Real Estate Digest

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Darkest Before the Dawn? Industry Players Hoping for Turnaround in Turbulent Market

Call it the perfect storm: Declining sales of new and used homes, large inventories, price reductions and, most significantly, the collapse of the subprime market, which in turn led to a credit crunch and record foreclosures.

What seemed a year ago to be an impossibility turned out to be a long overdue and necessary correction, a return to a normal, more balanced market following years of giddy appreciation and easy money, according to an article in the *Washington Post.*

Good news

Is the end in sight? Some analysts say they believe so, but with a few reservations.

The long-term good news is that "higher quality loans are being written and the tightening of standards should bode well for the market in general," said James R. Panepinto, president of Pinnacle Professional Consulting Services, of Red Bank, New Jersey, which advises financial institutions, real estate firms and home builders.

Better loans should lead to a reduction in delinquencies and foreclosures, now a major factor in downward price trends.

Bill Cary, executive vice president and chief operating officer of Florida-based HFN, also sees reason for optimism.

"Right now, the mortgage market is in a state of shock. I think the light at end of the tunnel for everybody will be when inventory gets back in line with demand. The markets have ways of correcting themselves. This is not the first time we've gone through a real estate downtown, and it won't be last."

New strategies

Every segment of the industry needs to rethink its priorities and strategies, says Cary. "Number one, on the real estate side, companies need to buckle down, focus on their core strengths, make hard decisions to eliminate fixed overhead unnecessary for current market conditions, and apply fiscal discipline in ways not done before, to position themselves not only for today but for the future. They have to change what they can control."

The tightening of credit standards will take some consumers out of the market, according to Sue Barber, senior vice president at J.P. Morgan Chase Home Loan Lending.

"Tightening standards certainly will result in better performing mortgages and in turn have a more positive effect on the housing market."

TRENDS

Movers Want to Be Close to Family

One in every five homeowners age 50 or over is planning a move in the next five years, and three out of four believe it's important to be near family members, according to an ERA Real Estate survey.

Forty-three percent said nearness to family and work would be a consideration in their home purchases. Further, when considering buying a new home, 43 percent would purchase a home to be closer to work or family.

Of those considering moving in the next five years, 65 percent would most consider a single-family home, and only 11 percent said they were interested in moving into a condo or apartment.

Consumer Earnings Remain Unchanged

The Census Bureau has released its latest findings on income and poverty, reporting that household incomes were virtually flat between 2005 and 2006, and women's pay continues to lag behind pay for men.

According to the Census numbers, median household incomes by race were:

- Asian, $64,200
- White, $52,400
- Hispanic, $37,800
- Black, $32,000

The bureau said in 2006, women earned 77 cents for each dollar earned by men, statistically unchanged from 2005. Median earnings for both declined in 2006; men by 1.1 percent to $42,300 and women by 1.2 percent to $32,500.

As Home Buying Slows, Demand for Rentals Gains

Apartment managers polled in a survey said the slowdown in home buying across the country has resulted in more renters staying where they are. The poll taken by the National Multi Housing Council found that 18 percent of managers believe the housing slowdown had substantially improved their occupancy rates and another 37 percent said they had noted lesser improvement.

The bad news, however, is that apartment building owners say that even while demand for apartments is steady and on the rise, financing to build new units is getting tighter as a result of the crisis in the lending markets.

MARKETS

Metro Prices Slightly Up

Sales of existing homes fell in 41 states during the second quarter, the latest reporting period, but home prices were up in two-thirds of the metropolitan areas canvassed by the National Association of Realtors.

In all, prices were marginally up in 97 of the 149 metro markets surveyed by NAR. NAR Economist Lawrence Yun said the modest price improvement suggested the market may have bottomed out.

Smaller the House, Smaller the Price Drop

Small is beautiful. The online home valuator Zillow has released a survey showing that smaller homes have seen a smaller percentage price drop than larger homes in the same area. Zillow's second-quarter property value report showed values for all homes are down 2.8 percent year-over-year and are relatively flat quarter-over-quarter (0.1 percent).

Midsized and large homes – those with 1,500 square feet or more – showed the steepest declines among single-family residences, with values down 3.1 percent. Small homes declined just one percent in the same period.

Outdoors Magazine Names Top Cities

Some cities offer culture, other business opportunities. The outdoors magazine *Outside* has released a list of its top 18 cities that it says are "fit, fun and packed with adventure."

The publication named a large and midsize city in each region of the country. Here are the magazine's choices:

West Coast:
Santa Cruz, Calif., and San Francisco

Rocky Mountains:
Jackson, Wyo., and Denver, Colo.

Midwest:
Iowa City, Iowa; and Madison, Wis.

Northwest:
Bend, Ore.; and Portland, Ore.

Southwest:
Santa Fe, N.M.; and Tucson, Ariz.

Great Lakes:
Duluth, Minn.; and Minneapolis.

Southeast:
Asheville, N.C.; and Atlanta

East Coast:
Portland, Me.; and Charleston, S.C.

New England:
Burlington, Vt.; and Boston

Consumers Expect Only Modest Home Appreciation

A new survey by the University of Michigan and the Reuters News Agency suggests half of Americans do not expect to see any price appreciation in their homes for at least the coming year. Of those who do expect their homes to appreciate, the average rise anticipated was only 0.2 percent of the home's value.

Over the next five years, that group anticipated price increases of only about 3.1 percent. About 17 percent of those surveyed said they felt the value of their homes had declined in the past year.

MORTGAGES

Lease Option Looking More Attractive

The subprime fallout has made home loans that were once slam-dunk more difficult to obtain. That's causing both homeowners and buyers to seek more creative ways of buying and selling, including a lease with option to buy.

A lease with an option to buy often can solve a two-mortgage problem for a seller, and provide a cash-poor buyer with an opportunity to "try out" a house while getting a portion of the monthly rent credited toward a down payment.

Here's how a typical lease option works:

1. The buyer and seller agree on a purchase price, usually a figure somewhere between today's market value and the anticipated market value 12 months down the road.
2. The seller gives up tomorrow's presumably higher value for money in hand today. The buyer pays a bit more than today's value in exchange for very little cash down. Let's say buyer and seller agree the price will be $335,000.
3. The seller charges the buyer a nonrefundable fee for agreeing to this option. The amount can vary depending on factors such as how eager the seller is to move and the size and quality of the house. Typically, the higher the fee, the better the buyer maintains the property.
4. Let's use $3,000 for the fee in our hypothetical transaction. The fee is in addition to the monthly lease payments. And we'll have the seller give the buyer the right to purchase the property for $335,000 at any time within the 12-month lease period. If the option is exercised, the fee could be considered part of the down payment.
5. The lessee has made no down payment, hence the monthly option fee is typically higher than rental market rates. The two parties agree on what portion of the rent will be applied to the down payment. Any amount can be credited. For example, if the monthly fee is $2,000, $800 could be credited to the down payment. (If the seller really is not eager to sell, he may not agree to a higher rent credit.)
6. Buyer and seller must be sure to specify both lease and sale terms in the agreement. For example, when the time comes for the buyer to exercise the option, if the interest rates are at 8 percent, the buyer may not be able to qualify for a loan. It's a good idea to set an interest-rate ceiling in the agreement, or ask the seller to finance the home when conventional rates hit a certain level.

Some realty agents have been reluctant to seek lease options for clients because they have been unwilling to gamble their commissions on whether the option would be exercised. However, open-minded agents understand a lease option can help create a deal in situations that once seemed impossible.

U.S. Transaction Costs Comparatively Modest

The Organization of Economic Co-operation and Development says real estate transaction costs among its 70 member nations vary dramatically, with the United States coming in at the low end.

According to an OECD report, South Korea has the highest transaction costs – averaging 22 percent of a property's value. Fees for purchasing a home in Slovakia, Iceland and Denmark averaged less than three percent of the value of the home.

Transaction costs in Belgium, Italy, France, Luxembourg and Greece exceed 15 percent of a property's value. Transaction costs were typically between five and seven percent in the UK, Norway, New Zealand, Switzerland, Australia, Japan, Sweden, Poland, Ireland, and Canada. Costs in the United States were about 6.5 percent.

Costs included in the term 'transaction costs' are:

- Registration costs
- Legal fees
- Real estate agents' fees
- Transfer taxes

Stockton, Calif., Leads in Foreclosure Rate

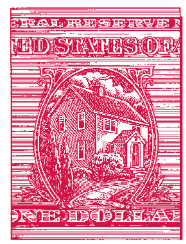
Stockton, Calif., Detroit and Las Vegas have the highest foreclosure rates in the nation, while McAllen, Texas; Greenville, S.C.; and Richmond, Va., have the lowest, according to data from RealtyTrac.

"The overall trend is toward escalating foreclosure rates, with 82 of the top 100 metro areas reporting year-over-year increases in the number of homes affected by foreclosure," said the report.

In Stockton, there was one foreclosure filing for every 27 homes. In Detroit, the number was 1 in every 29 homes and in Las Vegas there was 1 for every 31 households.

AGENTS' CORNER

Managing Homeowners' Expectations



As recently as June 2007, a survey by the Boston Consulting Group found that 55 percent of American homeowners believe their home is worth more today than it was one year ago. In reality, in many locations, home values have declined.

As a result, when agents meet with prospective clients, they may be concerned they won't get the listing (and thus not get a commission), so they tell clients what they want to hear – namely that their home will sell for top dollar in record time. Then when the house doesn't sell and the client agrees to lower the price, the client/professional relationship becomes strained. Clients can't help but feel their agent gave them inaccurate information.

To truly shine, agents should educate themselves on the realities of the market and then "speak the truth," according to Steve Harney, a residential real estate and mortgage expert who specializes in negotiation and sales training.

"Help clients understand where the pricing used to be, where it is today, where it will likely be three months from now, and most importantly, why it is that way. Only then will clients be able to make a realistic pricing decision that will enable you to help get their home sold," says Harney.

A hard pill to swallow? Following are the five pricing considerations that may help the news go down a little bit easier:

1. **Increased Inventory.** Why are there so many houses for sale today? Because we are witnessing the consequence of a pent-up selling demand. In other words, a lot of sellers waited to list their property because they wanted to catch the top of the market. They waited and waited and waited. Now that they see the market declining, they list their homes in an attempt to still sell at a high price before the market bottoms out. As a result, we have an overabundance of inventory, up approximately 39 percent from this time last year.

2. **Increased Mortgage Rates.** News and advertising tells us mortgage rates are at an all-time low, and that's true in a historical context. But short-term, over the past several months, mortgage rates have been increasing. And every time the mortgage rates go up, even a quarter of a percent, a large number of potential buyers are disqualified from the marketplace.
3. **Increased Mortgage Restrictions.** During the past few years, mortgage companies granted mortgages to just about anyone, including those who couldn't or wouldn't prove their income, those with no down payment and even those with very poor credit. But today, with foreclosures climbing steadily, almost all mortgage companies have re-enacted the tight lending restrictions that were common decades ago.
4. **Increased Vacancy Rates.** During the real estate boom, many people and investors bought spec homes with the hopes of flipping the house for a big profit. Today, vacancy rates on these homes are up over fifty percent. Since most of these people don't want to act as landlords, they have a strong desire to sell the home rather than rent it out. As a result, many are selling these vacant investment properties for rock bottom prices, grudgingly taking a loss.
5. **Increased Foreclosures.** Statistics from First American Real Estate Solution show if one house forecloses in a neighborhood, the average house in that neighborhood loses five percent of its value. If eight percent of the houses in the neighborhood foreclose, the value in that neighborhood goes down twenty percent.

Dealing with Loss Aversion

Even after you explain market realities, some of your clients might insist on pricing their homes at more than market value. According to a recent *New York Times* article, they could be demonstrating loss aversion, a classic (although irrational) consumer response to dropping prices.

The *Times* cited a 2001 study, "Loss Aversion and Seller Behavior: Evidence from the Housing Market," by Professor Christopher Mayer, director of the Paul Milstein Center for Real Estate at Columbia Business School and David Genesove, a professor of economics at the Hebrew University in Jerusalem. The study found that sellers who had bought their condominiums at the peak of Boston's boom market in the 1990s listed their properties at an average of 35 percent over current market rates because they did not want to sell at a loss, although the market had dropped. As you might expect, less than 30 percent of the properties sold in fewer than 180 days.

With housing markets in some areas on a downturn, Professor Meyer said this behavior could stall the overall economy. Because about half of home buyers are moving within the same metropolitan area, "The buyers and the sellers are the same people…," Professor Mayer said. "So if the sellers price so high that they, effectively, put themselves out of the market, it shows up on the buying side, too." When this occurs, high-priced homes end up sitting on the market.

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