

The following and attached is a comprehensive report on the upcoming **July Existing Home Sales report to be released on August 24th**. This will be the first post tax-credit read on the resale (distressed and organic) housing market and will not only usher in the **largest busy-season MoM drop** in EHS volume in modern history, but also the largest NAR reported median and average house price decline, and Month's Supply increase.

Much, if not all, of this should be consensus by now. But because so much time has passed since the April 30th tax-credit sunset, so much noise has been produced over New Home Sales, which by the way will be on it's third post-tax credit release the exact same day EHS is released, and consensus over the past few weeks has begun to turn positive on housing yet again, I believe that the weakness in all aspects of this month's EHS report will now catch many by surprise.

**Mark Hanson**

## **M Hanson Advisors – Real Estate & Finance**

*The Mortgage Pages - August 2<sup>nd</sup> 2010*

- ***The August Surprise - Extreme July Existing Home Sales Volume, Supply AND Price Volatility***

*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*

### ***The August Surprise***

In recent weeks consensus has begun to snap back from moving towards 'double dip' in May & June to somewhere between 'a double-dip in not likely', 'the bottom is in', and a 'sustained post tax-credit recovery is underway'. There is even faction that just doesn't think housing matters any longer... many of the same who think jobs don't matter I am sure. Over the weekend, Greenspan comments tying a potential economic "double-dip" to the health of housing gave latter solace.

With all the noise surrounding post tax-credit New Home Sales (NHS) over the past two months -- and the economist's overestimation of last month's Existing Home Sales (EHS) -- it is obvious **there is a lot of confusion** over the tax credit-sunset, tax-credit closing lag periods, closing velocity of the various types of sales (organic, foreclosure, and short) and length of time to close loans associated with the various sale types.

This confusion should create unexpected volatility when the July data are released in three weeks, as this is when the first month of post tax-credit EHS pain was felt due to sales being counted at closing, not at contract like NHS.

And by the time July EHS data are released -- on Aug 24<sup>th</sup>, **nearly full four months following the April 30<sup>th</sup> tax-credit sunset** and not coincidentally the exact day the third post tax-credit NHS report is released -- the correlation between the large sales volume swing and the end tax-credit will not be made by as many.

**This sets up the surprise. August will not only usher in the largest MoM busy-season drop in EHS volume (July sales) in modern history, but also the largest MoM NAR reported median and average house price decline and Month's Supply increase.**

### **NAR House Price Volatility Near-Term / Lagging Case-Shiller Volatility in October**

Two drivers most influence the highly volatile median and average house prices in the new-era housing market.

**First**, is traditional old supply and demand, which has been completely distorted due to pervasive can-kicking, shadow inventory, and pull-forward demand, created by the year long tax-credit. So, in the interest of being conservative in this report I only included NAR's monthly MLS listed inventory figures.

**Second**, is the relationship between the total number of distress sales (foreclosures and short sales) relative to total sales, called the 'distress-mix'.

**For the past year and a half EHS sales volume and prices have benefited from overwhelmingly positive, but mostly artificially created fundamentals...** **i)** historically low organic supply due to epidemic effective negative equity **ii)** ever-tightening lending standards making selling and re-buying challenging **iii)** foreclosure supply running at 40% of potential due to moratoria and mortgage mods **iv)** artificially low interest rates **v)** and significantly increased incremental & pulled-forward demand from the tax-credit.

**But in July most of these reversed...** **i)** improving sentiment causing more (late to the party) organic retail sellers to put houses on the market thinking it's the 'right time' to sell **ii)** foreclosures hitting record highs since March, which makes for record foreclosure resale supply typically a few months lagging **iii)** short sale volume surging, as servicers slowly ramp up their HAFA liquidation channel and just turn to short sales in general as a favored liquidation method **iv)** leading edge of the modification redefault wave hitting now making for an even greater amount of short sales & foreclosure resales

than most are modeling in the near-to-mid term **v**) and the tax credit ending.

**With respect to short sales**, which are now government endorsed and quickly becoming a preferred liquidation method of the servicers, **they may be the ultimate form of shadow inventory**, as the seller does not even need to be in default to be eligible; rather only owe 95% or more of the value of the property. Short sales are an inventory channel insignificant even a year ago. But going forward with well nearly 20 million borrowers in an **effective negative equity position**, they will weigh heavily on the market and economist's predictive housing models.

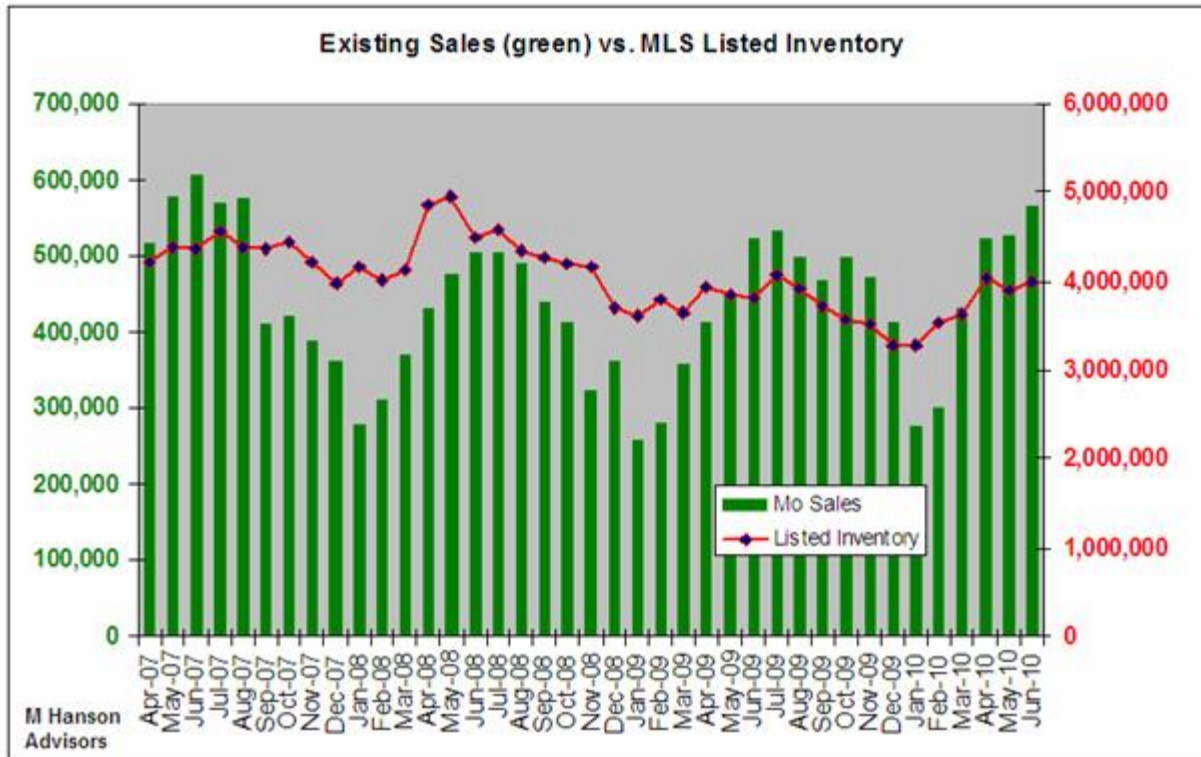
Because of this **near-term significantly reduced demand and increased supply**, particularly with respect to foreclosure and short sale volume relative to total sales volume, both key house price drivers (supply and demand & distress mix) that have been so supportive of house prices will reverse.

Thus, **I believe strongly that the back half of 2010 will experience a sharp drop in NAR reported median and average house prices. Case-Shiller** will also pick this up, but because it is up to five-months lagged when reported, it will not be as evident until July sales get a decent weighting in the three month average. This will happen in October's report covering June, July and August with November (covering July, Aug, Sept) being the month when CS fully reflects the post tax credit price slump and are notably below last year's levels.

The data that led to my conclusions are presented as follows:

### **1) Past 18-Mos of Positive Supply & Demand Fundamentals to Quickly Turn Negative**

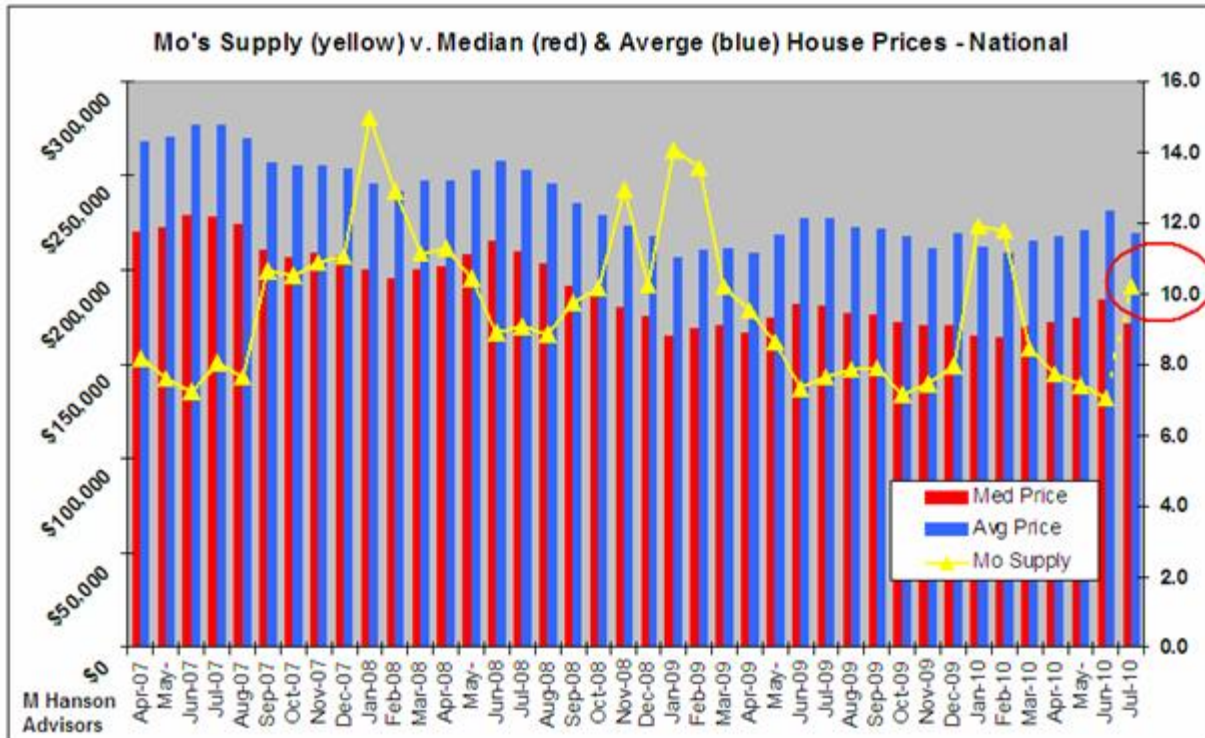
National monthly NAR MLS listed supply (**red**) has been trending lower long-term even as sales (**green**) have increased due to the stimuli. **This has been highly house-price positive.** In the past few month's, however, supply has risen sharply into the end of the tax-credit, but it is mostly seasonal. Over the near-term, supply will continue to increase even as Existing Home Sales plunge in July and remain depressed for the remainder of the year at least... **highly house-price negative.**



## 2) Past 18-Mos Positive Supply & Demand Fundamentals to Quickly Turn Negative

In June, NAR's **Month's Supply (yellow)** figure, which is calculated by dividing the total NAR MLS listed supply above by monthly sales was at 7.1 months -- **the lowest reading since the housing collapse began**. It is Important to note that the June seasonally adjusted Month's Supply figure that made headlines this week showed inventory climbing.

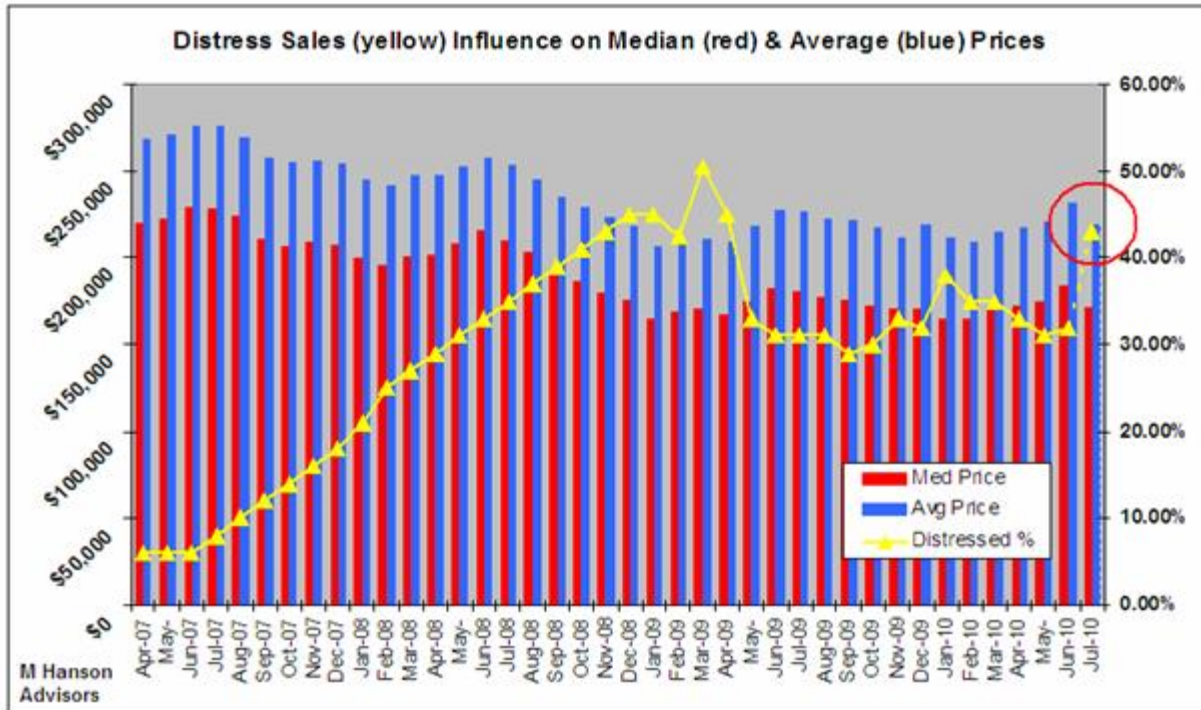
By overlaying Month's Supply data with Median and Average Price data (red & blue columns) it is clear by the correlation that this age-old fundamental still carries weight. Based upon my sales projections detailed in the following charts, beginning in July, Month's Supply will increase by nearly 45% to 10.2 months...**a house price negative**.



### 3) Past Year of Positive *Distress-Mix* to Quickly Turn Negative

When overlaying Distress Sales as a percentage of Total Sales (**yellow**) on top of Median and Average House Price data, **another house-price correlation exists**...more distress sales as a percentage of total sales negatively effects reported median and average house prices.

With foreclosures at record highs over the past few months, short sales now endorsed by the government, modification redefaults finally beginning to hit, and the post tax-credit sales volume hangover on tap in July, this slope of the near-to-mid term Distress-Mix chart will look a lot more like 2007 and 2008 than 2009. In July, distress sales should make up approx 43% of total sales from 32% in June -- **a house-price negative**.



#### 4) July Sales Volume Preview by Buyer Group

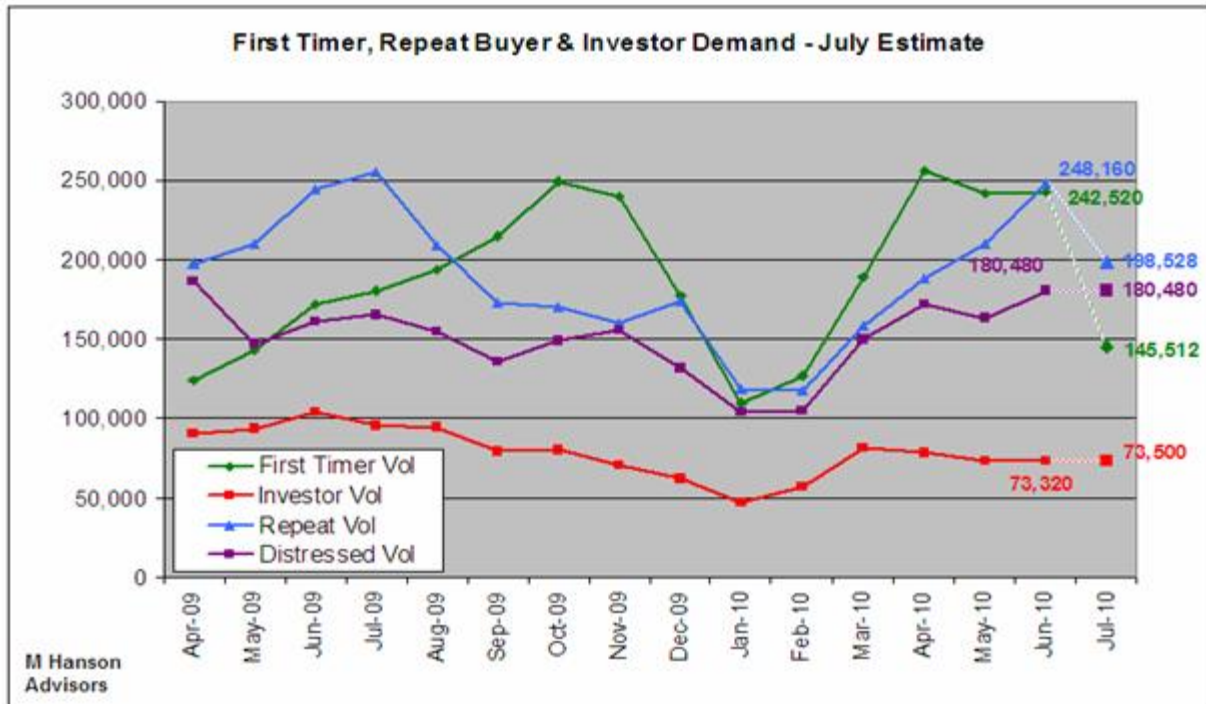
The tax-credit worked wonders in drawing out incremental and pull-forward demand by first timers over the past year. Even repeat buyers got into the game, but to a much lesser degree, with tax-credit 2.0.

**The chart below** highlights each buyer group's volume during the tax-credit periods through June '10. To the far right are my estimates of July Existing Sales volume for each group in addition to the total distress sales volume.

**This details how the negative mix-shift will occur.** The **Fist-timer** group (**green**) absolutely took most advantage of the tax credit due to the ability to monetize it for downpayment purposes in many states. This is best seen in the divergence in first timer sales leading up to the November 30<sup>th</sup> tax-credit sunset (**green line** -- Sept through Dec 09) when first timer volume increased and repeat buyer volume slumped due to typical seasonality. Therefore, they will be the hardest hit.

The **repeat buyer** population is highly seasonal and was less influenced by the tax-credit, therefore, will not experience as much of a volume drop. **Investor** volume declined going into both tax-credit sunsets, but increased in the month's following last year's, so for the purposes of being conservative for this report, I forecasted this group as flat MoM. Lastly, with respect to **distress sales**, which have been highly stable and back near record highs in

June, I also forecasted as flat MoM in the interest of being conservative.

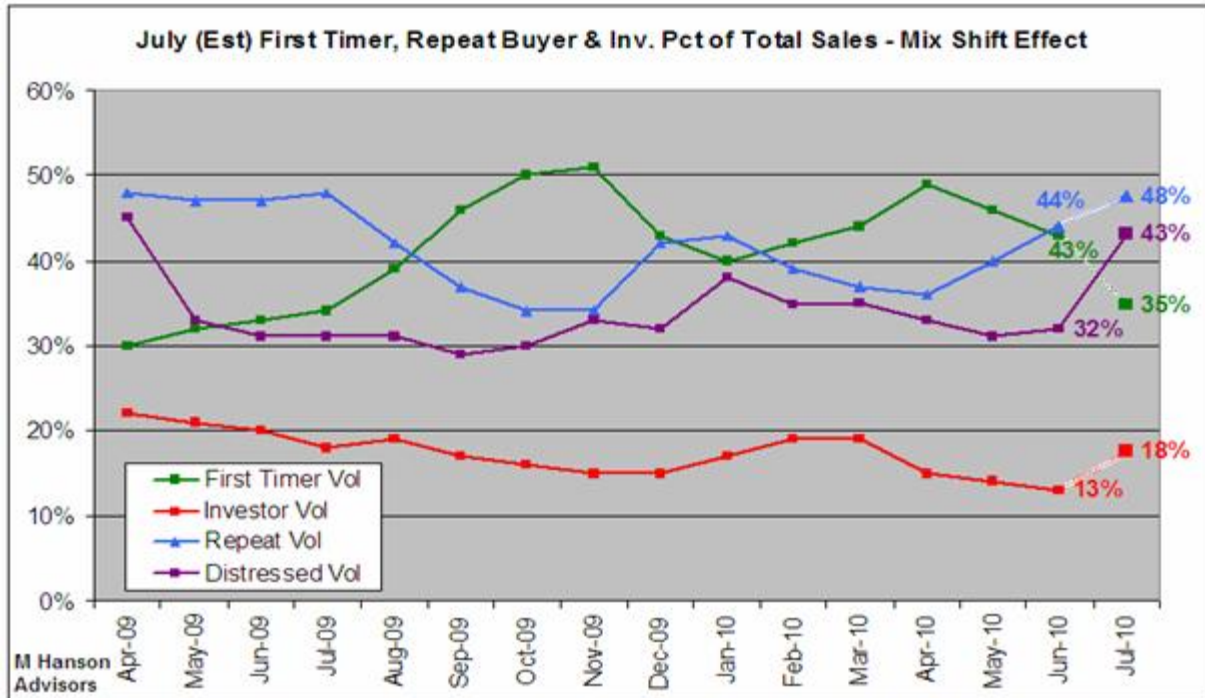


### 5) July Sales Volume Preview in Percentage Terms (Note jump in Distress Sales -- purple)

The **chart below** is of the same data as the previous chart but expressed as a percentage of total sales. This highlights how the distress mix (**purple line**) will come back into play for July sales literally overnight after consistently dropping for six months and statistically supporting house prices. The high for this metric was in March 2009 at 50.5%.

**Bottom line - A 43% distress sales ratio takes us all the way back to levels seen from Nov 2008 through April 2009, not coincidentally the interim statistical “bottom” for reported median and average house prices.**

**It is important to point out** that when using the conservative inputs I chose here, repeat buyer volume (more supportive of prices) also rose in July both in absolute terms and as a percentage of total sales. But because this buyer segment was moved less by the tax-credit and has options available (vs. first-timers many of whom monetized the credit for downpayment purposes making this their only shot at buying), I expect them to use the tax-credit sunset as a price reduction bargaining chip, essentially taking it as an up-front discount putting pressure on house prices.



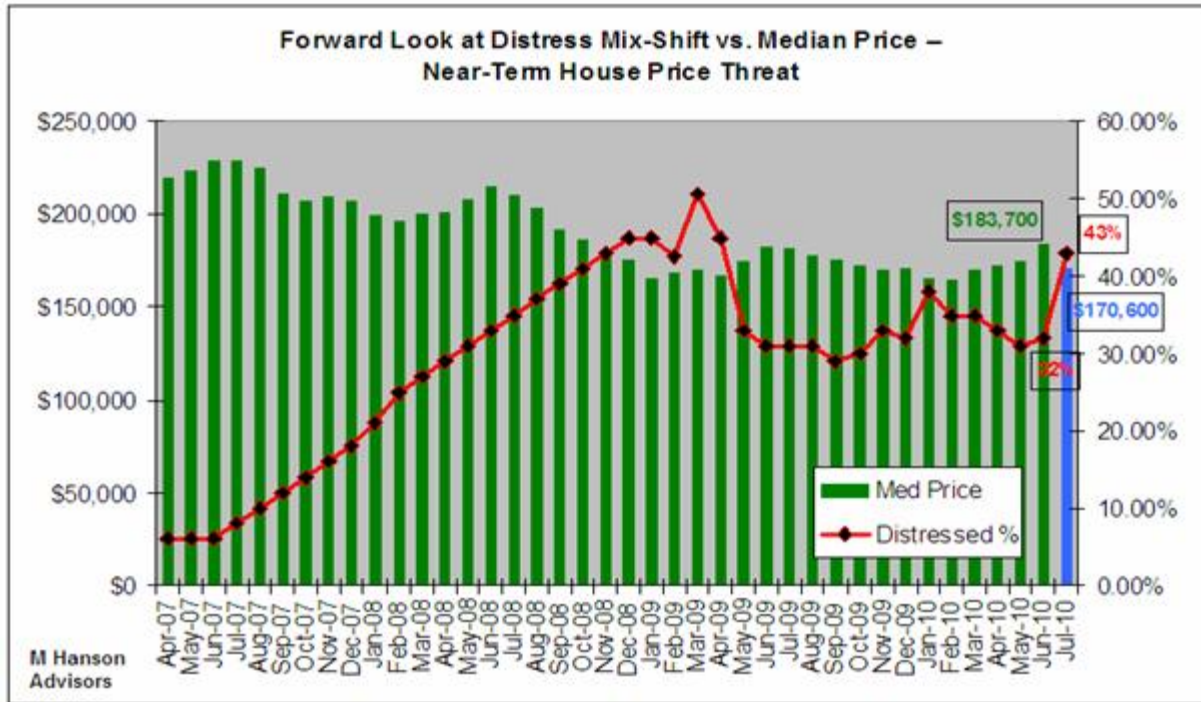
## 6) July Median House Price Projection based upon *Distress-Mix Shift Surge*

In June, NAR reported the median house price at \$183,700, however, that represented an unusually large 5.2% MoM increase likely due to the last minute rush to get into contract by the April 30<sup>th</sup> tax-credit deadline and has to be discounted.

Therefore, plotting from where median house prices were in May against the last time we saw a distress mix near 43% -- and to be conservative allowing for some natural appreciation as determined by our in-house automated valuation model, which electronically estimates house prices for all properties in the default and foreclosure pipeline -- **my conservative July median house price estimate is \$170,600, or down 7.2% MoM and 5.9% YoY.**

Realistically, however, I believe that NAR will report median prices at least 100bp worse than this conservative estimate.

**Either way, this print should make for the largest MoM median price decline since the housing crisis began...the largest was 6.2% and occurred in January 2009 and was largely seasonal.**



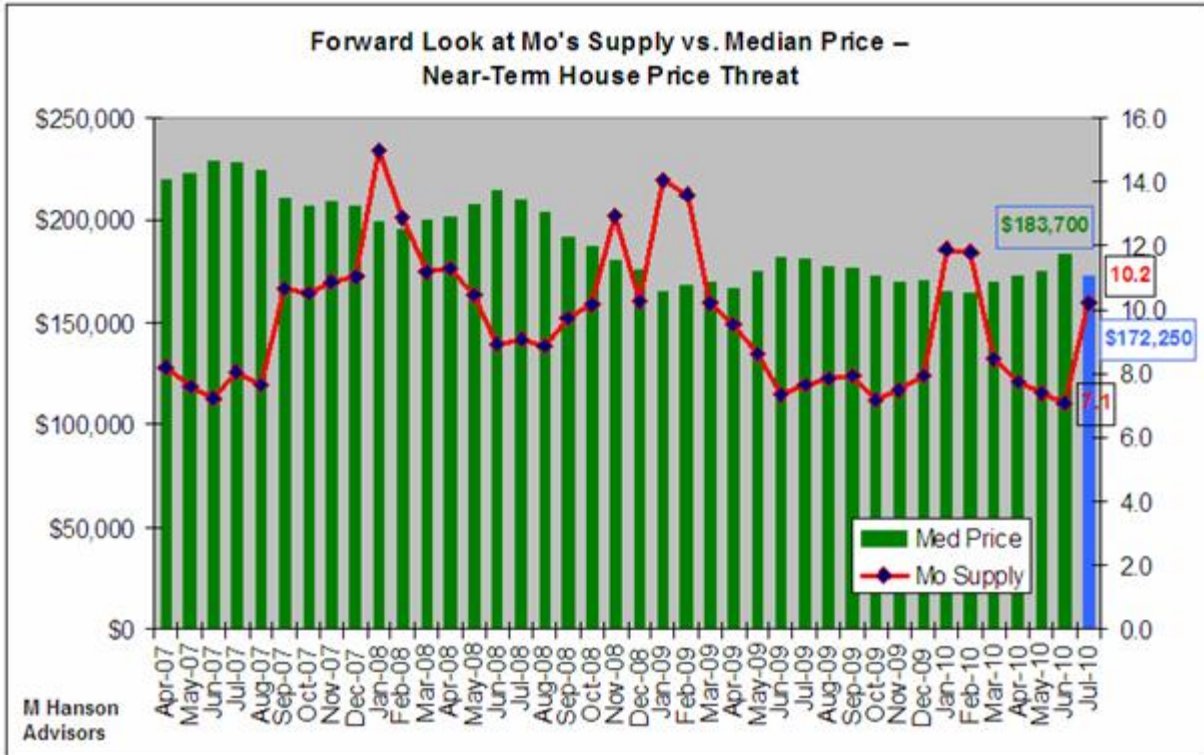
### 7) July Median Price Projection based upon *Month's Supply* Surge

In June, NAR reported an unseasonally adjusted **Month's Supply** of 7.1. When accounting for the average MLS listed property growth from June to July since 2007 and my July unseasonally adjusted sales volume projection of 417,540, **July Month's Supply should jump to 10.2 months.**

Therefore, after backing out July median house prices as a one-off and plotting from where median house prices were in May against the last time we saw a Month's Supply factor of 10.2 -- and to be conservative allowing for some natural appreciation as determined by our in-house automated valuation model, which electronically estimates house prices for all properties in the default and foreclosure pipeline -- **my July median house price estimate is \$172,250, or down 6.23% MoM and 5% YoY.**

Taking this further out (not shown here) **my estimate is for over 13-months supply on tap this year**, which would be a cycle high.

As with the mix-shift projection, I believe the actual median house-price print will be at least 100bp worse than this conservative estimate.



**Best Regards,  
Mark Hanson**

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**\*Data for this report provided by M Hanson Advisors. NAR and DataQuick**