

The Residential Resale Market in the Central Valley 2010 – 2011

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We are in the midst of very interesting times in the residential real estate Business. The media, the internet and practitioners are full of opinions, analysis and predictions about this market:

In the Central Valley, we continue to be mired in distressed sales. We're still referred to as ground zero in the foreclosure morass, and we now have the unpleasant distinction of being named to "Worst places to live" lists by National Magazines.

If we were to look around for a source to give clarity to this housing market, we would be challenged.

They say "It's all in the numbers", but what if the numbers don't match up- in fact what if they don't even come close when comparing apples to apples? Trying to analyze and then forecast the residential market poses difficulties when NAR, CAR, Case-Schiller, CNN, Trulia, Zillow, the government and others have figures, statistics and prognostication that conflict and seem to be describing completely different markets.

It's hard to reconcile these diverse opinions and reports. It's no wonder the Public and the rest of us are confused.

Today I'd like to share some ideas and report on where we've been, what's happening now, and some trends we are seeing in the California residential Resale market and specifically here in the Central Valley.

One year ago a major driving force in our market were the Tax Incentives offered by the government. Buyer activity was strong—especially as we neared the expiration date of the incentives.

Now that the **incentives have expired** and run their course, the market has had to operate on its own to move forward. 2011 appears to be another transition year- just like 2010 was. It seems to continue a slow move toward stabilization.

On a statewide level, the California Association of Realtors forecast 502,000 home sales in 2011 compared to 492,000 in 2010 – modest 2% increase. Their economists also predict the Median price will increase a mere 2% to \$312,500.00 statewide.

Although Foreclosures and REO's seemed to be on the decline in the second half of 2010, we expect them to remain high in the Central Valley as the foreclosure filings rise, employment statistics are weak and our economy continues to struggle.

On a larger scale, there are factors which will prevent the housing market from a full recovery.

There is the possibility of a double-dip recession, there's the impact of Federal

Economic policies. The size of the unknown Shadow inventory. There is the uncertainty of Freddie Mac & Fannie Mae's future. Congress is considering curtailing and or eliminating the mortgage interest deduction.

These are powerful forces that could and are affecting the National, State and our local real estate markets.

Now, that being said, even with those uncertainties, there are tremendous opportunities in the Central Valley real estate for: 1st time buyers, investors, long time owners with equity and even the international buyers.

These buyers, taking advantage of opportunities will pave the way to a healthier housing market in 2012 & beyond.

In comparing 2009 to 2010, some interesting trends emerge. Specifically the ratio of distressed sales, compared to overall sales is important in determining the health and future of our market. We all know in California we have seen significant numbers of distressed properties on the market. In 2010 the share of distressed sales relative to all sales, declined to 41% from 46% in 2009 in California. We did not see that decline here in the Central Valley.

There are still many distressed properties on the market, but perhaps this reduction in California is a good sign the housing market is at least heading in the right direction.

I'd like to take a moment to share some statistics that compare the various components of the listing inventory in the Central Valley. I think you will see some noteworthy trends. If we analyze the current listing inventory for San

Joaquin and Stanislaus & Merced Counties we find that as of February 2011 there were 4801 listings for sale.

. 42.2% are Short Sales 22.7% are REO's and 35% are non distressed listings. Compare this to February 2010 when 3519 were for sale.

36.2% Short Sale 26.3% REO's and 37.3% non distressed listings.

Short sales as a market segment continue to increase here. This increase in Short sales represents a definitive change in our market. Short Sales often tend to be higher priced than REO's, but less than non distressed sales. Due to the nature of the process they tend to stay on the market and in escrow longer, than REO's and foreclosures. They typically are in better condition, since they are usually occupied and maintained during the short sale process---unlike REO's and foreclosures.

Because short sales represent a better financial settlement for the banks, we are seeing them more frequently, and they are becoming somewhat easier to accomplish.

It has become obvious that loan modifications aren't successful and do not Work. Thus the next alternative is the Short Sale. Some lenders are streamlining and simplifying the process by implementing computer programs that connect the Realtor® with the asset manager and decision maker. Other lenders reach out to the Real Estate community promising cooperation, speed and minimizing paperwork and obstacles.

All is not perfect nor rosy, but these new approaches to disposing of Short sale

properties could lead to an improvement in conditions favorable to our market recovery, especially in mortgage lending.

Mortgage financing is the backbone of every Real Estate market. Aside from the obvious effects we've felt from the subprime meltdown, there are a few other trends that have occurred. There has been a change in the distribution of loan products over the past few years. The gap between FRM's and ARM's mortgages was smaller between 2004 & 2006 for first mortgages. That gap has widened tremendously with FRM's representing 97% of all first mortgages. The usage of second mortgages and HELOC'S has diminished considerably. Buyers Using no down payment mortgages have declined to about 4% of all buyers. Other than VA and USDA loans, zero down payment mortgages have pretty much disappeared.

There seems to be a HAVE'S vs. HAVE NOT's situation when it comes to down payments. More buyers today are putting the recommended 20% down payment compared to an average down payment of 12% in 2006. Due to changing mortgage underwriting terms and the fact that buyers in 2010 are turning to their savings or 401k's instead of creative financing for their down payments in 2010. These buyers now have more SKIN in the game.

FHA is Back in greater numbers in the Central Valley for a number of reasons.

Due to tightened lending criteria and standards, FHA's easier qualifications make it attractive. The smaller down payment requirement of 3 ½ % fits well for 1st time buyer strapped for cash. A few years ago many REO's and Short sale asset managers refused to consider FHA loans on their properties. Now these asset managers realize that FHA mortgages are not the trouble they perceived them to be. Depending on who you believe-----

Anywhere from 29 – 40% of new first loans in 2010 in our area were FHA mortgages, compared to just 1% in 2006 & 2007.

For the upper end, jumbo financing poses a unique set of problems. Another fall out of the mortgage meltdown is the difficulty in obtaining jumbo mortgages. This has had a serious negative effect on the move up real estate market the past few years. Currently there is a move to lower the limit for jumbo mortgages as well as further tightening underwriting criteria for upper end buyers. This does not help, nor bode well for recovery.

Another interesting trend in our market is the increased number of "all cash" sales. I think there are a few reasons for this. First the decline in prices has allowed good savers to reach out and pay **All Cash**. Secondly, tighter loan criteria forces some buyers to elect to pay cash instead of financing their purchase and going through a mortgage hassle. 3rd-, investors realize that today's prices are attractive as an investment. This **All Cash** phenomena became very clear to me when throughout most of 2010 in our Stockton

office, approx. 30% of our sales each month were **ALL CASH** sales. In January 2011 and February 2011, 50 % of our sales were All Cash – No Mortgage.

The tightening of underwriting standards in general and across the Board have become very problematic.

The lending pendulum has swung to the other extreme to where buyers < and properties in the eyes of underwriters are considered **“GUILTY until proven innocent.”** All of us in the field and I’ll bet many of you in this room, have fresh war stories of last minute – day before recording demands posed by underwriters that become “deal killers.” Review underwriting and review’s of review appraisals with new findings pose challenges and often defy logic. It often seems the over correction has become a CYA in case there’s ever another melt down. None of us would think it’s sensible to return to the “anything goes Steam on the mirror” underwriting standards of the past, but today’s super restrictive environment is hindering the housing recovery.

Another interesting perspective on our changing market is the length of time to close. For the 4 year period of between 2005 & 2008 the time it took to go from contract to close averaged 30 days for a normal transaction. In the last two years with the tougher underwriting standards for mortgage loans, escrows are taking longer-----about 40 days on average. Actually the length of time it takes to close escrow is the same as it was in 2003. (Just prior to the mortgage frenzy of 2004, 2005 & 2006.)

longer time

This shows the market returning to somewhat normal conditions as local escrow companies are taking the time to properly review documents and close the transaction.

For distressed sales, the length of time to close the escrow is about 5 days longer than non-distressed home sales. As we all know, not all distressed sales are created equal, the problems in closing are generally with short sales, which take about 50 days to close escrow compared to 35 days for REO's /Foreclosures sales.

Last minute surprises, problems and delays aren't just caused by mortgage underwriters. Out of the area title and escrow companies contribute their share of problems in getting deals closed.

A few years ago legislation was passed giving buyers the choice of selecting the title and escrow provider. Sadly, this has not happened. REO's and short sale asset managers select the providers. Oh, they put in their preprinted counter offers that the buyers do have a choice—if the buyers are willing to pay all of the title and escrow fees for both themselves and the seller. I am amazed this has not been challenged. In any event, we see many problems with these out of town and even out of state title companies. Late, last minute prelims, lost documents, unrecorded liens and back HOA dues present challenges and delays in the sale---- typically just as the buyer per diem costs are due to kick in.

As the market here improves and normalizes, a welcome change will be dealing with local title and escrow companies, lenders and local appraisers.

BUYERS

I believe analyzing the buyers gives us a little more clarity in understanding today's market and perhaps a window into the next market.

It's ^{so much} easier to spot trends when we know the mindset and motivations of the buyer.

We can't say enough about the significant impact of first time buyers in this market. While inventory has been tight the past few years, demand has risen as first time buyers enter the market place demanding their share of the American Dream. They are looking for what I call the "Real Estate Trifecta." The right house at the right price and the right rate.

The share of the first time buyers increased again in 2010 representing 47% of all buyers in California. In the Central Valley higher affordability and low interest rates created opportunity for well qualified buyers with a steady job, stable income, a good fico score, a down payment and **a lot of patience.**

First time buyers were spurred on in the first quarter of 2010 by the tax incentives offered by the government. The expiration of the tax credit had a direct effect on slowing down sales in the balance of 2010.

According to CAR, 73% of the first time buyers admitted the federal tax credit had an impact on their decision to buy their home. It was big for 1st time buyers but not the primary reason to buy for most other buyers. For many 1st time buyers, it was likely the tax credit represented part of their down payment or their closing costs.

Another factor and trend we saw last year was that the share of buyers who bought an REO/ Bank owned property increased from 38% in 2009 to 41% in 2010, while those who purchased a short sale increased from 13% to 16%. Because distressed properties generally sold at a bigger discount than regular sales, interest in distressed sales was fueled primarily by first time buyers. The stigma was minimized.

An interesting observation by CAR is that buyers in 2010 were more optimistic about future home prices than buyers in 2009.

As I mentioned earlier, even with all the first time buyers, buyers in general were putting a larger percentage down payment for their purchase compared to 2009. This may signify a change in buyer's attitude toward home ownership as well as complying with the requirements of mortgage lenders.

Home buyers in 2010 continued to experience difficulty in obtaining mortgage financing. On a scale of 1 – 10, with 1 being “Very Easy” and 10 being “Very Difficult”, home buyers in a CAR study reported an average difficulty level of 8.5. It was 8.1 in 2009. It is getting tougher to get a mortgage. It's getting tougher for

buyers to take advantage of these low interest rates.

Today's buyers are different than the buyers of previous markets. The Internet and the wide spread availability of information on the real estate transaction has made today's buyers more educated, more empowered and more demanding. Overall 70% of buyers are pleased with their agents, however, with prices falling sharply from the peak years, and distressed properties galore, many home buyers have very high expectations of their agent in the negotiation process. Often they were dissatisfied that they didn't get a "Better Deal" on an REO or Short sale.

Buyers today control more of the process. Due to the ready availability and immediate access to listing websites, buyers are on almost equal footing with many agents on the knowledge of homes available. Buyers armed with cursory information on homes and sensitive to lack of inventory, often look at properties not in line with their goals and/or price range. The search process gets muddled by misunderstandings

Even armed with all the listings, buyers still need the agent for market advice, risk management, contract, disclosures and managing the process to a successful close.

All in all, the internet and access to information for Buyers and Sellers is Beneficial to all of us in the Real Estate transaction: the Realtor, appraiser, lender, inspector and escrow officer. Because "A better educated client is an easier client to do

business with.”

PAUSE

I spoke earlier of the “Real Estate Trifecta” I believe the months ahead in the Central Valley offer an opportunity to achieve the home buying trifecta: finding The right home at the right price at the right interest rate **and here’s why:**

There is a wider variety of homes on the market right now. There is a larger inventory of short sale , REO’s and non distressed homes for sale. Today’s buyers have more to choose from than in the past two years.

Secondly, home prices some areas have stabilized and in other areas they are still dropping. **You know** these prices remain well below the peak of the past decade. In California there used to be a 10 – 1 ratio between the California median price and the California median household income during the last peak. That ratio has fallen to 5 – 1; a level that hasn’t been seen in this century. It’s even lower here in the Central Valley. Affordability is growing to historic proportions.

Third, mortgage rates are still at a 50 year low, which pushes the monthly

payments down, growing affordability. Despite a few bumps and declines in the past few months, today's rates fuel greater affordability and the opportunity to lock in cheap money for a long time.

This is a market loaded with opportunities.

There are some challenges. High unemployment, tighter credit standards and assets that have lost value in recent years give households ongoing speed bumps to face in the year ahead. Still the next few months offer a rare chance to win the home buyer Trifecta. We know that rates will rise as the economy gains strength. The supply of homes is better than last year, but that may point to stable or slowly rising prices in the near term. In the end, if a household can buy now- and find the home that will meet its needs for the next few years ,at a payment they can afford, they cannot lose if they act soon.

INCLOSING...

The situation in the current housing market continues to be a tale of two housing markets. The market under \$300,000 has been driven by distressed sales and is very active. Well priced homes commonly draw multiple offers. The Higher market is constrained by restrictive financing options, and now increasingly have seen an increase in distressed properties listed in the upper end.

"If there is a leaner supply of homes available in the lower end, prices will

stabilize and rise, but a larger inventory and limited financing will cause softness at the high end” according to Leslie Appleton Young, Chief Economist of the CAR. She also said,

“There are indications that lenders will increase the number of foreclosures coming on the market, but it’s not likely lenders will flood the market with distressed properties.” (End quote)

Predicting markets entails looking at the wild cards as well as the givens...

WILD Cards

Some of the Wild Cards for 2011 include the federal government’s housing policies,

Increasing numbers of ^{upside down} ~~underwater~~ homeowners, and the strength of the economic recovery.

THOSE ARE SOME WILD CARDS.

What we do know for certain, is that Favorable home prices, Attractive Interest rates and high Affordability will continue to make buying a home in the Central Valley attractive for those in a position to buy.

This truly is an opportunity market.