Easier Money, Steadier Sales

For housing, the worst is over but just barely; markets will teeter until prices firm up.

By Robert Freedman

When Kenneth Lowman worked with a buyer on a multimillion dollar home purchase in Las Vegas last fall, the transaction took an unusual turn: It closed, and quickly. The buyer was able to get jumbo financing in just 22 days—a far cry from six months earlier, when getting such a big loan, even for a highly creditworthy buyer, would have taken months and still might not have closed. "I think we're starting to see the jumbo market open up," says Lowman, broker-owner of Luxury Homes of Las Vegas.

That is in fact what's happening, says NAR Chief Economist Lawrence Yun. Thanks to solid gains in the lower end of the housing market, the first-time home buyer tax credit, and the rebounding stock market, lenders in mid–2009 began cautiously lending money beyond the safe Fannie Mae, Freddie Mac, and FHA loans on which they relied for income during the credit crunch.

"Lenders can make only so much money holding Treasuries," says Chris Varvares, president of the national economic forecasting firm Macroeconomic Advisors in St. Louis. "They've been holding onto reserves and hoarding capital, in part because of the decline in their share prices and in the price of the assets they hold on their balance sheets. Now that these are turning up, and the risk-adjusted return on making loans is rising, they're pursuing more aggressive lending."

Vijay Lala, a product executive at Bank of America Home Loans, says his company had already exceeded its $16 billion jumbo loan total for all of last year by mid-October and expected to continue that growth pace going into 2010. "We believe in these loans," he says. "The assets are performing well and we continue to be very strong in this market." The company says it had about 20 percent of the jumbo market nationwide in 2009.

Lala says he's seeing other lenders entering the jumbo space as well, but they're all large lenders that can afford to hold the loans on their balance sheet. "We continue to see very little to no secondary market activity," he says, meaning smaller lenders that can't afford to hold jumbos in their portfolios remain financially unable to make the loans, at least in significant volume. For investors to start coming in, he says, home prices will need to firm up more.

Yun says that price stabilization is happening, but he doesn't expect investors to regain their appetite for non-agency mortgage-backed securities until at least 2011.

2010: The Year of Growth

If 2009 was the year of economic recovery, 2010 will be the year of growth, says Yun.

Existing-home sales in 2009 rose to an estimated 5 million units for the year, a 2 percent increase over the 4.9 million sales in 2008. For 2010, Yun is forecasting sales of 5.7 million units, a 13.6 percent increase.

The key to recovery in 2009 was the lower end of the existing-home market. Fueled by the huge number of distressed sales—which drove down prices nationally by an average of 13 percent for the year—buyers returned to the market looking for bargains.

Also helping were continuing low interest rates (5.2 percent on average for 2009) and the first-time home buyer tax credit, which the IRS says had been tapped by an esti- >>>

demand. More than 16 million renter households at the end of 2009 had sufficient income to buy a median-priced home, up from just 11 million in 2000, before the boom, Yun says. Once they get off the fence, sales will start heading up to a level reflective of the population.

Solid Economic Growth Projected

Economists disagree about how the economy will fare in 2010, but they agree the recession will be firmly behind us. Yun forecasts economic growth of 2.8 percent, up from a recessionary –2.5 percent in 2009. Varvares puts growth at a more robust 4.2 percent.

Improved stock market performance, the need for business to replenish inventories, and the continuing impact of the federal government's stimulus efforts are all playing a role in boosting the economy, they say. Supporting it all is the improvement in housing. As home prices stabilize, households feel wealthy and start spending again, which drives retail and other business growth, in turn boosting confidence and the stock market, and creating a virtuous cycle of growth.

Yun predicts home prices to grow 3.6 percent in 2010, a significant rebound from 2009's 12.9 percent national price decline.

Lingering high unemployment is the major unresolved problem, Yun and Varvares say. The unemployment rate is expected to hold at an elevated 9 percent to 10 percent in 2010 and won't likely show notable progress until 2011 because job-cutting in recent years has been so severe.

Sustained unemployment levels, however, do offer a temporary upside. Because of the huge budget deficits the federal government assumed to stimulate the economy—now almost $1.5 trillion, up from $500 billion in 2008—inflation can be expected to rear its head at some point, Yun says. But it remains at bay in part due to slack in the economy: high unemployment and continuing excess capacity with regard to business productivity.

But what happens once employment improves and productive capacity nears equilibrium? The fear is that the high deficits will spur inflation, driving up mortgage rates and hurting home sales. What's needed, says Yun, is a credible government plan for tackling the deficit. Markets need to see the government taking the deficits seriously and mapping out an exit strategy. As it is, Varvares projects the short-term federal funds rate, one of the Federal Reserve's main vehicles for influencing the cost of money, to rise to 0.50 percent from 0.25 percent in 2009. Yun says the rate could rise to 1 percent. ■

Commercial: A Longer Horizon

On the commercial side, the forecast remains cloudy. Commercial mortgage-backed securities continue to be troubled, with few investors prepared to get back in the market. That makes it hard for owners to refinance their existing debt and for others to buy. Some $300 billion in debt comes due in 2010, followed by $500 billion in 2011 and then a whopping $1.8 trillion in 2012.

Against this challenging financial environment, the main commercial sectors will remain sluggish through 2010, with little sign of significant improvement until 2011 or even 2012, NAR data show.

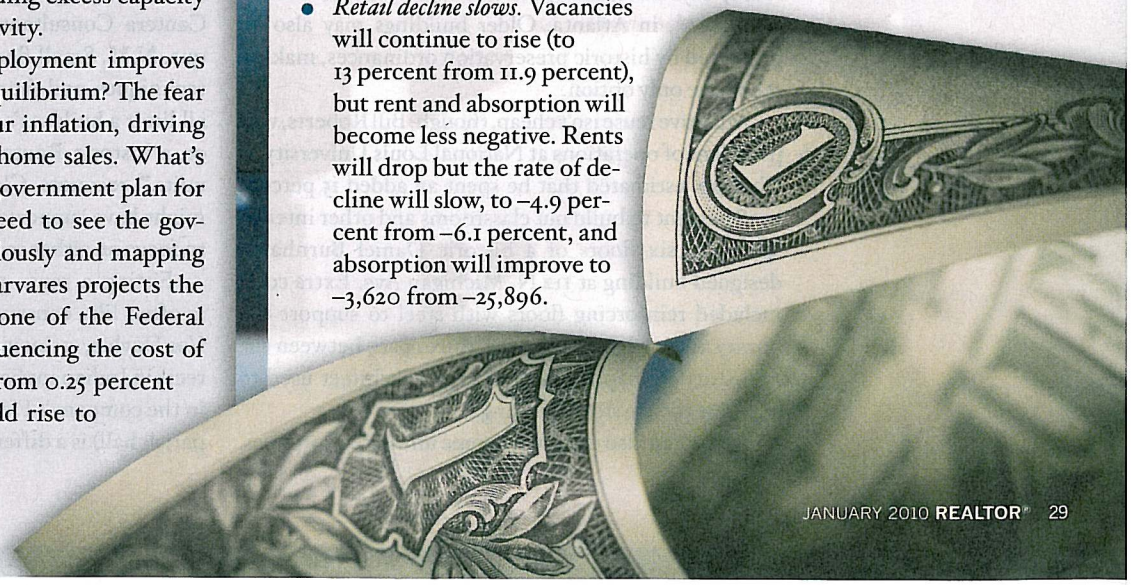
On the plus side, there are signs the financial picture has begun to ease. Major deals in the second quarter of 2009 totaled about $9 billion in 650 transactions, up from about 625 transactions a year earlier. That's still a drop in the bucket, but it's movement in the right direction, says NAR Chief Economist Lawrence Yun.

Part of the improvement stems from the federal government's 2009 move to use economic recovery funds from the Federal Reserve's Term Asset-Backed Securities Loan Facility to buy commercial mortgage-backed securities. That has helped to get liquidity into the financing market to fund transactions. Those purchases are slated to end by the first quarter of this year, and it remains to be seen whether investors regain their appetite for CMBS by then.

Sector Analyses

With the exception of multifamily housing, which will benefit from the continuing slack in home sales, all major sectors are expected to see increasing vacancies, negative rent growth, and generally weak absorption in 2010.

- *Multifamily in best shape—but only marginally.* NAR is projecting the multifamily vacancy rate to remain unchanged at 7.3 percent, with rents moving toward positive territory—but not quite getting there.
- *Office slide eases.* In the office sector, vacancies will continue to rise (to 18.9 percent from 16 percent), but the news won't be all bad. Absorption is expected to improve, although it will remain in negative territory (at –47,229 square feet, an improvement from –75,023 square feet), and rents will take more hits, staying negative at –10 percent, a mild improvement from –14.1 percent.
- *Industrial picture mixed.* Vacancies will rise (to 15.1 percent from 13.3 percent) and rents will drop (to –11.7 percent from –11.4 percent), but absorption will improve to –111,987 square feet from –299,520).
- *Retail decline slows.* Vacancies will continue to rise (to 13 percent from 11.9 percent), but rent and absorption will become less negative. Rents will drop but the rate of decline will slow, to –4.9 percent from –6.1 percent, and absorption will improve to –3,620 from –25,896.



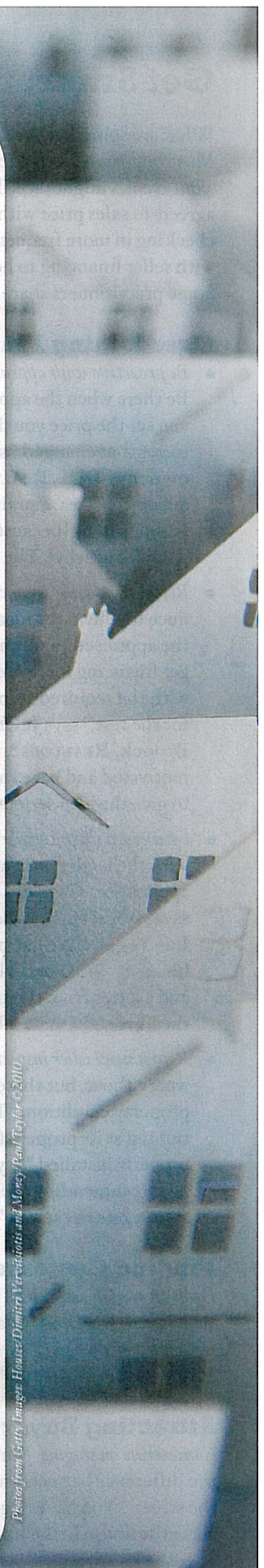
	2008	2009*	2010†
Economic Indicators			
Inflation rate	3.8%	-0.4%	1.6%
Unemployment rate	5.8%	9.3%	9.8%
Gross domestic product	0.4%	-2.5%	2.8%
Housing			
Existing-Home Sales			
Sales (in millions)	4,913	5,011	5,694
Prices	$198,100	$172,600	$178,800
Change (in price)	-9.5%	-12.9%	3.6%
New-Home Sales			
Sales	485,000	397,000	549,000
Prices	$232,100	$211,100	$219,900
Change (in price)	-6.4%	-9.0%	4.2%
Affordability Index	135	166	147
Inventory			
Housing starts	904,000	564,000	752,000
Months' supply (national average)	10.5	8.5	8.0
Mortgage delinquencies**	7.88%	9.24%	NA
Mortgage Financing			
Federal funds rate	1.9%	0.2%	0.5%
30-year fixed rate	6.1%	5.2%	5.7%
One-year adjustable rate	5.2%	4.8%	5.1%
Commercial Markets			
Office			
Vacancy rate	13.4%	16.1%	18.5%
Rental rate change	0.4	-12.1	-8.5
Net absorption (sq. ft. in millions)	12.3	-56.1	-43.3
Industrial			
Vacancy rate	10.4%	13.5%	15.4%
Rental rate change	-0.8	-10.8	-11.5
Net absorption (sq. ft. in millions)	-57.2	-298.7	-140.5
Retail			
Vacancy rate	9.7%	12.2%	13.0%
Rental rate change	-2.0	-1.3	-3.0
Net absorption (sq. ft. in millions)	-7.3	-21.9	-4.7
Multifamily			
Vacancy rate	5.7%	7.3%	7.4%
Rental rate change	2.9	-4.1	-3.3
Net absorption (units)	24,390	168,300	59,700

* Estimated. † Projected.

** National Delinquency Survey data from the Mortgage Bankers Association; 2009 data is as of the second quarter. NA: Not available.

Source: NAR Research

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Get Smart for 2010

What are some ways to succeed given the shape of today's market? Most important, say practitioners, get in front of any financing trouble your clients might face. That means being proactive in defending the agreed-to sales price with appraisers, staying on top of lender concerns by checking in more frequently than you ordinarily would, and get creative with seller financing to help keep low appraisals from derailing a deal. Some practitioners share a few ideas:

Overcoming Financial Obstacles

- *Be proactive with appraisals.* Worried about an appraisal coming in low? Be there when the appraiser arrives, show your CMA, and explain why you set the price you did. "Once the appraiser makes a value, it's hard to get that changed," says **Debbie Jones-Kelly, CRS®, GRI, broker-owner of DJK, REALTORS®, in Atlanta.** "I spent two hours with an out-of-the-area appraiser on a loft property. We had to go further away to pull comps [because of the low number of non-distressed comparables nearby]. The appraiser had never set a value on a loft before."
- *Recommend seller financing.* If the appraisal still comes in low, introduce to sellers the idea of taking back a note for the gap between the appraised value and the agreed-to sales price. "If the buyers can get financing for 80 percent of the appraised value and are prepared with the required 20 percent down, ask sellers to take back a note for the rest," says **Jeffrey Barker, ABR®, a sales associate with Max Broock, REALTORS®, in Bloomfield Hills, Mich.** "Sellers who are motivated and have the financial security to do so can be expected to give the idea serious consideration."
- *Check in with the lender twice a week.* You typically may check in with the lender once a week on the status of your client's mortgage application. Consider doubling that. "You want to catch issues early," says **Kenneth Lowman, broker-owner of Luxury Homes of Las Vegas.** "We had a high net worth borrower who had most of his assets in a trust. The lender needed more documents on the trust and a letter from the trustee. Knowing that early enabled us to alert the buyer and solve it before it caused a delay."
- *Recommend seller inspection.* With cash buyers there's no appraisal to worry about, but these buyers can be demanding when it comes to property condition. "They'll walk if the air conditioning isn't functioning at its proper efficiency or if, in a new home, something isn't properly installed," says **Lowman.** "You can head off these surprises by recommending the sellers get a home inspection before the transaction gets to escrow."

Finding Customers

Focus on open houses. Hold multiple events for the same property and hold them every weekend for an extended period. "It shows buyers and sellers you're working hard," says **Tim Greene, executive vice president of John Greene, REALTOR®, in Naperville, Ill.**

Attracting Buyers

Concentrate on staging. Much more than in the past, staging can make the difference between your listing selling before the competition down the street. "You have to go room by room with the sellers to help them show the house in the best light possible," says **Barker.** "It doesn't have to cost a lot of money—just paint the room and rearrange the furniture to make it less personal. Add new front door hardware; maybe stain the front door."

>>> mated 1.4 million households halfway through 2009, a figure that includes 350,000 to 400,000 consumers who wouldn't have bought without it, according to NAR and other industry estimates. Close to 2 million buyers were expected to use the credit by the end of November, according to industry projections.

As a result of the sales pick-up, inventory for homes priced at $250,000 and under, which is well under the $417,000 conforming loan limit, improved to just 4.6 months in 2009, according to NAR data. That's below what's considered sustainable and has been inviting multiple bids in high-demand markets, including parts of California. Even the inventory for homes priced at $500,000 and below, which is well within the $729,750 conforming loan limit in high-cost areas, is at a sustainable 5.2 months, NAR data show.

In part because of the difficulty of obtaining jumbo financing, no such turnaround was seen in the upper-end housing market. Indeed, nationally the inventory of homes above the $729,750 threshold remained above 40 months throughout 2009.

But Yun is forecasting improvement in 2010, as the strong performance at the lower end helps kick-start the upper-end market. In time for the spring selling season, spreads between jumbo and conforming loans are narrowing considerably. In the fourth quarter of 2009, spreads narrowed to about 70 basis points from about 150 basis points a year earlier, and that trend is expected to continue with more lenders returning to the jumbo space.

The new-home market is expected to improve as well. NAR estimates sales this year to jump to 549,000 units, up from 397,000 units in 2009, and housing starts to reach 752,000, compared to 564,000 units last year.

Yun and Varvares make clear that, even under their best-case scenarios, the performance of 2010 will lag behind what they consider to be a market in equilibrium. Although Yun's estimated 2010 sales volume of 5.7 million is close to what it was in pre-boom 1999, that level is low when the country's population, now 30 million larger than it was a decade ago, is factored in. Ideally, sales should be closer to 6 million, he says.

One reason for the subpar performance is continuing slow household formation, a key precursor to home sales. Until young people stop doubling up in rental units or living with their parents in such large numbers, sales will continue to lag, Yun says. That shift will be fueled by job growth and consumer confidence.

Once household numbers increase, sales may ignite because the market is seeing a lot of pent-up