

REAL ESTATE NEWS



Penny & John
DUMKE
Fine Homes



4th Qtr. 2007

Penny 562 596-4461

www.LBRE.com

John 562 596-4451

CAR's 2008 Economic Outlook

Credit Crunch, Short Pays & CAR's 2008 Economic Outlook

by John Dumke

We recently had the good fortune of attending an economic presentation by Robert Kleinhenz, CAR's Deputy Chief Economist.

On our website, we have posted information contained in this presentation. Go to www.LBRE.com and click on 2008 CAR Economic Outlook.

The article to the right, cites this document and is a treasure trove of detailed housing data.

The Credit Crunch

I'm a big fan of financial sayings. "It's only when the tide goes out that you discover who's been swimming naked" - Warren Buffett, is one of my favorites. In August of this year, that is exactly what happened to many sub prime lenders and the loans they made. See page 34 of document referenced in sidebar to left for timeline of credit crunch.

Our 2nd quarter 2003 Newsletter was titled "Creative Financing, A Sign of Trouble? We expressed concern over bad loan quality. It wasn't too hard to spot a bad business practice, lending to buyers unable to repay. But as long as the tide of home prices was rising, no one knew who was headed for foreclosure.

The credit crunch created an immediate repricing of mortgage risk. Interest rates on Jumbo loans (greater than \$417,000) went up, while exotic loans disappeared. The housing market lost the cheap & easy money which helped propel it dramatically higher. During the last three years of the boom market 03'-05', many lenders said that the majority of the loans they were originating were for marginal buyers, either 100% loans, bad credit and/ or "stated income" (buyers unable to document income), now referred to as liar loans. Post credit crunch, lenders have tightened up all around, some loan programs are gone and other loan programs with higher loan to values or "stated income" loans are more restrictive.

Loosing these loan products means loosing buyers. Less buyers means less sales, and it has shown up as a big drop in the number of sales. The charts of SFR sales in Long Beach (as seen on the front cover), shows the number of sales chugging along at about 170 sales per month for the first half of 07' and in the last two months (August & September) sales dropped to about 110 per months, a whopping 35% decrease. The date that I track is the opening escrow date, not the escrow close date that is typically reported, so we are usually ahead of the curve in reporting a trend.

Taken in a positive way, if this is possible, we only lost the loan programs lenders shouldn't have offered in the

first place. Loans are still readily available to qualified buyers at great interest rates.

The negative spin is that we have lost a significant portion of buyers, so the demand for housing at current prices has diminished. Availability of marginal loans helped prices on the way up. Their loss will hurt prices as these loan programs disappear.

Short Sales

Moving forward the housing market will be saddled with the baggage of these bad loans. Which leads us to the topic of "short pays". A short pay is a home sale in which the seller owes more than the net proceeds from the sale of the home. For those fiscally responsible, having your home loan in excess of your homes value might seem like rare case. But keep in mind that any home purchased with 100% financing is immediately underwater. Even a home purchased with 5% down is immediately a potential short pay, since 5% equity doesn't quite cover the typical closing costs in a sale. Then add a small price decline like 10%, which we have already seen and then anybody with less than 20% down who bought at the market's peak is a potential short sale.

While LTV (loan to value) is an issue, the real issue is whether the buyer can afford the property or not. The best case scenario is a buyer obtained a full doc loan (the income was verified) and qualified for a fixed rate loan, and has not had any financial hardship. But this was often not the case with many exotic loans. Many loans that were 0% or 5% down were stated income loans (income was never verified) or buyers qualified at an unrealistically low teaser rate, made possible by Alan Greenspan's lowering short term interest rates below the rate of inflation. With a low teaser rate of 1-2% and lure of rapid price appreciation, even a prudent buyer might be seduced into buying more home than they could afford.

While the unwinding of these loans will affect the market, it is too hard to tell how much prices will be affected and how long it will take for the market to digest these loans. Certainly the supply will increase as many of

these marginal buyers that purchased in 03'-06' find it difficult to hold on to a home that they can't afford.

While homes that go into foreclosure will affect the entire market, some neighborhoods will see more visible signs than others. For example, in many of the well established neighborhoods of Long Beach, there are a lot of original owners. In addition, recent buyers of these properties were more likely to put 20% down and qualifying with no "shenanigans".

While entry level neighborhoods, condos, and newer tracts in the Inland Empire will be more likely to have a significant number of buyers that obtained marginal loans and are struggling to hang on. Last week I was pricing out homes in Anaheim under \$425,000. Out of 30 active listings, 20 were listed as "short pays". The likely reason the home is on the market is because the owners can't afford the payment. They won't get any proceeds from the sale, so there is no other reason to sell. With no equity in the property and little incentive or ability to continue to make a high payment there is little reason to hold on. My guess is that a majority of these 20 homes will be REO's in the next 6 months if the short sales don't get approved by the lender. Even if these short sale do get approved, short sales sell for prices similar to or less than foreclosures, putting downward pressure on prices.

Similarly, I was just pricing out a home in the Los Altos area. Out of 75 competing homes on the market, only 5 were short pays, showing East Long Beach homeowners are more stable. So while better neighborhoods will see less foreclosures and short pays, no market exists in a vacuum.

For buyers in the jumbo loan category (loans greater than \$417,000), the credit crunch has raised interest rates significantly. The usual spread between conforming (<\$417,000) and jumbo is around .25% - .50%. While Fanny Mae and Freddie Mac provide a market for conforming loans, and the Fed stepped in to provide liquidity in this market, jumbo loans are packaged into CDO's (collateralized debt obligations) and sold to insurance companies and retirement funds and other private investors. These companies have jacked up the rate at which they are willing to loan money. Several weeks ago I saw jumbo loans over 1% higher than conforming. Fortunately we are seeing jumbo rates only about 5/8% higher before I went to print.

Prices

The new year saw the number of unsold homes drop significantly from 1200 homes for sale to 800 homes for sale in January (See chart on outside cover). This re-energized the market for the first half of 07', but inventory kept climbing and now stands at 1375 unsold homes. During the first part of 07, it felt like we were in a sideways market. Where many list prices remained optimistic and buyers only snatched up the well priced listings. This kept prices level. With 170 homes selling per month, there was an 8 month supply of homes. Not too much above historical averages. (See pages 13,14,15 of CAR 2008 Economic Outlook - www.LBRE.com). But like the last two years, the fall season has seen a slow down in activity, and the credit crunch has dramatically slowed the pace of sales. So if the last two months sales, around 110 units, becomes the activity going forward, our inventory of 1375 homes becomes a 12.5 month supply of homes.

As for the current state of the market, we are seeing a possible addition to current 10% give back in prices. Again if you bought your home more than 4 years ago and watched it double or triple in price, giving back a little is no big deal. But if you are selling your home now, you may be faced with downward price revisions.

As a side note to prices. Statistics are a funny thing. They can lie. While prices have dropped from peak values, CAR hasn't reported any significant drop in prices. This is because the mix of sales has favored more expensive homes. The number of sales for homes below \$500,000 has dropped 24.6% YTD, while homes from \$500,000 - \$999,999 have dropped 24.2% YTD, sales of homes \$1 million and above are only down 0.5% YTD (See page 7 of CAR report). So while home prices have dropped, CAR reports that the median priced home is almost the same as last year. Think of a class of students. If you reduce the number of small students by removing 25% of the shortest students and 25% of

the medium sized students, but leave all of the tall students, the median height of the class would increase. But did any of the students grow? Certainly not.

Affordability still remains low

Affordability is still very low. Only 28% of California households can afford the median home. Compared to nationwide the affordability index is over 60% and in Q1 of 2003 the California affordability index was around 50%. For affordability to increase, either one or all of these three factors have to change: Incomes need to go up, interest rates need to come down, or prices need to come down. Incomes usually only see a 3%-4% annual gain, this takes time. Interest rates may come down a little but the Fed has to keep foreign investors in treasuries happy with higher rates, so Bernake has a difficult balancing act. This leaves prices to do some of the heavy lifting.

Housing Slowdown with No Economic Slowdown

On the plus side this is a housing slowdown without an economic slowdown. During the last SoCal housing crunch 1990-1995, people were concerned about losing their job, and during one of those years, there was a net outflow of people from Southern California for the first time ever. Now the economy is still strong and there are prospective buyers with cash in hand just waiting for the right property at the right price.

While 1990 -1995 was a very long malaise that seemed like it took forever to work out, it is possible that this correction will be quicker. I say this for several reasons. Last cycles marginal buyers, bought homes with 20% down. That was the easy qualifier of the time. 5% down loans weren't yet available and 10% down required full income documentation. It takes a lot longer for a buyer with a 20% downpayment to fold. But today's marginal buyer has nothing at stake, and will more likely toss in the towel quicker. The economy is also healthier, which will provide a quicker rebound as we work off some excesses.

On the plus side those with income property will likely see rents stable. A healthy economy will increase demand, and tighter credit standards will reduce home ownership opportunities for those renting. So the pool of renters is likely to remain strong or even increase.

California Outpaces the Nation

California Real Estate prices far outpaced the nation for appreciation. (See page 107). From the bottom of the market in 1995, the median home in the US was a little over \$100,000 while California's median home was just under \$200,000. Now rather than less than 2 times the national average we are almost 3 times the national average. Just a worthwhile chart to note. It seems like California has a greater propensity to booms and busts.

Summary of 2008 CAR Report - Not that bad

While the overall statistic coming from CAR showed that the housing market has slowed very significantly. It has slowed from an unsustainable pace, making year over year comparisons look pretty bleak. But when these benchmarks are contrasted to the long term averages, the market is only slightly weaker than average. However it is interesting to note that CAR's forecast for the Median price of a home is a 4% drop in 2008. This is the statistic that recently made the front page of many newspapers. (see page 105 of 2008 CAR Economic Forecast).

Finally, I would like to conclude with another one of my favorite economic quotes which may sum up the future outcome of this market. "It's a recession when your neighbor loses his job: it's a depression when you lose your own." - Harry S. Truman

This quote seems apropos, since those with conservative or no loans and manageable payments will not be affected, while those who over extended themselves or gambled on more price appreciation may face hardship. The current housing downturn will likely be very selective. The smart money will start stepping in to buy when the price is right. Till next time. - John

Market Activity

The following information is from the Multiple Listing Service as of 10/18/2007.
Properties in Black are currently for Sale, Properties in Red are currently in escrow

Address	Br/Bth	Sq Ft	Lot Size	List Price
Alamitos Heights				
655 Ultimo	2/2	1450	6500	615,000
621 Manila	3/2	1556	4100	749,500
340 Ultimo	3/2.5	1674	3250	775,000
421 Havana	2/1	1084	3900	798,000
5494 E. 4th	3/2	1626	6500	845,000
820 Havana	3/2	2322	6092	849,000-879,000
775 Los Altos	3/2	1745	6500	888,000
705 Terraine	3/2	1630	9100	889,990
424 Winslow	3/2	1800	4100	945,000
717 Terraine	3/2	1504	5460	949,999
744 Santiago	3/2.75	1922	5460	998,000
785 Terraine	3/2.75	2250	4050	1,049,000
5642 E. 4th	3/3	2380	4874	1,075,000
365 Flint	4/3	2624	6500	1,199,000
735 Ultimo	4/3	2904	6500	1,199,000
618 Havana	3/3	2830	6500	1,299,000
376 Terraine	4/3	3172	8100	1,495,000
739 Terraine	3/3	2936	9100	1,499,000
362 Orlena	3/2	1716	9750	1,499,000
La Marina Estates - No Active or Pending Listings				
Los Altos (S. Fwy)				
2131 Fidler	1/1	727	5775	465,000
2265 Fanwood	2/1	1045	6000	479,900
2185 Ocana	3/2	1087	6240	499,900
1808 Josie	3/2	1318	6758	518,000
2156 Tulane	2/1	859	5775	519,000
6808 Espanita	3/2	1288	5580	524,997
6938 Rendina	3/2	1518	5580	525,000
2336 San Anselme	2/1	1000	6720	529,000
6935 Mantova	3/2	1323	5580	534,900
2163 Fidler	3/2	1244	6300	549,000
2317 Tulane	3/2	1278	6090	549,900
6081 Marita	3/1	1193	6398	558,000
5874 Los Arcos	3/2	1805	6000	559,000
2241 Fanwood	3/2	1551	6000	549,000-569,000
2347 Tulane	3/2	1613	5985	574,999
1824 Greenbrier	2/1	1267	7865	575,000
1849 Chatwin	3/1	1200	6039	579,000
6939 El Cedral	3/2	1060	8080	589,000
1933 Montair	3/2	1202	6220	595,000
1817 Greenbrier	2/1.5	1294	5775	595,000
5980 Marita	3/2	1641	6760	599,900
2236 Montair	3/2	1448	6090	599,900
6939 El Roble	3/2	1342	5580	609,800
1971 Josie	3/1.75	1648	6104	609,900
6714 Driscoll	3/2	1513	5580	619,000
5414 Daggett	3/1.5	1248	6780	629,000
1841 Hackett	3/1	1420	6820	645,000
6928 Espanita	4/2	1534	5580	649,997
2020 McNab	3/2	1561	6195	650,000
6475 Bayard	3/2	1660	6350	665,000
2236 San Vicente	4/2	1506	6120	665,000-668,950
5424 Abbeyfield	3/2	1938	8210	670,000
1870 College Circle	2/2	1635	7350	679,900
1841 Montair	3/2	1386	5775	689,000
7008 El Cedral	3/2	1450	5580	690,000
2049 Carfax	4/2	1886	5985	695,000-715,000
1337 Vuelta Grande	4/3	2622	10880	799,000
1880 Knoxville	4/3.5	3071	6327	834,900
1848 College Circle	4/2.5	2724	7370	939,000
University Park Estates / College Park				
1108 Stevely	3/2	1714	6290	629,000
853 Lees	4/2	1674	6440	649,900
829 Kallin	4/2	1700	6156	689,000
6891 Septimo	3/1.75	1517	6538	699,000
6861 Roxanne	4/1.75	2064	6470	729,000
6207 E. 6th	4/4	3124	7690	990,000

Analysis of Current Market Activity.

A quick gauge of market activity is to compare the pending sales in a market to the active listings.

Alamitos Heights shows only one pending sale out of 18 active listings. If pending sales represent how many homes may sell in a months period of time. Alamitos Heights has an 18 month supply of homes. Quite steep by historical standards.

Los Altos shows better activity, however there are no sales over \$600,000, showing a bias to the lower priced properties. Overall, there are 6 pending sales and 33 active listings, for a 5.5 month supply of homes.

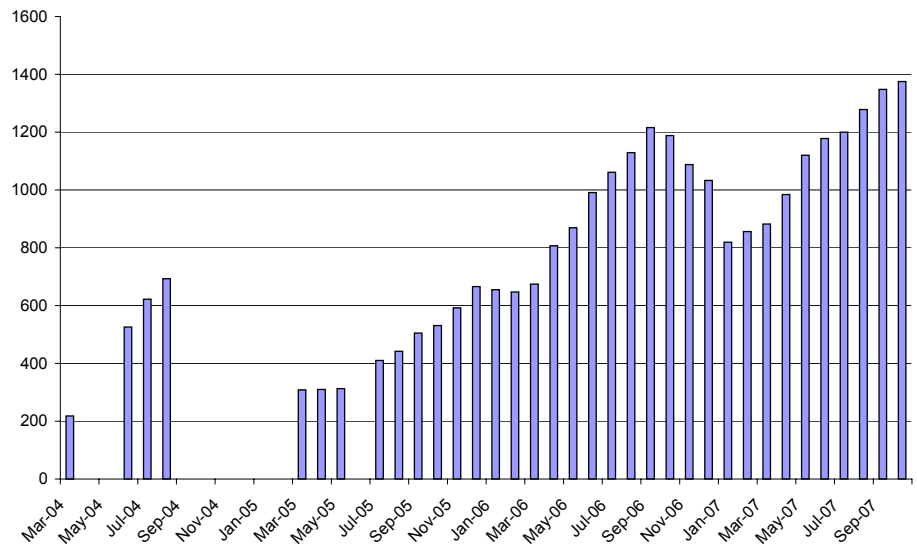
Inside

Credit Crunch, Short Pays & CAR's 2008 Economic Outlook.

Market Activity: What's happening in your neighborhood?

The credit crunch - How much has it affected the market? Read Inside.

Unsold SFR Inventory in Long Beach



SFR Sales in Long Beach

