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Real Estate as a Commodity Play

By Lawrence Yun, Chief Economist



We are all well aware of high commodity prices in today's market. All tangible raw materials are commanding sky high prices. Oil, diesel, copper, steel, cement, and other construction-related costs (except lumber) are all up substantially. Some have even brought back the [Malthusian theory of too many people on earth outstripping available resources](#).

In the past five years the consumer price index rose 18 percent while the producer price index for construction rose 39 percent.

In light of the resource price boom, one interesting angle that has not been delved into deeply is that real estate could be a nice commodity play. Real estate with all the tangible and concrete solid qualities - unlike paper financial assets - has historically been a good hedge against inflation. High commodity prices and high inflation rates in the late 1970s and early 1980s led to double-digit gains in home prices. Why not this time?

Well, right now there are too many home sellers in relation to home buyers. This short-term dynamics of high inventory will require some time to work off. However, once inventory reaches a manageable level, does it then mean a catch-up of real estate prices to reflect high commodity costs and the high cost of construction?

Think about a home that is situated where land is cheap and plentiful. How much is that home worth? If a person desires to build a home there, then the price of the home will be the cost of construction. Say that home owner wanted to charge a much higher price than the cost of construction. Then a buyer would do well by simply building a new home at the cost of construction rather than paying the higher asking price. So the long-term home price equilibrium can be viewed simply as the cost of production. If the cost rises, then so will the home price.



"A sale is not something you pursue, rather, it is something that happens to you while you are immersed in serving the best interest of your customer" – Author Unknown

Where land is not cheap and plentiful, then real estate prices will not only reflect the cost of construction, but also the shortage and the premium value of the land. New York, San Francisco, and the Washington D.C. areas, for example, will always command high home prices because of the very limited land supply that is close to downtown job centers.

Going back to areas of the country where the developable land is relatively widely available, the rising cost of construction will surely then lead to proportionately higher home prices.

Inflation has been a big headache for the country. A way to assuage that pain, however, is to own commodities- and a simple, good way is to own real estate. If commodity prices further accelerate for some reason, you will automatically be in the game.