

REAL ESTATE NEWS

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Nothing But the Best



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Home Prices Drop Double Digits in only 4 Months!

by John Dumke

Credit Crunch - the Straw that Broke the Buyer's Back.

It was the perfect storm. A seasonally quiet time coupled with the now infamous "credit crunch", quoted as the worst credit crunch in the last 20 years by Bear Stearns president, James Cayne.

As the credit crunch started to unfold, it was unclear what would be its impact. 100% financing was gone, 5% down would now require stellar credit, and underwriting became more stringent all around. It seemed to me like it might just be no big deal, just a return to prudent and sane lending practices.

Furthermore, Penny & I had avoided working with buyers that we knew would financially explode. For many reasons, these transactions that put buyers beyond their means were best to simply avoid. As agents representing both buyers and sellers, we lost what we had rarely used. What would be the big deal?

But it was a big deal for the housing market, because over the last 5 years exotic loans (read - stupid loans) made to marginal buyers were the norm, often comprising the majority of properties sales and refinances. Everything was fine until foreclosures rose drastically around August of 2007. With foreclosures drastically on the rise, credit markets no longer knew how to price CDO's (collateralized debt obligations). With pricing unsure, liquidity dried up and new money to lend became scarce. Lenders pulled loan programs and drastically raised rates.

The government immediately stepped in and provided liquidity to government sponsored organizations like Fannie Mae and Freddie Mac, but these organizations only buy conforming loans, up to \$417,000. Not much help in our area. Jumbo loans usually run 1/4% to 3/8% more than conforming loans, but after the credit crunch, jumbo money went up to over 1-1/8% above conforming rates.

Hooked on Easy Money Like a Junkie.

The Real Estate markets have behaved like a junkie on crack. The easy money policy of the combined efforts of Greenspan and Wall Street in collusion with Ratings Agencies, drove the market into a frenzy.

As prices headed out of reach for many buyers, lenders expanded their loan programs. This helped fuel home prices at an accelerated rate and prices shot up, similar to the Nasdaq in the late 1990's.

Many reputable lenders that I spoke to said that around 70% of their transactions were on marginal transactions. Either low or no down payments, marginal credit or stated income (liar loans). Many loans made from 2003 until 2007 were a combination of several of these

deficiencies. Lenders allowed these looser guidelines, since most loans were not held on the books of the banks making the loans.

As long as prices kept heading up, all was good. But prices peaked in 2005 & 2006, leaving buyers without higher prices to bail them out. With great velocity, the mortgage market turned on a dime from willing to loan money to anyone, to a normal level of prudence. Like an addict without their drug of choice, easy money and higher prices, the real estate market is going through withdrawal.

It is likely that if these questionable loan products were never made available, the real estate market would be less prone to boom and bust. But these risky loans were made and now we need to deal with the fallout.

Market Activity Plunges To Less Than Half.

After the credit crunch hit, the market got very quiet. During the boom times of 2004 and 2005 there were as many as 250-300 SFR sales per month (see chart inside). In 2006 and 2007 sales slowed to around 175 per month. After August 07 there were less than 100 SFR sales per month. That is a HUGE drop in activity.

Activity and price are separate issues, but are linked. How much does a "quiet market" translate into a price drop? During these first several months, it was difficult to determine how much prices were being affected. We knew the market was weak. Our pricing strategies took into account a drop in prices to position our listings as the most attractive on the market. But this often was still not sufficient to create a sale. This is when you know prices are still dropping, when the best listings on the market still aren't selling.

How Much did Prices Eventually Correct?

Finally, in January there were enough sales to paint a picture, and it wasn't pretty. There was a stark contrast between prices of homes that had sold in the first half of 2007 and homes that had just recently sold in Nov & Dec. The difference in prices was staggering. See the chart inside for examples of certain local markets. And these price drops highlighted in red are just the difference between 3rd quarter sales and 4th quarter sales.

The Correction has been Much Quicker this Time!

The speed of this correction is in sharp contrast to the last downturn of 1990-1995, which was slow and grinding. Previously it took about 5 years to correct 25%. Within the last 4 months, the market has almost corrected by half that amount.

Part of the speed of this correction is related to the marginal buyer. In 1989, the risky loan product was the “easy qualifier”, now known as a “stated income” loan. This loan required no income documentation, but in required 20% down and great credit. A buyer with 20% down & good credit would be reluctant to walk. Only a job relocation, job loss, or a divorce, might cause these buyers to cave.

Today, we have buyers that purchased with nothing down, poor credit, and lied about their income. They literally brought nothing to the table. How long might it take this buyer to fold? You guessed it. Not very long. That is why this correction has been quicker.

Now for the Good News

After the most recent price correction, prices are actually pretty appealing, and buyers are starting to realize it. This I believe will put a floor in prices.

Coming into January we knew that the market would pick up. After all, it couldn't get any worse. We have been pleasantly surprised that when a listing is priced based upon the new lower sales prices they sell quickly and often times with multiple offers.

Market Observations.

Areas where supply didn't run wild such as Long Beach and LA County in general, seem to be fairing much better than areas such as the inland empire and other locations where land is plentiful. These areas are still in for some hard times.

Certain markets are likely to face a tougher time in working out the excess. Areas where there might have been more first time buyers will likely have more homes go into foreclosure.

But the supply of homes is not overwhelming the market. The number of homes for sale in Long Beach peaked around 1,400 (see chart lower right), and has come down to around 1,200. But these numbers are artificially high. Why? Short sales. (For more info on short sales read my primer on the next page). My estimate is that short sales are around 25% of the market. This was not true last year. The true inventory is probably down to around 900 homes. Soon the MLS will allow us to remove the short sales from our criteria, so I will be able to correct the supply data.

While overall, short sales comprise about 25% of the active listings on the market, they are significantly lower in more expensive neighborhoods where the financial profile of buyers is stronger. While in entry level markets, short sales might comprise half of the available listings, since many buyers bought with little or no down, over the last 4 years.

The good news about short sales is they really aren't viable listings. The seller doesn't have marketable title and the list price is irrelevant. So inventory is lower than it might appear. The bad news is that most of these short sales won't go through and many will end up being on the market in 2-5 months as foreclosures.

Today there aren't as many homes on the market, compared to the early 90's, where it seemed like there were several for sale signs on every block. The flip side to limited supply, however, is that buyer activity is still relatively subdued, as reflected in the still weak 110 sales in January 08. Because activity is still lackluster, it feels like buyers or sellers could easily overwhelm the other and cause prices to drop further or to shoot up. After such huge volatility to the downside in the fall, the markets will need some time to settle down and seek a more predictable level.

More Good News - Prices are actually pretty reasonable compared to rent now.

In my 2005 4th quarter newsletter (see www.LBRE.com - Market News for details), I wrote that rents were cheap relative to home prices. A nice way of saying that home prices were well ahead of rents. Based upon my quick seat of the pants calculation in late 2005, home prices were 40% ahead of rents.

If rent is fair market value, then home prices have quickly come back to fair market value. A combination of lower home prices by around 15-25% from peak values, plus lower interest rates, and rents that have continued to climb, have closed the gap on this imbalance.

Will rents go up or go down?

This is a hard to predict question, because I see equal forces on both sides.

The logic for higher rents looks like this. With loans harder to get and owners losing their homes to foreclosures, more would be home owners will be renters. Keeping rents high.

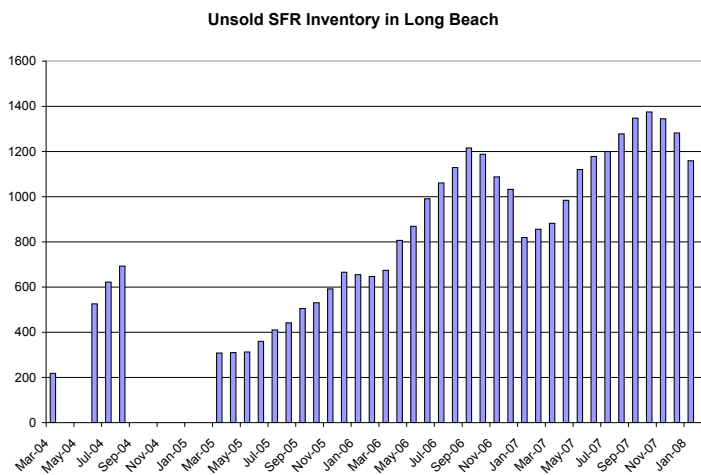
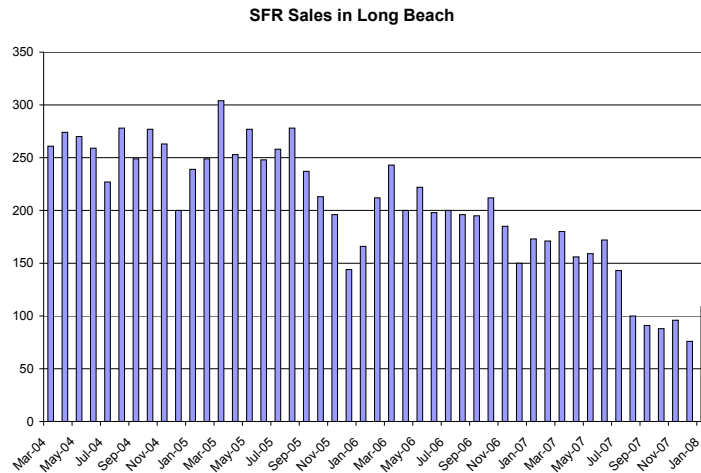
The counter argument is that many current sellers are willing to rent their homes if they don't get their price. This may increase supply and keep rents in check.

Holding onto a home and renting it out certainly makes better sense today than it did in late 2005, so we may see more homes becoming available for rent, keeping rents in check.

Either way, home prices being relatively in line with rents certainly helps encourage home ownership, and will support prices.

And Still More Good News - Its a great time to trade up!

.....Really..... This may seem a little counter intuitive, because most people want to trade up after their home has gone up in value, but this is not the best time to trade up. Let me explain. When trading up, you shouldn't care how much your home is worth or how much you spend for a new home. Assuming you have the liquidity, the only thing you should care about is how much MORE the new home will cost and at what interest rate that difference is financed. So let me be facetious. Let's say your home plummets to only 1 dollar, and you can go out and buy a home twice as nice for 2 dollars. Trading up to a home twice as nice will only cost you *One Additional Dollar!* Whoo Hoo! And if prices are weak, interest rates will likely be lower. Double



Whoop Hoo! And don't forget about property taxes, they will be lower as well. Whoop hoo hoo!

So if you have been considering trading up, and figure you should wait until prices head back up, don't, give us a call. It is much better to trade up when the gap is smaller and easier to finance. My cell number is 562 572 2296. Consultation is always free (shameless plug). But seriously, this is something that should be evaluated, especially if you were priced out some years ago and just gave up.

Conforming loans going from \$417,000 to \$725,000?

This segues well from the topic above, trading up. Because if you trade up you would likely get a loan amount over \$417,000 and this would be a jumbo loan, meaning you would pay a higher interest rate. But it is likely that within 30 days, we will see the conforming loan limit raised up to around \$725,00.

The market has actually been pretty active with many buyers in the lower price points. I think we will see activity work its way up the price scale as loans previously in the Jumbo category get priced like conforming loans, effectively dropping rates on these loans by around a full percentage point.

Still helping you maximize value.

And finally one more shameless plug. While 50% of Realtors didn't sell one home last year and at least 30% won't even renew their license this year, we are still going strong, keeping our clients ahead of the market. We offer expert home preparation and "Staging" advice to maximize the value of our clients home and are known for being able to improve the seller's bottom line.

We invite your calls should you have concerns about how the latest twists and turns may have impacted your situation.

Wall Street Shenanigans - Nothing New

Hearing about the major investment houses, packing mortgage debt in new fangled ways, and then getting the rating agencies to rate it AAA so they could sell it to unsuspecting buyers is nothing new. About a year ago I read a book suggested by a past client and bond trader, called "F.I.A.S.C.O. - The inside story of a wall street trader". A true story about a Morgan Stanley bond salesman. It was Morgan Stanley's goal to take junk debt, and through the use of breaking it up, derivatives and repackaging it, they would get it AAA rated. In most instances it was the debt of foreign countries. Getting a AAA rating enabled them to sell the debt to unsuspecting, retirement funds, or in one case, Orange County, CA. Remember when Orange County filed bankruptcy? It was for precisely the same type of reason that we now have had this credit crunch.

The motivation for Wall Street to take risky debt and get it rated AAA is simple. The value of junk goes up, *ALOT*, and it is easily sold. The bond salesman often joked about creating weapons of mass destruction, where their clients often "blown up" or have their "faces ripped off".

This time wall street just found a way to play the same game with different debt, mortgage debt.

Short Sales - Banks Don't Like Losing Money & Why buyers should avoid them.

A short sale is when a seller has to sell a home but owes more than it is worth. Because the seller can not pay off the loan through the proceeds of the sale, they need to petition the lender to lower the loan amount equal to the net proceeds from the sale. The term short sale refers to the lender accepting a payoff, short of the full loan amount.

Or as Penny so eloquently puts it, "the lender takes it in the shorts".

There is a lot of myth surrounding short sales, so here's the skinny. For a buyer they are usually a complete waste of time. Less than 20% of short sales actually close escrow. It usually takes a lender about 60 days or more before they might even respond. And if they do come back with a willingness to cooperate it is most often at a much higher price than what the buyer and seller proposed.

Why do most short sales not get approved? There are several reasons. First a seller must have *Real* hardship, like medical issues or job loss. Secondly, often times there are two loans. It is very difficult to get both lenders to agree to reduce the loan amount. Why would the first agree to lower their loan amount if the second trust deed holder isn't being completely wiped out. And if the second trust deed isn't going to get any money, why would they agree to help the seller?

Finally, banks simply aren't set up for short sales. The amount of paperwork required to complete a short sale is overwhelming. The

seller must provide complete financial documentation showing their hardship. The lender needs to have several appraisals so that they feel confident they are giving up as little as possible. This all has to happen before the property goes into foreclosure. Because if the seller is making the payments they won't consider a short sale and if they aren't making payments then foreclosure is only 4 short months away.

Then there is the whole issue of whether you are even speaking to a decision maker. Maybe the lender is just servicing the loan and the true investor is unreachable.

For a buyer there are two issues. First is the time factor. If it takes two months to negotiate a sale and only one in six goes through, it will take the average buyer about one year to buy a home through the short sale process. Time translates into missed opportunities. Just think of all of the great deals a buyer would miss over the course of one whole year. There are plenty of the well priced foreclosures and motivated sellers that have clear and marketable title ready and waiting.

The second issue is equally important, and that is price. The ultimate decision maker regarding price is the lender, *NOT* the seller or listing agent. Yet the seller sets the list price and negotiates the sale. So a buyer needs to realize the list price is irrelevant and often times unrealistically low, and whatever is negotiated with the seller is irrelevant. The real sales price will be what the lender decides based upon their appraisals, which in most cases is higher than true market value.

Our recommendation should a buyer want to submit an offer on a short sale is to realize that the real price will be revealed only after several months of waiting, and to keep looking. Or simply to wait 3-5 months until it comes back on the market as a foreclosure.

2007 Property Sales by Quarter

East Long Beach 1,500sf - 2,000sf Homes

Areas 25,28,29,31,32,33,34,35,37,42

	Ave SP	# Sold	DOM
1st Qtr	648,145	60	56
2nd Qtr	657,828	56	41
3rd Qtr	637,221	35	60
4th Qtr	579,338	27	70
% Drop	-9.08		

Belmont Shore & Heights - 1500sf - 2,500sf Homes

Areas 1 & 2

	Ave SP	# Sold	DOM
1st Qtr	1,050,888	27	54
2nd Qtr	1,173,113	29	79
3rd Qtr	1,101,053	16	81
4th Qtr	984,928	14	74
% Drop	-10.55		

Lakewood Areas - 3/1 1250 or less sf Homes

Areas 21,22,23,24,25,28

	Avg SP	# Sold	DOM
1st Qtr	509,897	51	60
2nd Qtr	508,036	47	54
3rd Qtr	491,556	22	52
4th Qtr	448,096	20	58
% Drop	-8.84		

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Alamitos Heights - 5601 Colorado

Large Custom Home - 2 bedroom, 1.5 bath, 2,044 sf. Large 6,500sf lot
\$799,000 [More photos online](#)



Plaza - Golf Course View - 7215 Stearns

4 bedroom, 2.5 bath, 1,892 sf
Pool overlooks Golf Course.
\$649,000 [More photos online](#)

Inside.....

Home Prices Drop

Market Activity Plunges

Good News, More Good News,
And Still More Good News!

Wall Street Shenanigans

Short Sales



Whalers Cover - Golf Course View - 6029 Loynes

3 bedroom, 2.5 bath, 2,159 sf.
Newly remodeled.
\$599,000 [More photos online](#)



Eastside - California Bungalow - 2843 6th Street

2 bedroom, 1 bath, Large 6,250 sf lot.
Remodeled Throughout.
\$549,000 - \$579,000 [More photos online](#)

More Photos & Complete Details @ www.LBRE.com



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