

Four Corners Economic Quarterly

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Office of Business and Economic Research, School of Business
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Durango Real Estate: Look West To Cal-i-forn-i-a

By: Dr. Luke Miller

As a finance professor, I often get asked my opinion of the housing market. Many times I respond with the most recent housing numbers.

"On August 1st, the National Association of Realtors reported that existing home sales, which represent approximately 85% of the housing market, fell 3.8% in June to a 5.75 million annual rate. That was a larger decline than expected and marked the lowest level in nearly five years.

Additionally, on August 2nd, the Commerce Department showed sales of new homes dropped by 6.6% last month to an annual rate of 834,000, well below the consensus estimate of 900,000. The median home price also fell 2.2% to \$237,900. That was the largest drop since April 2007."

Today I would like to share a relatively unknown statistic with you concerning the housing market and indicators of its future direction. Over the last 80 years, housing activity in southern California has preceded moves in other U.S. cities with 90% accuracy. For example, southern California's real estate market leads New York City by 6 months, Boston and Washington D.C. by about 1 year, and Seattle and Houston by about 2 years. It's like having a crystal ball to gauge the future of your local housing market.

So, how does Durango measure up? Well, first you need to select an indicator. Although there are numerous indicators to consider, the favorite of most economists is residential building permits. When demand is strong, builders pull more building permits so they can build and sell homes. Unwilling to be stuck with homes they can't sell in a softer market, builders reduce the number of permits when demand drops. Second, I selected San Diego as the benchmark city, as it has had the highest correlation with other U.S. cities over the last 20 years.

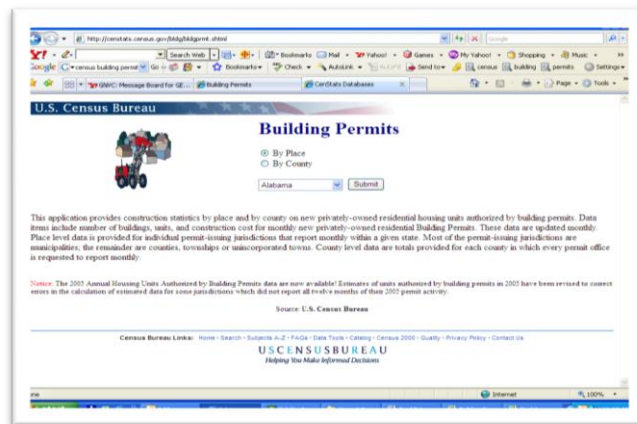
I evaluated Durango versus San Diego residential building permits since 1995. As you can observe on our website at

soba.fortlewis.edu/econoweb, Durango is eerily tracking San Diego building permits with a one-year time lag. If the trend through the first half of 2007 continues, San Diego building permits will be down for the year – suggesting a weaker 2007-2008 for Durango real estate, as well. As for median home prices versus sales, I have found these attributes are unique; in some areas home prices correct to the downside, whereas other areas maintain prices through an increase in unsold inventories. Finally, one important point to consider is the greater volatility (upswings and downswings) of the southern California market versus most other markets. As such, the magnitude of southern California swings is not as important as the direction of the swing and the duration.

No one is capable of exactly calling the end of this housing correction and the start of the next run. However, I will gladly take one quick glance at San Diego residential building permits over the word of any self-proclaimed sage. Please visit our website at soba.fortlewis.edu/econoweb, for several plots comparing Durango and San Diego on an annual and monthly basis, plus links to building permit and other indicator websites.

The following plots compare La Plata County and San Diego residential building permits annually and monthly. Because of the magnitude differences between the two areas, I developed an index to better depict the relationship.

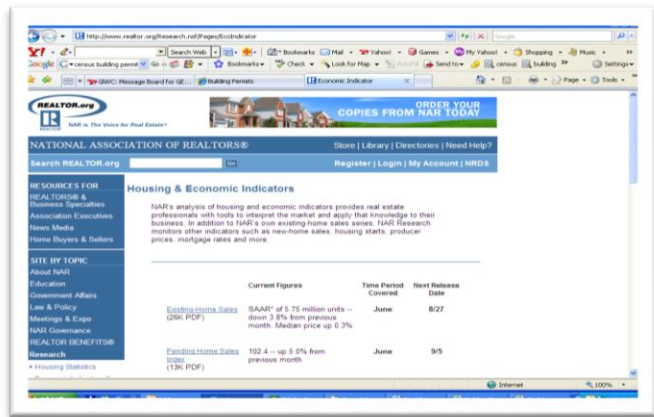
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The National Association of Realtors provides a list of real estate indicators that one can analyze to indicate some trends. Here are some of the indicators they follow:

- Existing Home Sales
- Pending Home Sales Index
- New Home Sales
- Housing Starts
- Housing Affordability
- Mortgage Rates
- Mortgage Applications

Go to: <http://www.realtor.org/Research.nsf/Pages/EcoIndicator>



statement. The calculator will request that you input the monthly pension you will receive from your public sector work. From this some people incorrectly infer that, if they will not receive a pension from their public sector work, they are unaffected by the Windfall Elimination Provision. If money was placed in a retirement fund in your name while working in the public sector, you will be affected. The lump-sum value of those retirement dollars will be used to impute a pension value based on your expected lifespan at retirement.

You may be thinking you can skirt all of this by collecting a Social Security benefit based on your spouse's work. However, the Government Pension Offset requires that, for public employees, the spousal benefit be reduced by an amount equal to two-thirds of the public pension. So, if your spouse has a monthly Social Security benefit of \$1000 and the monthly value of your public pension is calculated to be \$750 then you are not entitled to any spousal Social Security benefit.

All of this is quite complicated. If you want to learn additional details, try the paper on my web site: <http://soba.fortlewis.edu/owings/> Or, better yet, pay a visit to our local Social Security office. Make sure to bring along your annual Social Security statement.

Coloradans and Social Security

By: Dr. Stephanie Owings

If you have worked in Colorado in both the public and private sectors, you need to be aware that what you will receive in Social Security benefits may be less than your annual statement from Social Security indicates. For many individuals, the difference is very substantial. For instance, the actual benefits I can anticipate receiving are almost 40% less than what my annual statement from Social Security specifies. This discrepancy is due to the Windfall Elimination Provision. Although this law went into effect in 1983, many people are still unaware of it.

To understand how the Windfall Elimination Provision works, you first need to understand how Social Security benefits are calculated. If you worked exclusively for employers who collected Social Security taxes, your benefits will be based on your average monthly earnings, adjusted for inflation, for the 35 years in which you earned the greatest amount. The benefits that you will be paid are based on a formula that

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more heavily weights initial dollars earned. For instance, a worker who turns 62 in 2007 will receive a monthly benefit equal to ninety percent of the first \$680 in averaged indexed monthly earnings plus thirty-two percent of the next \$3420 plus fifteen percent of anything above \$4100. Thus, a 62 year-old retiring this year who earned \$54,000 per year, on average, in today's dollars, over the course of 35 years, would receive a monthly benefit of \$1766. Do the math yourself and see if you agree.

In any given year, about 18% of La Plata County residents work for an employer who does not collect Social Security taxes. If you transition between these employers and the private sector, the above formula structure generally overestimates what you will receive in Social Security benefits. Nonetheless, that is what is used to generate the benefit estimate on your annual statement. However, when your retirement actually arrives, the first bracket of monthly earnings will be multiplied by some number considerably less than ninety percent. How much less depends on how long you worked in the public sector.

If you wish to estimate by how much your benefits will be reduced, Google “Social Security On-line WEP Calculator.” You will need the history of your Social Security earnings found in your annual

Bears: Who is the Pest?

By: Dr. Robert J. Sonora

As is becoming increasingly obvious the number of human-bear interactions is on the rise. This is largely due to one factor humans have control over and one we don't.

What we can't control is the weather. As we know, an unseasonal frost killed much of the bears' natural source of food. Given bears daily requirement of 20 thousand calories to prepare them for hibernation they have to find nourishment somewhere. And that somewhere is town.

What we can control is the ease of access to unnatural sources of food. And herein lies the solution to the problem.

Economists are often maligned for our almost slavish attachment to “the market” and its equilibrium. The “impact of this”, and the “impact of that” are viewed through a lens of supply and demand. However, there are many circumstances where the market, and its resulting stability, collapses.

Externalities are defined as the cost or benefit resulting from an economic transaction that is borne by a third party.

An obvious example is smoking. If the economic decision is to smoke others bear some of the cost of the smoker's decision: second hand smoke, higher insurance premiums, smelly clothes, etc. To offset these costs we impose taxes on the smoker to “internalize” the external costs felt by the third party. Thus, we are not trying to necessarily protect the smoker from herself, but rather, protect others whose welfare is undermined by the smoker.

Similar analysis can be used to discuss the impacts of individual's decision to not use bear proof trash containers. The existence of a single “rebel household” can generate negative externalities for an entire neighborhood on two easily identifiable levels.

The first, and most obvious, is a bear who gets garbage from one house and opens the contents of the bag on a neighbor's lawn. Who bears the cost of the decision? The neighbor.

Secondly, suppose the rebel household leaves their garbage out, now we have a hungry bear roaming the neighborhood attracted by the easy pickings, teaching its cubs to dumpster dive not to forage for

berries and acorns. The bear, now habituated by the easy pickings, searches other houses for similar sources of food. And so the original choice of the rebel spreads throughout the neighborhood.

More externalities – more loss of social welfare. And the choices made this year will impact us for years to come.

If the rebel household lived in isolation, they would bear – no pun intended – the full cost of their decision. This is the pure market solution. But once the impact of their decision undermines third party welfare, some institution, the city of Durango, say, must arbitrate to realize the social equilibrium. As in the case of smoking, a tax is imposed to force the scofflaw to internalize the external costs borne by others – a fine.

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Alternatively, the city can encourage the use of bear proof containers, which provide an external benefit, or positive externality, by subsidizing the price bear proof containers.

Given the external costs of not having bear proof containers, six extra bucks a month over a four year period, or about \$190 in present value, is a bargain. A fine of \$200 or more should be sufficient to induce everyone in town to buy the new cans (assuming they are available, of course) or to change their behavior.

It may seem strange to view bear instinct as an externality, but the end result is the same – less euthanized bears. And it is bears which pay the ultimate price for problems associated with human’s choices – two strikes and they are out.



The *Four Corners Economic Quarterly* is a newsletter on economic indicators of Southwest Colorado published by the Office of Economic Analysis and Business Research in the Fort Lewis College School of Business Administration and Region 9 Development District of Southwest Colorado, Inc.

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