

The Real Estate Report

SILICON VALLEY MARKET TRENDS



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Mortgage Rates on Jumbos Leap

The current credit crunch has hit the jumbo loan market. Lenders are raising rates on jumbo loans, those for more than \$417,000, by a full point, or more.

Jumbo loans are now a point and a half above conforming loans. That's way up from the traditional premium spread of about a half to three-quarters of a point.

Blame it on Wall Street which has stopped buying the loans, even those with AAA ratings. The lenders hope with the higher premium, Wall Street will start buying again. We hope this is only a temporary blip.

The median price for single-family, re-sale homes fell 1.3% in July, up 6.4% year-over-year. The median price for condos dropped 0.8% to \$534,500.

Sales of single-family, re-sale homes fell 10.3% from June, off 9.5% year-over-year. Condo sales were down 6.7%, month-over-month, and were off 8.3% com-

Trends at a Glance (Single-family Homes)			
	Jul 07	Jun 07	Jul 06
Median Price:	\$856,500	\$867,500	\$805,000
Average Price:	\$1,042,711	\$1,066,610	\$977,524
Home Sales:	881	982	973
Inventory:	4,448	4,504	4,023
Sale/List Price Ratio:	100.3%	100.2%	99.6%
Days on Market:	50	53	40
Days of Inventory	151	138	124

pared to last July.

Inventory fell in July, with single-family homes down 1.2% from June and up 10.6% year-over-year. Condo inventory was down 1.6%, month-over-month, and up 10.3% compared to last June.

My advice? For buyers, the rise in mortgage rates for jumbo loans, which are needed for most all sales in the Valley, will reduce your buying power.

The thing to do is to look for lenders who keep their loans in-house and don't bundle them up and sell them on Wall Street.

For sellers, the pool of buyers in the low-end of the market have already been hit by tightened underwriting standards, now, the mid and upper-end of the market have been hit by rising mortgage rates. The pool of potential buyers has shrunk again. If you have to sell, you need to be very aggressive.

The real estate market is very hard to generalize. It is a market made up of many micro markets. For complete information on a particular neighborhood or for an evaluation of your home's worth, call me.

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What Do Average and Median Prices Say About Home Values?

The short answer to that is nothing!

What is the median? Given an ordered set of numbers, the median is the number that appears in the very middle of the list (or, in the case of a list with an even number of elements, the average of the two numbers at the midpoint).

The average price is reached by adding up all the sales prices then dividing by the number of homes sold.

Let's look at the five home sales in Atherton last month. The homes were sold at \$3,725,000, \$4,750,000, \$6,150,000, \$10,600,000 and \$26,000,000.

The median home price was \$6,150,000. The average price was \$10,245,000 — higher than three of the five homes. The average price

is computed by adding up all the sales prices then dividing by the number of homes sold.

A few higher than normal sales will skew the average dramatically.

County	\$(Avg-Med)	% ▲
County	\$186,211	21.74%
Campbell	\$67,367	7.74%
Cupertino	\$159,994	12.80%
Gilroy	\$143,772	21.30%
Los Altos	\$141,450	7.86%
Los Altos Hills	\$185,008	8.71%
Los Gatos	-\$66,242	-3.97%
Milpitas	\$38,614	5.66%
Monte Sereno	\$683,333	24.30%
Morgan Hill	\$72,124	8.40%
Mountain View	\$36,242	3.42%
Palo Alto	\$139,543	9.46%
San Jose	\$81,839	10.64%
Santa Clara	\$33,538	4.47%
Saratoga	\$140,521	9.34%
Sunnyvale	\$2,029	0.22%

This table refers to the July sales statistics median and average prices table on page 2.

Median price gives a better picture of the typical amount being paid to buy a home than an average price. In the current market, where the entry-level home sales have been savaged by the sub-prime loan mess and the share of \$1,000,000+ home sales have risen, statistical prices have been rising. The question is have actual home prices been rising? The answer is no. It just looks that way.

The problem with placing too much emphasis on median and average prices occurs when people equate the typical amount being paid to buy homes with the market value of a specific home.

If the median price increased by 10%, many people would assume that the market prices of their own homes have increased by 10% as well. But this is a questionable assumption, because while the median accurately reflects the price tag of typical home sales, it does not measure changes in the character of homes being purchased (such as house and lot size, condition, location etc.)

Put another way, the median price shows how much the typical person is willing to spend on a house -- but it does not show what that person is getting for the money.

The median price can overstate pricing power, as is happening now, or ...

Continue on Pg. 3

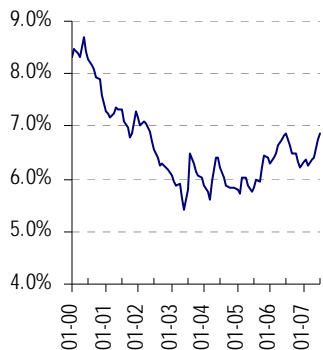
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The Real Estate Report

Mortgage Rate Outlook

30-Year Fixed Mortgage Rates



Aug. 3, 2007 -- Mortgage borrowers and industry participants hoping for a quiet mid-summer had their hopes dashed anew this week, as more bad news pummeled select portions of the mortgage and lending markets. As is usually the case, traditionally-documented, good-credit quality borrowers are among the least affected by the stanching of certain forms of credit. 30-year fixed rate mortgages rose by a lone basis point (.01%) to an average 6.88%, while hybrid 5/1 ARMs held on at 6.47% amid the swirling maelstrom.

Because of investor pullback, certain mortgage products are said to be very dear right now, including alt-A and alt-doc programs, especially at higher LTV ratios. That pullback carried over into the non-conforming ("jumbo")

markets, with at some lenders jumping by as much as 7/8% for certain products, with rate quotations all over the ballpark for some (and "no quote" for others). Underlying credit markets are clearly jittery, and borrowers with loans in process which require certain budget- or credit-expanding options should stay in close touch with their lender... and perhaps be prepared to have a deal fall through, if present credit market troubles continue to expand.

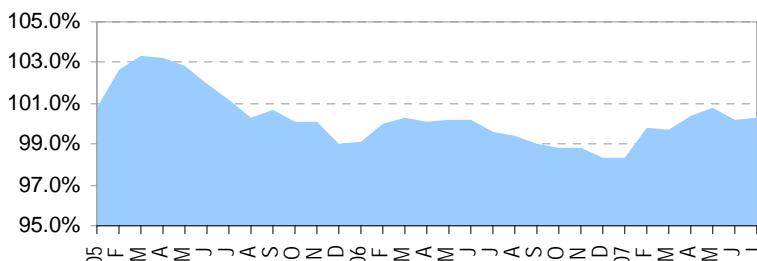
The moderate (and moderating?) pace for the economy and slightly easing inflation may help move the Fed to a easing bias, but any such expectation is premature. Even if the Fed was to lower interest rates 25 or 50 basis points, the effect on long-term interest rates would be negligible in the

present market environment; even 50 basis points would provide little help for borrowers facing ARM resets. Interest rates aren't the problem at the moment, at least so far, but the continued and perhaps accelerating pullback in the availability in credit for marginal mortgage seekers is a situation which could do considerable additional damage to the nation's housing markets.

For top-flight borrowers, the continued downward pressure on underlying interest rates hasn't yet translated into lower mortgage rates, but history says it ultimately will. For borrowers closer to the fringes of lending, your rates, product choices, and available credit are all becoming more limited.

July Sales Statistics															
Single-family Homes															
County	Prices		Unit Sales	Listings		DOM	SP/LP	Compared to Last Year				Compared to Last Month			
	Median	Average		New	Total			Med.	Ave.	Sales	Listed	Med.	Ave.	Sales	Listed
County	\$856,500	\$1,042,711	881	1,892	4,448	50	100.3%	6.4%	6.7%	-9.5%	10.6%	-1.3%	-2.2%	-10.3%	-1.2%
Campbell	\$870,000	\$937,367	28	43	75	47	101.1%	3.0%	4.1%	115.4%	-5.1%	13.4%	10.0%	-15.2%	-9.6%
Cupertino	\$1,250,000	\$1,409,994	43	45	64	34	101.0%	20.2%	21.8%	19.4%	-34.7%	3.7%	9.0%	26.5%	-13.5%
Gilroy	\$675,000	\$818,772	40	93	405	93	98.3%	-6.9%	-2.7%	-18.4%	30.2%	-9.4%	-4.2%	21.2%	-4.9%
Los Altos	\$1,800,000	\$1,941,450	33	22	28	36	104.3%	0.0%	-0.1%	57.1%	-69.6%	7.5%	4.8%	-26.7%	-36.4%
Los Altos Hills	\$2,125,000	\$2,310,008	6	12	49	61	95.3%	-7.6%	-19.6%	-45.5%	-30.0%	-21.2%	-21.2%	-45.5%	2.1%
Los Gatos	\$1,670,000	\$1,603,758	31	38	97	63	98.9%	28.5%	11.3%	72.2%	-31.2%	28.5%	2.6%	-20.5%	-14.2%
Milpitas	\$682,500	\$721,114	24	65	140	66	99.0%	-10.2%	-14.6%	-41.5%	4.5%	-6.5%	-5.2%	-7.7%	4.5%
Monte Sereno	\$2,812,500	\$3,495,833	3	7	18	14	96.2%	32.8%	42.6%	-33.3%	-25.0%	52.0%	89.0%	200.0%	-5.3%
Morgan Hill	\$858,730	\$930,854	30	78	285	78	97.9%	-14.1%	-12.1%	-16.7%	5.6%	4.2%	11.4%	0.0%	-5.6%
Mountain View	\$1,058,500	\$1,094,742	26	20	20	26	104.5%	16.3%	5.9%	18.2%	-57.4%	2.0%	4.9%	30.0%	-39.4%
Palo Alto	\$1,475,000	\$1,614,543	41	39	39	20	105.6%	10.5%	-2.0%	-10.9%	-56.2%	3.0%	-8.2%	-29.3%	-17.0%
San Jose	\$769,000	\$850,839	411	1,151	2,736	52	98.9%	3.2%	3.0%	-20.8%	25.1%	-0.4%	-0.8%	-14.0%	1.9%
Santa Clara	\$750,000	\$783,538	49	98	155	27	101.0%	7.1%	3.8%	-12.5%	15.7%	0.0%	1.1%	2.1%	5.4%
Saratoga	\$1,505,000	\$1,645,521	33	49	114	95	99.2%	9.1%	12.2%	22.2%	-22.4%	-15.4%	-15.1%	6.5%	-4.2%
Sunnyvale	\$930,000	\$932,029	71	102	121	17	102.9%	12.0%	9.6%	14.5%	3.4%	-2.6%	-5.5%	-13.4%	-4.0%

Sales Price/Listing Price Ratio



The Real Estate Report

Buying a Home in California

REAL ESTATE AGENTS

In California anyone who offers to buy, sell, or lease real property for compensation must be licensed.

There are two types of licenses given by the state: Brokers and Salespeople. Any broker or salesperson can also be referred to as a sales agent, every salesperson must work for a broker.

Brokers can also work for another broker. When doing so, they function as sales agents and not as the Broker of Record. The Broker of Record is the person who assumes all responsibility for supervising the sales agents.

AGENCY

Agency is one of the more arcane aspects of real estate law in California. It includes sub-agency, dual-agency and buyer's agency. Agency is in a state of flux at this moment in many parts of the country. Suffice it to say, unless you have signed a contract delineating your agency

relationship, the agent you are working with may not owe his primary fiduciary responsibility to you.

FINDING THE RIGHT HOME

This is the first task your agent will perform for you, and it is probably the least important. Before driving all over, your agent will conduct an interview to determine if you are ready, willing and able to buy a home. Don't take this personally, the seller wants to know. Plus, the more ready, willing and able you are to buy a home, the better price you will get.

It's funny how that works sometimes. We've shown people the perfect home at the best price and they decided to wait. One day, one week, it didn't matter. When they finally decided to buy, that house is invariably gone.

Next, the agent will inquire as to the details of the home you are looking to buy. This way the agent

can bring you directly to the most suitable homes on the market.

If the first thing an agent wants to do is pop you in his car, go find another agent. Driving willy-nilly around the county is an exhausting experience. No experienced agent drives people around without a qualifying interview first.

You do want an experienced agent, don't you?

Also, a good agent will have you begin the loan process immediately. We're not talking about getting pre-qualified, we're talking about getting approved for a loan. This will put you in the strongest possible negotiating position next to buying with all your own cash.

CONCLUSION

There's a lot more that goes into buying a home, but we're running or understate it, which will start happening as the housing market returns to normal. out of room. If

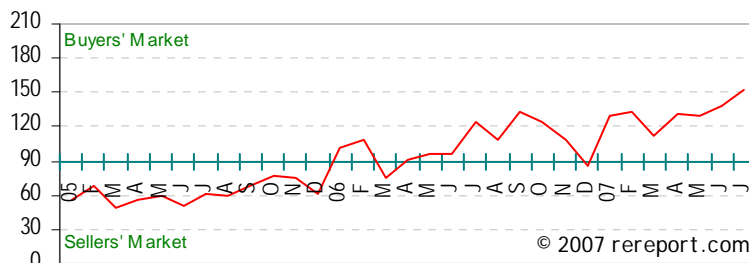
you want to discuss the entire process, please contact me to schedule a meeting.

...Continue from Pg. 1

understate it, which will start happening as the housing market returns to normal. The median home price certainly has its uses as a statistic. It is very easy to ascertain and can be sliced and diced by area, price level, property type, and any number of characteristics. And it is a fairly accurate assessment of what people are, in general, willing to pay for a home at any given time. But the median only gives us a rough idea of the changes to the market price of a given home. For this purpose, it fails to tell the whole story. In the years to come, as everyone attempts to interpret what's going on with the housing market, it will be important to keep the limitations of the median price in mind.

County	Prices		Unit Sales	Listings				Compared to Last Year				Compared to Last Month			
	Median	Average		New	Total	DOM	SP/LP	Med.	Ave.	Sales	Listed	Med.	Ave.	Sales	Listed
County	\$534,500	\$556,013	387	683	1,579	46	99.8%	4.3%	4.2%	-8.3%	10.3%	-0.9%	-3.2%	-6.7%	-1.6%
Campbell	\$491,950	\$546,079	24	29	52	55	99.3%	-12.2%	-1.2%	60.0%	36.8%	-14.4%	-4.2%	-25.0%	2.0%
Cupertino	\$644,190	\$691,834	21	17	18	40	99.5%	-14.7%	-9.6%	133.3%	-41.9%	-5.8%	-1.5%	-4.5%	-5.3%
Gilroy	\$405,000	\$405,000	1	9	35	129	99.0%	24.0%	9.5%	-500.0%	25.0%	n/a	n/a	n/a	9.4%
Los Altos	\$610,000	\$975,000	3	5	4	11	107.0%	-19.2%	23.9%	-72.7%	-63.6%	-41.9%	-15.6%	-40.0%	-76.5%
Los Gatos	\$585,000	\$646,376	13	7	22	43	99.0%	-11.4%	-12.3%	62.5%	-26.7%	-26.0%	-18.5%	-7.1%	-40.5%
Milpitas	\$591,500	\$565,288	10	29	59	41	99.2%	12.7%	9.6%	-50.0%	-9.2%	1.1%	1.0%	11.1%	13.5%
Morgan Hill	\$458,750	\$469,875	4	16	33	104	97.7%	-12.3%	-10.1%	-55.6%	13.8%	-13.4%	-9.4%	0.0%	6.5%
Mountain View	\$650,000	\$633,735	39	41	46	26	102.3%	8.3%	11.2%	8.3%	-43.9%	1.6%	1.3%	0.0%	0.0%
Palo Alto	\$720,000	\$745,847	17	11	11	30	101.1%	2.4%	-4.8%	54.5%	-42.1%	-1.4%	-16.9%	30.8%	10.0%
San Jose	\$470,000	\$497,366	197	406	1,102	54	98.9%	-4.1%	0.2%	-18.3%	22.4%	-5.7%	-2.1%	-1.5%	-1.3%
Santa Clara	\$517,500	\$525,107	26	60	118	38	99.8%	16.3%	6.9%	-16.1%	10.3%	6.2%	0.6%	-7.1%	6.3%
Saratoga	\$821,500	\$821,500	2	9	12	25	98.7%	48.6%	39.8%	-33.3%	0.0%	14.9%	17.5%	-33.3%	50.0%
Sunnyvale	\$589,500	\$586,846	30	44	67	30	100.4%	3.8%	4.1%	36.4%	-2.9%	4.8%	3.1%	-34.8%	-8.2%

Days of Inventory



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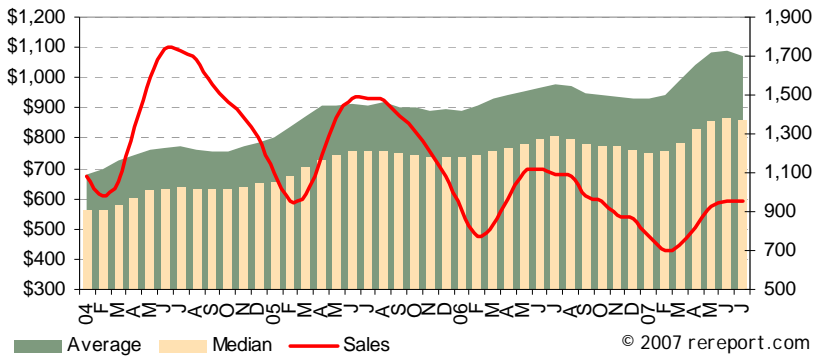
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Silicon Valley Homes: Prices and Sales

(3-month moving average — price in 000's)



“The Super Tax Break” – Personal Residence to Rental

Did you know that you can avoid paying tax on more than \$500,000 of gain on your home? Many people are aware of the advantages of Internal Revenue Code Section 121, which allows a married couple to exclude up to \$500,000 of gain on the sale of their personal residence (\$250,000 for a single taxpayer). Although this amount of gain is generous in most areas of the country, in California and a few other states, many people expect to receive more than \$500,000 of profit when they sell their home.

What is much less understood in the real estate world is that a homeowner can avoid paying all of the tax on their home by converting it to a rental. Once the home is converted to a rental, the owners can sell it and use both the Section 121 exclusion of gain and the Section 1031 deferral of gain provisions to exclude some of the gain and defer paying tax on the rest.

For example: John and Mary Smith have lived in their home for twenty years. They acquired it for \$100,000 and it is now worth \$1 million, so if sold, they would have \$900,000 of gain. If they sell it without converting it to a rental, they would be able to exclude \$500,000 of gain but would have to pay state and federal capital gains tax on the additional \$400,000 of gain.

John and Mary Smith decide, however, to convert their property to a rental. After renting it for a year or two, they sell it for \$1 million. Since they used the home as their personal residence at least two of the past five years, they are able to exclude \$500,000 of the gain. They can then use the remaining funds to acquire replacement investment property and defer paying tax on the balance of the gain.

In order to completely defer the remaining gain, the traditional rule is that the investor must acquire property with a fair market value equal to or greater than the relinquished property, and must invest all of the equity from the relinquished property into the replacement property. When gain has been excluded under Section 121, the amount of value and equity required is reduced by the amount of gain that was excluded.

To be certain that they will defer all of the remaining gain, the Smiths should consult with their tax advisor before setting up the exchange. Although the new property must be investment property, the Smiths can decide later to move into it, and if they live in it a minimum of two years and own it for at least five years, they can exclude up to \$500,000 of gain on the sale of that property.

Of course, investors need to comply with all of the rules of Sections 121 and 1031 in order for this to work. The IRS recently published Revenue Procedure 2005-14, which explains how the two statutes may be combined for one property. This includes not only the situation mentioned above, but also a sale of a personal residence with a home office or separate guest house that is rented.

Some of the requirements to keep in mind are:

- To take advantage of the \$500,000 exclusion (\$250,000 for single taxpayers), you must own and live in your home at least two of the past five years;
- You can only take advantage of the section 121 exclusion once every two years;
- Section 121 doesn't allow you to exclude any gain attributable to depreciation deductions taken since May 6, 1997, but that gain can be deferred under Section 1031; and
- To take advantage of the deferral of gain under Section 1031, all or a part of the property you sell and the property you acquire must at the time of sale be used in connection with your business or held for investment.

This article discusses some general concepts, but you should consult with your tax advisor to plan your particular situation. Compliments of First American Exchange Company

for a [city-by-city breakdown](#) and to receive the [monthly report regularly](#), visit my website at

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