REAL ESTATE FINANCE
THE QUARTERLY REVIEW OF COMMERCIAL FINANCE TECHNIQUES

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Are We Still Rich? Were We Ever?

The Wilshire 5000 indicates that the national net worth has dropped about 10% over the last 12 months. That is $4T on a total U.S. household net worth of $40T. The drop is about the size of all the nation's defined benefit pension plans, or all of the defined contribution plans since the two are of similar size. After taking that kind of hit, it is fun (in a morbid sort of way) to see how your business is performing and how the real estate business is doing overall.

First, how is our industry doing? The latest NCREIF returns (December 31, 2000) show good times continuing to roll with a 12% annualized rate of return in the fourth quarter. The commentary in the Fourth Quarter NCREIF Report focuses on whether 1) real estate returns lag and a big "second shoe" is about to drop on real estate prices, or 2) real estate never got as overvalued as technology and/or shows low correlation with stock market returns. My view is that the truth lies somewhere between these two possibilities.

Commercial real estate is roughly $5+T of the $40T net worth while individual homes are $10+T. If both drop by half of the Wilshire drop of 30% ($4T on $14T), then the national net worth is down another 5% or $2+T (15% on $15+T).

So how have you done? The personal benchmark looks roughly like this. The median household income is about $50,000 with the average closer to $75,000. The corresponding net worths are a little tougher to estimate since net worth is skewed even more to the upside. Still, the following breakdown is not outside the realm of reason.

Starting at the top, for the relatively few high fliers with sufficient IQ to read this journal, here are the official REF upper-end numbers:

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Group	Net Worth Definition	# of Members	Average per Household in Category
Well-off	$500,000-$5,000,000	4,000,000	$2,000,000
Affluent	$5,000,000-$25,000,000	1,000,000	$8,000,000
Rich	$25,000,000 up	10,000	$80,000,000

To be classified as a rich household, you really *need* $25,000,000. With this kind of base, you earn $1,000,000 per year in real terms after tax even if you never get out of bed. You can afford both a big boat and a partial interest in a jet. Your percentage of free time is limited only by how well you really want to get to know yourself.

If the average of the well-off families have $2,000,000, the affluent $8,000,000 and the rich $80,000,000, then the top 5% of Americans have 60% of the nation's net worth. Since we know with a little more precision that the top 5% of income earners pay 50% of the nation's income taxes (pre-Bush), the slightly higher figure for net worth seems reasonable. This leaves $16T for the other 105,000,000 households or about $150,000 per household. Most of this group own less that two second homes and have thought seriously about executing a Chapter 7 financial escape plan at least once in the last five years.

With these highly rigorous definitions, its back to real estate, the national wealth drop, and your personal performance. If the average rich person's $80,000,000 in net worth is divided like the national wealth, then she has $30,000,000 in stock and $30,000,000 in various forms of real estate. This isn't big to the California Public Employees Retirement System, but it's roughly equal to the real estate allocation of a $600,000,000 pension plan (chronically under-allocated at only 5%). So, if you are average rich and lost less than $9,000,000 in the stock market and less than $4,500,000 in real estate, then you had an above-average year and you can walk tall at the club.

On the other hand, if you are the average working stiff, then the performance test is considerably less forgiving. Since your net worth was only $150,000, if you lost over $45,000 on that Amazon/Cisco play when you could have invested the money in a midsize BMW, you're a loser. This really is a morbid way to have fun.

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