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OCAR Membership Meeting **2009 Economic Outlook**

In September of 2007, I watched as Fed Chairman Bernanke, Treasury Secretary Paulson and the head of the FHA all testified before the Senate Banking Committee. They outlined the housing problems and what steps Congress should take to prevent further destruction. Barney Frank, Chairman of the Senate Banking Committee, ended the meeting by saying: "So what you are telling us is that we must act immediately. If we wait until March, it will be too late." All three presenters said: "Yes". Well, it is now 22 months later and not one single program has been designed to deal with the true problem of the housing market . . . Negative Equity!

Since that time, we have witnessed:

1. Economic Stimulus Act of 2008 – **Cost: \$180 Billion**
The government mails out 132 million checks to taxpayers, to keep the slowing economy from getting worse. **Result:** 78% of the rebates went to pay bills – not to purchase goods and services in the economy.
2. Housing and Economic Recovery Act of 2008 – **Cost: \$645 Billion**
 - a. Designed to shore up Fannie Mae and Freddie Mac by injecting \$100 billion into each company. The government required a \$5 billion dividend paid yearly but Freddie Mac never made that much in the profitable years!
Result: Both companies went into receivership.
 - b. Inject \$300 billion into FHA for refinancing troubled home loans.
Result: A failure, as financial institutions refused to address potential losses.
 - c. Raise conforming loan amounts to help refinancing in high-priced areas.
Result: Lenders split loans into conforming or jumbo conforming.
Most credit markets would not buy jumbo loans – even with the higher rates.
 - d. Tax credit of \$7,500 for 1st time buyers.
Result: Failure because it was really a loan that needed to be paid back.
3. Emergency Economic Stabilization Act of 2008 – **Cost: \$850 Billion**
Since Fannie, Freddie and FHA failed to function effectively, the Treasury decided to take over by purchasing troubled mortgages/securities - thus hoping to free-up the financial markets. **Result:** Treasury did not buy the troubled mortgages or securities, but began buying shares in troubled banks and insurance companies - to keep them from collapsing. The credit markets have pretty much remained frozen.

Orange County Real Estate in 2008:

1. Last year, 26,551 homes were sold. This was the lowest on record (by DataQuick) since 1988, and it represented a decline of 42% below the 20 year average. Expect the home sales numbers to remain under 30,000 for quite some time.
 - a. In the '70s, the U.S. averaged 3.9 million sales a year.
 - b. In the '80s, the U.S. averaged 4.0 million sales a year.
 - c. In the '90s, the U.S. averaged 4.4 million sales a year.
 - d. From 2002 to 2006, U.S. sales averaged 7.1 million yearly!
 - e. Since then, the U.S. is averaging 4.5 million sales a year – a realistic number.
2. The year ended with the median resale price of a single family home declining 29.2%, while condos declined 30.8%.
3. The median price for all homes ended the year at \$397,000, a decline of 24.1%.
4. There were 24,819 notices of default filed and lenders took back a total of 11,560 homes in 2008. Notices of Defaults filed in the 1st Qtr. were up 19% from last year.

Epilogue to 2008:

As 2008 came to a close, the government had either loaned or guaranteed a total of \$8.7 trillion dollars, which resulted in the money supply increasing by 71.8%! Our economy had shed 2.6 million jobs, (the worst since 1945) and the unemployment rate continues to rise in 2009. Lenders began the foreclosure process on 1.8 million mortgages and the banks took back 860,000 properties.

The mortgage relief for homeowners has yet to materialize in any significant way. One reason is that those securitized loans represent 68% of the total home mortgage market. These instruments are just too complex to unwind easily; they possess too many different owners in various “tranche” positions and, as housing prices fall, there is no simple way to fix this mess, which was originated by complex models.

The longer these problems persist, the deeper housing woes will go. The banks are turning down the TARP money, as it contains too many restrictions. The Fed is walking on a tightrope. One risk is that if too much money is printed, our economy evaporates in an inflationary spiral. This would mean higher loan rates and thus kill and recovery in our housing market. The other is that if you print too little, we will head towards a deflationary abyss, like the one that swallowed Japan in the 1990s and from which they have yet to recover.

Now for 2009

All branches of the government have been busy this year pumping out new programs, designed to stabilize the financial markets, get the economy going and help housing.

1. American Recovery and Reinvestment Act of 2009 – Cost: \$1.3 Trillion
Better known as the: *Something for Everybody Plan*. It has lowered rates (for now) and made the under \$500,000 a hot market. However, above that price, the market is barely alive. **Result:** It may be a little early to tell, but so far the lenders are not really interested in modifying loans to help troubled homeowners. Banks are not actively lending, foreclosures and short sales are continuing to rise, unemployment is at record levels and the economy is still not moving forward.
2. Financial Stability Plan
Has the U.S. Treasury creating the Public-Private Investment Fund to acquire troubled loans. Almost two months later, they create two more programs (Legacy Loan Program and the Legacy Securities Program), providing 50% of equity capital. The Federal Reserve expands the TARP (Troubled Asset Relief Program) to provide as much as one trillion dollars.
3. The Homeowners Affordability and Stability Plan:
Promoted by President Obama, this is to help troubled homeowners with Freddie Mac and Fannie Mae mortgages refinance to a lower rate. It also creates the Homeowner Stability Initiative to modify eligible home loans. (Note: One month later, the Treasury announces new guidelines for the program.)
4. Term Asset-Backed Securities Loan Facility (TALF)
The Fed makes \$200 billion available to purchase recent AAA securities from institutions that are in financial trouble.
5. Supervisory Capital Assessment Program (Bank Stress Test)
Created by the Federal Reserve to test the asset strength of banks in a “worse case scenario.”

So How's This Working For You?

Well, the government took conservatorship of both Fannie Mae and Freddie Mac earlier in the year, and last quarter the two companies lost \$23.3 billion and \$9.9 billion, respectively. These are on loans they thought would not go bad. Each company will need \$100 billion, to stay afloat.

Hope For Homeowners, (launched last October) was to help save 400,000 families their home. To date, it has helped only one family. Thus all the new “stability” programs!

There have been 40 bank failures through June 1st, which has caused the FDIC funds to decline 24% to \$13 billion. However, they have set aside \$28 billion for future failures this year, as problem banks have grown from 171 to 305 – the highest in 15 years!

Orange County Real Estate Market – As of June 15th

<u>Listings</u>	<u>Housing Supply</u>	<u>May Sales</u>	<u><500,000</u>	<u>Demand</u>	<u><700,000</u>	<u>Demand</u>
9,313	3.49 months	2,667	1,602	60%	2,261	84%

1. Attached homes under \$500,000 make up 74% of the active listings.
2. Detached homes under \$500,000 make up 21% of the active listings
3. Number of active listings that are vacant . . .27.3%.
4. Distressed properties total 3,062, representing 33% of our active listing inventory.
5. Short sales take 2.1 months to sell and receive 97% of their list price on average.
6. Foreclosures are 5% of our inventory; sell within 0.65 months; at above list price.

Through May . . .

1. Sales volume exceeded 2008 by 26.3%, yet prices declined 24.1%.
2. Monthly, OC is averaging 2,793 NOD's and 644 foreclosures.
3. Average down payment was 18.5% with only 2.5% opting for adjustable loans.

The New World of Lending:

For The Buyer:

1. There are 71% fewer mortgages available than a year ago.
2. Tightening credit standards are now in place at 85% of our banks.
3. Buyers putting down less than 20% must have a FICO score of at least 720.
4. All assets and income must be verified and could be re-verified at closing.
5. New conforming residential loan amount for Orange County is \$625,500.00
6. Only 2.9% of buyers are taking an adjustable rate mortgage vs. 85% in 2005.

FHA is the New Big Player.

1. Up-front insurance premium (MIP) is now 1.75%.
2. Over 95% financing, .55% monthly and .50% for less than 95% financing.
3. Down payment is 3.5% and the FICO score must be at least 580.
4. Down payment assistance programs have been abolished.
5. 45% front end and 55% back end debt ratios and 2 year employment history.
6. Must be greater disclosure to buyer on monthly payment changes.
7. Borrower must have a valid Social Security Number and be a legal resident of U.S.
8. Owner-occupied properties only, but “gift” is still available for down payment.
 - a. “Kiddy Condos” for kids in college.
9. Ch 7 BK – discharged 2 yrs. / 1 yr. Ch13 and foreclosure/short sale is 3 years.
10. FHA appraisers must be certified, which will cause a decrease in the number of available appraisers. This will increase the appointment time for an appraisal.
11. New FHA Loan Limits for Orange County are:

<u>One Unit</u>	<u>Two Units</u>	<u>Three Units</u>	<u>Four Units</u>
\$625,500	\$800,775	\$967,950	\$1,202,100

The New World of Lending: (continued)

For Lenders:

1. Most lenders may no longer use “in-house” appraisers.
2. Financial institutions will be held liable for any misleading advertising.
3. Adjustable sub-prime loans cannot have a pre-payment penalty for 4 years.
4. Fixed sub-prime loans cannot have a pre-payment penalty for 2 years.
5. Truth in Lending statement must be printed in the native language of the borrower.

The Investor:

1. No more than 4 to 10 investment properties can be financed, depending on a lender.
2. If investor puts down less than 20%, it introduces: PMI; higher rates; added approval by insurance companies.
3. Loan rates are usually 0.75% to 1.0% higher than owner-occupied financing.
4. Investor loans are more difficult to get, because 40% of foreclosures are investment properties.
5. Investors have to be prepared for rent reductions on their properties.
6. Investors slogan is: ***“Repent and Rent”***

For The Seller:

1. Foreclosures and short-sales will continue to dominate the 2009 real estate market. Orange County filed 8,427 notices of default in the 1st quarter of 2009. This is up 19% from the 1st quarter of 2008.
2. Listing prices must be competitive with these properties for a successful sale.
3. Regardless of sellers’ expectations, their house will be appraised conservatively.
4. The buyers are still in control of pricing:
 - a. give careful consideration to a counter offer.
 - b. expect to pay for all termite and inspection report disclosures.
 - c. length of escrow will be the buyer’s/lender’s choice.
 - d. market conditions can push escrow periods much longer.
 - e. making repairs and improvements ahead of time will help the marketing.

And if all else fails, tell your unreasonable seller:

“I need a version of reality I can understand.”

The New World of Lending: (continued)

Loan Modifications:

1. Must have authorization letter to communicate with lender.
2. New law allows borrower to have an intermediary to discuss situation.
3. Fannie Mae has a Streamline Modification Program (SMP), for its securitized loans. It is a fast-track method for getting homeowners affordable mortgage payments, extending the term of the loan, lowering the interest rate and even deferring payments. Seller must be 3 months behind, live in the home and have no bankruptcy filings.
4. Obtain required information and help seller complete the package properly.

Short Sales:

1. Must have authorization letter to communicate with lender.
2. Expect the entire process to take approximately 60 days to 6 months.
3. An investor may still have to sign off, even after asset manager gives the "OK".
4. Make sure to "pad" estimated HUD-1 and cover non-paid items such as taxes, association dues, transfer fees, county taxes, transaction coordinator, etc.
5. After lender approval, escrow closes within 20 to no more than 45 days.

Foreclosures:

1. New law requires lenders to contact borrowers 30 days prior to filing a notice of default, but only on owner-occupied home loans.
2. New state law immediately allows tenants to have 90 days to vacate a foreclosed property, if the new buyer is going to occupy the home. If the buyer is an investor, then the tenant can remain to the end of the lease agreement.
3. Lender or investor acquiring the property must care for abandoned animals.
4. Law requires lenders to maintain the properties or face \$1,000 a day fines.
5. Both Fannie Mae and Freddie Mac will now notify renters prior to property entering the foreclosure process, and will execute a short-term rental agreement with the tenant until the property is sold.
6. California has followed the Federal laws, extending tax relief from any debt forgiveness. This is for purchase money loans only, no REFI's or HELOC's.
7. Effective June 15th, California lenders must postpone all foreclosures for 90 days on owner occupied homes.

IRS:

1. Will expedite release of tax liens on homes and paychecks.
2. In Offers-in-Compromise, equity in the property will no longer act as a deterrent.
3. Will postpone collections due to a loss of job, devastating illness or significant medical bills.
4. Will be more flexible on missed payments due to loss of job or hardship.

The Outlook for 2009:

The Current Economic Headwinds:

1. Wealth Effect – due to declining assets

- ◆ Americans lost \$1.33 trillion in household net worth during the 1st Qtr. 2009
- ◆ In the U.S., there are 40 million homeowners who have no equity.
- ◆ PMI Mortgage Insurance Co. has ranked OC #6, in the nation for continued price declines.
- ◆ If housing declines another 5%, another 2.1 million more homes will be upside down in the U.S.
- ◆ California home prices are down 32.2% from the previous year.
- ◆ Ca. foreclosures in 2008 totaled 236,231, versus 84,375 for 2007.
- ◆ Existing home sales, in the State, are dominated by foreclosures – 51.1%.
- ◆ In the 4th quarter of 2008, banks reduced credit lines by \$500 billion dollars!
- ◆ By the end of 2009, credit lines will be reduced by another \$2 trillion dollars!

2. Income Effect – due to higher unemployment

- ◆ May's U.S. unemployment rate was 9.4%, the highest rate in 26 years!
- ◆ California's unemployment rate in May was 11.5%!
- ◆ In the past 12 months, California lost a total of 706,700 jobs!
- ◆ Orange County lost 71,100 jobs in the past year, wiping out gains for the past 4 years. The unemployment rate is 8.6% - the highest in 14 years.
- ◆ With less income and thus less paid taxes, more pressure will fall on federal, state and personal budgets, as evident by the problems of California.
- ◆ The deficit for the 1st quarter for the U.S. was \$485.2 billion – highest on record. This is due to the government's \$3.6 trillion budget.

3. Financial “Credit Crunch”

- ◆ We are now in the 28th month since the financial crisis began.
- ◆ Four states account for 46% of all new foreclosures in the U.S., with California leading the pack.
- ◆ A record 12% of U.S. homeowners with a mortgage are behind in their payments or in foreclosure. Many with good credit!
- ◆ The foreclosure rate on fixed-rate loans has doubled in the past year.
- ◆ First came the sub-prime defaults. Now comes the next wave of defaults on Alt-A, Option ARMS and Prime loans. Commercial loan defaults will follow them.

The Outlook for 2009 (continued):

4. Option ARM Nightmare

- ◆ Option ARM mortgages total \$1.5 trillion, with Californians holding half.
- ◆ 90% of Option ARMs borrowers are paying the minimum payment.
- ◆ This is causing the recast date to be reached earlier than had been projected.
- ◆ This year, 47% of all Option-ARMs will be recast.
- ◆ If borrower's rate began at 1% to 2%, their payments will rise 80% to 100%.
- ◆ There is no doubt the borrowers are going to walk away!

To make things worse, lenders will have to restate their earnings, because they counted the unearned interest as income. After foreclosure, they will have to restate each quarter they claimed, which will add additional losses to their balance sheets. They will have to raise additional capital to cover losses – the *double whammy!*

Sources: Mortgage Bankers Association, U.S. Bureau of Labor, Ca. EDD, Federal Reserve, DataQuick

A Final Perspective

The recession has gone on so long and has been so crippling that any small piece of economic data that comes out favorably leads one to think that things are finally going to get better. Unfortunately, this is not so!

Housing has low prices and extremely low mortgage rates. This should have been enough to turn us around. However, when you balance this against shrinking access to credit, instability of American workers to receive higher wages and crippling unemployment, the outlook is not good.

The current increase in foreclosures is beginning to look very similar to what occurred in early 2007. The difference is that we were reaching a peak in housing prices. This time around, we have no price buffer for the next onslaught of foreclosures.

Although the low-end of the market is fairly strong, in the past they took their equity and “moved-up” to the next pricing tier. These sellers are leaving their homes with nothing and therefore the next pricing tier (over \$500,000) has no support coming.

Pent-up demand will soon wane, investor purchases will begin to decline and inventory will grow. This will put a new round of pressure on an already price-declined market. To add to the housing woes, the Treasury is issuing a lot of money. The market is beginning to wonder who is going to buy all these notes and bonds. This will force interest rates upwards, putting more pressure on our already weak housing market.

