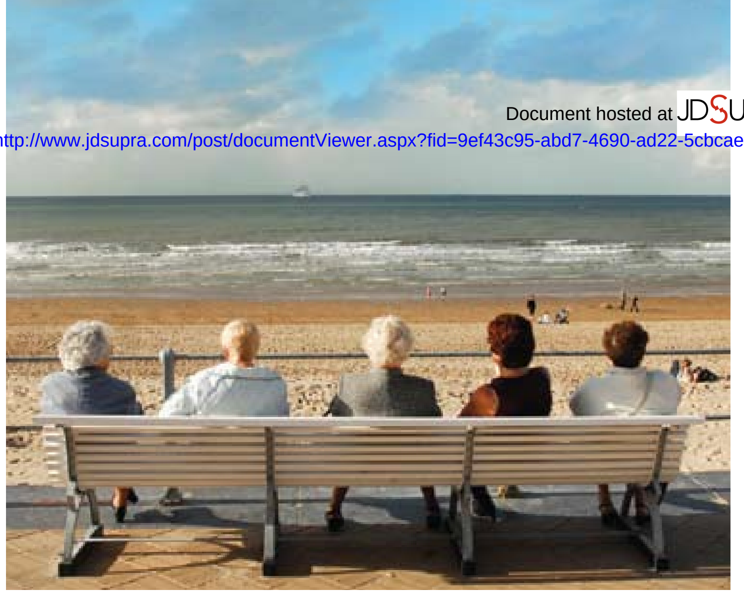

They're Coming! They're Coming!

Baby Boomers will transform the rental and healthcare markets in the Bay Area.

By **Jesshill E. Love III** & **Todd J. Wenzel**

The impacts of the Baby Boomer generation and their progeny, the Echo Boom, can be seen across virtually every sector of American society. As these proportionately large demographic sectors pass through the population timeline, they have a tremendous impact upon markets such as healthcare, financial planning and the job search.

In 1990, Ken Dychtwald and Joe Flower published the book, The Age Wave: How The Most Important Trend Of Our Time Can Change Your Future. In this seminal work, Dychtwald and Flower coined the phrase "age wave" and overviewed the impact of the Baby Boomer generation upon society at large.

Few have analyzed or taken account of the potential future impact of these two demographic sectors upon residential rental markets across the nation. The bottom line, as demonstrated below, is that the Baby Boomers and the Echo Boom will dramatically impact the residential rental market over the next ten years.

Supply and demand play an important role in residential income property values. The demand for rental property has been increasing steadily because the number of people entering the rental market has been increasing each year. At the same time, construction costs, stricter zoning ordinances and environmental factors are limiting the new construction of residential income property. Together, these trends bode well for investing in residential income property.

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The greatest demand for rental property is created, however, by the Baby Boomers' children, the Echo Boomers. An analysis from the book by Harry Dent, The Roaring Twenties, demonstrates a cycle of increasing apartment demand created by Echo Boomers. This cycle is calculated by lagging the birth rate by 25.5 years, and it shows that the Echo Boomers, who traditionally make up a significant percent of the adult population, are moving rapidly into the rental market.

In addition, lifestyle changes and elderly preferences are swelling the ranks of renters. Since changes to the tax act in 1997, individual taxpayers are able to exclude up to $250,000 of gain realized on the sale or exchange of a principal residence, and married couples can exclude up $500,000 if filing a joint return. Generally, this exclusion is allowed each time the taxpayer sells his principal residence, but no more frequently than once every two years. Because of this tax exemption, more and more Baby Boomers are selling their homes, saving their money and moving into rental property.

It is estimated that the demand for rentals is likely to increase over 10 percent during the next 10 years. Thus, it is easy to see why residential income property can offer one of the best protections against inflation. In fact, a study reported by the Journal of Financial Economics found that residential real estate is the only investment that offers a complete hedge against both anticipated and unanticipated inflation. People always need three basics: Food, clothing and shelter. As the population grows, the need for shelter grows along with it.

Alternatively, Boomers may sell their homes, take advantage of the $250,000/$500,000 capital gains exclusion and purchase rental income property in which they reside for two years. They then can move out of that primary residence and rent it out and move into separate rental property while keeping the income property as an asset. As long as they reside in that property as their principal residence the minimum two years, they may still sell the income property and again take advantage of the capital gains exclusion.

This discussion leads to two related impacts on the healthcare industry: First, developers continue to build more and more senior healthcare facilities to make room for the incoming boomers. This has been a boon for healthcare development. Second, because the Boomer's predicted move into the rental market, this will create an additional avenue of financial security to enable Boomers to afford the future skyrocketing costs of healthcare.

The hedge against inflation with residential rentals is greater because, unlike long-term commercial leases, they are generally on a month-to-month basis or short term leases less than a year. As prices increase, apartment owners can increase rents more rapidly with month-to-month leases than commercial owners who have long-term leases. Residential income property is one type of investment that can be a source of security and stability. Every investment has peaks and valleys, including rental real estate. But over the long-term, residential income property has historically come out ahead. The key is knowing the right time to buy and sell. That is the golden rule in investing. Presently, we are experiencing a buyer's market for the first time in approximately five to seven years, depending upon which analyst you follow. Further, commercial and residential lending rates are favorable for buyers. In short, it is appears to be a good time to buy and hold residential real estate for long-term investment. And sound investing and taking advantage of tax laws can be critical towards meeting the demands of increasing healthcare costs. ■

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