.

Not surprisingly, the IRS keeps close tabs on this sort of investment, so anyone considering this option should seek the advice and consultation of an investment and tax professional.

IRS regulations require that either a qualified trustee or custodian hold self-directed IRA assets on behalf of the IRA owner. Most big wealth managers offer the service while a few firms that specialize in self-directed IRA investments have been gaining market share in recent years.

Custodians and/or trustees facilitate investment transactions and hold the assets in trust for the IRA owner, just like a traditional IRA. The primary difference is that the owner, not the man-



ager, calls the shots.

Once a self-directed IRA is opened, the custodian or trustee permits the client to engage in a broad range of investments that are approved by the IRS. These options include: real estate, stocks, mortgages, franchises, partnerships, private equity and tax liens. There are rules for each specific investment type, but it’s easier than you think to diversify away from the stock market and into other asset classes.

One important aspect of self-directed IRA custodians is their inability (legally) to provide investment and tax advice. They act simply as intermediaries, not advisors. The idea is to give investors control; there are plenty of options to pay someone to professionally manage your retirement money, self-directed IRAs are designed for investors who want to be 100% in control of some portion of their retirement funds.

Of the restrictions on real estate investments, one of the primary ones is that the property cannot be for personal use. That is, you can’t move up into that mansion you’re family has been eyeing with cash set aside for retirement.

So even though retiring baby boomers can’t pick up a getaway in Hawaii, they can opt to invest in something a bit less volatile than stocks. Low-risk opportunities abound to make smart real estate investments in this environment, you just have to know where to look.

*DISCLAIMER: Cirios Real Estate is not a tax, financial or investment advisor. All investments carry risk. Before considering any investment options, including a self-directed IRA, consult your investment advisor and tax professional.*

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## Around the Bay: Local News Bites

### CalPERS Licks Wounds, Eyes Real Estate Investments (San Francisco Business Times)

CalPERS, California's public workers' pension fund, isn't sitting idly by to licks its wounds. Fresh after confirmation that it would lose \$500 million on a botched deal to develop Stuyvesant Town on Manhattan's east side, CalPERS is on the prowl for opportunities in the battered housing market. In conjunction with seeking new opportunities, CalPERS chief investment officer Joe Dear said the massive fund is also looking unload losing bets. There should be options aplenty, CalPERS' real estate portfolio sunk by 47% in the first nine months of 2009.

(Read more here: <http://tinyurl.com/cirios trendsfeb102>)



### Obama Ponies Up \$2.25 Billion for High-Speed Train (San Jose Mercury News)

As part of a nationwide \$8 billion high-speed rail initiative, the White House is allocating more than \$2 billion to support plans to connect Northern and Southern California with a high-speed train. The highly politicized project is being developed alongside the San Francisco Transbay Center, which also picked up some cash last week. The US Department of Transportation will provide a \$171 million loan to speed up construction of a state of the art transport hub beneath what is now the city's Greyhound Bus station. Proponents laud the plans as essential to promoting public transportation and controlling carbon emissions, while opponents lament what they believe is yet another round of government spending gone wild.

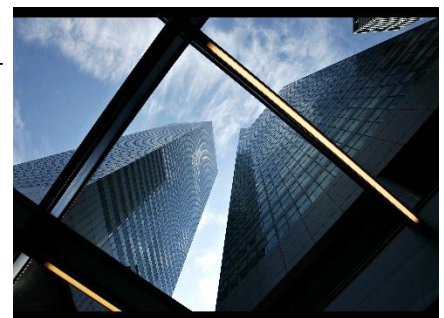
(Read more here: <http://tinyurl.com/cirios trendsfeb103>)



### Who Says Commercial Real Estate is Dead? (San Francisco Business Journal)

Commercial Real Estate has been called the "next shoe to drop" .... For what seems like years now. But despite the abysmal fundamentals still facing most segments of the commercial market, opportunistic investors are starting to dip their toes in the water. Loja Real Estate LLC plunked down \$44 million on a Dublin, CA shopping center anchored by Safeway grocery store that abuts a 390-unit apartment complex. The deal, the investment group's first in the Bay Area, marks the launch of a series of investment funds aimed at well-priced commercial real estate opportunities, according to Tom Engberg, Loja's CEO.

(Read more here: <http://tinyurl.com/cirios trendsfeb104>)



### Silicon Valley Unemployment Below California ... Barely (Silicon Valley Business Journal)

Unemployment in Silicon Valley ticked down to 11.5% last December, 0.4% below November's tally of 11.9%. Overall California unemployment stands at a lofty 12.1%, almost 2.5% higher than the national figure of 9.7%. The broader Bay Area, however, is faring a bit better. Joblessness in the metro area stretching from San Francisco to Redwood came in at "just" 8.9%, down from 9.2% in November, but up almost 50% from this time a year ago.

(Read more here: <http://tinyurl.com/cirios trendsfeb101>)



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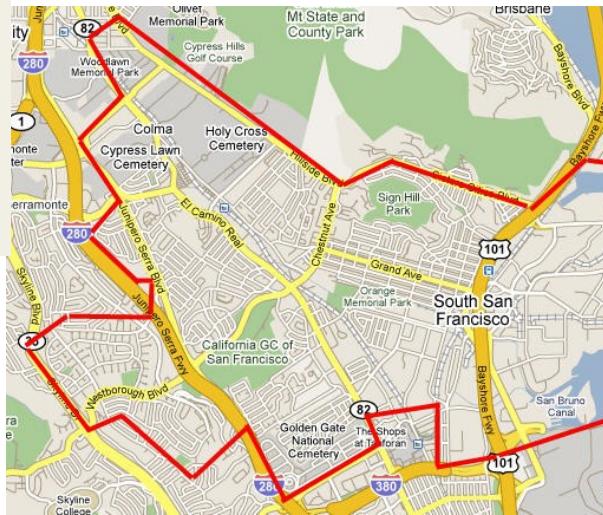
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## Zip Code Spotlight - South San Francisco (94080)

This month, the zip code spotlight returns to South San Francisco (94080), the "Industrial City." While its hill-side moniker makes South City sound like a place no one would ever want to live, the opposite is true.

In fact, the "Industrial" turns out to be apt, as several prominent biotech firms have their industrial headquarters here. But rather than factories belching noxious fumes, these companies kick off an ample supply of high paying, stable jobs.

**"There must be terrific investments to be made in South City."**

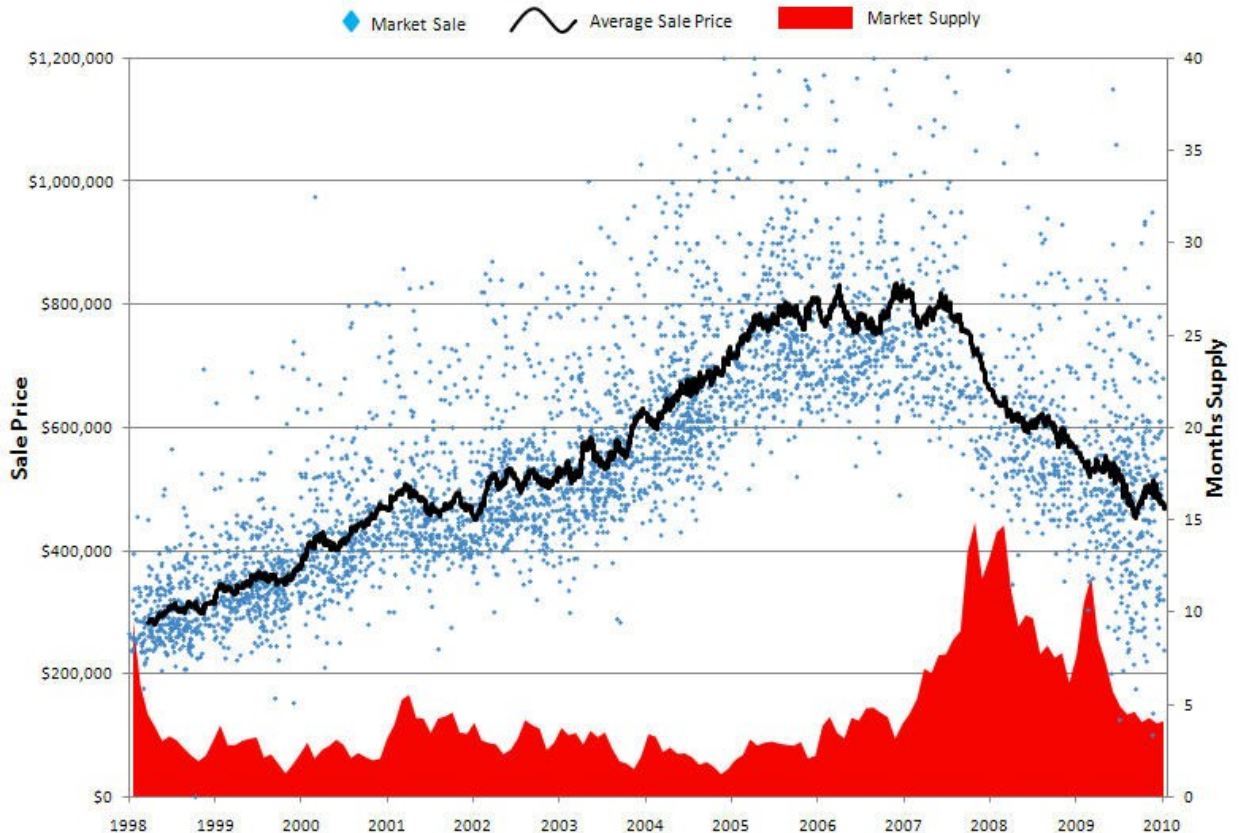


A quick look at the market activity graph below shows that prices have declined in the area by a staggering 40% since the height of the market, back to levels not seen in 10 years. This has brought the average home price down to \$450,000 - downright cheap by peninsula real estate standards.

The next thing to notice is the steadily declining supply levels shown by the red graph on the bottom. These numbers look to be trending back towards more traditional levels, indicating that price declines in the area could be a thing of the past.

These three factors (prices at early 2000 levels, declining supply, solid white collar job market) make our mouths water here at Cirios Real Estate. Clearly there must be terrific investments to be made in South City. The question is, how? (*flip to the next page to find out*)

### Market Activity - South San Francisco - 94080



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## Zip Code Spotlight - South San Francisco (94080) (continued)

To answer this question, we have drilled down to look at the South San Francisco market in even more detail - specifically as regards to how home condition affects sale prices.

As you can see from the next graph, we have divided sales over a three month period in this zip code into three groups based on the property's condition. We define our groups as follows: 1 = Move in ready, great to perfect condition; 2 = Livable but in need of some upgrading or light repairs; 3 = Unlivable, needs major repairs and upgrades. We then looked at the average price per square foot for each group. As one would expect, the best condition properties sold at the highest price and vice versa. No big surprise there.

What is interesting here is the MAGNITUDE of the differences, particularly between groups 1 and 2. The average price for the best properties was ~\$460/ sqft, about \$68 more than those in group 2. What this means is that for a 1,500 square foot home (the average size in the area), you are looking at over a \$100,000 spread between a home in need of light repairs and an identical one in pristine condition. So, if you can turn 2's into 1's for significantly less than \$100,000, you've likely got yourself a great investment.

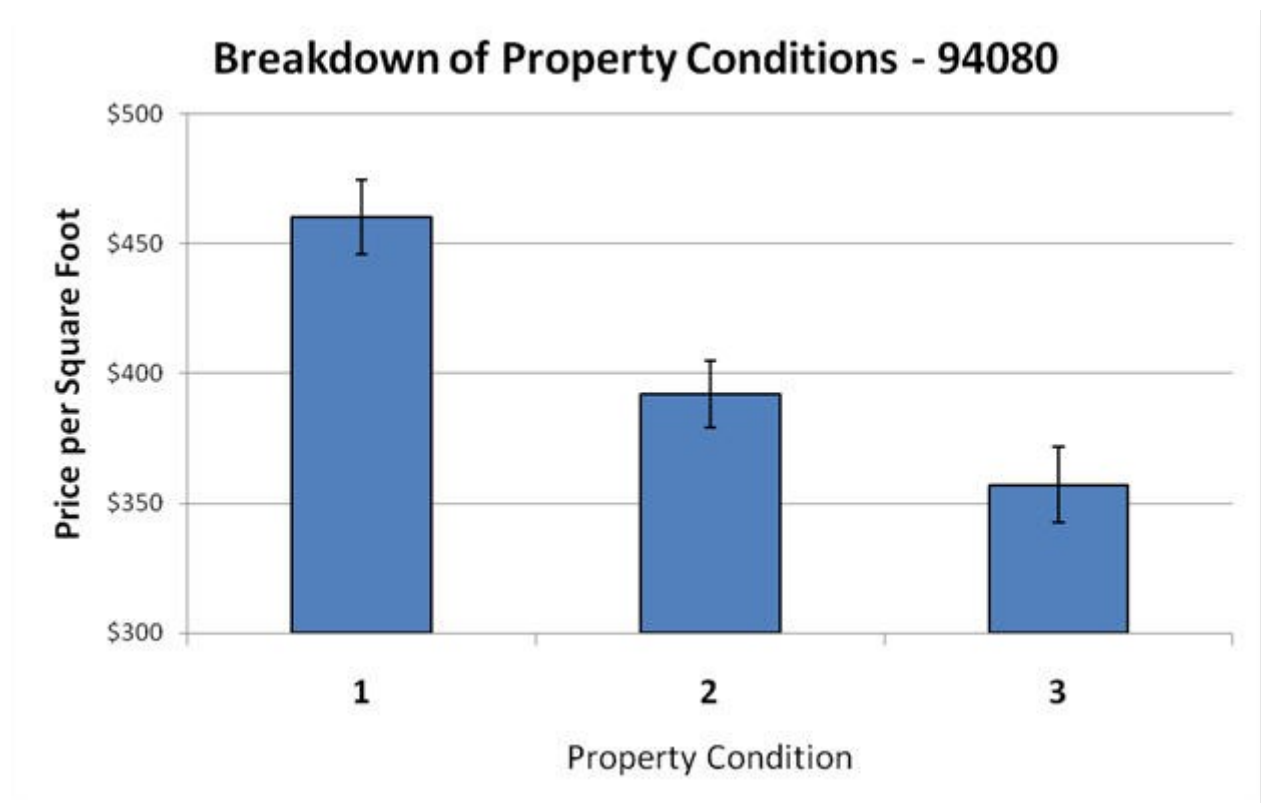
Of course, this is assuming you buy your 2's at market prices. If you can make purchases at below market prices, returns look even better. In today's distressed real estate market, opportunities abound to do exactly that. (Flip to the next page to see an example of a recent investment deal in South San Francisco.)

### Did You Know?

Annual sales volume of single family homes in South San Francisco is up more than 50% since the nadir in 2007.

#### South City Total Home Sales:

2000: 356  
2001: 336  
2002: 410  
2003: 412  
2004: 465  
2005: 386  
2006: 334  
2007: 211  
2008: 271  
2009: 332



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## Cirios Opportunities: Sweet Salvation in South City

### Opportunity Overview:

Of the many profitable real estate investment opportunities available in the Bay Area, one which has recently received attention in the media is buying foreclosed homes directly at the public auctions held on the courthouse steps. These deals are not for the faint at heart. For example, the property below required the buyer to saunter up to the San Mateo County courthouse with over half a million dollars in cash (cashiers checks of course, not a stack of Benjamins). Read on to see how the numbers for such a deal break down.

**605 Lassen St., South San Francisco, CA**

#### Property Details

**Bedrooms:** 4

**Bathrooms:** 3.5

**Living Area:** 2,240 square feet

**Lot Size:** 4,998 square feet

**List Price:** \$799,500

**Sale Price:** \$780,000

**Sale Date:** 12/30/2009

This property was purchased at the steps on August 4th, 2009 for \$527,124. In a matter of 5 months, it sold on the open market for \$780,000. The difference between the sale price and the purchase price of \$252,876, however, doesn't represent the profit on the deal since the investors incurred a number of expenses from purchase to sale.

While we don't know for sure just how much the buyer put into the property, based on the listing photos to the right, it looks like the investor spent quite a bit on high end upgrades. Here is one potential scenario and how the investor made out:

*(Note that the cost figures below are estimates)*

\$60,000: Repairs and remodel

\$2,635: Taxes

\$4,000: Insurance

\$39,000: Real Estate Commissions

\$6,000: Escrow costs

**\$111,635 Total**

When you add the purchase price of \$527,124 to these expenses, the total investment under this scenario was \$638,759. The final numbers in our scenario look like this:

\$780,000: Sale Price

\$638,759: Less Total Investment

**\$141,240: Profit**

**22.1% ROI**

Many people would consider this a staggering sum to put down on a property South San Francisco, which is far from the Bay Area's most desirable locale. But as this month's zip code spotlight illustrates, the housing market South City presents some attractive investment opportunities due to current market conditions and the area's economic outlook.

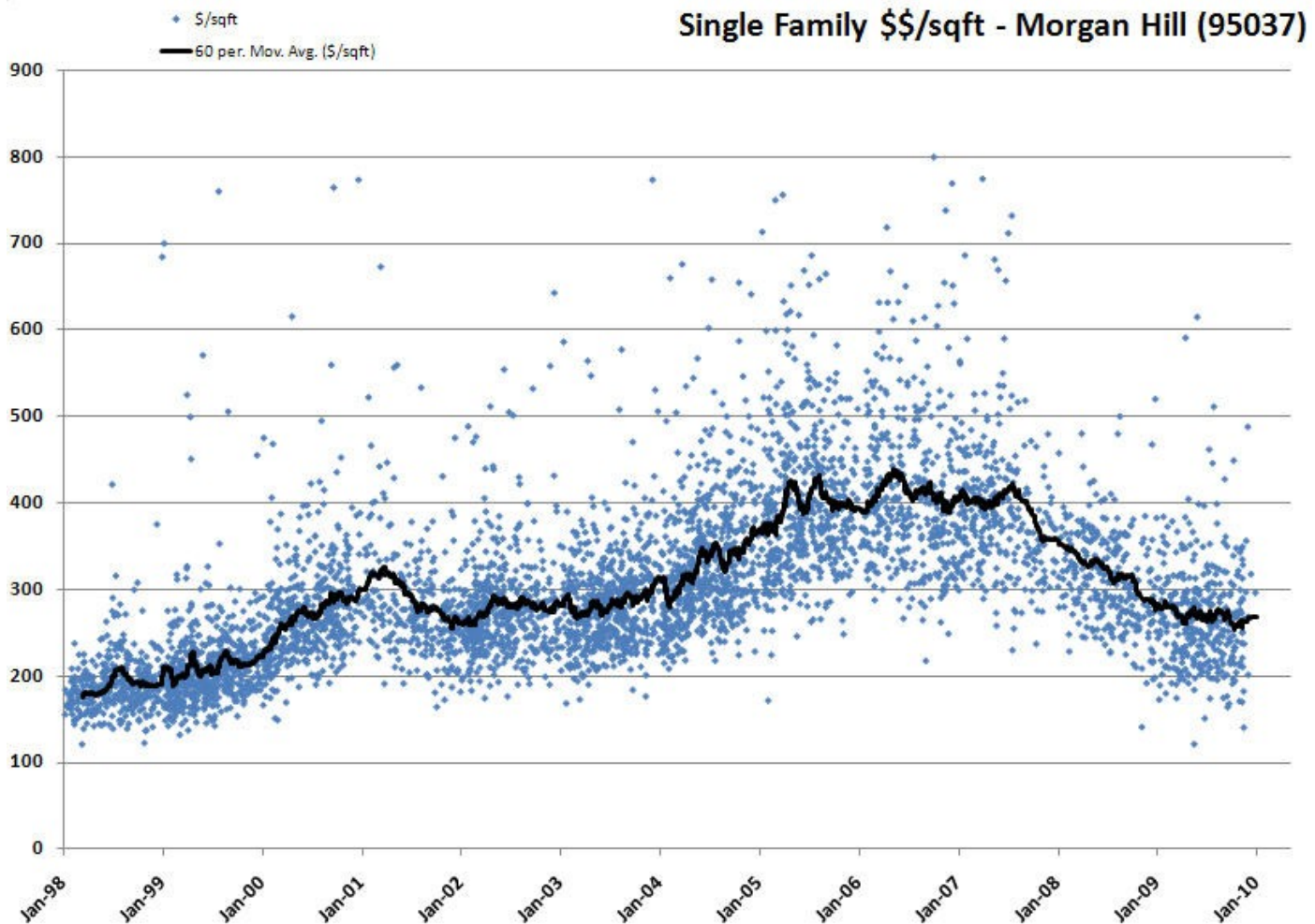


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## Talking Charts - Morgan Hill, CA

It's been our long-held view that the housing recovery would be a prolonged, localized event. That is, even while pundits are out there hailing that the bottom is in, or that it's a great time to buy, we are more cautious. It certainly is a great time to buy ... certain properties at certain prices in certain locations with a certain strategy. To say much more borders on recklessness, since current market strength is so heavily reliant on government intervention to support prices. And, if a picture is in fact worth a thousand words, this graphical depiction of a few representative Bay Area real estate markets are certainly worth a look.

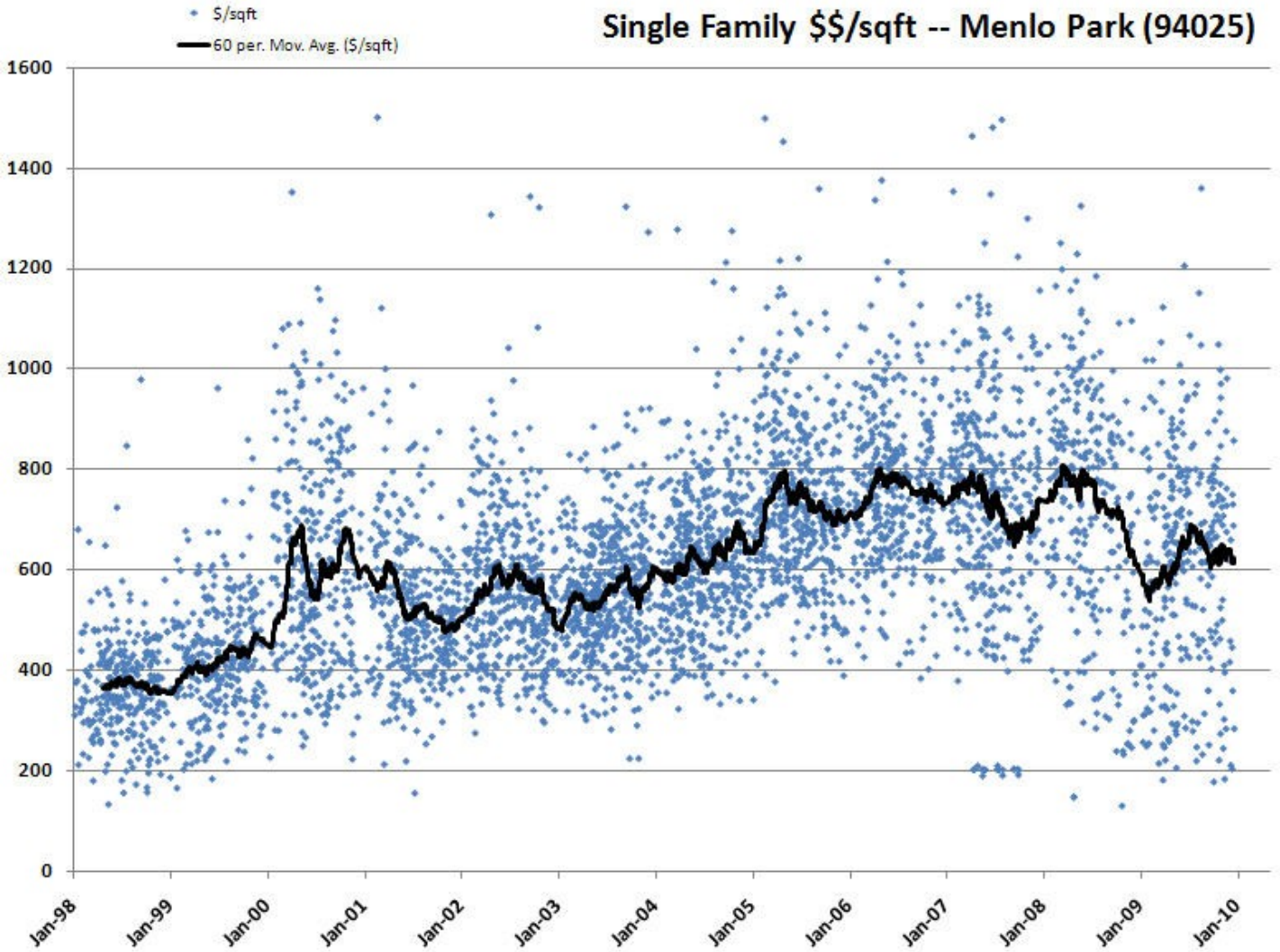


Judging by the activity shown above, there are a whole lot of under water borrowers in Morgan Hill, a southern suburb of San Jose that saw a huge pop in luxury homebuilding during the dotcom then housing booms. Even buyers as late as Mid-2007 are in rough shape, but prices are trying to stabilize here at levels not seen since the early part of the decade. We would urge caution however, as based on current foreclosure data there is a decent amount of looming shadow inventory in the Morgan Hill market. This, along with pricing pressure in desirable parts of San Jose like the Almaden Valley, could make calling a bottom in Morgan Hill home prices a bold call indeed.

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## Talking Charts - Menlo Park, CA

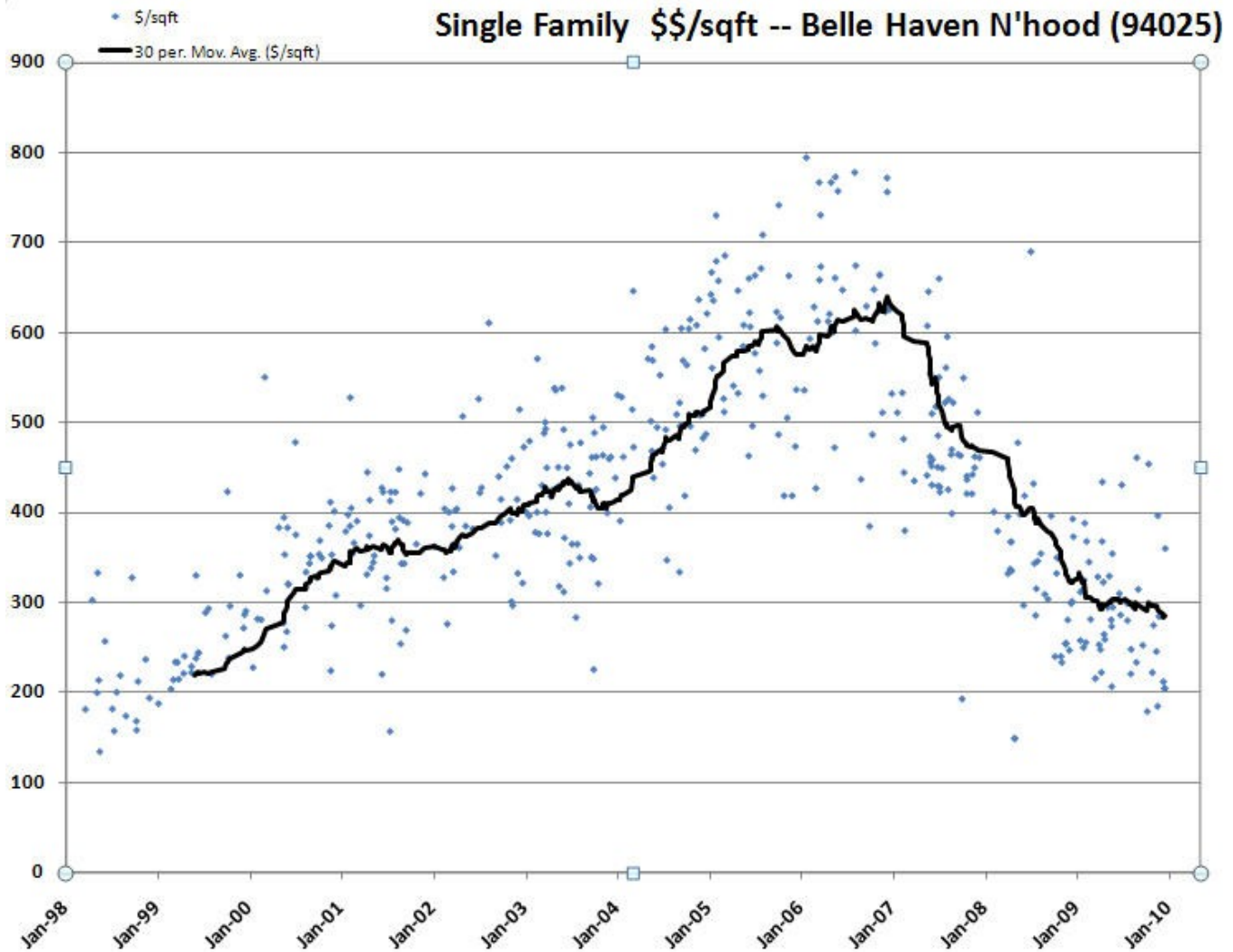


Menlo Park, CA has seen an immense boom in wealth in the past two decades. But what stands out to us isn't the bulge in home prices during the dotcom mania of 2000-2001. It isn't even what looks like a precipitous drop in values in the latter half of 2008. Instead, any market where in a given year you see more than a \$1000 / sqft spread in sales prices warrants a deeper look. And indeed, if you flip to the next page, you will find that deeper look.

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## Talking Charts - Belle Haven Neighborhood, Menlo Park, CA

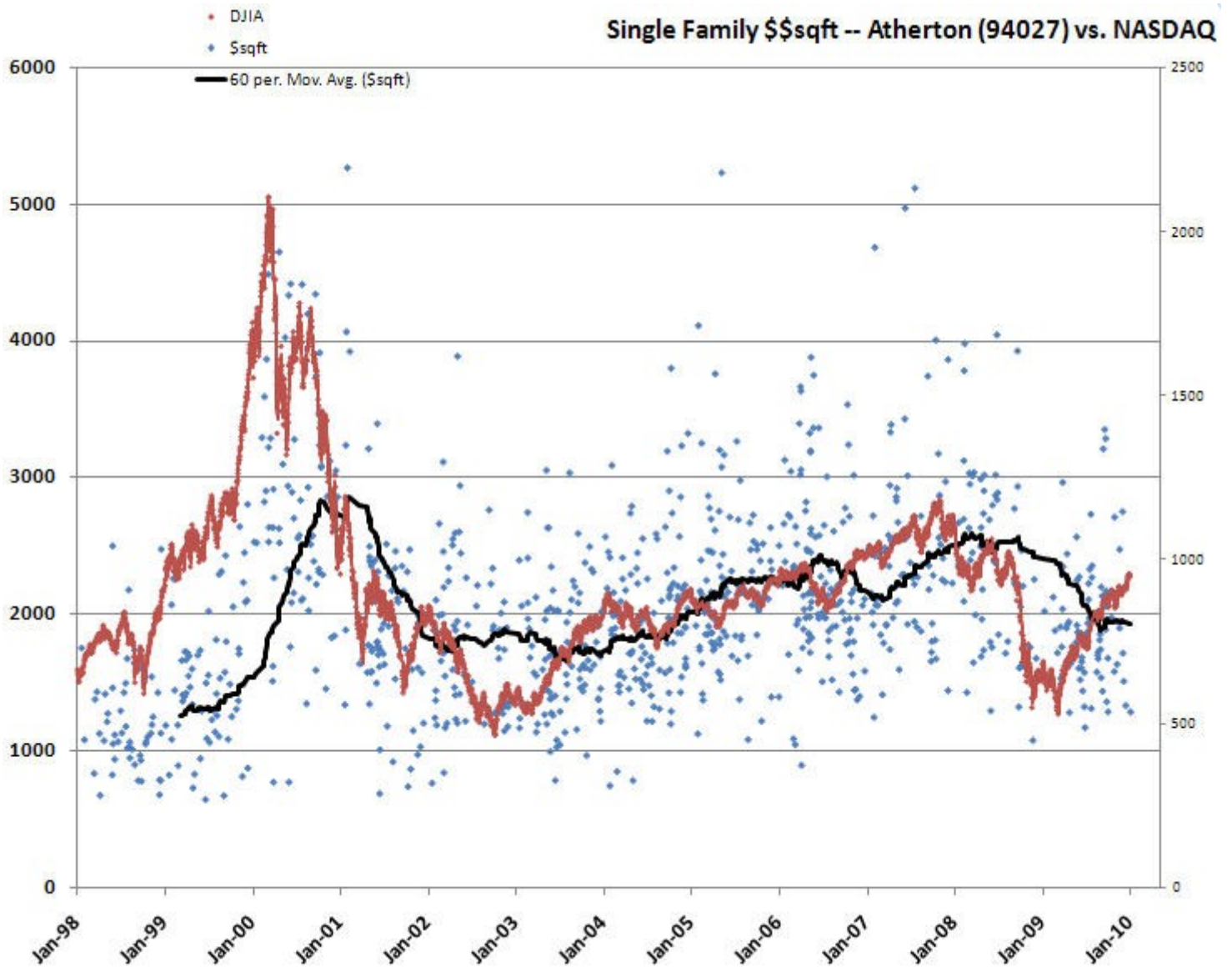


Zip code data is great, but it rarely tells the whole story. Dig into individual neighborhoods and you often find a very different story. Menlo Park is a case in point. On the east side of 101 lies a Menlo Park few residents have ever visited, except on the way to the Dumbarton Bridge: Belle Haven (and even then most probably think they're in East Palo Alto). Vastly different demographics yield property values that belie the trend in West Menlo. In Belle Haven, starting in early 2007 prices truly fell off the proverbial cliff even as the rest of Menlo Park hung tough. The difficult question is now what part of town is now the safer bet? Would you pick the established, wealthy neighborhoods where prices have just dipped back to 2004 levels, right in the middle of the boom, or the rougher area in the midst of gentrification long over-due, where prices are now back to pre dotcom levels?

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## Talking Charts - Atherton, CA vs. the NASDAQ

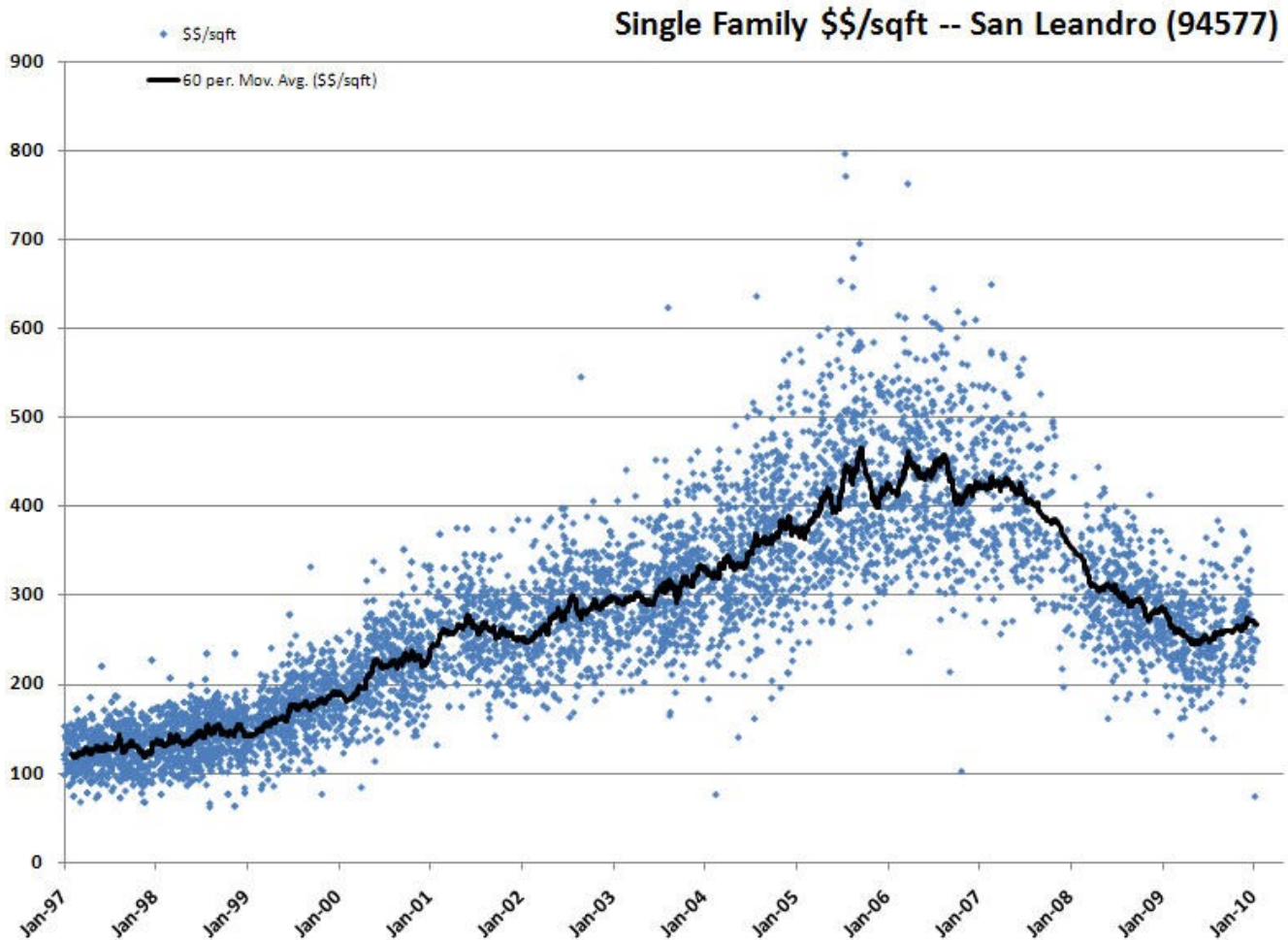


Next door to Menlo Park lies sleepy Atherton, CA, a town constantly ranked in the top 5 wealthiest communities in the country. With a single sale below the \$500 / sqft mark since 2004, Atherton is truly a luxury market. It's also a case study in understanding your market. Even at the peak of the recent housing boom, prices didn't reach the astronomical heights of the dotcom boom, when every overnight millionaire in Silicon Valley rushed to buy in Atherton (if their stock options had to time vest, of course). More recently, it took the stock market's crash (see red line) to dent this exclusive community's housing market. So, with history as a guide, in Atherton it appears that stock prices lead home prices. As the stock market struggles to hold its recent gains, let's see which way the wealth effect cuts in the coming months.

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## Talking Charts - San Leandro, 94577



Let's end this month's newsletter with what could be a feel good story in the making. San Leandro, CA has the misfortune of being located immediately south of Oakland, a city rife with violent crime. San Leandro may not win any awards for its French Cafes or Ballet troupes, but there is precious little affordable housing left in the Bay Area. Many San Leandro neighborhoods are quiet, safe and convenient to job centers around the Bay. Inventory is being severely limited by government-led efforts to forestall foreclosures, and buyers armed with government loans are chomping at the bit to get in. It remains to be seen if the recent trough in prices can hold, but the fundamentals exist for a sustainable recovery.



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