Real Estate and the Next Generation

The top concern of the wealthiest 1% of families is no longer the impact of terrorism on the economy or the markets. It is a concern much closer to home, literally and figuratively: the financial well-being and future of their children. The recently released study by US Trust of affluent Americans (those with an adjusted gross income of more than $300,000 per year or net worth of more than $5.9 million), shows that more than 80% believe their children will face a tougher future financially.

Looking at how the affluent invest their money among stocks, bonds, cash and real estate, we find about 15% allocated to real estate, only slightly more than in past years. What is interesting though is the outlook for real estate. The survey shows that the affluent do not think there is a real estate bubble and that it is still a good investment. In the 2005 survey, 72% said real estate values will increase and only 14% believe real estate prices will decrease.

What does this study mean for us in Orange County? We certainly have our fair share of concern about the financial futures of our children. We see young families, even with two incomes, struggle to stay ahead of the game, to save for their children's college and for their own retirement. We know it is a rare "twenty-something" (or thirty-or-forty something) who can afford a down payment for a home without the help of parents or grandparents.

Many of us wrestle with the fine line between wanting to support our children (financially and otherwise) yet at the same time encouraging them to be independent and self-sufficient. We also want them to have the financial life skills and competence that will help them to make smart decisions as they go through life.

Since real estate has been the basis for much, if not most, of the wealth we enjoy in Orange County, let's explore how it might affect our children and their financial future. With skyrocketing home prices, people talk about buying a home in the 90s just as they used to talk about buying Microsoft in the 80s. A home is no longer just a roof over your head; it is now a piggy bank, an ATM, a 401 (K) for many people. All of this brings to mind some key concerns:

CONCERN #1 Those in their 20s and 30s who haven't yet bought their first home are afraid of being left out and are rushing into a market that is overvalued. A recent survey in *Smart Money Magazine* reviewed data on median home prices, salaries, population and new construction of 148 housing markets around the country to determine how over, under or fairly valued homes were. Orange County, with our 88.2% increase in home prices over the last five years, now tops the list of 148 markets in terms of being overvalued (by 59%!) according to this article.

CONCERN #2 Creative mortgages, aggressively marketed, are tempting homeowners to tap their equity to finance their spending and lifestyle. These days it seems that anyone with a pulse and a checking account can finance or refinance a home mortgage. Attempting to lower their monthly payments, some young homeowners are turning to interest only and low rate teaser mortgages – choices that could come back to haunt them. Few people realize that the difference in monthly payments between that teaser 1% interest rate and a 5% interest rate is essentially added to principal each month.

If you are concerned about the financial future of your children and believe real estate is a good investment, you can:

Help adult children understand that home ownership is not a source of income but a critically important asset with which to build net worth.

Be wary of mortgage ads that sound too good to be true. Explain how to compare rates and features of different mortgages and the long-term impact of negative amortization.

Provide opportunities for adult children to learn financial life skills, perhaps by participating in a family business, a family foundation or a family investment club. An interesting opportunity to learn with other young adults is the one-week retreat in August at the Paul Merage School of Business at UCI. More information is available on the UCI website or through www.iffadvisors.com.

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