Newsletter - Vol. 8 Issue 3
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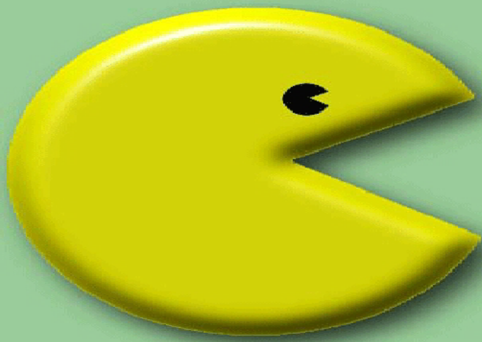

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THE MONTH IN REVIEW

2/1-2/4 **The Institute for Supply Management's index for manufacturing activity climbed to 60.8 in January, up from 58.5 in December.** Any reading above 50 indicates expansion, and the index has remained above that level for 18 consecutive months. Following the strong manufacturing report, the Dow closed above 12,000 for the first time in over 2 ½ years. **The yield on the benchmark 10-yr. U.S. Treasury bond which affects interest rates on everything from savings accounts to home loans broke above 3.5%, Thursday. Jobless claims dropped by 42,000 over the previous week's number according to the Labor Dept. The unemployment rate unexpectedly sank to 9%, down from 9.4% the month before. But, the economy fell far short of expectations, adding just 36,000 jobs in January.**

2/7-2/11 **Treasury prices moved lower Monday—pushing yields higher—up as much as 3.68%.** Bond prices and yields move in opposite directions. **Zillow.com reports that 27% of homeowners with mortgages owe more than their homes are worth; that's up from 23.2% a quarter earlier.** The same survey showed that a 2.6% nationwide drop in home prices was responsible for more borrowers being upside down in their mortgages. **According to the Mortgage Bankers Association (MBA), refinance volume fell 5.5% this past week as interest rates hit a 10-month high. Nation-wide home sales volume reportedly rose 15.4% to an annual rate of 4.8 million units in the 4th quarter of 2010 said the National Association of Realtors (NAR).**

2/4-2/18 The **Commerce Department said retail sales rose 0.3% in January**, down from an increase of 0.5% in December. Sales were expected to have gained 0.5% in January. **Housing starts rose 14% to an annual rate of 596,000 units last month, while building permits, considered a leading indicator of activity, fell 10% to an annual rate of 562,000 in January. The Fed revised its growth forecast for 2011 from between 3.0% to 3.6% in November to between 3.4% to 3.9%.** The Mortgage Bankers Association (MBA) reports **that mortgage delinquency rates have declined to 13.56% at the end of December**, their lowest level since late 2008.

2/21-2/25 (Mortgage markets were closed because of President's Day). **The Consumer Confidence Index rose to 70.4 this month,** up from a 64.8 in January, hitting its highest level since February 2008. **Oil prices jumped to $95/bbl** Tuesday as unrest in Libya continued to shake the energy and stock markets with the **Dow Jones Industrial Average dropping 178 points.** Wednesday**, stocks slid another 107 points amid mounting turmoil in Libya.**

A report from the National Association of Realtors showed that **existing home sales rose 2.7%** to an annual rate of 5.36 million units. **The Labor Dept. reported that jobless claims fell to 391,000 for the previous week. Nationally, sales of new homes fell 11.2% between January and a year ago. Oil prices touched $103, Thursday, before retreating to $97/bbl.**

2/28 **The Institute for Supply Management-Chicago Inc. said today its business barometer for the manufacturing sector rose to 71.2 from 68.8 in January.** This is the highest level since July 1988. Recall that a number greater than 50 signals expansion.

THIS ISSUE'S TOPIC:
HAS THE HOUSING MARKET BOTTOMED?

The problem with attempting to gauge the bottom of any market is that you can't know for certain if it has hit bottom—until it's past—and prices and rates have risen. Because I had slated this topic for the March newsletter over six months ago, the results of the latest S&P/Case-Shiller Home Price Index of the 20 Metro Markets struck me as particularly fortuitous. Home prices had fallen in all but one of metro markets surveyed—only the San Diego market had managed to eke out a gain from October to November. Admittedly, the gain was a scant 0.1%, but a gain nonetheless. That one market locale can be up while nineteen others are down is further proof of the adage "that all real estate is local'.

The primary variables that are generally regarded as affecting a market turn around are: existing home sales; new home building permits; mortgage defaults; foreclosure sales; interest rates; and the Case-Shiller Index. Analyzing these factors enables buyers and sellers to identify whether the current market is trending up or down and whether it is in their best interests to be a buyer or a seller. It should be noted here that inflation, flow of funds into real estate, job growth, in- or out-migration, and the path of progress are also relevant, but to a lesser extent and for that reason they will not be addressed here.

SIX VITAL SIGNS THAT THE MARKET HAS HIT BOTTOM

1. EXISTING HOME SALES:

Existing home sales is the pre-eminent indicator of real estate price trends. But, as such, the number of homes sold in a given month is just a number. What one wants to focus on is the moving 12 month average, because this removes the seasonality from consideration. By averaging the past 12 months' sales (locally), one gets a fairly accurate indication as to whether sales are slowing or increasing. When existing home sales are trending up, there are more and more buyers entering the marketplace which increases the demand for housing thereby driving up the price. When existing home sales are declining the demand is abating and prices are apt to weaken.

Nationally, the Existing Home Sales report for January 2011 from the National Association of Realtors (NAR) showed that:

- First-time buyers accounted for 29% of purchases, down from 33% in January
- Repeat homebuyers accounted for 48% of purchases, up from 47% in January
- Investors accounted for 23% of purchases, up from 20% in January

In addition, distressed sales—foreclosures and short sales—made up 37 percent of the market.

Locally, existing home sales have been in neutral territory during the last two quarters of 2010. More recently, though January sales showed a 1.1% decline, prices increased by 0.9%

2. BUILDING PERMITS:

Another excellent marker is new home building permits. New home building permits are highly regarded in market analysis because 1) real estate construction is the largest single industry in the United States, and 2) homebuilders are highly sophisticated in analyzing the demand for housing. As with existing home sales, when builders pull more permits in consecutive months than they did previous ones, it is indicative that they think the market is improving and they want to be ready to break ground should other signs confirm as much.

The actual amount of new construction is largely irrelevant, just as long as it's not greater than the demand. The more new construction falls short of demand, the stronger the ensuing market. Fluctuations in supply will cause prices to ratchet up or down accordingly, as demand waxes or wanes. The number of new home building permits peaked last June. Since then, it has fallen into negative territory.

3. RESIDENTIAL MORTGAGE DEFAULTS:

Residential mortgage loan defaults are also helpful in forecasting real estate market trends. Loan defaults are indicative of the strength of the local economy and its employment because job loss is the most common reason that borrowers become delinquent and lose their homes. If defaults are rising, it suggests that the employment market is weakening. As a result, lenders are apt to have an excess of REOs or foreclosure inventory that has yet to hit the market because job losses trigger delinquencies, which in turn become foreclosures. And, when supply exceeds demand, sale prices fall until a new equilibrium point is established where the demand rises to equal the supply. Falling prices may also indicate that fewer loans are being modified and more and more loan payments are ratcheting upward, such that borrowers cannot keep up with the increasing payments. When foreclosure filings are on the wane, it signals that prices are stabilizing and the employment market is strengthening. Recent data demonstrates that the monthly number of residential mortgage loan defaults in San Diego have continued to decline from 3,409 in June 2009 to 2,207 in September 2010. The 12-month trend shows that notices of default have been tapering since November 2009. So, the current data suggests that although homes sales are down, the local real estate market is stabilizing.

4. FORECLOSURE SALES:

Foreclosures are the actual number of delinquency filings less the number of owners who have been able to bring their loans current. Lenders tend to dump foreclosures on the market 20% to 30% below the rest of the market, so they can clear their REO inventory quickly. The foreclosure sale becomes the new *de facto* value until sale prices change.

Foreclosure sales are a lagging indicator because they usually take place after the requisite 3 months have elapsed for the property owner to bring the arrearages current and an additional 15-day period for the Notice of Sale to be arranged. A rising foreclosure rate is usually indicative of two things: 1) the homeowner lacks any equity in his home, and/or 2) the demand for purchasing the home is more or less non-existent. In a normal housing market, a defaulting homeowner will be able to short-sell his home before the occurrence of a foreclosure sale. For this reason alone, diminishing foreclosure sales are more predictive of market bottoms than of market tops.

Market research shows that residential foreclosure sales have been trending down in San Diego since October 2009. While downward sloping, the rate of descent has also decelerated since March 2010. It should also be noted that the decline may, in part, be accounted for by lender paperwork problems and robo-signing scandals. Also, since October 2009, the drop in the 12-month moving average has coincided with a decrease in the average amount of time required to sell a home in San Diego. This suggests that homes are currently under-priced *vis-a-vis* the demand. In any event, these factors are further evidence that the residential real estate market is recovering, albeit slowly.

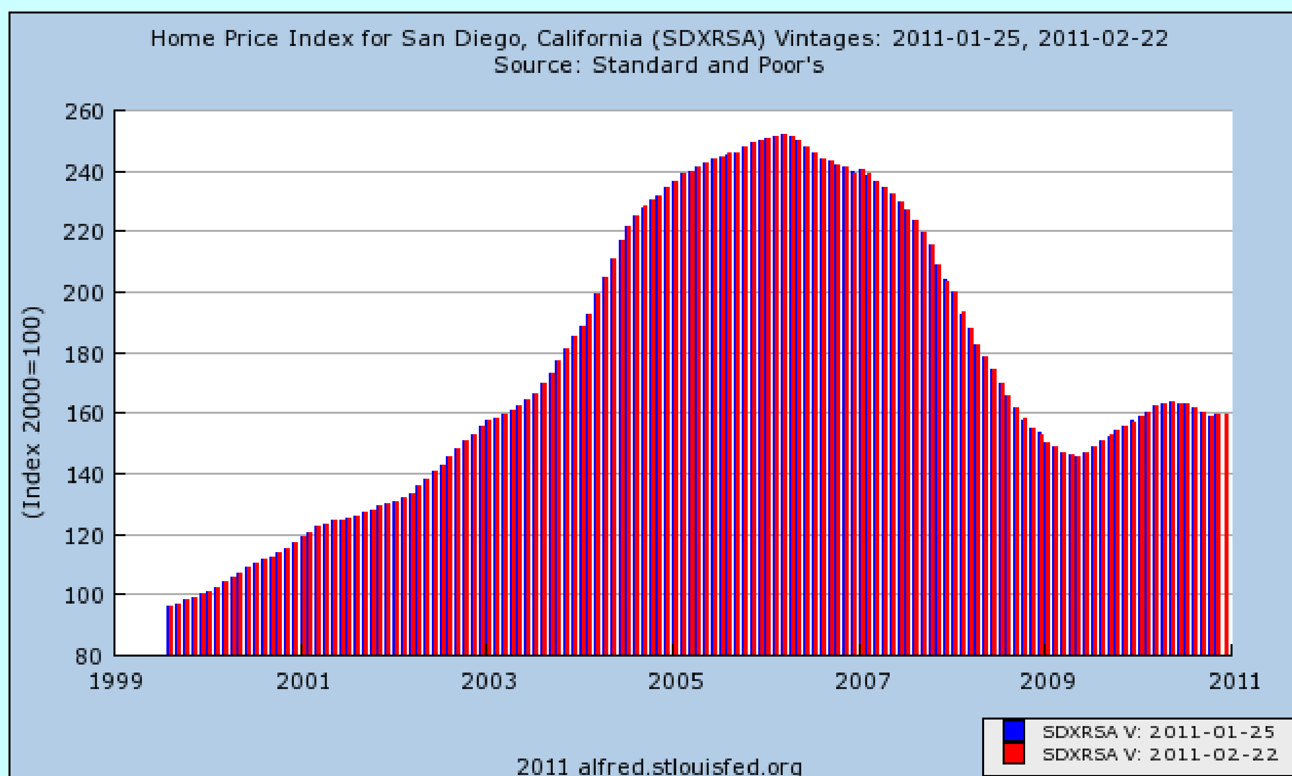
The rate of deceleration in the 12-month foreclosure sales and the 12-month moving average may be attributed to banks being more amenable to short sales in lieu of foreclosing or the temporary moratorium on foreclosures that occurred last year. The time to receive lender approval on short sales has dropped markedly from 2009. Short sales have always been in the best interest of both sellers and lenders, but it has taken a surprisingly long time for lenders to realize the obvious by hiring more staff and providing better training for their Loss Mitigation teams.

5. MORTGAGE RATES:

Mortgage rates aren't as much of a portent as they are an "exaggerator". Falling interest rates are a stimulant, while rising rates act as a brake on the housing market. Home prices are very much a function of a borrower's monthly payment. When factors one through four above, signal that the real estate market is trending upward, then rising interest rates will retard the uptrend and decreasing rates will accelerate it. Conversely, when these factors suggest a downward trend, then rising interest rates will accelerate the down trend and decreasing rates will slow the decline. Even so, interest rates are not the key issue for buyers. Interest rate increases don't act as a huge deterrent, per se, because home prices tend to decline in response to higher rates which offsets some of the increase.

Interest rates have decreased from April of 2010 until they hit 50 year lows in October. Then, thirty-year fixed rate loans were @ 3.875% and 5/1 ARMs bottomed out 2.75%. Interest rates have been steadily creeping up since the first week in November 2010. Their rise, if they continue, will act like a brake on the market. Higher rates will necessitate an accommodation in prices.

6. Case-Shiller Index



The San Diego Index (SDXR-SA) climbed in the first and second quarter of 2010 from 156.95 in January to 165.02 in July. And, as I mentioned at the outset of this article, San Diego was the only metropolitan area surveyed in the 20 city survey that showed a gain from October to November—modest though it was—at 0.1%. From November to December it retreated to 158.97, a decline of -0.7%. Nevertheless, the recent 12-month data shows a strong upward trend.

Just this past week (ending 2/24/2011) San Diego was shown to be one of two major metro areas in the S&P/Case-Shiller Home Price Index that closed 2010 with an annual gain—further confirmation that the region and other parts of the state are rebounding better than other U.S. areas from historic lows. Home prices in the San Diego area increased 1.7 percent in December from a year ago, according to the 20-area index, a leading economic indicator calculated monthly. The only other area to post a gain was Washington, D.C., with a 4.1 percent increase year-over-year. (The index has a two-month lag.) More recently, the NAR's Existing Home Sales report for January 2011 showed a price increase of 0.9% for homes in the San Diego market.

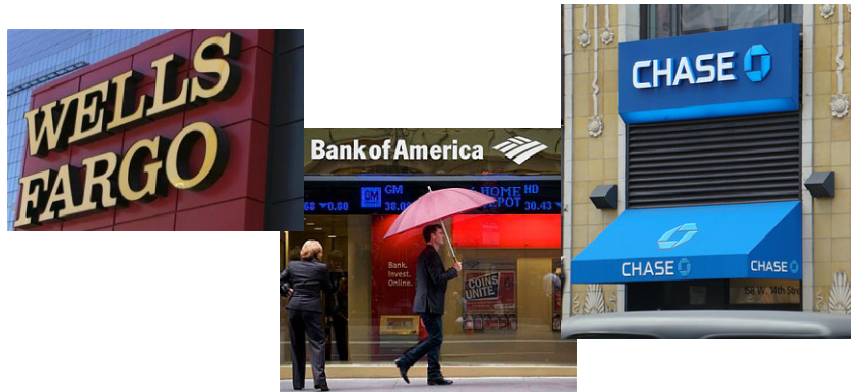
CONCLUSION

As we have seen new home building permits are down, mortgage financing is restrictive and while interest rates have risen, they still remain relatively low by historic standards. Consumer confidence is in positive territory, though it is lower than it was last summer. Home prices throughout San Diego County are starting to increase, according to the Case-Schiller Index, and residential foreclosures are slowing. With the exception of existing home sales, the factors discussed signify that the San Diego County residential real estate market is stabilizing. In fact, San Diego is now the 2nd highest ranking city out of 20 national metropolitan areas in the highest percent in quarterly home price changes.

Hence, the current data suggests that the real estate market in San Diego County is at a bottom. This is not true for all communities as real estate always has been and will continue to be a local phenomenon. Now is an ideal time for buyers to purchase a home for long term with the express purpose of living in it. It is, however, not the time to purchase a property for the purpose of "flipping it" since foreclosures still constitute over 26% of real estate sales in the state. Short sales and foreclosures will continue to exert a downward pressure on prices and preclude significant price appreciation in the near term. Price appreciation is heavily dependent on what is known as the "move-up" buyer and they will likely be *in absentia* until employment improves.

3 BIGGEST LENDERS CLOSE OVER HALF OF U.S. MORTGAGES

Of the $1.530 trillion worth of home loans originated by U.S. lenders during 2010, more than half of last year's totals were generated by just three lenders: Wells Fargo, Bank of America and Chase originated 56 percent of last year's business, according to Mortgage Lender Ranking. Though total fundings were down 8% from 2009, Wells' $387 billion in 2010 fundings made it the biggest lender. The most growth versus 2009 among top-15 lenders came from PHH, where production climbed 30%. PNC's 45% drop was the weakest performance.



The share of government-insured loans was higher. FHA's 2010 share was around 19.8%, edging up from 19.1% a year earlier.

Lenders are also ranked by the balances of the mortgages they service. Servicing involves the collection of payments, loan accounting and disbursements to investors. B of A maintained its standing as the biggest servicer with a portfolio in excess of $2 trillion.

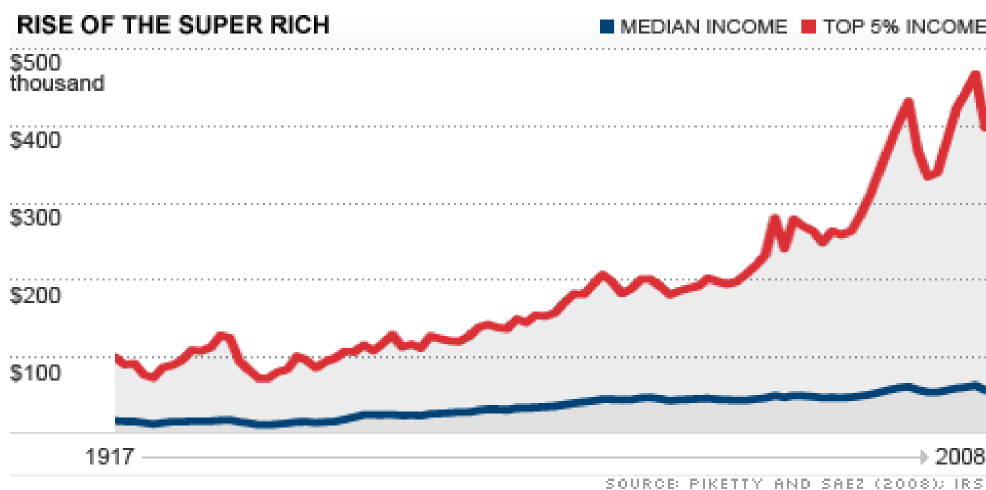
Ed. Note: Because they are the biggest, they also tend to be among the slowest to process a loan. Again, because of their size, they're also inclined to be indifferent when it comes to service, products and rates. Their approach tends to be: You need us more than we need you.

THE HAVES, THE HAVE-NOTS AND THE HAVE-MORES

There has been a major wealth re-distribution in America in the past three decades. It will come as no surprise to Americans in the vanishing middle class that their income has barely budged in the past 30 years. In 1988, the income of an average

American taxpayer was $33,400, adjusted for inflation. Twenty years later, after adjusted for inflation, the average income was slightly lower at just $33,000, according to IRS data. In the 1950s, the bottom 90% of Americans controlled about 68% of the economy, in 2009, this number shrank to 50%.

In the meantime, the richest 1% of Americans—those making $380,000 or more—have seen their incomes escalate 33% over the last 20 years. The gap between the haves as George W. Bush once referred to them as and "the have-mores" has become even more pronounced. The top one/one-thousandth (or one-tenth of 1 percent)—those who make at least $2 million each year— now control 10% of the nation's wealth.



The graph shows the divergence of income between only the richest 5% of Americans and the average American's income which has changed little. This chart includes capital gains.

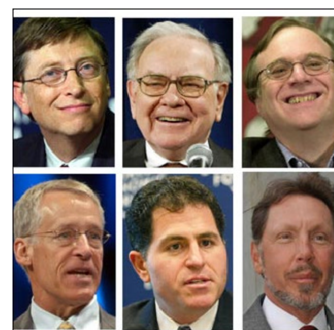
Research shows that this meteoric rise among the top economic tiers of income began in the late '70s and was fueled interestingly, in large part, by public policy. The policy of deregulation was advanced by lawmakers on both sides of the aisle and the Federal Reserve. As a result, the financial industry grew increasingly powerful, which lead to a race for more out-sized profits that brought about a new era of financial innovation and extreme risk-taking. But deregulation subjected the economy to greater risk, as a whole, as it pushed up top tier incomes.

Corporations also used new global channels to reduce costs and boost profits. In addition, new markets around the world have created even greater demand for their products. How do you define middle class? Another driver of the rich: The stock market. The S&P 500 gained more than 1,300% since 1970. While that's helped the American economy grow, the benefits have been disproportionately reaped by the wealthy. Tax cuts enacted during the Bush administration and extended under Obama also contributed to the disparity.

Globalization and technology exacerbated the disparity between rich and middle class incomes even further. While globalization lifted millions out of poverty in developing nations, it did so at the expense of middle class workers in the U.S. In the process, America shifted away from a manufacturing economy to a service economy. Factory workers, here, saw production outsourced to third-world countries with cheaper labor which put added downward pressure on American wages. This also created a shift in the demand for job skills by American employers. Thirty years earlier, there were plenty of blue collar jobs for workers who had only a high school diplomas, now employers want skills that are more often acquired in college. As a result, the gap in wages for college educated workers versus high school grads increased.

Another factor in the erosion of middle class incomes was the decline of labor unions. Historically, union workers have earned 15% to 20% more than their non-union counterparts. Such is no longer the case as union membership has waned over the past 30 years. In 1983, union workers made up about 20% of the workforce; in 2010, they represented less than 12%. Without collective bargaining pushing up wages, especially for blue-collar work—average incomes have increased only marginally.

As corporate profits have come roaring back and the stock market has surged ahead, the wealthiest people continue to pile up untold wealth while their middle-class counterparts languish amidst an excessively high unemployment rate, a real estate market showing few signs of rebounding, and stagnating incomes—hardly the recipe for a resurgent economic rebound.



RATE SUMMARY:

Rates WORSENED SLIGHTLY, this month.

***Conventional conformings—UP by an 1/8TH**

***Jumbos—UP by an 1/8TH**

***Governments (FHA/VA)—MOSTLY UNCHANGED**

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO: www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

SPECIAL(S) OF THE MONTH:

Conforming 30-yr. fixed @ 4.625%

Conforming 5/1 ARM @ 3.25%

Conforming 5/1 ARM Interest Only @ 3.500%

FHA High Balance 30 yr. fixed @ 4.500%

FHA Conf. 15yr. fixed @ 3.875%

MORTY'S MAILBAG

Q. This may not be in your wheelhouse, but I'm confused by all this talk about Quantitative Easing and what Federal Reserve Chairman, Ben Bernanke, means by Credit Easing. Can you explain the difference between the two, if any.

A. The term Quantitative Easing (QE) came into use and accordingly into disrepute a decade or so ago when the Bank of Japan belatedly and unsuccessfully tried to rouse a floundering economy by giving commercial banks more money. The bankers obliged their policymaking peers by not lending any of it, leaving the economy thrashing around and a debilitating deflationary trend intact. The Federal Reserve's approach to supporting credit markets resembles quantitative easing in one respect: It involves an expansion of the central bank's balance sheet. It's been said, "For some, perception is reality" and thus far the bond market and others have "perceived" that credit easing and quantitative easing are one and the same.

With a pure QE regimen the policy focus is on the quantity of bank reserves, which are liabilities of the central bank; the composition of loans and securities on the asset side of the central bank's balance sheet is incidental. Indeed, although the Bank of Japan's policy approach during the QE period was quite multifaceted, the overall stance of its policy was gauged primarily in terms of its target for bank reserves.

In contrast, the Federal Reserve's credit easing approach focuses on the mix of loans and securities that it holds and on how this composition of assets affects credit conditions for households and businesses. This difference lies not with any doctrinal disagreement with the Japanese approach, but rather the differences in financial and economic conditions between the two episodes.

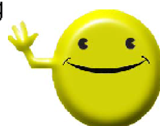
Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question, it needs to identified as "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is.... **morty@mortgagestraightTalk.com**

MORTGAGE MIRTH

What kind of necktie does a pig wear?

A pigsty

If you'd care to share one that you've heard, please email it to me at.... **rod@mortgagestraightTalk.com**



NEXT ISSUE'S TOPIC: LOANS THAT MOST BORROWERS AND MANY REALTORS ARE UNAWARE OF