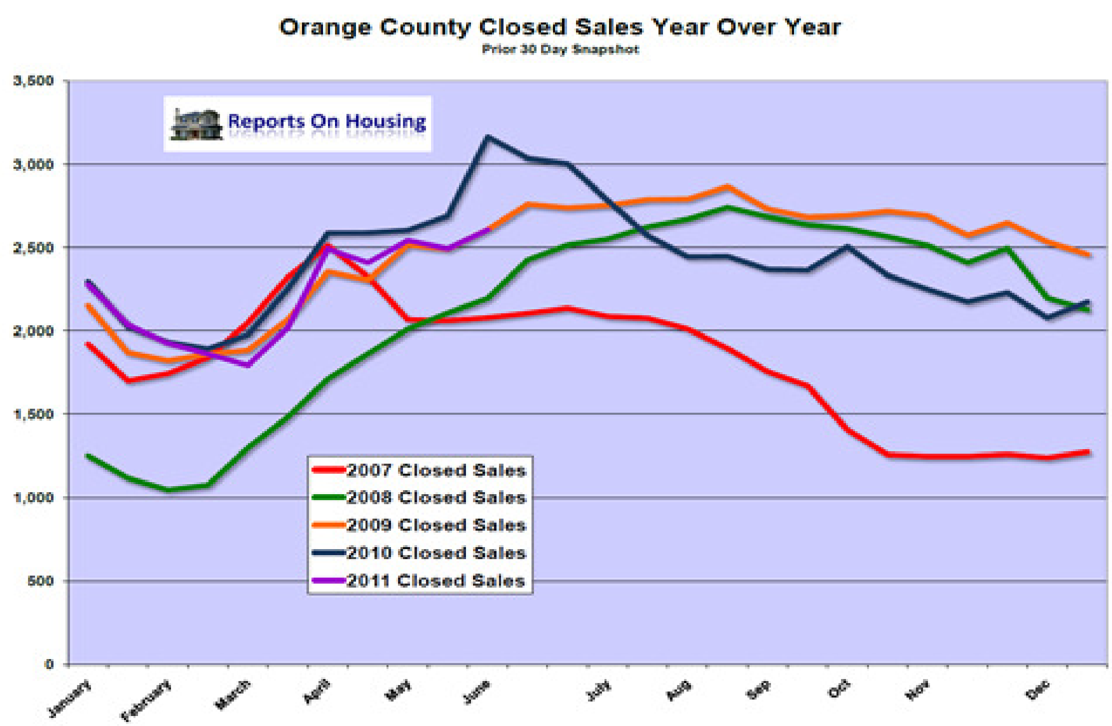
WHERE IS THE ECONOMIC RECOVERY?

June marks the 23rd month of the United States' economic recovery, so the big question is: "How is it working for you"? If you are in real estate (and many other industries) the answer is not good. Unfortunately, the negative numbers keep piling up, and this continues to erode consumer confidence, slows down sales and puts continued price-pressure on housing. If we look to the future, there are not many signs that this "recovery" (or lack thereof) will end anytime soon. All we can do is "hang in there" and continue to plow our way through this market.

This report is a combination of economic data and artful techniques for selling in this difficult economic period. The goal is to help give the agent useful information to impart to both buyers and sellers. When these potential clients have an understanding (as much as possible) of the numbers, then, just maybe, we can help these clients make the right decisions.

The Comparisons

1. Total Housing Sales for 2010: 30,657
   This was the 3rd lowest sales total since 1988 and a decline of 1.1% from 2009.



The Comparisons

2. The Breakdown:
   (a) Resale homes: 19,379 - down 5.2% (from 2009)
   (b) Resale condos: 9,208 - up 0.6% (from 2009)
   (c) New homes: 2,150 - up 44.2% (from 2009)

3. The Reality for Agents
   (a) New homes: 2,140
   (b) Foreclosures: 7,900
   (c) Net sales: 20,607

As the year came to an end, the median priced home in Orange County had declined 5.7% from December of 2009. In the last 6 months of 2010, the median price had declined by $40,000!

What The Seller Needs To Know:

Most sellers are unaware that there was a decline in values in the latter half of 2010. Through May of this year, the median price has continued to decline. The median priced home is down to $425,000 which is 5.6% from May of 2010 with sales volume down 18.2%. By the end of May in 2010, Orange County had sold 12,431 homes. Through May of this year, only 11, 596 homes.

In your listing presentation, please explain to the client(s) that there are now <u>three</u> sellers in today's market:

1. The REO Lender: They represent only 6.1% of the market but 22% of the demand.
2. The Short Seller: They represent 27.8 % of the market and 18% of the demand.
3. The Equity Seller: They represent 66.1% of the market but only 60% of the demand.

For the seller, it is important that during your listing presentation you mention the above decline. Let them know that this 7% number is rather magical. Almost every seller who has preceded them to the market place has initially over-priced their home by 7%. Here is the breakdown that shows the original listed price in the MLS versus the last listed price before going into escrow:

1. The REO Lender: 95% vs. 98%
2. The Short Seller: 95% vs. 99%
3. The Equity Seller: 92% vs. 96%

Even more interesting is how the sales in the MLS breakdown along price lines. Here are the pricing values of the original list price in the MLS versus the last listed price before going into escrow:

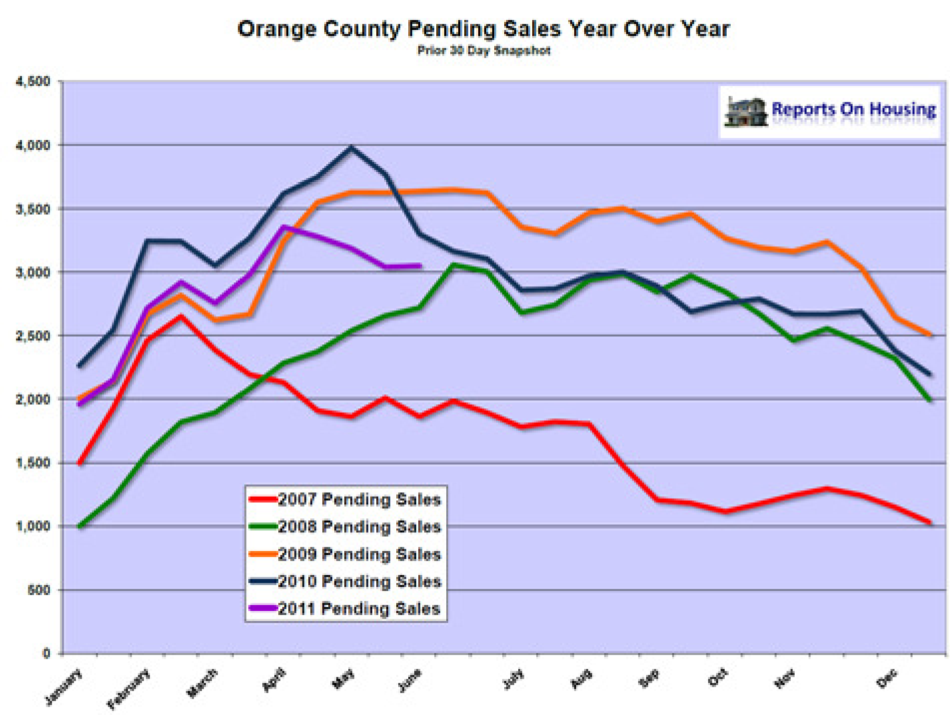
1. Under $500,000: 94% vs. 99%.
2. $500,000 to $1M: 93% vs. 97%.
3. Over $1M: 89% vs. 93%.

Here are the approximate marketing times for each of the different types of sellers:

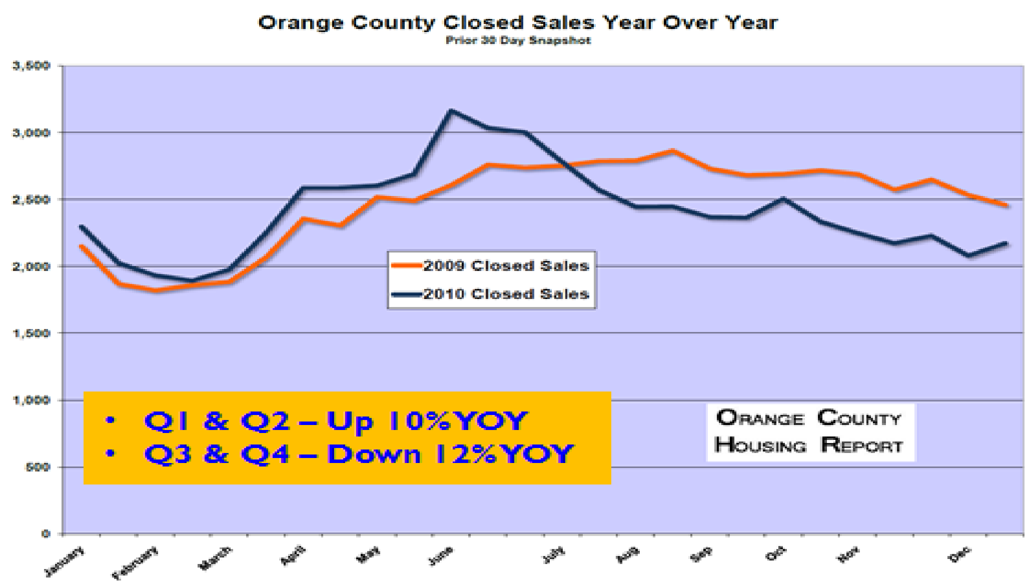
1. The REO Lender: 1.69 months.
2. The Short Seller: 2.94 months.
3. The Equity Seller: 4.65 months.

The Home Buying Cycle

In Orange County, our biggest selling season is from February to May, with May being our peak month for pending sales.



In just 5 months, approximately 65% of all our closings occur. This means that the remaining 35% of sales are distributed among the other 7 months! Last year, 50% of all sales closed in just 4 months – March thru June. If the seller still has their home on the market after June, they have now entered the "*dog days of summer*" when the sales begin to slow down. This trend continues until the end of the year.



THE BUYERS

With a decline in home purchases, it is important for an agent to capture as much of the market as possible. To do so, they need to know the makeup of the market and where to find today's buyers. We already know that 39% of today's sales are made up of buyers acquiring either bank-owned properties or short sales. Another factor to consider is who is buying and how are they acquiring these properties. Here is the breakdown of last year's purchases:

1. **FHA Purchases: 24%**
   This increase was largely due to the government's first-time home buyer program, which gave buyers a tax incentive for purchasing homes. This program helped to keep sales from tumbling in 2010.

2. **All-Cash Purchases: 28%**

   Last year we saw a large amount of properties being acquired on an all-cash basis. Many of the buyers were investors or foreigners. A very large percentage of bank-owned properties were acquired by all-cash buyers. Some acquired the property and then fixed it up and "flipped" it for a quick sale and profit.

3. **Investor Purchases: 22%**

   It is important for real estate agents to develop an investor clientele. They make up almost a quarter of the purchases, and many investors are in for the "long term." It would be wise for an agent to know how to manage rental property. Buying, selling and leasing commissions are generated in this way. Some tenants go on to become first-time home buyers, thereby creating another revenue stream.

When working with today's buyers, you need to enhance your initial interview process. Find out what is making them look for property in today's depressed housing market. If they are looking for a "great buy," please educate them on the actual list-to-sale price, which was discussed on page 2 and is duplicated here:

A. The REO Lender: 95% vs. 98%.
B. The Short Seller: 95% vs. 99%.
C. The Equity Seller: 92% vs. 96%.

They need to know that both REO Lenders and Short Sellers sell within 1% to 7% of the list price – depending upon how long the property has been on the market. If they need to be in a home with 45 to 60 days, then the short sale process is out of the question, which will eliminate approximately 28% of the listings on the market.

Many agents tell me that their buyers just can't "pull the trigger" due to the continuing decline of housing prices. They look, but they are in no hurry. In this case, you might want to discuss the impact of increasing interest rates on purchasing power.

THE INTEREST RATE EFFECT

One very important question to ask your buyer who seems to be in no hurry to acquire a home is if he/she thinks interest rates will be going up. Most buyers today have a pretty good understanding about the effect on interest rates of excessive government borrowing and the flooding of liquidity (by the Federal Reserve).

In addition, you can discuss the shrinking Fannie Mae and Freddie Mac market. A question was posed to bond fund managers as to what the market interest rate would be for a pool of mortgages without government backing. The results were ugly and the cost of mortgages would definitely rise. Below is a chart that shows various interest rates and the affect they will have on your buyer's purchasing power via the loan amounts.

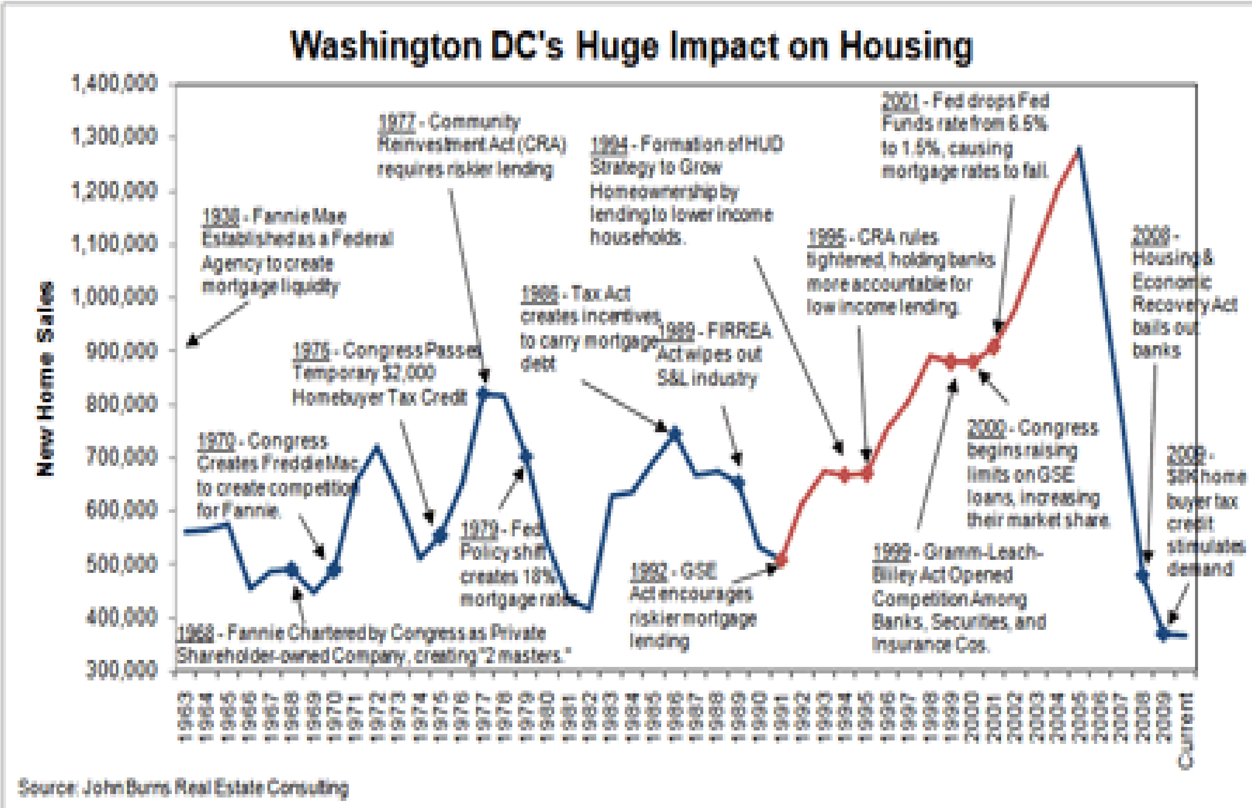
Interest Rates

	4.50%	5.00%	5.50%	6.00%	6.50%	7.00%
$ 200,000	$ 1,013	$ 1,074	$ 1,136	$ 1,199	$ 1,264	$ 1,331
$ 300,000	$ 1,520	$ 1,610	$ 1,703	$ 1,799	$ 1,896	$ 1,996
$ 400,000	$ 2,027	$ 2,147	$ 2,271	$ 2,398	$ 2,528	$ 2,661
$ 500,000	$ 2,533	$ 2,684	$ 2,839	$ 2,998	$ 3,160	$ 33,247
$ 600,000	$ 3,040	$ 3,221	$ 3,407	$ 3,597	$ 3,792	$ 3,992
$ 700,000	$ 3,547	$ 3,758	$ 3,975	$ 4,197	$ 4,424	$ 4,657
$ 800,000	$ 4,053	$ 4,295	$ 4,542	$ 4,796	$ 5,057	$ 5,322
$ 900,000	$ 4,560	$ 4,831	$ 5,110	$ 5,396	$ 5,689	$ 5,988
$ 1,000,000	$ 5,067	$ 5,368	$ 5,678	$ 5,996	$ 6,321	$ 6,653

If a buyer today wants to get a million dollar loan, his payment will be $5,067 at 4.5%. However, if he waits and the interest rate goes to 6.5%, to keep the same payment the loan would have to be $200,000 less! You might want to ask the buyer in your initial interview what the odds are of the interest rate going to 6.5% versus the price of the property dropping another $200,000? Even at the lower price ranges, the difference is approximately $100,000.

If he says he wants to wait it out, then have him call you when he is ready, and move on to a buyer who realizes this may be the time to buy with such favorable interest rates.

Looking Forward

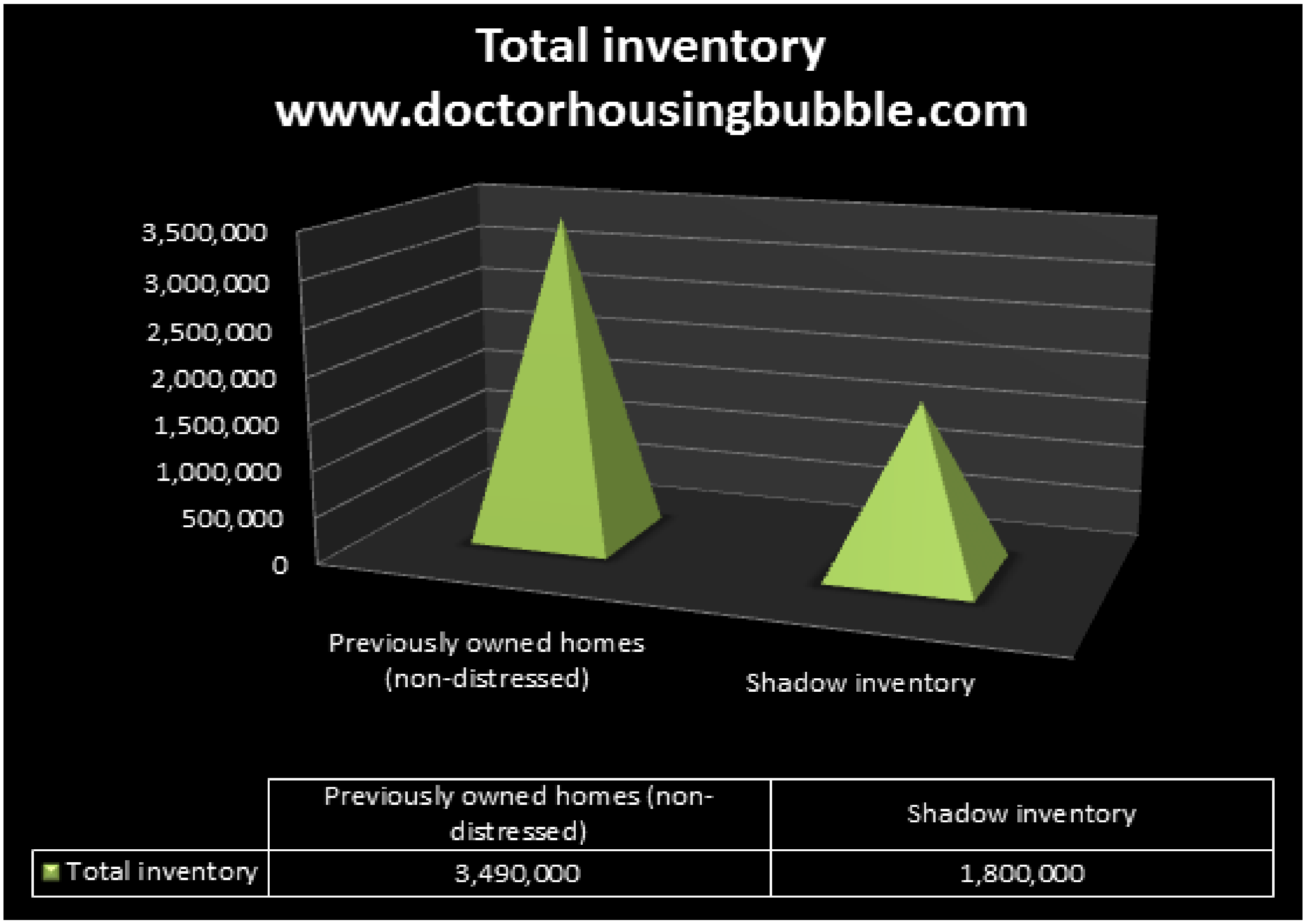


The above chart, from John Burns Real Estate Consulting, shows how both the good and the bad decisions (by our government) have played a role in housing sales. The government is getting more involved in housing decisions and, unfortunately, not for the good. Here is a list of items that are either in the works or being contemplated that was also covered by John Burns.

1. The government has already passed the Financial Reform bill, which is creating tremendous uncertainty in the mortgage industry. This is primarily because nobody has defined the parameters of a "qualifying mortgage."

2. Reducing the role of both Fannie Mae and Freddie Mac will have a tremendous impact on both lending and the cost of mortgages.

3. Last year there were over 2 million distressed sales. This year the number will most likely exceed 2.5 million and this will keep a lid on housing prices or cause further declines. It is anticipated that this 2 million + number will continue through 2012.



4. For borrowers, continued tightening mortgage underwriting, higher FICO scores, higher down payments and increasing mortgage insurance costs are all but a reality.

5. The future of the Mortgage Interest Deduction (MID) was once thought to be the golden egg that Congress would never touch. Well, they are taking a close look at it and although they may not eliminate it completely, there is a very good chance that they may significantly lower the cap – thus effecting expensive homes in many "high-end" states.

6. There seems to be a policy shift from promoting homeownership to promoting rental housing. This new attitude by our government should cause concern for all realtors. Homeownership reached 69% in 2004 and today stands at 66%. Before this decade ends, it is estimated that homeownership will drop to 61%.

The old adage of *Adapt or Die* certainly applies to our real estate market. These conditions will most likely persist through the rest of the decade, so please learn how to survive by working smart and expanding your business models.