RESEARCH

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FORECASTING MARIN REAL ESTATE PRICES

by

Peter Nielsen

College of Marin

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THE ISSUES TO BE EXPLORED

A previous paper titled proposed the topic of forecasting Marin County real prices and outlined a number of specific topics to be researched. Each of those topics is summarized here, followed by the relevant research.

Topic 1: To what extent have government tax credits and low interest rates stimulated home purchases, and what will happen to demand when these programs end?

While the federal government's $8,000 tax rebate program is scheduled to come to an end on April 30, 2010, California has instituted its own tax incentive program to take up where the federal program leaves off. On March 25, Governor Arnold Schwarzenegger signed California Assembly Bill 183, which provides a new tax credit for homebuyers. Below are some highlights of the new program[1]:

> AB 183 provides an additional $200 million in tax credits ($100 million for newly constructed homes and $100 million for first-time homebuyers of either newly constructed or existing homes).
>
> The tax credit is available to eligible buyers who close escrow for the purchase of a home on or after May 1, 2010 and before August 1, 2011 under a contract signed on or before December 31, 2010.
>
> Qualified buyers are eligible to receive a tax credit in the amount of 5% of the home's purchase price, up to $10,000, spread equally over three successive tax years if they live in the home as their principal residence for at least two years immediately following the purchase

The institution of this program can be expected to cushion the effect of the termination of the federal program.

In a posting on the IRS web site dated Sept 17, 2009 it states that the federal program "has provided a tax benefit to more than 1.4 million taxpayers "as of that date. Alex Finkelstein, in an April 13 post to *The Real Estate Channel*, says that "the positive effect of the program has been record-shaking. Depending on which trade group you prefer to believe, all of them agree that about one million homes have been sold to date, largely due to the tax program." In the event that the economy continues its growth, it will likely be the case that potential buyers that have been on the sidelines due to uncertainty in the direction of price changes and uncertainty about their employment and value of their investment portfolios will move back into the market, minimizing the effect that the termination of these programs would otherwise have had.

With respect to interest rates, the most immediate governmental factor influencing them has been the Federal Reserve's decision to terminate its program of buying mortgage backed securities as of April 1, 2010. Prior to that date, the Fed had purchased approximately $1.5 trillion in such debt. The private market has stepped into the market, but with its demand for better rates to compensate for the perceived risk of these investments, mortgage rates for 30 year fixed payments have recently moved up from 5% to 5.3%. Increasing interest rates can be expected to have a dampening effect on home prices.

Topic 2: What is the magnitude of the "shadow inventory" of REOs ? Are they being kept off the market in an attempt to control supply? Or has the backlog simply built up because lenders have not had the capacity to process the influx of distress property inventory? Is this inventory increasing or decreasing and what developments might

cause lenders to move this inventory quicker to market, and if they do so, what will be the impact on prices?

There has been a great deal of discussion about a supposed "shadow inventory" of homes which, when released by lenders into the market, will cause further declines in home prices. Yet in some segments of the market, we currently have a scarcity of inventory for sale, multiple offers and rising prices. The author's attached Q1-2010 Marin Market Update report shows increased sales price indicators that have not been in alignment since the second quarter of 2007.

This apparent contradiction is due in part to confusion over the definition of "shadow inventory". One definition is the supply of homes that have completed the foreclosure process, but have not yet been listed for sale by the lenders. While there has been much speculation, there is little, if any, evidence that lenders are purposefully holding back such inventory from the market – or that such inventory exists in any appreciable numbers.

A much broader definition, however, was used in a recent Standard and Poors report[3]. They have expanded the definition to include "all delinquent loans, not only those that are real estate owned [REO]". Using this definition, the "inventory" is vastly larger. S&P indicates that it "will likely take about 33 months (or nearly three years) to clear at the current rate of liquidations." Furthermore, they believe that with the current economic situation, this is a *conservative* estimate, and they argue that recent price increases are "the result of a temporary constriction in the supply of foreclosed homes on the market. This temporary constriction ensued because servicers have completed fewer foreclosures due to court delays, servicing backlogs, and political pressure to keep borrowers in their homes."

The author can personally attest to the delays in processing backlogs, which undoubtedly has added to the number of homes that ultimately end up as REOs, as buyers back out of short sale purchase contracts due to the delays in getting responses from the lenders, or simply stop looking at and making offers on pre-foreclosure properties due to the delay in processing such offers.

On April 5, the government launched a new program to speed up the processing of short sales. Among the provisions are the followimg:[2]

> The government will give $3000 to qualifying short sellers.
>
> Mortgage companies must set their minimum bid before a home in the program is listed for sale; any offer above that must be accepted. Buyers who submit offers should get responses in weeks, rather than months.

"The expanded incentives will help accelerate short sales," said Mark Zandi, chief economist at Moody's Analytics. He expects 350,000 homeowners nationwide to use the program through the end of 2012. Bank of America, which inherited a huge portfolio of problem loans when they acquired Countrywide, has just announced that they are implementing a new system for processing such offers. This system, called Equator, will be their primary tool for short sales. As stated in a recent email, "It is a self service portal that automates the short sale process. This will streamline the process and improve the experience for both customer and real estate agents." Hopefully, it will indeed streamline the process.

USRes, a major asset management company, in its April 2010 newsletter, indicated that they saw small increases in REO volumes in Q1, largely due to moratoriums being lifted at the end of last year. They "anticipate growth around the end of the 2nd quarter and building throughout the year."

A contrary view to Standard and Poor's position on shadow inventory is held by Larry Nusbaum, author of the book *Millionaire Now!* He argues that "with the threat of bankruptcy cram downs and other government intervention, banks are unlikely to dramatically increase foreclosure sales any time soon." Furthermore, he predicts that with increasing inflation, demand for home purchases will pick up, resulting in continued constrained supply in many parts of California.

Topic 3: How long will the current psychology of the buying and selling public continue to keep them on the sidelines? And how long before job growth will increase in a way to positively change this psychology, resulting in greater demand and therefore home price increases?

In recent weeks, the stock market has made steady gains, with the Dow Jones Industrials passing the 11,000 mark for the firs time since September 2008. Assuming that this trend continues, it will surely contribute to increased consumer confidence, although there is a concern that the volume of trading has been light, indicating that there remains a large contingent of participants that are not yet convinced that this is a bona fide bull market.

One indicator of consumer psychology is the Consumer Confidence index. This is based on a monthly survey conducted for The Conference Board by TNS, the world's largest custom research company. "For over 90 years, The Conference Board has created and disseminated knowledge about management and the marketplace to help businesses strengthen their performance and better serve society."[4] The Conference Board is a non-profit global independent membership organization. Its Consumer Confidence Survey® is based on a representative sample of a 5,000 U.S. households. The Index now stands at

52.5 (1985=100), up from 46.4 in February. Says Lynn Franco, Director of The Conference Board Consumer Research Center: "Consumer confidence, which had declined sharply in February, managed to recoup most of the loss in March. However, despite this month's increase, consumers continue to express concern about current business and labor market conditions. And, their outlook for the next six months is still rather pessimistic. Overall, consumer confidence levels have not changed significantly since last spring."[5]

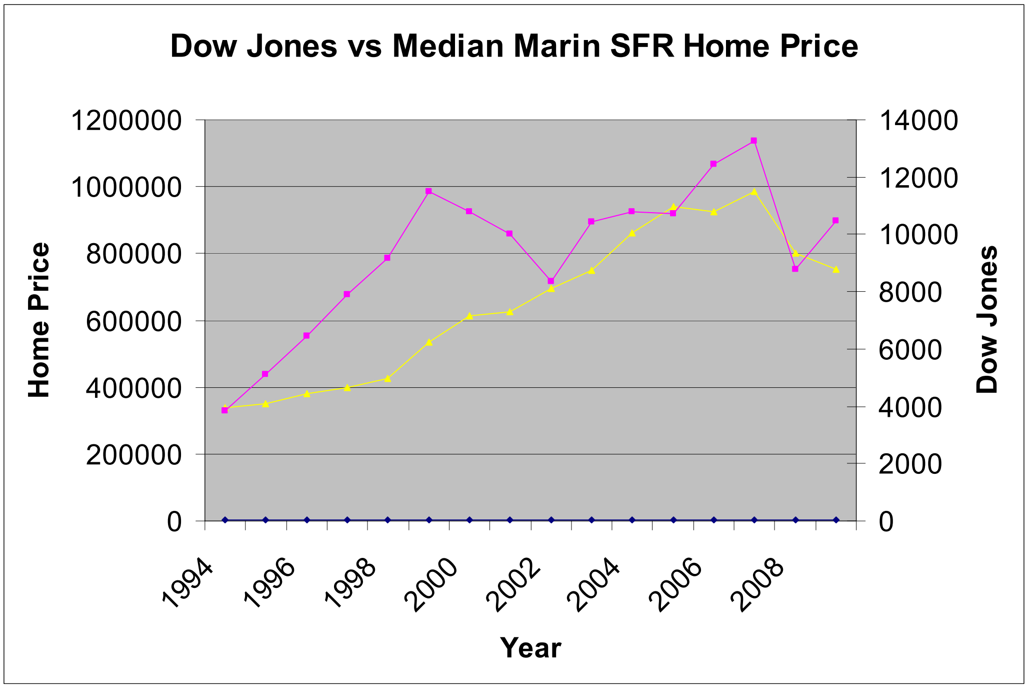
Topic 4:

To what extent is there a correlation between stock prices and Marin home prices? Does the recent recovery in the stock market portend a similar recovery and increase in prices of real estate?

The graph below shows the change in median single family home prices since 1994 and the level of the Dow Jones Industrial Average over the same period. Homes prices here and in charts that follow are from the BAREIS MLS. As can be seen, there is a definite correction between these two trend lines. The line (red) that ends at 10,500 is the Dow and the line (yellow) that ends at $750,000 is the median Marin home price at the end of each year. The pattern, however, is not sufficiently correlated to be able to predict the future home price trend based on the current level of the stock market.

A recent report published by one REALTOR® states that at the end of 2009, the Dow was down 3.3% from 10 years ago, whereas the average home price in Marin increased 17.9% in that time. While that may be true, the start of the timeframe selected is one in which the stock market was in the "dot com" bubble. If instead, one chooses the 15 year period beginning in

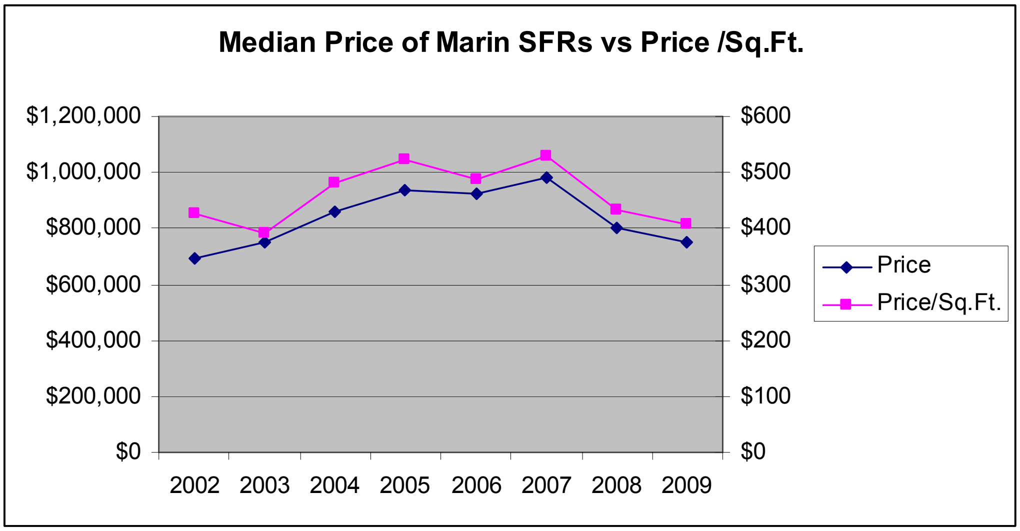
1994, the stock market outperformed the Marin single family home market, increasing by a factor of 2.7 vs 2.2 for homes.



Topic 5:

Would it be more accurate across all price ranges to use a price per square foot rather than median price as the standard measure of value?

The following chart graphs price and price/sq.ft. for Marin single family homes from 2002-2009. The two trend lines mirror each other very well, so it appears that either measure would produce the same result in terms of percentage changes in home prices.



In discussing pricing trends, the author publishes a quarterly Marin pricing analysis. This breaks the market into a low end (under $750,000), a mid-range ($750,000 - $1,750,000) and a high end (above $1,750,000). With prices having come down, is this still a reasonable way to segment the market when discussing pricing trends? What percent of homes are on the market in each of these segments? How should these pricing tiers be adjusted to make for more meaningful reporting of pricing trends?

After experimenting with various pricing segmentations, for the most recent quarterly analysis, the long-standing pricing tiers were altered as follows. The percentage of sales in each tier is shown:

Inventory	# Active	Percent
Homes < $500,000	147	16%
Homes $500,000 - $1,000,000	386	41%
Homes > $1,000,000	407	43%
Total	940	100%

While it would be possible to find the price points that would divide the inventory such that there would be an equal 1/3 share of the inventory in each tier, it was decided to use these tiers since they are in easy-to-relate-to half-million dollar increments. In Marin, most condos will fall into the first tier, with most single family homes split between tiers 2 and 3.

Topic 6:

What is the current "inventory" of homes on the market, and how does that compare with historic volumes? It seems that inventory is down, but price is not going up, contrary to the basic tenet of supply and demand. Why is this and does it mean that we can no longer use the months of inventory as a prediction of future prices?

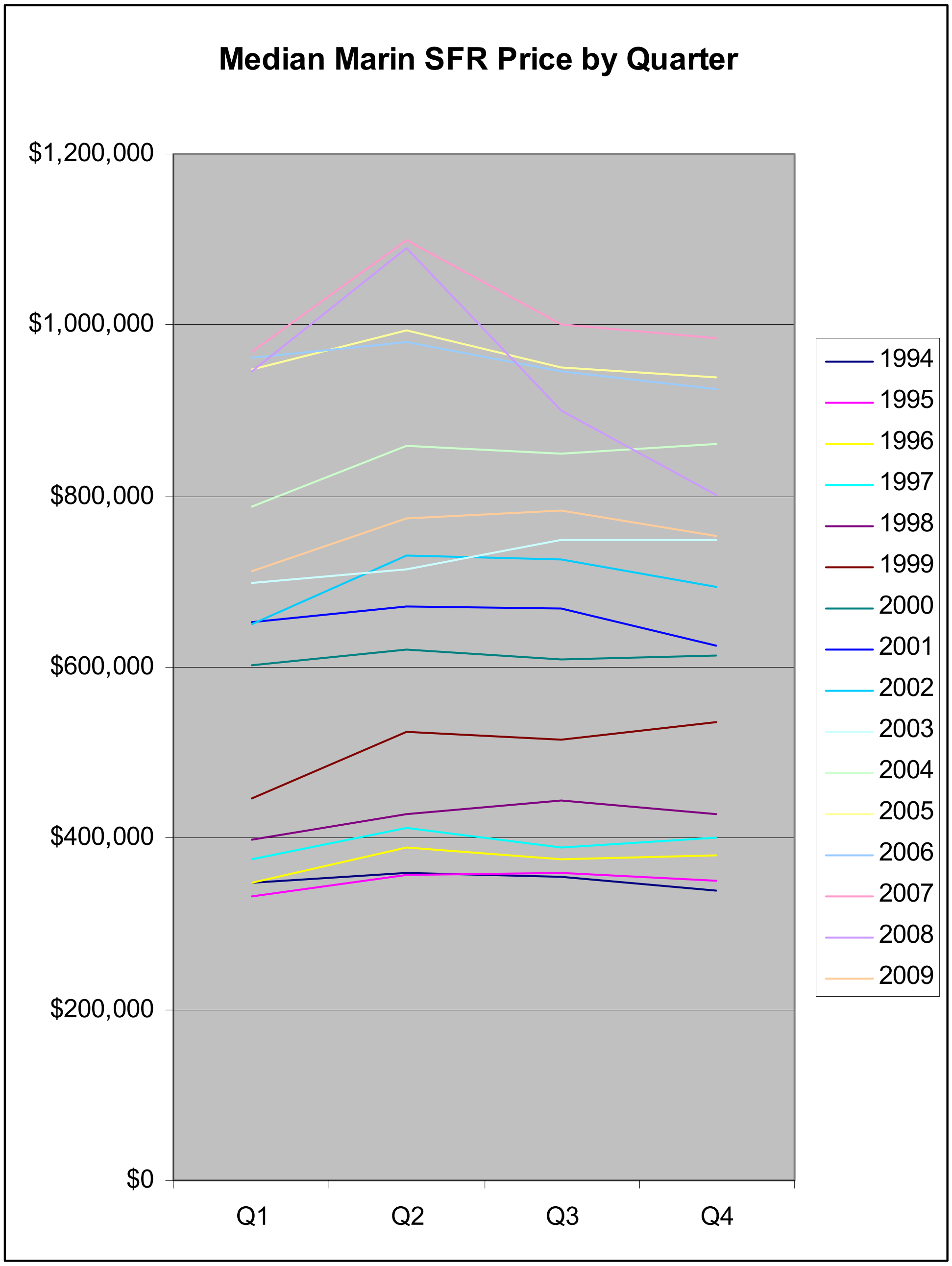
The following table shows the number of homes available for sale at the end of the first quarter of each year, and the median price of homes for that quarter of each year.

Q1	Inventory	# of Mo.	Median Price	Trend
2010	940	6	$650,000	Inventory up, # of mo. down, Price up
2009:	783	10	$601,500	Inventory down, # of mo. up, Price down
2008:	1007	9	$851,300	Inventory up, # of mo. up, Price down
2007:	761	2.5	$870,000	Inventory up, # of mo. down, Price up
2006:	626	3.5	$860,000	Inventory up, Price up
2005:	392		$829,000	

From this, we can see that the level of supply alone does not correlate with price. If it did, we would expect to see, from year to year, that when inventory is up price would be down and vice versa. However, this ignores the demand side of the supply/demand equation. The number of months it would take to sell all of the current inventory, based on the current rate of sales, though, *does* take demand as well as supply into account. As can be seen, for all of the years for which we have data, when the number of months required to consume the current inventory decreases (i.e., demand is up in relation to supply), the prices have increased; as the rate to consume the inventory slows (i.e., demand weakens and supply grows), prices have come down.

And finally, to what extend does seasonality affect pricing? Should a Realtor advise a client to put their home on the market only in the spring, when they might maximize the sale price? Or do the increased number of competitive listings balance out any perceived increase in buyer demand during the peak home buying season?

The chart below shows the median price of Marin single family homes each quarter for 15 years. There is a consistent pattern indicating that Q2 prices (homes that close escrow in April-June) commanded higher prices than those that closed in January-March. Since closes lag contracts by 30-60 days, this would indicate that there generally is a bump in prices for homes that are listed in Q1 over those listed in Q4. The months of November-December are typically slow months due to the holidays, so this seems to support the theory that buyers who shop during that period, when there are few other active buyers, can get a better price; and that sellers would be well advised to wait until after the first of the year to list their homes. It's difficult to draw any similar conclusions about other months of the year.



Most Critical Issues:

The most critical issues in attempting to predict the direction of prices for Marin homes for the remainder of 2010 and 2011 appear to be the state of the economic recovery from the "Great Recession" and the extent to which lenders may have a shadow inventory of distressed homes yet to come to market. The stock market has been gaining ground due to increases in corporate profits, but these have yet to translate to an increase in employment, which in turn has a dampening effect on consumer confidence.

There are different schools of thought regarding the existence and extent of a shadow inventory. There appear to be no published reports by lenders that indicate that they are purposefully holding back foreclosed homes from the market, or readily available statistics regarding the number of foreclosed homes in their inventory.

With the California tax credit (more appropriately called a deduction, since you can't get a refund if you can't use all of the "credit") coming in to play when the Federal tax credit ends, that no longer appears to be a critical issue for California home buyers.

These issues are for the most part in line with the author's expectations at the time the research areas where initially identified.

1 Association of Corporate Council, Luce Forward Hamilton & Scripps, "*New $10,000 California homebuyer tax credit signed by governor with guidance by the Franchise Tax Board*", April 6, 2010. http://www.lexology.com/library/detail.aspx?g=4765ec2f-4dee-4906-90ea-bb8a6d5b2163

2 "*Government launches effort to help homeowners in short sales,* " Alan Zibel, Associated Press, April 5, 2010. http://www.mercurynews.com/real-estate-news/ci_14823039?nclick_check=1

3 "*The Shadow Inventory Of Troubled Mortgages Could Undo U.S. Housing Price Gains*" Alan Zibel, Associated Press, February 16, 2010. http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245206147429

4 "*The Conference Board*" http://www.conference-board.org/aboutus/about.cfm.

5 "*The Conference Board Consumer Confidence Index® Rebounds in March"*, March 30, 201*0,* *http://www.conference-board.org/economics/consumerconfidence.cfm*