

M Hanson Advisors – Real Estate & Finance

The Mortgage Pages - April 21st 2010

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Our mission is to provide our clients a significant edge. This is done by turning the daily, market-moving real estate and mortgage news flow and events into old news by the time it makes headlines. - Mark Hanson

Introduction

Don't underestimate the **massive Quad-threat fear stimulus** influencing CA house sales and **Triple-threat** influencing National sales leading up to the April 30th (June 30th closings) Federal home buyer tax credit sunset.

This is not because I expect house sales to shoot through record highs and remain bid after the training wheels come off after almost a year and a half. Rather, when all these unprecedented forms of stimuli, which have crammed every ounce of demand forward into April contracts (closings through June) abruptly end, how there is very little supporting this housing market.

For sure, the original tax credit sunset in November did not have as many influential factors in play as the contract deadline less than two weeks from now. Current housing market stimuli include:

- 1) The \$8k First Timer Federal Tax Credit sunset on April 30th
- 2) The \$6.5k Repeat Buyer Federal Tax credit sunset on April 30th
- 3) Every loan officer and Realtor over the past four months carpet-bomb spamming the fear of soaring rates when the Fed quits the MBS purchase program so "you better buy now"
- 4) A \$10k First Timer and New Home credit for escrows that close after May 1st 2010

In CA, all are in play right now and nationally, #1, 2 and 3. Last November only #1 was in play. With respect to #4, this credit will help pad May through July total existing sales and obviously new home sales for many months.

And by all means, do not underestimate the influence that armies of Realtors and loan officers trying to get deals closed can have on the general public. I got a half dozen mailers myself.

Q1 and March House Sales

First Timers Going Hog-Wild with Obama Coupons, Investors Make Way

In March, 37,295 houses were sold in CA. This made for 2.1% fewer YoY Q1 sales and a weak 2.98% YoY increase in March sales. Remember, in Q1 we are comping against a time when there was no tax stimulus and the wheels were coming off of the fabric of society itself. This stats in and of itself is remarkable. The March MoM increase of 32% was not significantly above the average 31% increase over the past seven years.

First timers are going hog wild with their Obama coupons. The Quad-threat fear stimulus listed above is doing it's best sucking every ounce of demand out of the market going into July closings (national tax credit allows a closing by 6/30 for houses in contract by 4/30). A recent report by Campbell Surveys show first timers make up 50% of the market. Remember, first timers can and will turn it off on a dime.

Because of the strong demand by Obama coupon waivers, investors have backed off considerably in the past few months. Since investors and first timers took control of the housing market a couple of years ago -- when the organic buyer went away for good due to epidemic effective negative equity -- I have warned about these groups being highly volatile and a terrible foundation for a sustainable housing recovery. Investors simply will not bid aggressively in this market.

Luckily Foreclosures are surging, hitting record highs in March. Come July -- when sales are set up for a cliff dive because the last of the tax credit closings will be behind us -- Foreclosures could flood the market allowing investors to pad the fall to some degree.

But despite what happens to sales counts, a flood of Foreclosures and a sharp increase in the distressed/organic sales mix will negatively impact pricing. Obviously, not to the extent we saw in 2007-2008, but prices will fall. My estimate is for the distressed market nationally to go from about 35% at present to over 50% by Q4 when the new Foreclosure run hits and HAFA is fully up to speed.

Bottom Line - Despite rates being at record lows and multiple forms of stimuli not present last year or at the end of the original tax credit in November 2009, sales are not picking to the degree that would indicate a sustainable post-stimuli recovery can be maintained.

The stimulus driven market hand-off to a normal market has not occurred and to date the YoY comps have been easy. Jan's and Feb's YoY lower sales comps were just a taster of what we will see mid-year in CA and nationally

Simply put, we are running out of sellers and buyers quickly, as HAMP has kept distress inventory extremely low relative to year ago levels and **epidemic effective negative equity** (not enough equity to sell -- pay a Realtor and put a down payment on a new house -- and re-buy) has

trapped 10s of millions in their houses across the nation. When calculating negative equity with respect to house sales in this manner, it affects far more households than the commonly reported 23%.

Additionally, **flip-resales** that have provided a noticeable boost in sales counts due to double-counting will diminish in 2010 due to the heavy handed foreclosure prevention in 2009 and stimulus that has pushed investors away in favor of first timers. This will provide a further drag that few are looking for.

What now? With foreclosures artificially depressed for the past year due to HAMP and other aggressive initiatives, houses that are most in demand have become scarce. It is negatively impacting sales counts as evidenced by CA Q1 sales.

The only way for the 2010 sales pace to keep up with the 2009 to Q1 2010 stimulus and distress driven market is for foreclosures and short sales to flood the market. This is what the two primary buyer groups -- investors and first-timers -- want.

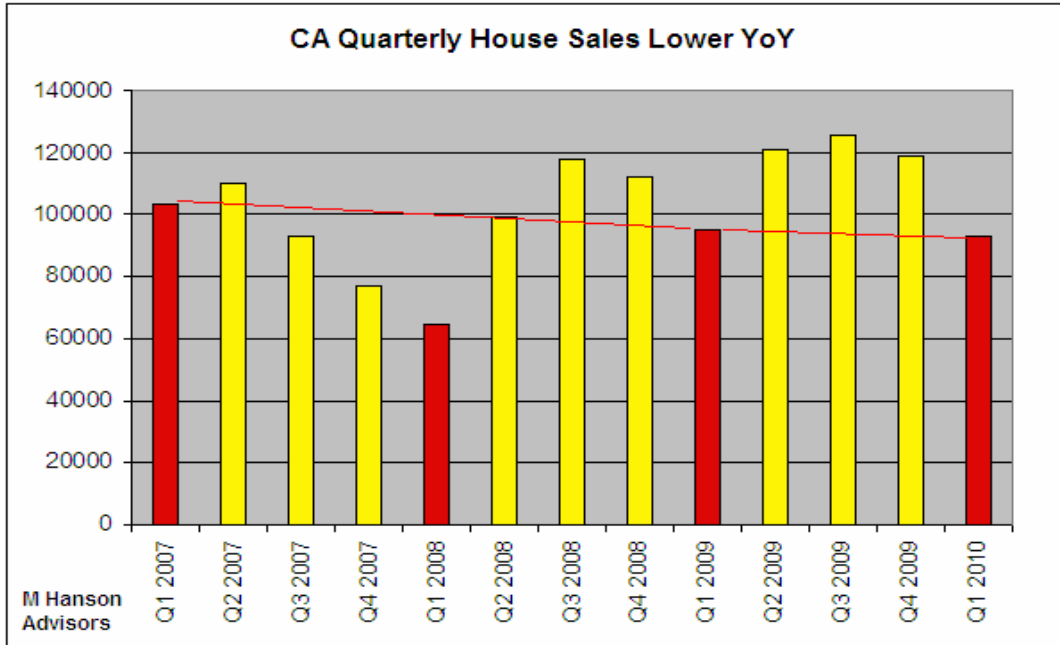
If foreclosures do not begin to soar past March's all-time highs right now -- or for some reason HAFA is not rolled out as it should be - house sales will disappoint for most months of 2010 just like you are seeing now, but worse as comps get tougher.

In fact, sales could outright collapse in July without abundant distressed inventory as investors and first timers do not make up a strong foundation and can literally turn it off overnight.

Yes, if distressed properties flood the market prices will be negatively effected but not like during 2007-2008. And prices are under pressure again anyway.

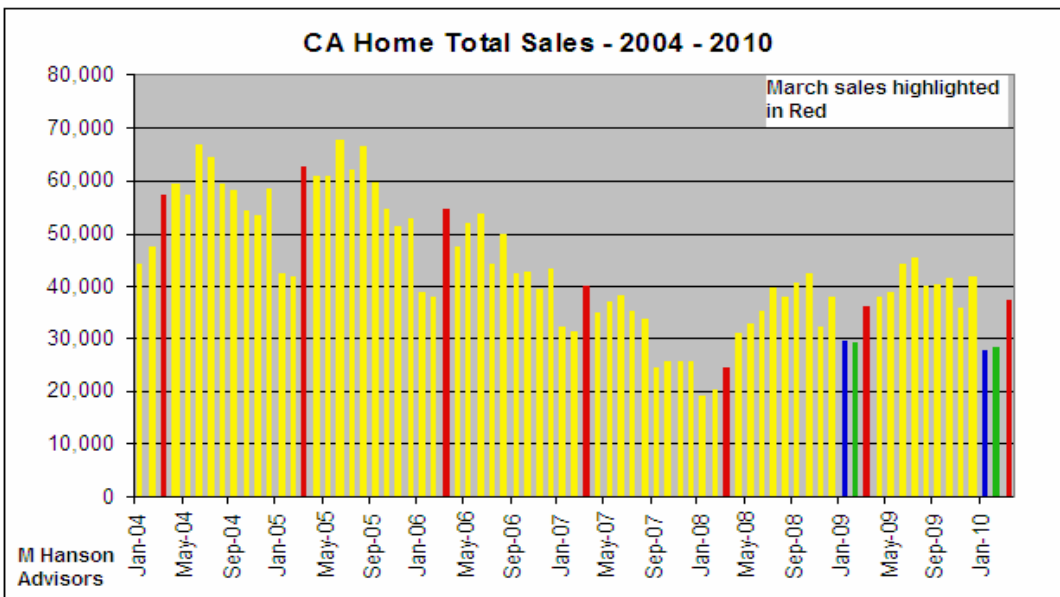
So, let's look at some CA and national house sales data.

1) CA Q1 House Sales Disappoint - Lower YoY. The second lowest quarter since before the bubble years (pre-2007 not shown on this chart).

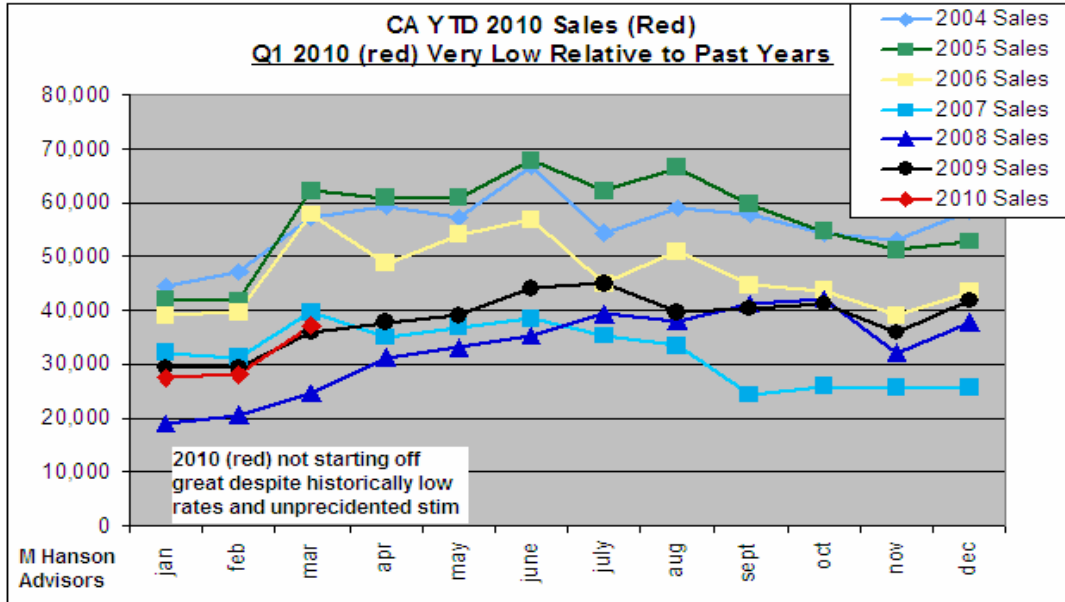


2) CA Total Home Sales Finally up YoY in March due to Massive Unprecedented Stimulus not present last Year (see 2nd paragraph on page 1 of report)

The first two months of 2010 (highlighted in the chart) show what the beginnings of a double dip looks like. In March sales actually beat last year's pace by a paltry 2.98%...when the world was melting down and no stimulus other than QE existed. This surely does not seem like a market that is ready to be on its own especially as YoY comps get really tough in Q2.

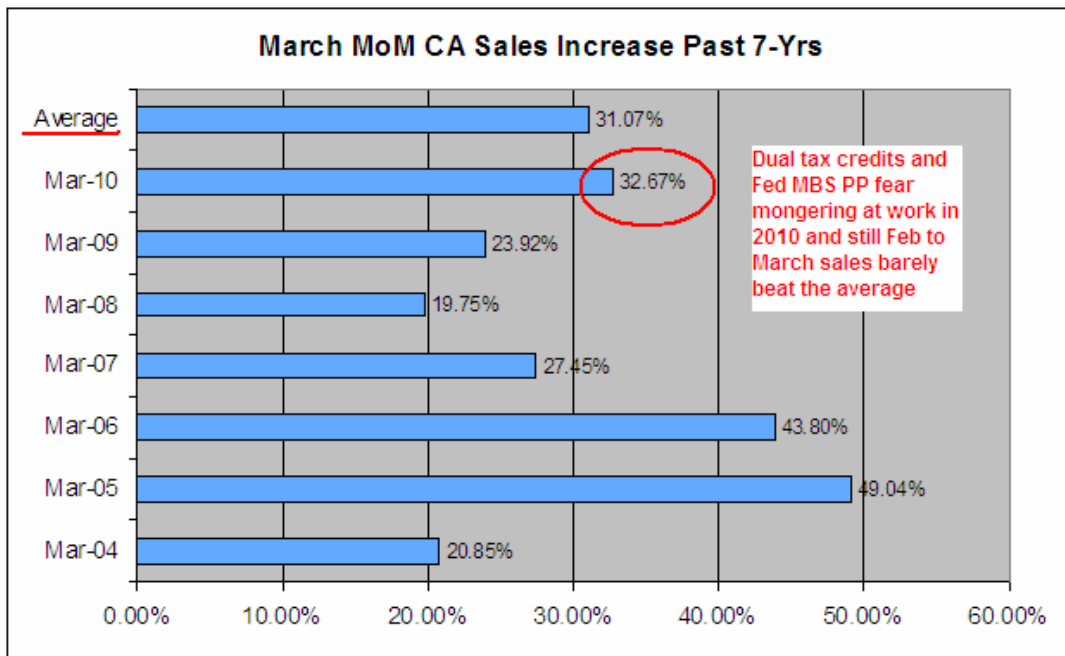


3) 2010 YoY CA Sales (red) are below any year other than 2008 when the wheels were coming off the housing and mortgage markets and prices were still closer to record highs than the lows. Again, even after unprecedented stimulus, this does not look like a market ready to have the training wheels taken off.



4) March MoM Sales Jumped But...

The average Feb to March jump over the past 7-years was 31.07%. This year with dual tax credits and Fed MBS PP fear mongering, sales barely beat the average.



5) CA Sales (Total vs Distress vs Organic vs Flip-Adjusted) and Loan Defaults - Loan Defaults Lead Pack

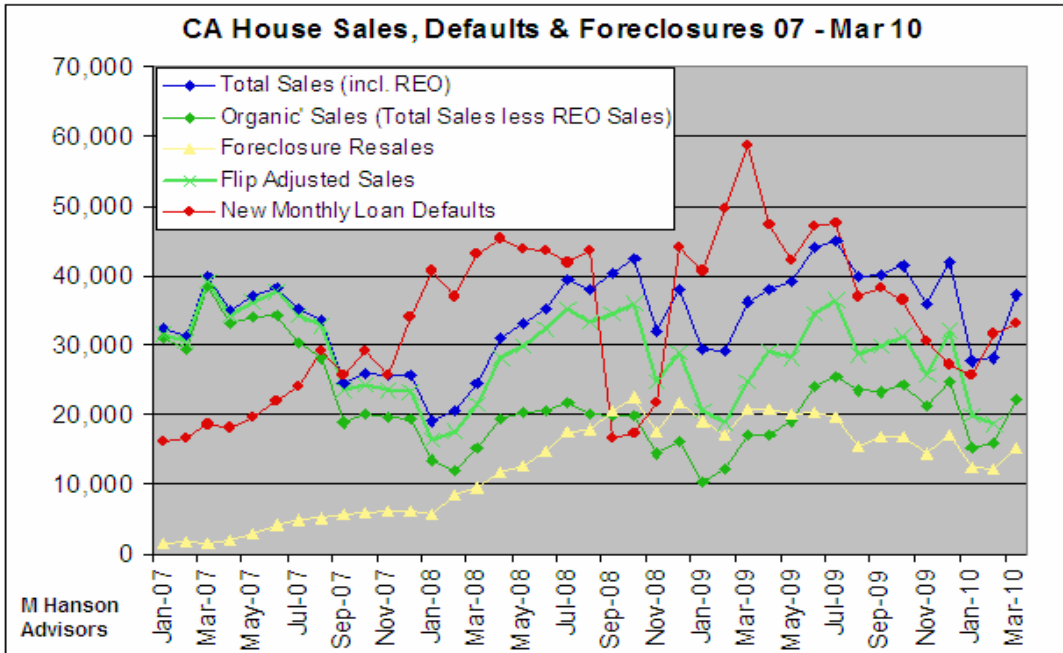
1) **Total CA home sales** (blue) plunged in Jan & Feb putting them below year-ago levels when the global markets were imploding, QE was new, prices were still tumbling, and sentiment was terrible. In March they finally beat due to unprecedented stimulus listed on page 1, paragraph 2.

2) **Organic sales** (green) holding steady at **low levels** emphasizing the epidemic **effective negative equity** that prevents the majority from selling and re-buying

3) **Foreclosure resales** (yellow) are languishing due to continued meddling. **The lack of distress supply, which is most in demand, is the primary threat to house sales in 2010 and beyond.**

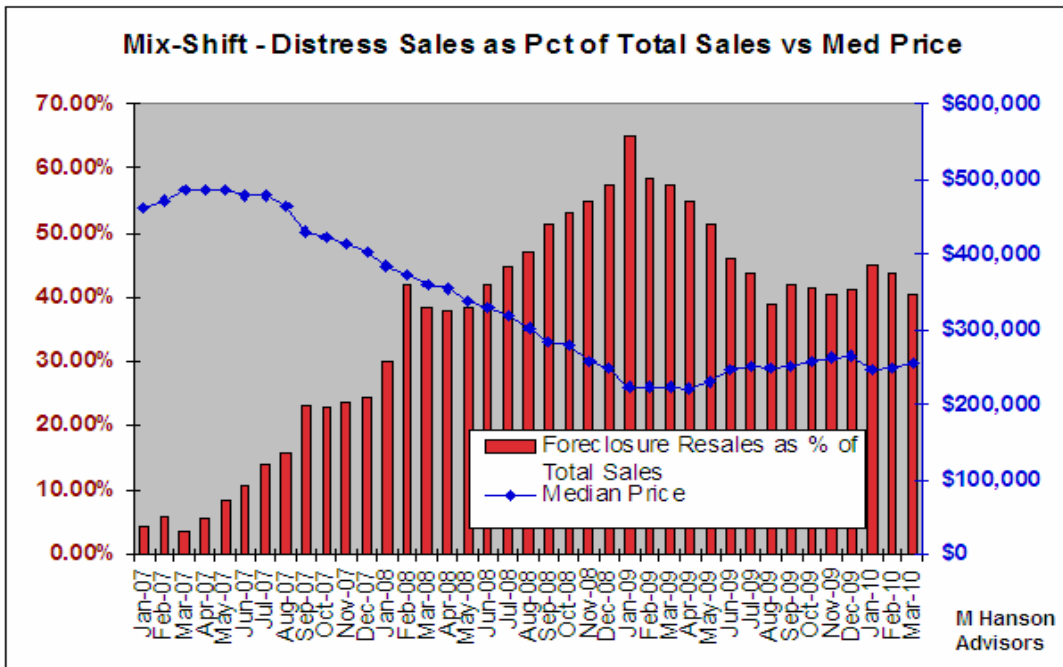
4) **Flip-Adjusted Sales:** When adjusting for **flip-resales (light-blue)**, which make for **double-counting** in the monthly house sales results, CA house sales are bouncing off lows not seen in decades. **It is important to note** that flip-resales, which provided much of the 2009 boost in sales counts due to double-counting, will diminish sharply into 2010 due to the lack of foreclosures in 2009 caused by all of the foreclosure prevention initiatives. This is something nobody is looking for.

5) **NODs:** Despite being artificially lower due to heavy handed mod initiatives of which at least half will fail, **new loan defaults** (red) are leading the pack meaning the supply pool is filling quicker than it's draining.



6) **Foreclosure-Resales Way Down - an intended consequence of foreclosure prevention initiatives, which has allowed reported and median house prices to stabilize at least temporarily.**

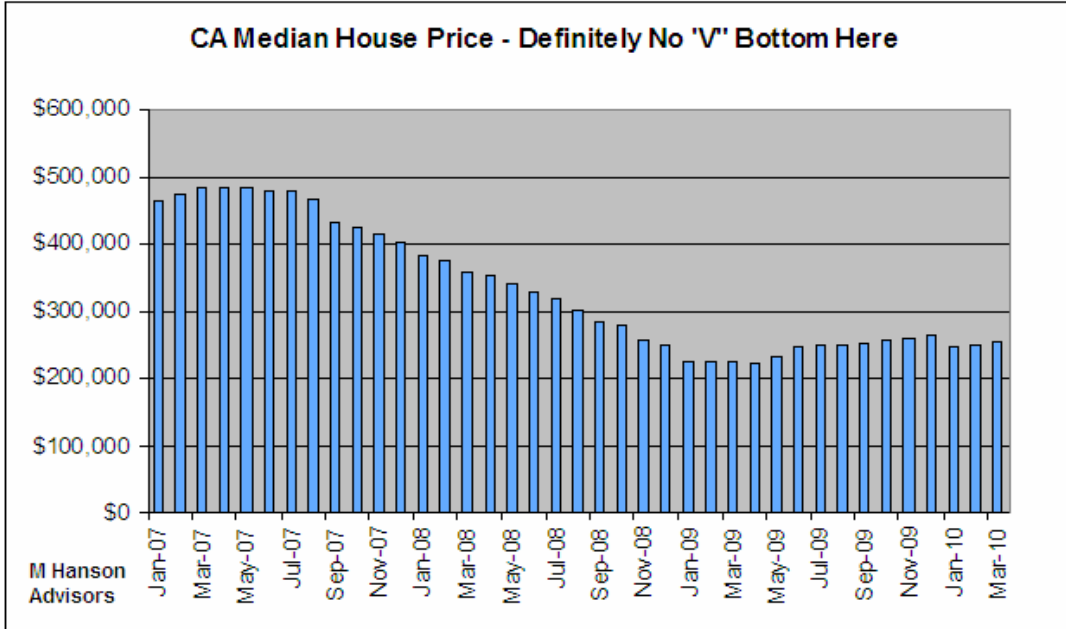
If Foreclosures continue to climb as fast as they have been, the Dec 2009 peak median price point is the best we will see for a long time.



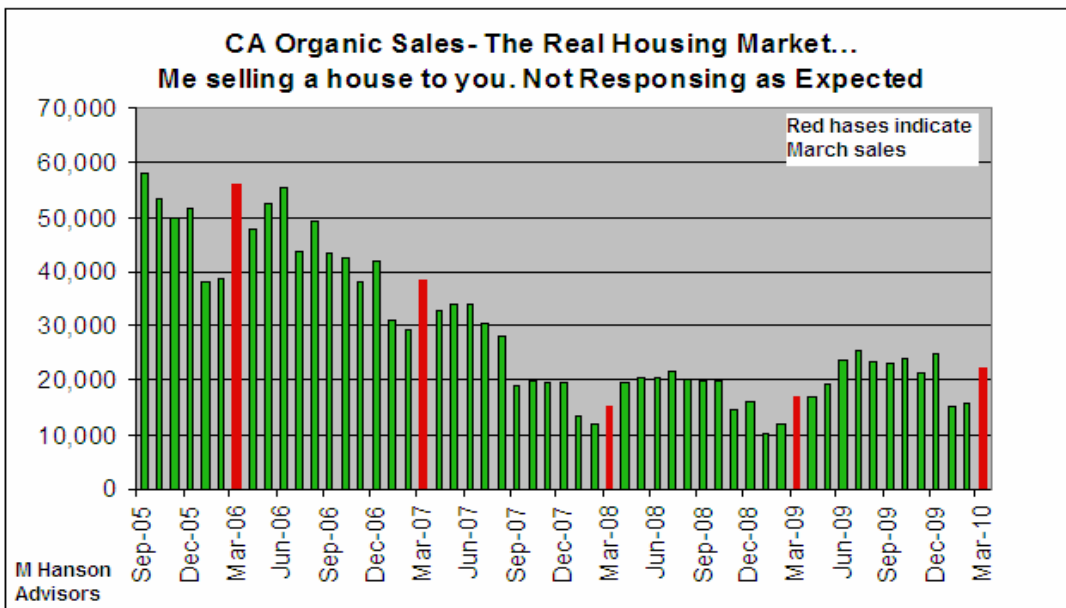
7) CA Median House Prices - No 'V' Bottom Here

Note - 'stabilization' and a 'v' bottom are two completely different things. This chart does not even look very stable. As in the chart above, when distressed sales begin to increase sharply as a percentage of total sales, which they will again this year, prices will once again resume their slide.

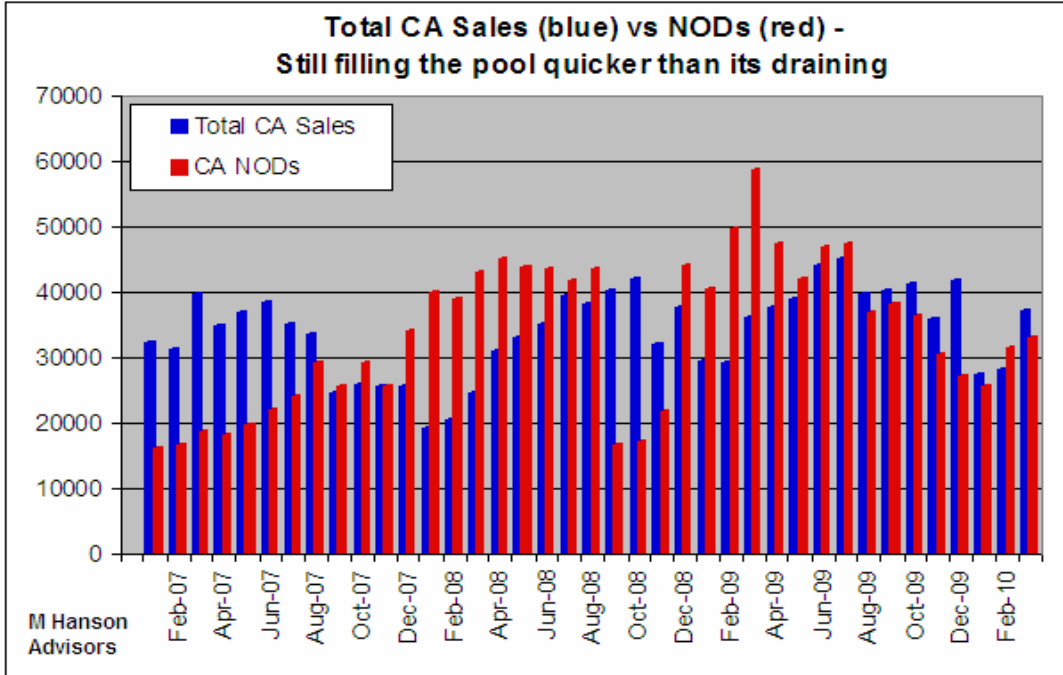
However, with demand for low-to-low mid end foreclosures still strong, we will not see anything like 2007-2008. But 5-10% per year for the next few years at least is not out of the realm of possibility.



8) Organic Sales picking up slightly, but it's not the hand-off most expected if Foreclosures were artificially suppressed. This is due to Epidemic Effective Negative Equity that prevents 10s of millions from selling and re-buying (paying off the loan, paying the Realtor, moving expenses, and putting a down payment on the new house)



9) CA New Notice-of-Defaults Continue to Swamp Sales. The pool is being filled with supply as quickly as it drains each month.

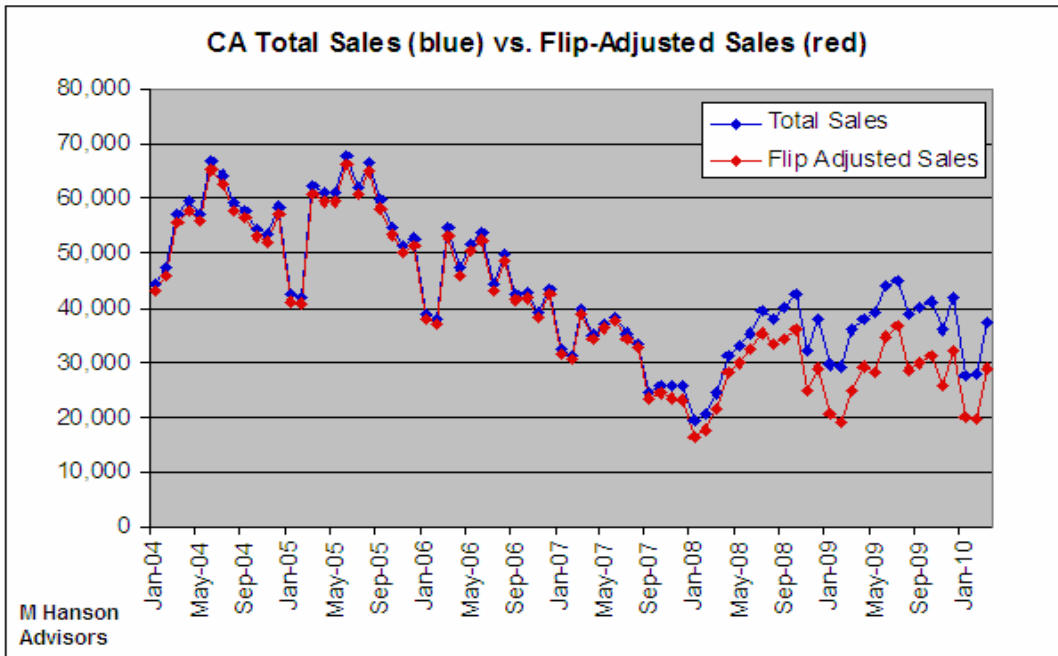


10) Flip-Adjusted CA Sales Tell Even Another Story

When adjusting for **flip-resales**, which are hot and make for **double-counting** in more recent monthly house sales results highlighted by the divergence below, CA house sales are bouncing off lows not seen in decades.

It is important to note that flip-resales, which provided much of the 2009 boost in sales counts due to double-counting, will diminish sharply into 2010 due to the lack of foreclosures in 2009 caused by all of the foreclosure prevention initiatives and the time to buy, rehab and sell.

This will be only a marginal decrease but on a national basis, Existing Home Sales were only marginally better in 2009 YoY (5.2%) This is something few are looking for.



National Existing Home Sales Preview

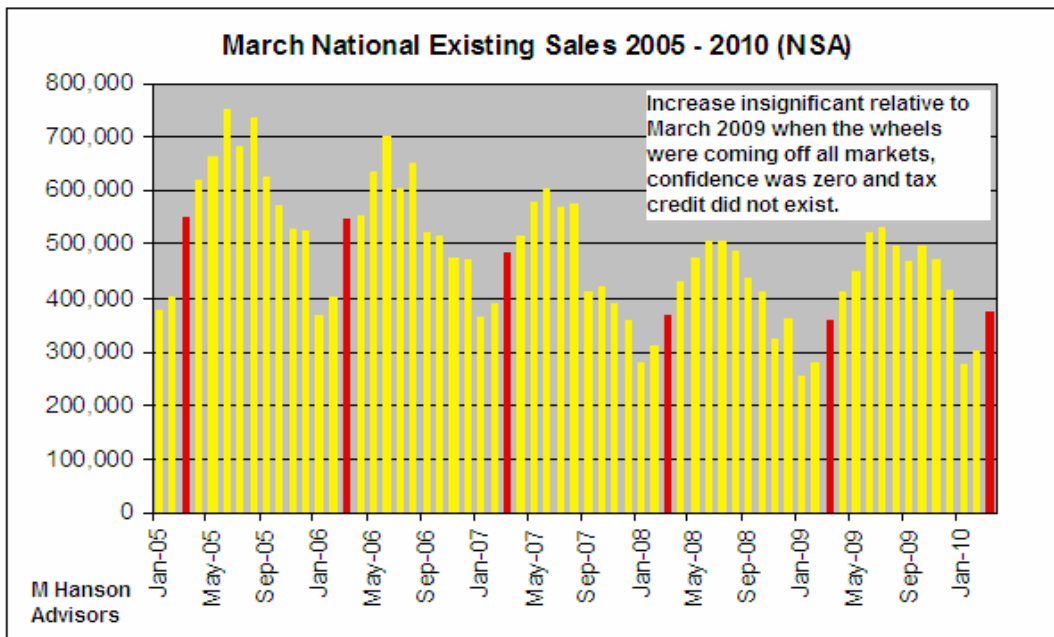
Based upon CA sales and other national sampling we perform, National Existing Home Sales released this Thursday will be up MoM and flattish YoY on a **Not-Seasonally Adjusted Basis**. My estimate is for 375k sales in March vs 302k last month and 357k last March.

Seasonally adjusted, consensus is for 5.3mm but it seems that is high, especially after CA results came in so mediocre. While it could be a close call, unless they jimmied their adjustments again, Seasonally Adjusted Sales should be closer to 5 to 5.1mm. **Given everybody is expecting a big push due to the stimulus, a consensus miss will be treated especially harshly.**

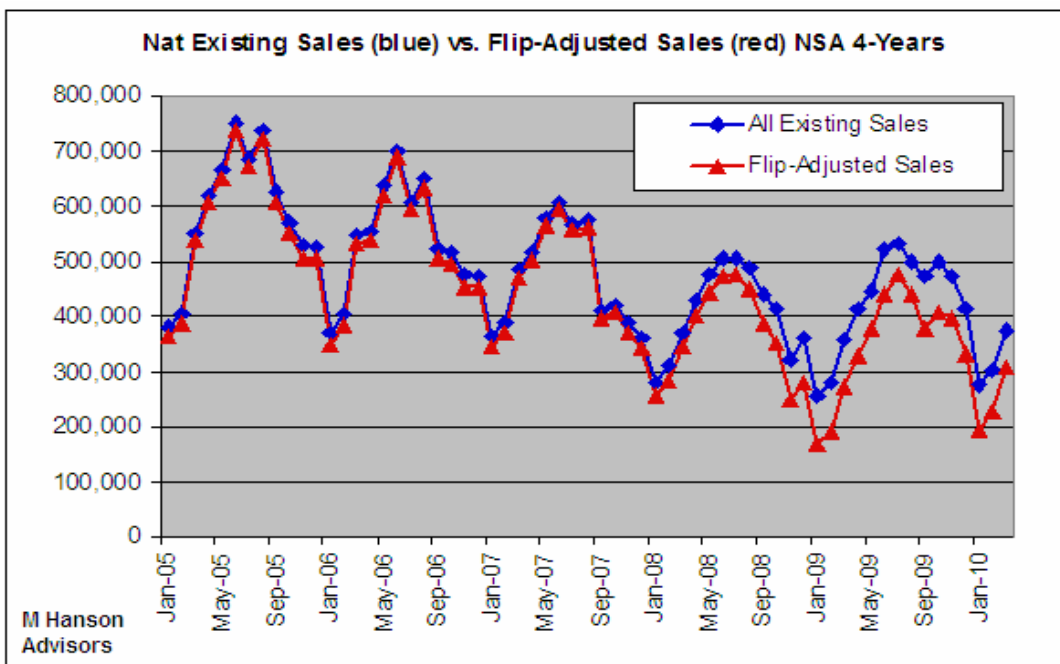
Despite NAR's voodoo seasonal adjustments, the same trend in national sales as with CA sales is obvious...the lack of distressed inventory is beginning to take its toll on sales and despite historical stimulus, the stimulus-driven market has not handed the baton to a more normalized market.

First-timers and Inventors continue to dominate due epidemic effective negative equity among organic sellers and buyers, and these two groups can literally turn off the demand overnight.

Bottom line - the national housing market 'recovery' sits in a precarious position and ironically enough, the deciding factor will be how quickly foreclosures and HAFA liquidations can hit the market and be absorbed because that is all the buyers want.



Lastly, **flip-sales double counting within the Existing Home Sales reports provided a sizeable boost** to house sales counts in 2009 as shown in the chart below. When backing out flip sales double-counting the resulting weak **'Flip-Adjusted' total sales (red)** in 2009 highlight the fundamental weakness in this housing market.



The 'Lack of Inventory' Myth, 'Effective' Negative Equity and Significantly Increased Distress Supply

Yes, "**listed**" inventory is way down from year ago levels. Pundits use this metric as leading evidence that the housing market has nowhere to go but higher. Obviously, they will not mention the 8.4mm houses barreling down the foreclosure pipe -- and the approx 120k that enter the pipe every month -- of which the vast majority will end up as inventory through foreclosure, deeds-in-lieu or short sales.

But aside from the shadow inventory, the **lack of organic inventory (natural sellers) is not a positive rather it speaks to the epidemic negative equity preventing most from selling and re-buying. Homeowners are trapped.**

****Remember, effective negative equity does not begin at the point in which somebody owes more on their house than what it's worth. It begins at the point at which they can't pay the Realtor and put a down payment on the new prop.**

In the Jumbo market this could be 75% LTV (sales proceeds less 6% Realtor fee and 20% down payment). When calculating neg-equity like this, the figures are vastly greater than the popular reports suggest.

Also, this speaks to how strong foreclosure prevention has been with respect to keeping in-demand foreclosures off the market. This is why allowing more distress supply into the market via significantly increased foreclosures and the new **HAFAs program (short sales and DILs) is beneficial to the housing market and will happen.** At this point, holding back distress inventory is detrimental to the housing market.

Best Regards,

Mark Hanson

Mark@MHanson.com

www.MHanson.com

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