

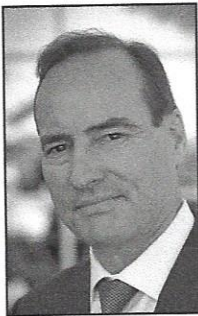
Boom & Bust

July 2018

Real Estate Is Going Nuts in Leading Cities

Time to Protect Yourself From the Burst

— Harry Dent, Editor



China's largest cities are so overpriced that migrant workers are going back to the rice paddies. And I predict urban unrest in the coming years from the younger migrant workers who don't know how to farm, or who refuse to leave the city. There's at least 150 million in that group.

In San Francisco, you have people living in cars and taking showers at the office. Teachers live in dormitories. Others rent out single rooms in houses. Starter homes average around \$1.1 million, and that's for a smaller home. Not some mini McMansion!

In Vancouver, you have a 15% foreign buyer tax, plus 12% to 16% on top of that if you flip within one to two years. Prices dropped at first, but are now shooting to new highs despite that aggressive policy. You've 400-foot micro studios with a fold-down bed for \$400,000 or more.

In China, there are 66-square-foot "closet" apartments. That's the size of the 7-by-10 foot carpet in my home office. A bed, a toilet and sink, a small drawer and closet... Practically a jail cell.

In Los Angeles, and more cities like San Francisco, Washington, D.C., and Cleveland, there's been renter riots. Meanwhile, rent crashed 15% in Chicago.

This just can't keep going on for much longer...

How could cities and countries not understand that super-high real estate prices are bad for the economy. It only raises property taxes for the government – typically not commensurate and on a lag – and largely rewards older people who already own.

It kills the younger workers that will drive the economy for decades to come!

Many can't afford to buy until much older. Some will never be able to afford to buy housing. This causes income spending to shift towards housing and leaves less for everything else, especially discretionary spending like eating out and vacations.

Perhaps the most important point is that the next real estate crisis and bubble burst is going to come from the high-end and trickle down.

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Editors

Harry Dent and Rodney Johnson

Last time, it came from the low-end with defaults on subprime mortgages and moved up to the higher end...

And my most important principle is: The bigger the bubble, the bigger the burst.

It's the most attractive cities that bubble up, while attracting the most affluent domestic and foreign buyers, that end up crashing the most.

This was as true back in the 1930s, when Manhattan crashed 61% versus 26% for the average house, and took 25 years to get back to the highs. Whereas the average house did in just seven years – as it was in the 2006 to 2012 housing crash.

It'll be even more so this time, as the best cities are way above the last bubble. The average house is back at the same levels of price and overvaluation.

I was living in bubble-prone South Beach, Miami, when the last bubble peaked, and saw the second worse crash in Miami. Upscale condos are now twice as high as then at \$2,000 per square foot compared to the \$800 to \$1,000 price tags last time around.

My wife and I were looking at moving back to her home town. But we finally decided, "No thanks!"

Now I live in a similar condo on the beach in San Juan, Puerto Rico, for \$500 a square foot, one quarter the price of my South Beach condo. When I was in Miami for New Years, there were more than twice as many cranes as in 2006 – and more than I saw in Dubai in 2006 just before the crash there.

Penthouses keep selling for prices near \$100 million in Manhattan, and there's a new one listed at \$250 million.

The latest record-breaker in home prices in Los Angeles was an 8,000 square feet home on the beach in Malibu for \$110 million. That's \$13,750 per square foot, rivaling the highest valuation for a penthouse in Manhattan in 2014. Houses rarely sell at valuations similar to top penthouses in major cities.

In San Francisco, a recent poll showed that 46% are considering leaving the city they love in the next few years due to off-the-chart high prices and rents.

How many have to actually leave or riot to stop the madness?...

The Bubbiest Cities in the World

There are two themes to the cities with the most extreme bubbles.

The first city, China, has a massive debt bubble, along with overbuilding, and over-investing. (The Chinese buy and hold empty condos and think they will keep going up. Try doing that in the U.S. or anywhere else.)

The second is mostly in top English-speaking cities. With great educational systems, they attract foreign buyers who want their kids to have a firm education. They're also drawn to these cities of abundance so that they can launder their money out of their more corrupt countries.

If we look at the most dangerous valuations globally, we see these two factors clearly.



The most overvalued is, of course, Hong Kong. It's the most prosperous and global city in China. The median value is 19.4 times income for 2017. The average value is 41.1, but that's skewed toward the high-end by the affluent and foreign buyers who spend exponentially more.

Then comes Beijing and Shanghai, at 15.0 and 14.5, respectively, with average values at a whopping

48.1 and 42.8 times income. Cities like Shenzhen, Tianjin, and Guangzhou would also be at similar values.

The Western deniers, Australia and New Zealand, are in the mix. Sydney's at 12.9 median and 11.1 average, with Melbourne at 9.9 and 9.0. Auckland's at 8.8 and 11.1. The fact that the average is lower than the median in Sydney and Melbourne shows that it's the everyday person bringing up prices and not just the foreigners.

Other dangerous valuations are San Francisco (9.1, 12.3) and Honolulu (9.2, 9.0) in the U.S., Vancouver (12.6, 16.0) in Canada, London (8.5, 22.2) for England, and Singapore (4.8, 22.2). Sky-high averages in London and Singapore suggest very high foreign buying.

These cities are where foreign buyers launder money outside of their more corrupt countries and governments, especially the Chinese, along with the Russians, the Arabs, and the wealthy Latin Americans or the drug dealers.

You buy expensive real estate to get money out of your country under the guise of needing it for your kids to go to school or for your temporary residence or for business. Then you never send the money back to your home country.

The Chinese are restricted to moving \$50,000 a year out of the country. But they can buy an expensive condo or home for tens of millions, or commercial real estate for more. And, of course, to maximize their money laundering, they want to pay all cash – even with record low interest rates. Their goal is to get as much money out of the country as possible in a seemingly legitimate way.

I've been predicting the Chinese government would start cracking down on major business and real estate purchases, and they finally started that big time in 2016. Capital outflow for business purchases has fallen 35% from \$241.4 billion to \$158.1 billion into 2017. They're cracking down on major real estate purchases, too.

How can China afford to have their top 1% funnel money out of the country, or leave and move to countries like the U.S., Australia, Canada, the U.K., or Singapore?

They can't.

And many of the top English-speaking cities are fighting back to prevent them from flooding the economies, or holding up real estate.

Vancouver was one of the first (after Australia) as its citizens were starting to revolt against Chinese buyers and sky-high prices that were driving them out of their own city. On August 2, 2016, they slapped a hefty 15% tax on foreign investors, with another surcharge of 16% if you flip within one year, and 12% if you flip within two years.

You'd think that would stop the madness.

And for six months into February 2017, it did.

The average prices for detached homes fell from the peak of \$1.83 million in January 2016 to a low of \$1.53 million in March 2017. But now they're approaching new highs.

Average prices overall, including the larger majority of condos and apartments, are already at substantial new highs. Small apartments, on average, go for \$600,700.

When we had our Irrational Economic Summit in Vancouver in the fall of 2016, the new trend was 400-square-foot studio apartments with a fold down bed for \$400,000!

Try getting laid with that condo...

The number of vacant houses in Vancouver has doubled from 3% between 2001 and 2006 to 6% in 2011 due to foreign (Chinese) buyers who typically don't rent them out.

Vancouver has recently raised its 15% tax to 20%.

Even worse, the tax surcharge in Vancouver caused a spike in foreign buying in Toronto. Prices there surged 33% between March 2016 and April 2017.

Yes, that much in one year! It forced Toronto to slap on a foreign surcharge of 15%.

When your primary goal is laundering money outside of your country before it blows, or the government starts confiscating it from the wealthy (which already happened in Saudi Arabia), you just aren't that price-sensitive.

Singapore taxes sellers as much as 16% to discourage flipping by foreign buyers.

Australia originally joined in on a less aggressive level.

Originally, New South Wales (Sydney) legislated a 4% tax on foreign or absentee buyers, and a .75% land tax for all investors, for 4.75% total.

Since then they have doubled that 4% tax to 8%.

Queensland (Brisbane) put on a 3% tax on foreign and a .75% land surcharge, or 3.75% altogether.

Victoria (Melbourne) was the most aggressive at 7%.

And in Australia, foreign buyers are restricted to buying new construction. If they buy land they have to start building on it within two years. It's estimated that 10% to 15% of new construction is bought by foreigners. Within that percentage, around 25% is for condos, and it's estimated that around 75% of all construction comes from the Chinese.

Have all those taxes made a big difference? No!

The favored cities, in order, for Chinese buying Down Under are: Melbourne, Sydney, Brisbane and Perth.

After the taxes in 2016, Chinese demand only accelerated. Chinese students are the largest portion of foreigners at 29.4% since 10-year visas have become easier to get.

So, Australia's fighting foreign buyers on one hand, while encouraging on the other.

Hong Kong now has an even higher median income valuation of 19.4 times. It has had to fight mainland Chinese buyers with a stiff 15% tax on non-permanent residents for selling, and restrict small areas to residents only for the next 30 years. The government is expected to announce a tax on vacant apartments to help increase supply.

The U.K. has put an up-front 28% capital gains tax for foreign residential purchases, and an added stamp tax of up to 12%.

Switzerland has hard quotas for foreign buying by canton (like counties). That sounds like the best approach to me in this runaway money laundering market.

So, cities are increasingly fighting back, but with little progress. China's government is fighting back with stricter capital controls with more success.

But the truth in such a persistent bubble is that prices are going to have to start to visibly crack more to get buyers scared. That's starting on the high end

in places like London, Manhattan, Toronto, San Francisco, and Miami, as well as in niche markets like Santa Barbara, Napa, and Austin.

High-End Starting to Crack: More to Cracks Come

Manhattan is obviously the bubbliest area in New York.

Luxury housing there peaked at \$9.55 million in the fourth quarter of 2016 after bubbling from the fourth quarter of 2012, when prices were closer to \$4.8 million – doubling in just four years. It fell to 7.58 million during the fourth quarter of 2017.

That's 21% in one year.



The London Prime Index has fallen from 114 in the second quarter of 2014 to 98 in the first quarter of 2018. That's a more gradual fall of 14%, with most of that since the fourth quarter of 2015. It fell 3% in just last quarter, with volume down 19%, and 24% year over year and 33% since the peak.

The Miami luxury market took a sharp fall in 2016, but has recovered substantially in 2017 and early 2018.

It's getting volatile, but not clearly ready to crash just yet.

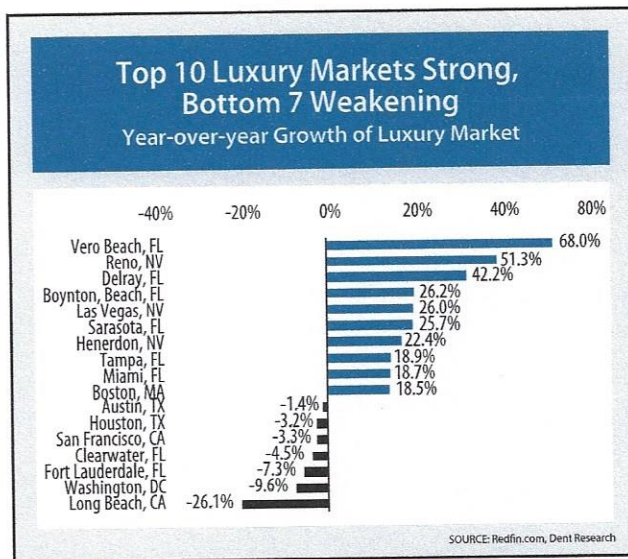
Toronto's finally feeling the brunt of that sharp

33% rise in home prices between March 2016 and April 2017, when Vancouver slapped on its aggressive surcharge. Home sales were down 22% year over year in April 2018, and a whopping 68% on homes over \$1.5 million Canadian dollars. Prices are down 12.3% from the peak, and 28.5% on detached homes.

Then there are what I call “niche” high-end areas like Santa Barbara. It’s down 17% in last year, while Napa’s down 6.7%. Both fell after being ravaged by fires. Hip, hi-tech, and funky Austin is down 4.3%. Foreclosures there are up 30% year-over-year.

Rent has crashed 15% in Chicago. It takes a salary of \$96,600 to afford a two-bedroom apartment in the downtown area. Chicago also has the most homes underwater at 15% versus 9.1% nationally – and that’s largely due to its high level of poverty in the Southside area.

In D.C. and New York, rent is falling from being high, while still rising aggressively in Los Angeles and San Diego (hence the rent riots) and is more mixed in San Francisco and Seattle.



This chart best summarizes the luxury markets top 5% that are still going strong – and they are crushing the rest.

Vero Beach led the last year, but is somewhat distorted by one large sale.

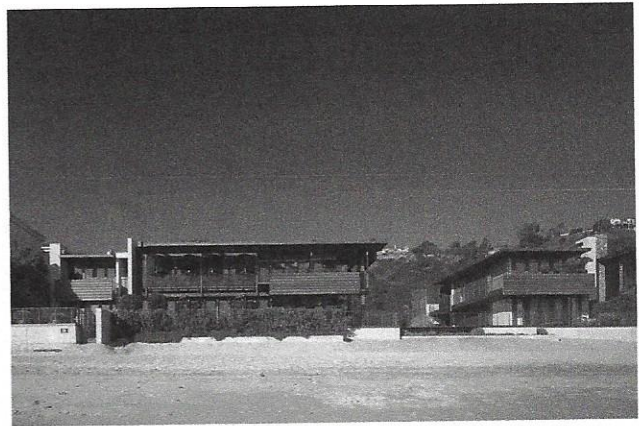
Even San Francisco is cracking by 3.3%.

Florida and Las Vegas real estate markets are doing the best.

The falling markets are greatly underperforming the rest – and they’re focused more on the West Coast, which is likely to see a broader-based decline due to having the highest valuations.

Recent Signs of the Madness

The most notable sign of the high-end bubble was the sale of a not so large Malibu beachfront home for \$110 million – the highest price on record in Los Angeles. The last record sale was the Playboy Mansion for \$100 million, which is a highly outdated house.



Source: Dent Research

This Malibu house is modest in size for the price. The property has a five-bedroom main house and a three-bedroom guest house with a total of 8,000 square feet. The biggest shocker is the price of \$13,750 per-square-foot that gets me. No house I know of has sold for anywhere near that.

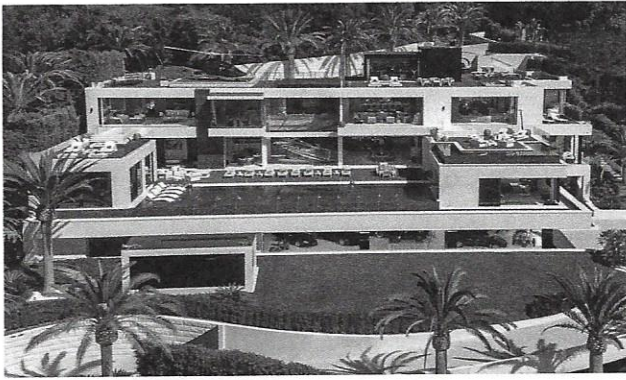
Is the beach that nice there? Does the ghost of Elvis live there?

The Hard Rock Café co-founder sold this to a natural gas billionaire, Michael S. Smith.

I previously showed the highest house listing at \$250 million in Bel Air.

As outrageous as that price sounds for a house on a rather small lot, it’s nowhere near as high as that \$13,750 per square foot price.

This house is a whopping 38,000 square feet with a helipad, three pools, a grass roof playground, and a \$30 million Ferrari collection on the bottom floor inside. That asking price was a mere \$6,579 per square foot.



Source: Dent Research

Well, that price just got dropped to \$188 million after a deal near that value fell through. That lowered it to \$4,947 per square foot – just above the typical high-end (non-Central Park penthouse) condo in Manhattan at \$4,000 per square foot.

In 2016, a 23,000-square-foot penthouse at 220 Central Park South – spread across four floors with 16 bedrooms, 17 baths, five balconies, and a massive terrace – was put on the market for \$250 million. It's to be completed in late 2018.

We'll see if that "pig" sells.

That's \$10,870 per square foot. It's right in line with other top penthouse sales over recent years between \$8,000 and \$11,000 per square foot. The annual taxes are \$675,000. The monthly maintenance fee? About \$45,000 to \$540,000 per year.

The highest valuation came back in 2014 when Sandy Weill (former Citibank Chairman and CEO) sold to a Russian mogul for \$88 million, or \$13,049 per-square-foot at 15 Central Park West. The most expensive sale so far has been \$100.5 million, at the 90-story One57, to a Russian buyer – a friend of Putin's, I'm sure. That house in Malibu tops even that.

And recently, a smaller condo of just 4,000 square feet on the 94th floor (out of 96) on 432 Park sold for \$32.4 million. That much for a modest box in the sky...

It comes out to about \$8,100 per-square-foot, and it's not even a penthouse. It was dropped from the asking price of \$40.5 million, or \$10,125 per-square-foot – another sign that the bubble is starting to crack on the higher end.

My condo in San Juan with an equally good view –

if not better – and about the same size would sell for less than \$2 million, or just \$500 per square foot.

To top them all, Mansion Global is now listing the most expensive home in the world for sale at one billion euros, or about \$1.15 billion U.S. dollars.

This place was once home to King Leopold of Belgium, and looks just as old. It has 10 bedrooms on 35 acres, and, of course, a 30-horse stable in the Saint-Jean-Cap-Ferrat area of southern France.

Meanwhile, in Hong Kong, there's a new trend of 600-square-foot upscale apartments that sell for \$3 million in the best areas... That's \$15,000 per square foot!

Bubbles Die at Their Own Hands

Once a bubble gets going, more and more people jump on the bandwagon until everyone's on, or until the bubble finally peaks of its own extremes. Nothing can grow that far past the fundamentals of income, or GDP, and not defeat itself.

It's like that one grain of sand that will suddenly cause a landslide if you keep dropping them, growing and steepening it into a mound. No one knows which grain will cause it, but you can see it coming.

The bubble that's been the most harmful in the U.S., and still shows only minor signs of cracking, is in San Francisco. It's beautiful, hip, has great food, and is the broader home to Silicon Valley and the information revolution.

A recent survey showed that a whopping 46% of people there say they are likely to move out of the region in the next few years and the overwhelming reason was simply runaway housing prices and rent.

Again, how can sky-high real estate prices be good for businesses or workers? And what do people sitting on accelerating real estate do for the economy?

Not a thing. They become a negative factor.

And who are these people ready to leave?

It's those under 40, which means Millennials. (The oldest being in their early 40s, and the youngest being in their early teens.)

That 46% was 40% in 2017, and 34% in 2016 (this trend is accelerating rapidly). Does this bubble finally end with a sudden mass exodus to Washington,

Nevada, and Texas? Places that are more affordable and have growing job markets...?

And where do they actually tend to go?

They go, in order, to: Sacramento, Seattle, Austin, Portland, Las Vegas, Phoenix and Chicago. Despite good weather and zero income tax rates, they aren't flocking to Florida.

The median (the everyday home) at the end of 2017 was \$850,000. That's up 13% from just last year. As of April, it's already up to \$882,500 – another 13% and it will be up to one million dollars.

Someone calculated that it would take 27 years for the average Millennial to save up for a 20% down payment in San Francisco. To buy just that one median home in the broader San Francisco metro area it would take a salary \$231,216 with a 10% down payment. In the downtown area, it would take \$350,000. Only downtown Manhattan is worse at \$418,000.

And then there are the even more downtrodden renters who've no hope of buying ... One-third of renters say they're having a hard time making payments, with 79% simply cutting back other spending, and 43% are drastically slashing their spending. Only 13% over 60 are having problems with making payments. And only 29% in the 40 to 59 age range – all of which are Boomers.

Los Angeles has the highest percent of renters.

Their home prices are not as high as San Francisco, but their income is substantially lower. Its prices at \$602,000 median make it the city with the second highest percentage of renters in the U.S. at 54%. And 57% of renters there pay over 30% of their income for rent!

So, no surprise it's leading in renter protests.

Miami tops the percentage of renters in Florida at 61.5% for the same reasons. High prices, but lower income jobs on average compared to San Francisco, Seattle, New York, or DC.

An Asian investor, Chung Suk Kim, bought a

seven-building apartment complex near a major university. The residents were all Latino or black. He immediately issued evictions for all 80 so he could turn it into student housing (people supported more by their parents or student loans). The residents protested aggressively in front of his mansion and refused to pay rent while this was contested.

People are fighting back.

Another Hispanic neighborhood, Boyle Heights, saw rent increases by as much as 80% in 2017. One group protested and took their landlord to court and got agreements for a 14% one-time rise and then a maximum of 5% a year.

That's a victory, but no way their incomes are going up that fast. So, even this isn't sustainable.

Homelessness in Los Angeles has gone up 40% since 2000.

When does that become untenable?

Renter strikes are growing in San Francisco, D.C. and Cleveland.

Miami has to be next.

Something has got to give here – and I think within the next year or so.

Will it be a sudden crash on the high end that is more noticeable and pervasive? Or will it be growing renter protests and buyers leaving expensive cities in mass?

A lot of people will say: "Harry, why do I care about the high end here? I'm not in the market for a \$110 million house."

One thing that's clear to me: This crash is starting at the extreme high end and it will affect you before long.

I say by early 2020, real estate will be cracking everywhere, and likely will crack before that. So, don't get complacent if prices keep edging up.

We'll keep monitoring the high end for signs of cracking to keep you updated. Now on to Rodney with his portfolio update.