

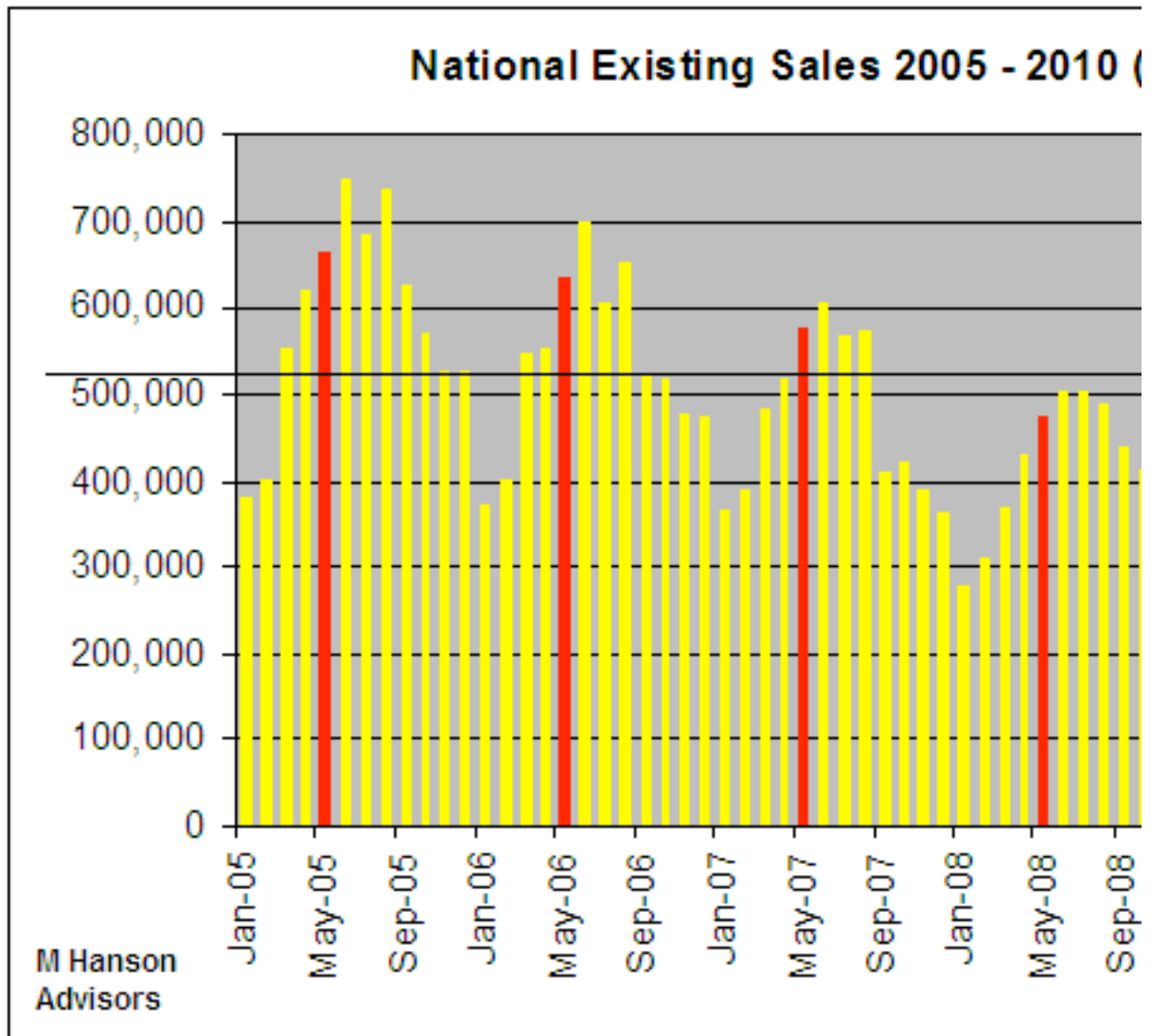
Today's Existing Home Sales' 7.2% consensus headline miss was more aggressive than my 3% estimate, which is likely how tomorrow's New Home Sales report will go as well. The market is absolutely betting on a miss tomorrow, but I doubt a 10% to 20% consensus miss, which is likely. That may be enough to shake things up again in the builders.

With respect to today's sales numbers, they tell an important story, especially the unseasonally adjusted numbers, which came in at a low 526k vs April's 522k. There are several likely scenarios. The **first** is that the buyers were ahead of the tax credit this time around; the **second** is because short sales, which have a lower and longer closing ratio, make up such a large part of pendings in the new-era housing market they have rendered this indicator very unreliable; **thirdly**, the rush to put in offers on any available house by the April 30th deadline is leading to a much lower closing ratio than normal again rendering pending sales unreliable in the new-era, stimulated market; **forth**, tax-credit buyer demand was not as robust as thought; and **lastly** the short sale cohort is having a tough time closing because of longer short sale processing times and the buyer and bank can't agree on price. Most likely, all contributed to some degree.

NAR says that up to 180k houses set to close by the June 30th deadline may be delayed for one reason or another, **which is doubtful**. Very little truth has come out of NAR over the past few years so cutting this number in half is more reasonable. And when adding back 45k sales into this month's Existing Sales print, there is your consensus miss. **This bodes ill for June as well**. However, as I have stated on several occasions, I highly doubt that those who missed the June 30th tax-credit closing deadline will walk away. More likely they will just close anyway or perhaps counter the bank at a lower price one last time and then close either way. Therefore, these 90k missing closings will simply shift forward helping to somewhat pad what should have been a plunge in July sales reported in the third week of August.

Now, for some pictures.

**1)** May unseasonally adjusted Existing Sales came in at 526k, **only up 4k from last month**. But **more importantly**, we know the credit pulled forward significant demand and May's sales were less than June and July of 2009 before the stimulus took hold. **Bottom line - underneath this mega cash and interest rate stimuli, the housing market is double-dipping right now**.

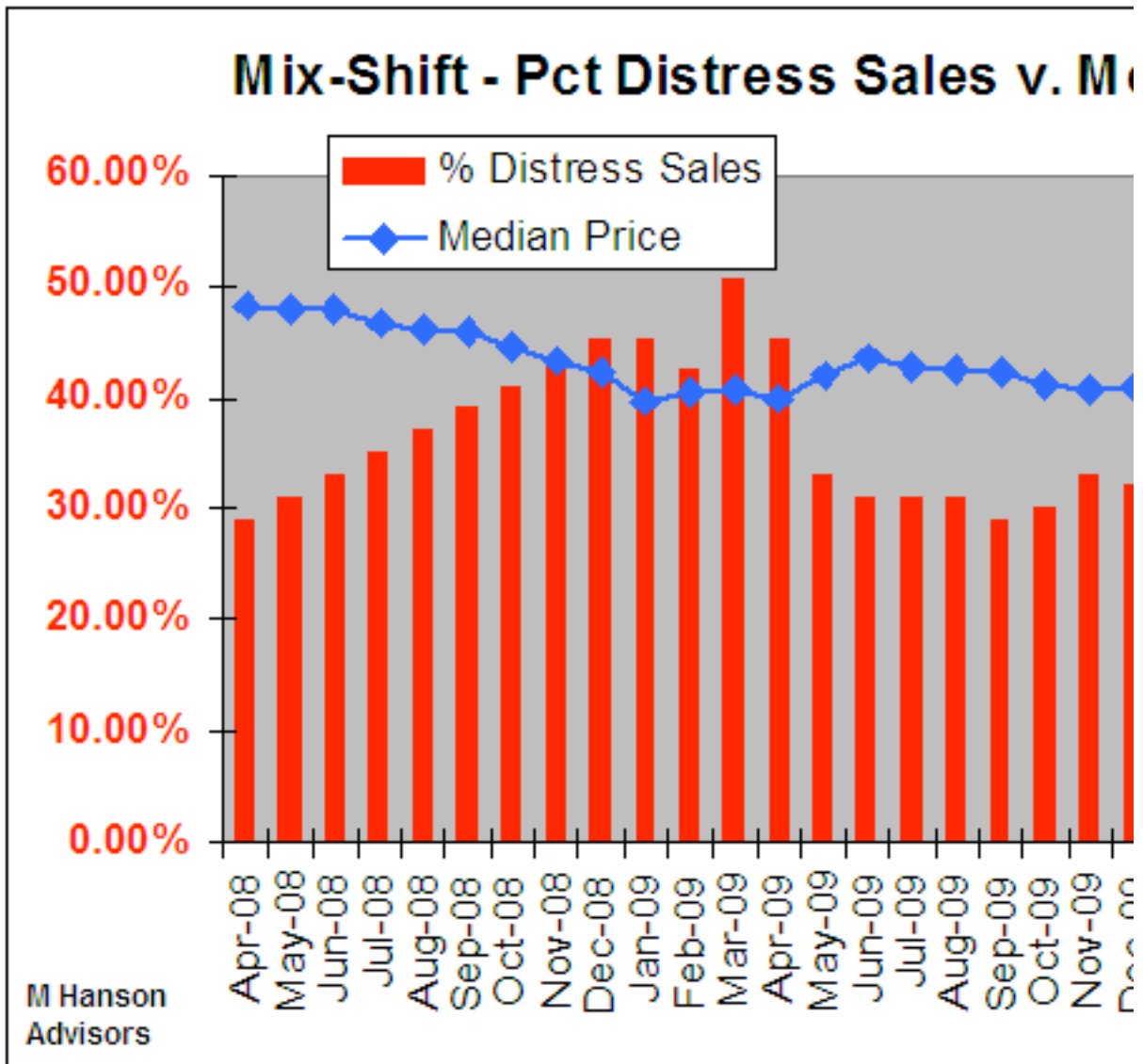


**2) Mix-Shift Effect on Reported Median & Average House Prices about to Abruptly Shift Again**

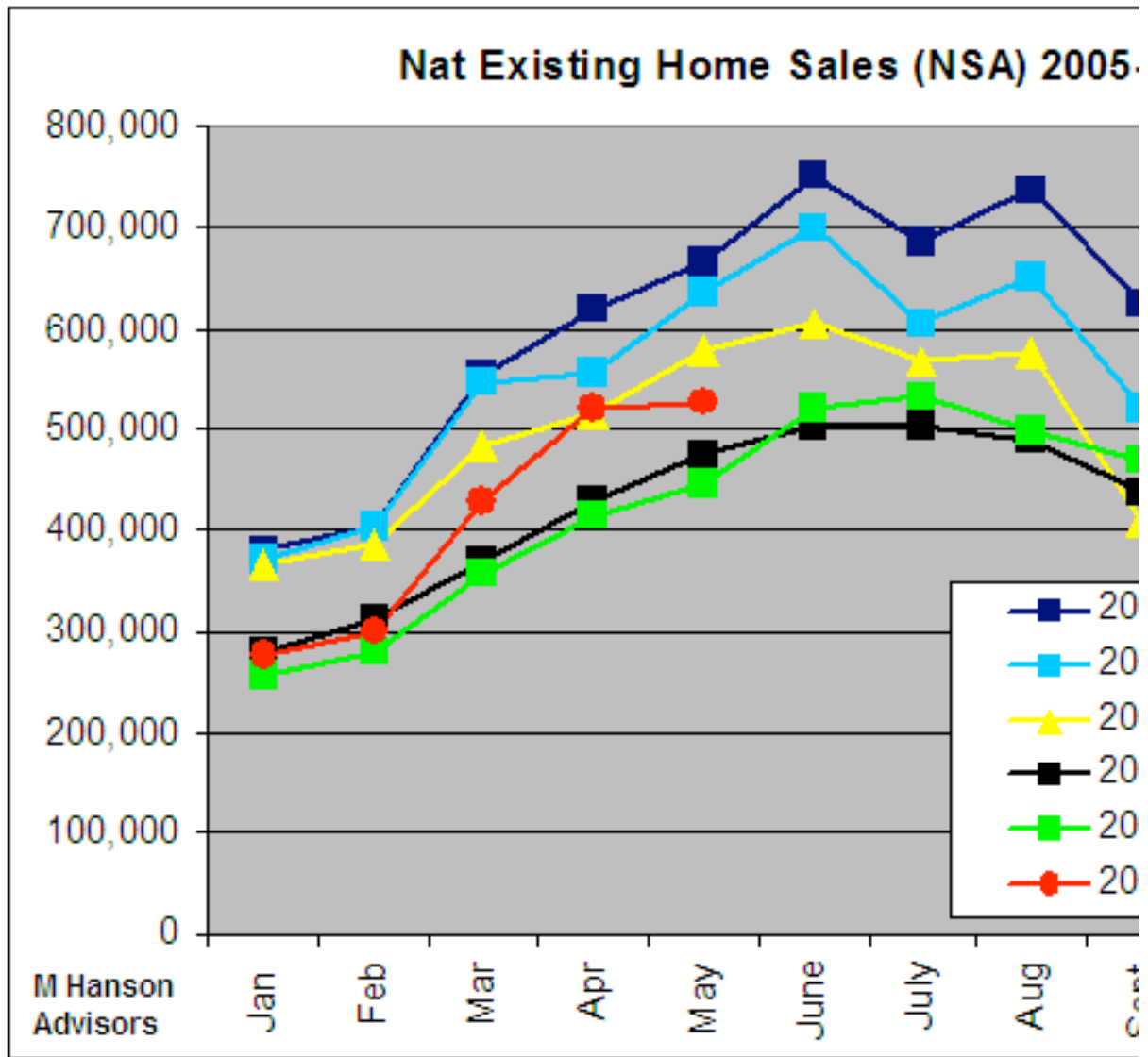
Pundits are pointing to strength in May median and average prices as a positive. However, going into the tax-credit deadline with such a manic rush to get into contract, it makes sense sellers had some pricing power. In addition, **the percentage of distress sales-to-total sales dropped once again from 33% to 31% supporting prices.**

**But this is all about to shift again and quickly.** For over a year house prices have been supported from distress sales as a percentage of total sales remaining contained relative to the 2007 to early 2009 period when reported median and average prices were crumbling. This is due to the combination of artificial and temporary demand stimuli and aggressive mortgage mod, moratorium, and legislative supply suppression tactics. But with foreclosures at record highs for months and the five forms of shadow inventory I highlighted in Sunday's note in their early stages of providing inventory -- and with house sales volume to come under pressure after the lion's share of the tax-credit effects are felt -- **the all-important distress-to-organic sales ratio should again begin to rise sharply.**

In May, the distress sales percentage of total sales was only 31% down from 50.5% at it's high in March 2009, which also marked the period of time when reported median and average housing prices statistically 'bottomed'. The demand for distressed real estate is strong and should continue to be post-tax credit, as investors come back in the market to fill *some of* the void left by first-timers with their Obama coupons. **When the distress ratio suddenly jumps sharply beginning in July the reported average and median house prices will turn down suddenly and sharply in response.**



3) After a slow start to 2010, sales pulled higher than 2008 and 2009 in March through May but still remain well below 2005-2007 levels. Given the flattening in sales volume in May and the extent of the pulled forward demand, it is easy to conclude than **2h10 will bring the weakest sales volume in years and YoY comp misses will be common.**



#### 4) Buyer Groups as a Percentage of Total Sales

As first timers ramp-up closings going into this tax-credit sunset identical to last Nov's sunset, investor demand has dropped off. This is also price supportive. Going forward as first timers and repeat buyers lose their weighting and investor weighting increases, it will make for an additional drag on prices.

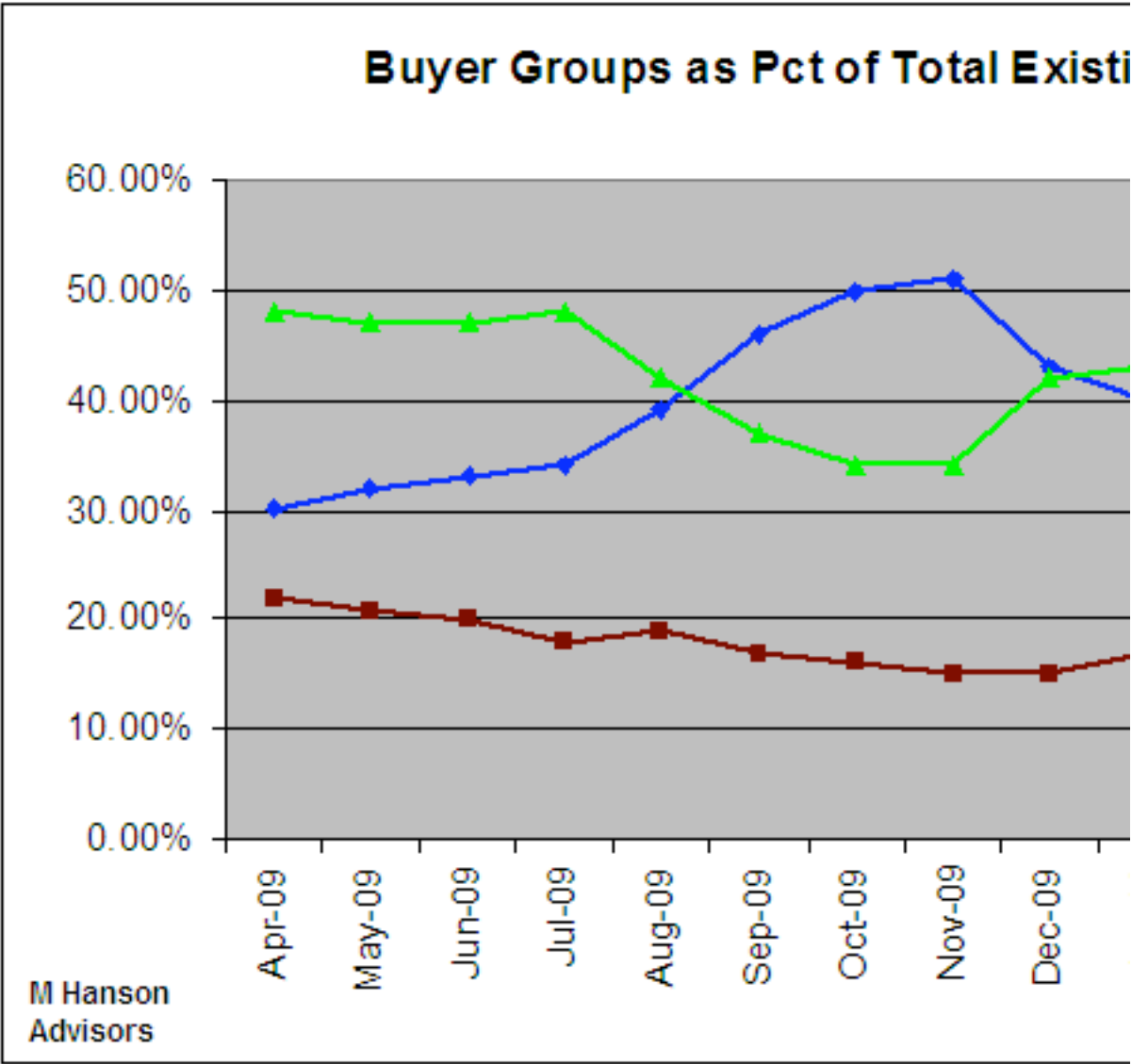
**a)** As with the tax-credit sunset last Nov, first-timer buyer volume has sharply increased going into the June sunset. First-timers and investors are highly volatile groups who have been known to turn it off on a dime.

**b)** In April, a full 60% of buyers put down payments of less than 6% while only 14% put down more than 20%.

**c)** As in Nov, investor purchase volume is declining going into this

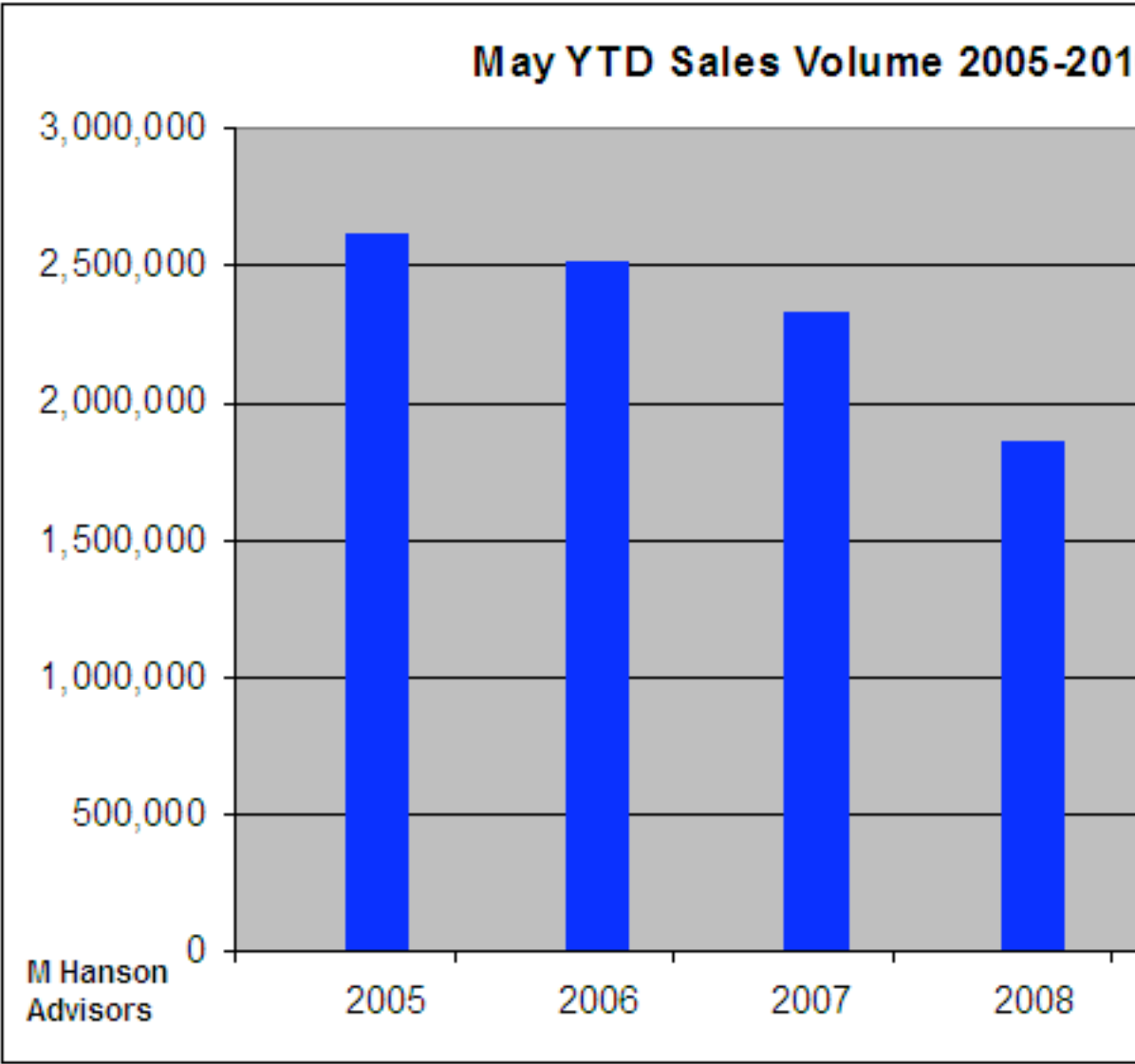
sunset, as first-timers went to war with Obama coupons in hand. This is a post-tax credit positive and negative; a positive because they will fill some of the void left by first-timers and negative because increased investor demand will weigh on median and average house prices.

d) Organic 'repeat buyers' continue with weak market share, as effective negative equity leaves far more than the commonly thought 23% unable to sell (pay loans and a Realtor 6%) and rebuy (10% to 20% down payment). **Without this cohort making substantial come-back a true housing recovery will never happen.**



5) May Year-to-Date Sales

Considering the mega-cash and interest rate stimulus that was not in effect in the previous troubled years of 2007-2009, May ytd sales too weak to conclude that a successful hand-off from the stimulated to organic market can occur at this time.



Best Regards,

Mark Hanson

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