Could Existing Home Sales and Prices just fall off of a cliff in the near-to-mid term?

For existing home sales, the stimulus effects will be felt in sales through June 30th. Contrary to what consensus became until a couple of weeks ago, I maintain that the stimulus was more of a driver -- that not only added to volume but pulled forward more demand -- than most think. If this is the case, then in the near-term the lack of stimulus could lead to a larger sales volume decline than expected going into the busy season when seasonal adjustments subtract from sales and YoY comps are at peak levels.

Moreover, distress sales as a percentage of total sales hit a low for the year in April, as sales prices hit a high. But with Foreclosures suddenly back to record highs, short sales surging, and sales volume set to decline post-tax credit, this trend could quickly and sharply reverse adding measurable pressure on reported median and average house prices.

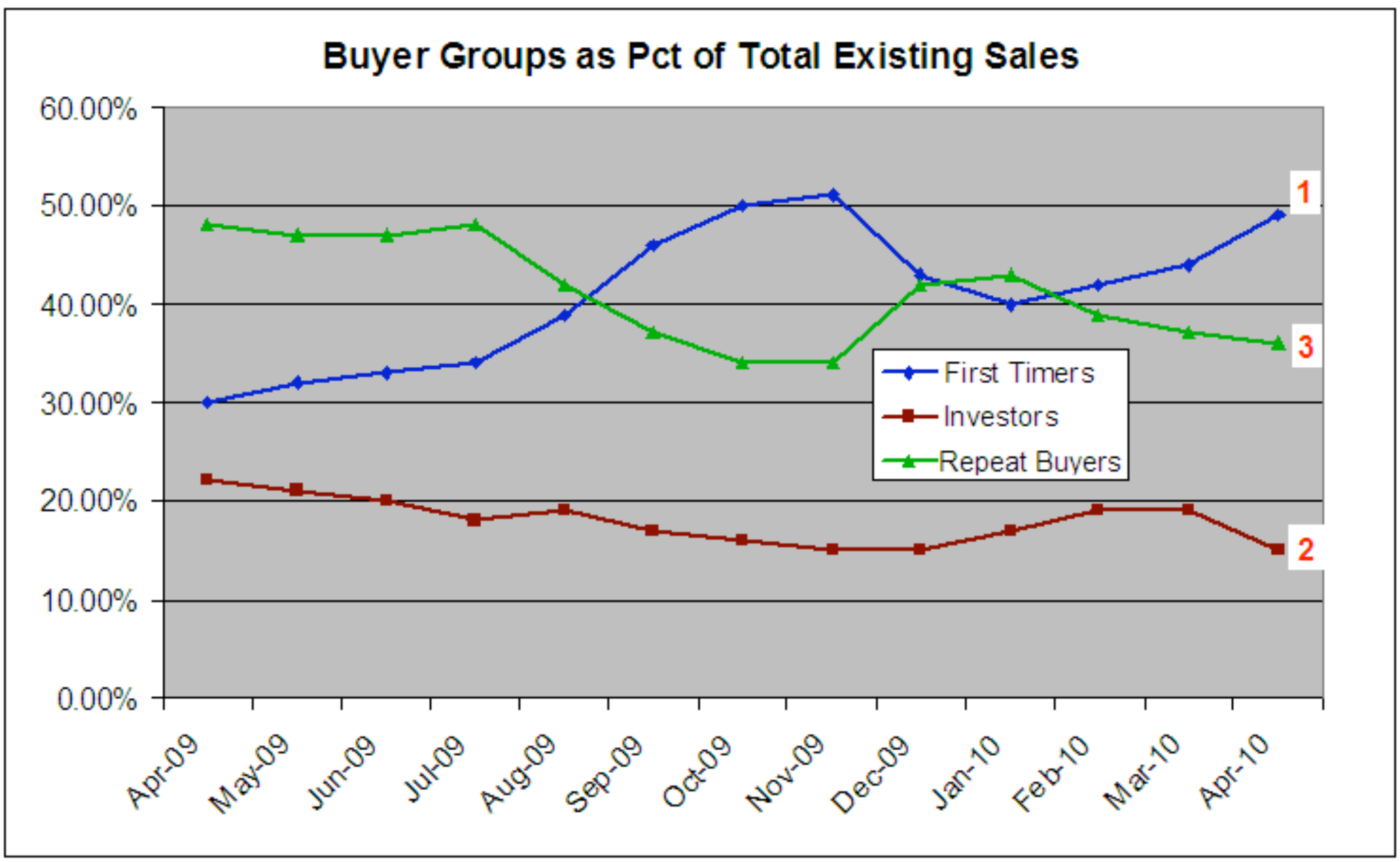
In today's existing sales report, signs of these conditions are apparent so I rather focus here than on my typical monthly volume and pricing metrics, which do not make for any further meaningful analysis than I have already done up to this point in time.

Existing Home Buyer Groups as a Percentage of Total Sales Portend Post-Stimulus Weakness

1) Like when the tax-credit ended in November, first-timer buyer volume is surging. First-timers and investors are highly volatile groups who have been known to turn it off on a dime.

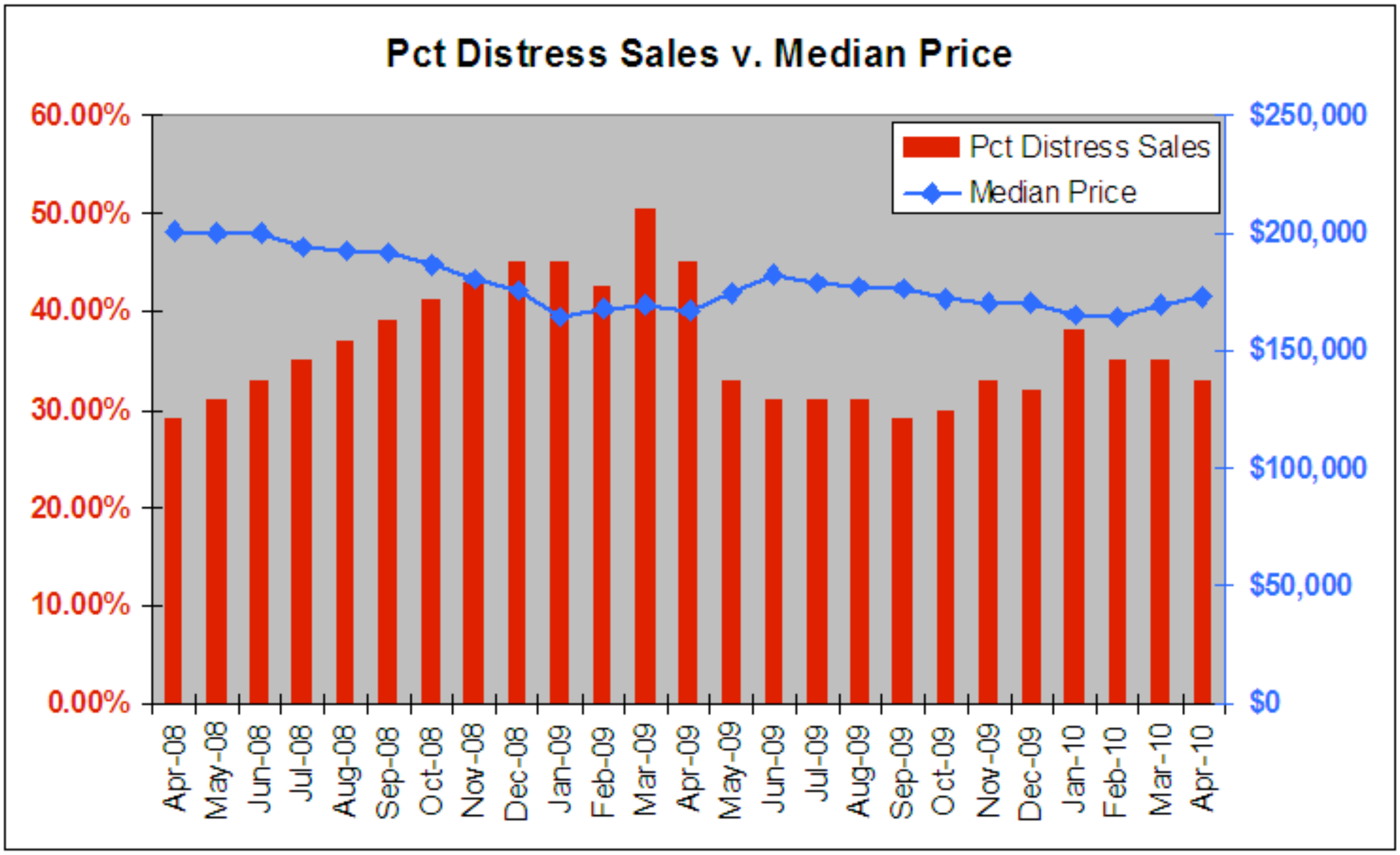
2) Also as in Nov, investor purchase volume declined going into the tax-credit sunset, as first-timers go to war with Obama coupons in hand. However, this is a post-tax credit positive because as first-timers leave the market, investors will pick up some of the slack. But investor demand will never come close to the stimulus-driven first-timer demand, unless prices come down and distress supply pick up significantly.

3) Organic 'repeat buyers' continue to lose market share, as effective negative equity leave far more than the commonly thought 23% unable to sell (pay loans and a Realtor 6%) and rebuy (10% to 20% down payment).



Distress Sales as Percentage of Total Sales Drop for Three Straight Months as Median Price Increases for Three Straight Months

The percentage of distress sales to total sales remains low benefiting prices. In fact, the correlation over the past three months in uncanny. But with Foreclosures suddenly back to record highs, short sales surging, and sales volume set to decline post-tax credit, this trend could reverse quickly and sharply adding notable pressure on reported median and average house prices.



April Existing Housing Supply Surprisingly Increases Even as Sales Rise

This one caught many off-guard, yet it is still is a low-ball estimate. Remember, this is only for houses listed on the MLS, of which not all REO are. In addition, short sales are surging and they are the ultimate form of 'shadow supply'.

The universe of potential short-sellers is massive. It consists of any homeowner that has an LTV of 94.01% or greater (due to 6% Realtor fee). Short sales never even have to be listed on the MLS, as the first offer is generally the one that gets submitted to the bank. Most Realtors have a long list of candidates awaiting short sales so when a homeowner makes the decision to short sell and calls their Realtor, there is no reason to ever put it on the MLS. In fact, the Realtor is advantaged not to list it because it means more work and a longer closing cycle.

Temporary, Synthetic 100% First-Timer Mortgage Loans Another Existing Sales Volume Driver

One sales volume driver I have never seen analyzed is how for the tax-credit **HUD allowed the $8k to be used to make synthetic 100% loans.**

It is impossible to know how many first-timers were only able to buy because of this temporary 100%+ financing gift, but I suspect it could have been a decent number given how in April the higher priced Western region, in which the $8k would not have covered the downpayment and closing costs, significantly lagged all other lower-priced regions with respect to the tax-credit volume bump.

From the Federal Tax Credit info site.

<u>HUD is now allowing "monetization" of the tax credit. What does that mean?</u>

HUD allows buyers using FHA-insured mortgages to apply their anticipated tax credit toward their home purchase immediately rather than waiting until they file their 2009 or 2010 income taxes to receive a refund. These funds may be used for certain downpayment and closing cost expenses.

Under HUD's guidelines, non-profits and FHA-approved lenders are allowed to give home buyers short-term loans of up to $8,000. The guidelines also allow government agencies, such as state housing finance agencies, to facilitate home sales by providing longer term loans secured by second mortgages.

Housing finance agencies and other government entities may also issue tax credit loans, which home buyers may use to satisfy the FHA 3.5 percent downpayment requirement. In addition, approved FHA lenders can purchase a home buyer's anticipated tax credit to pay closing costs and downpayment costs above the 3.5 percent downpayment that is required for FHA-insured homes

May 19th 2010 - Purchase Applications Plummet in Week Following Tax Credit Sunset

This one caught most off-guard and will be interesting to see where it levels out over the next few weeks. In no way can organic buyers or investors suddenly make up what will be lost, as first-timer volume drops.

> "Purchase applications plummeted 27 percent last week and have declined almost 20 percent over the past month, despite relatively low interest rates. **The data continue to suggest that the tax credit pulled sales into April at the expense of the remainder of the spring buying season.** In fact, this drop occurred even as rates on 30-year fixed-rate mortgages continued to fall, and at 4.83 percent are at their lowest level since November 2009," said Michael Fratantoni, MBA's Vice President of Research and Economics. "However, refinance borrowers did react to these lower rates, with refi applications up almost 15 percent, hitting their highest level in nine weeks."

Best Regards,

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