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# It's Very Basic Economics, Stupid

By Harlan Green

What was the reason for Fed Chairman Bernanke's almost pathetic plea to understand real world economics, in his latest speech at the Atlanta IMF Conference? He said in essence that the Fed is caught between worries about inflation and an economy that is sputtering along. But in fact he was really calling for help—that he needed help from Obama and Congress to keep economic growth going, because there is really no danger of inflation.

If politicians want to obsess over the possibility of future inflation, in other words, then let them tackle the longer term entitlement problems—like Medicare, or foreign wars. But instead they are doing all the wrong things, as are the Europeans. They keep advocating drastic austerity measures while cutting taxes, when that will only depress growth further and expand the deficit (via less tax revenues), not shrink it.

Economic growth has slowed drastically at the moment. But much of this is because of geopolitical uncertainty—the Arab Spring, Mideast oil, the euro bailouts of Greece, Portugal and Ireland, and maybe even our own debt ceiling problem.

But the Federal Reserve's Beige Book report says most of the U.S. is still growing, retail sales are getting better, consumers and homeowners are paying down debt, and service sector activity in general that provides

up to 70 percent of our growth is expanding faster.

Then why the obsession with inflation when it is just gasoline prices that are boosting the CPI index at the moment? Without gas prices the CPI has risen just 1.2 percent in a year. It is the classic battle between creditors and debtors that heats up during recessions. Creditors hate any inflation, since it devalues existing debt. And right now creditors—bankers and other holders of debt on Wall Street—seem to control the agenda. That is why we are hearing cries of austerity and budget cutting—all deflationary measures. Such policies drive down prices, all right, into deflationary spirals such as caused the Great Depression if done at the wrong time—like during this weak recovery.

The best weekly news was the jump in the Institute of Supply Management non-manufacturing (i.e., service-sector) index. The ISM reported broad month-to-month acceleration in the non-manufacturing economy. The report's composite headline index rose 1.8 points to 54.6 with strength centered where it should be, that is in new orders which rose more than four points to 56.8.

The ISM employment index also accelerated nicely, up 2.1 points to a 54.0 level that for this report is very strong. In other readings, deliveries lengthened, which is a sign of strength, and backlog orders rose at a healthy pace. Given that this report is based on a broad sampling of the nation's purchasers, says Econoday, it indicates that



economic momentum is headed back up, albeit moderately.

One reason for what looks like a temporary slowdown, is that sales of combined North American-made vehicles and imports dropped to an annualized 11.8 million units from 13.2 million in April. The North American component declined to 9.1 million from 10.1 million.

The North American component includes Japanese brands assembled in the U.S. and parts shortages limited supply of many models significantly. Lack of available

Japanese brands pushed up related prices. This may have convinced many car buyers to wait for the desired model to become available and/or for a lower price, according to analysts.

What is the help that Bernanke's Fed needs? It can't do all the heavy lifting, if more fiscal stimulus isn't forthcoming. A good place to start is forgiving some of the \$trillions in delinquent real estate debt in-

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# Hybrid Housing Holds Appeal

By Lynn Underwood  
*Star Tribune (Minneapolis)*  
MCT

Mary Myss never has to paint her Chaska, Minn., home, mow the lawn or shovel her driveway. That's because her walkout rambler is in Pioneer Point, a subdivision of single-family homes that are maintained by a homeowners' association.

"It's one of the best kept secrets," said Myss. "It's amazing that more people don't know about it."

Before moving to Chaska, Myss and her children lived in a big house in Wayzata, Minn., with an equally big yard that she was fine with tending — until she wasn't.

"What put me over the edge was coming home from work in the winter after a snowfall and I couldn't get up the driveway," she said.

At Pioneer Point, she still has her own entrance, her own yard and her own deck, but none of the work to care for them. Her \$220 monthly association fee covers lawn care, snowplowing, exterior repairs, maintaining the common grounds and even blacktopping the driveway.

"When I'm home, I'm sitting on my deck barbecuing and playing with my grandchildren rather than dealing with maintenance

issues," she said.

This type of housing — called manor homes, villas, cottage homes or detached townhouses — is tailored to people who want the privacy of a traditional single-family home with the convenience of a condo. And although it accounts for only a tiny slice of the real estate pie, builders and developers are cautiously optimistic that this hybrid style of house will grow in popularity, partly because it's designed for a growing population: retiring baby boomers.

"Many of my buyers are people who just want to lock the door and leave to go to the lake or to a second home in the winter," said builder Forrest Harstad, whose 69-lot development, the Fields of St. Michael, offers homes ranging from \$200,000 to \$400,000.

In the past, Harstad has built twinhomes and townhouses, but he said customers were looking for "homes that don't share a common wall but everything was taken care of."

K. Hovnanian Homes, a national builder based in New Jersey, is aiming at the 55-plus crowd with its Four Seasons at Rush Creek in Maple Grove, Minn. Homes range from \$260,000 to \$400,000. Owners pay \$260 a month for the tennis courts, clubhouse, pool and fitness center, as well as lawn care. According to John Nelson, Minnesota division director of marketing, many of the buyers are snowbirds.

"We've done more than 100 of this type of housing developments across the country," said Nelson. "But it's more common in the Southern market and East Coast, where there are more retirees."

Here in Minnesota, empty nesters and retirees aren't the only ones attracted to the low-maintenance housing. Some builders have discovered that busy young professionals and families with young children are interested, too.

"We started with ramblers for empty-nesters, but now we're doing two-stories for families with young kids who like that kind of atmosphere," said Tom Budzynski, owner of TJB Homes, whose St. Andrews Village in Blaine, Minn., offers a community pool and a park. About half of the 60 homes, which start at \$300,000, have been sold.

Budzynski said the "no snow, no mow" amenity is giving his development a competitive edge in a tough housing market. "We have a model in a nearby development that's not association-maintained," he said. "We're getting a lot more action at St. Andrews."

The upscale Crosby Cove, a collection of \$2 million-plus mansions on a channel leading to Lake Minnetonka, has attracted a mix of young families and seniors, said Jennifer Cramer-Miller, vice president of L. Cramer Builders, who also owns a home there.

"There's so many inherent benefits, such as noise reduction, and it also unifies the neighborhood because they maintain it together," she said.

In most developments, the homeowners' association hires a management company to take care of services or contract the work out themselves. One of the perks is that all the mowing, trimming and weed-whacking is done on the same day, leaving the rest of the week quiet. Monthly fees range from \$95 for basic mowing and snowplowing to \$260 depending on the range of services and neighborhood amenities such as community pools, docks and parks.

But not everyone wants to live in a managed subdivision. Associations have guidelines and often reserve the right to approve landscaping, exterior modifications, even paint colors. Some subdivisions don't allow fences or swing sets and gardens are scrutinized in case they impede lawn mowing.

"There are rules in order to maintain everyone's home values and make it a cohesive neighborhood," said Steve Meillier, a real estate agent selling villa homes in St. Johns Village at Dancing Waters in Wood-

bury, Minn., for local builder McDonald Construction.

Myss has no issues with the restrictions. "I do have to get permission to do anything," she said. "I can't paint my house purple, but I view that as an advantage. And everyone's lawn looks fantastic."

Mark Gergen, president of Miles Development in Bloomington, Minn., said his company recognizes that some buyers might

*This type of housing — called manor homes, villas, cottage homes or detached townhouses — is tailored to people who want the privacy of a traditional single-family home with the convenience of a condo.*

feel that associations pose too many restrictions. At their 28-lot project Rosewood of Northfield, residents can put in a garden or put up a fence if they wish.

"Our goal was to create the best of both worlds — bigger lots than a townhouse that allow for a three-car garage," he said. "Owners get lawn care and snow removal, but they don't have anyone telling them they can't put a tomato in a pot."

Despite the growing interest in association-maintained single-family homes, builders are proceeding with caution.

"We'll watch how the market develops," said Bjorn Freudenthal, vice president of sales and marketing for College City Design/Build. "Right now we're focusing on selling the homes in Liberty Park," a 22-home maintained development in Northfield, Minn.

And Pulte Homes, which built Myss' home in Chaska, is targeting a different group of buyers. The company is offering 177 home sites in five new Twin Cities projects this summer. None is association-maintained.

"We're getting back to fundamentals," said Marv McDaris, Pulte division president. "We feel location, schools and communities are driving the housing demand. Our clients have said they'd rather use their purchasing power to buy a good location and nicer home features vs. having their lawn maintained."

But for Jim and Holly McGill, who own a walkout rambler in the Fields of St. Michael, their monthly fee of \$95 is money well spent.

"We enjoy sitting on the deck every Tuesday and watching someone else cut the grass," said Jim. "When we run Up North during the winter and come home, we know we can drive right in the garage," he said. "It feels really good."

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## Basic Economics...

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curring during the Great Recession. Real estate is hurting so much because it is estimated 25 percent of home loans are under water—i.e., have more loan than equity in their property. So the quickest way to bring down their debt load—which is holding back consumers spending—is to forgive some amount of the underwater mortgage principal.

The first quarter 2011 Federal Reserve so-called Flow of Funds report shows just how much is already "forgiven", in some sense. Much of homeowners' equity has been lost with so many foreclosures and short sales, of course. But homeowners are also paying down debt in record amounts.

The Fed estimated that the value of household fell \$339 billion in Q1 to \$16.1 trillion in Q1 2011, from just under \$16.5 trillion in Q4 2010. The value of household real estate has fallen \$6.6 trillion from the peak - and is still falling in 2011.

In Q1 2011, household percent equity (of household real estate) declined to 38.1 percent as the value of real estate assets fell by \$339 billion. A note by Calculated Risk says something less than one-third of households have no mortgage debt. So the approximately 50+ million households with mortgages have far less than 38.1 percent equity - and 10.9 million households have negative equity.

But banks are reluctant to do so unless urged by the White House, banking regulators, and/or Congress, even though it is also in their interest to take the delinquent mortgages off their books. And there has

been no requirement that mortgage holders/servicers do so, even with the HAMP loan modification program.

Creditors—or rentiers in Europe—were also calling the tune at the beginning of the Great Depression in the Hoover Administration. Roosevelt understood this, and instituted inflationary measures by increasing government spending, with regulations that controlled the banking speculation that caused the credit bubble—i.e., highly leveraged bank loans with no regard to risk. It took some inflation to get the economy growing again. In other words, it was the debtors turn to recover, to bring us out of the Depression.

The Roosevelt Administration actually refinanced more than 1 million homes under the Home Owners' Loan Corporation from 1933-35, with bonds sold to the banks. It also bought many homes lost to foreclosure and rented them back, until they could be sold into the private market. Can we imagine what could be done today with that same political will? One million homeowners then would translate to at least 5 million today, when it is estimated there are no more than 8 million homes in various stages of delinquency. That is, if there is the political will to clean up the real estate mess.



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