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Meltdown in residential real estate far from over

Data indicates serious imbalance in housing supply, demand

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In recent months, residential real estate experts have become more confident that the battered housing market is starting to emerge from its worst crisis in decades. News headlines and "official" housing statistics — like new home starts, median housing prices and inventory levels — offer seemingly positive news.

Dig a little deeper, though, and an entirely a different picture becomes apparent. Consider the following:

• Sales of finished homes sank 31 percent during the past year to an all-time low. Just 9,000 newly built home sales closed in January, and February's preliminary numbers are a tad lower.

• It's now taking builders a record 14.2 months to close a sale of a newly built housing unit. This compares to three months back in the glory days of the housing boom.

• The unsold backlog of homes rose in January to 9.1 months' supply from 8.0 in December, 7.8 in November and 7.3 months in October. Inventory has risen even as median prices have fallen — January's median home price fell 5.5 percent from December.

• Mortgage applications hit a 13-year low in January.

• 21 percent of housing units built since 2000 sit empty.

Today, four years into the residential real estate correction, housing supply and demand remain seriously imbalanced. And that's despite historically low mortgage interest rates, an $8,000 first-time homebuyer credit, government agencies (Fannie Mae, Freddie Mac and FHA) 90 percent of residential mortgages and various other government stimulus programs to prop up the market.

And, the problems are more acute in the mid-to-high priced segment of the market. Economist David Rosenburg of **Gluskin, Sheff + Associates** points out that "the latest existing home sales data shows transactions under $400,000 are 3 percent below a year ago. Sales of homes priced above $700,000 have fallen a whopping 47 percent."

As any mariner knows, the dangerous portion of the iceberg isn't the 10 percent that peeks above the surface but the 90 percent invisible below. Looking at the Multiple Listing Service (MLS) data will provide only a blurry image of the housing market. To see with clarity, you also need to investigate foreclosure and pre-foreclosure data — what mortgage insiders call "shadow inventory."

Banks have long been holding back on releasing this shadow inventory to the market, artificially lowering the supply of homes for sale. A reliable source reports that one of the three largest money center banks has been holding back 6,000 Las Vegas housing units for more than a year. The MLS for Los Angeles lists 6,900 homes for sale — not a lot of inventory for such a large metro area. An analysis of the shadow inventory — notices of default recently filed (6,600), bank owned homes (3,400) or those about to be auctioned (4,300 scheduled) — yields twice as many homes (about 14,300) as in the "regular" market. When you connect the dots, the picture that emerges isn't a pretty one for future housing values.

Rosenberg agrees that not enough attention is being paid to the shadow inventory and when this supply comes to market, prices must fall, noting that "there remains a glaring supply-demand imbalance that can only mean more deflation ahead. There are 231,000 vacant newly built housing units for sale. On top of that, we have 3.29 million existing owner-occupied housing units listed for sale. Then, we have 3.5 million empty housing units for sale that have been taken off the market for unspecified reasons. Right there, we have over 7 million units overhanging the residential real estate market, and there are 112 million homeownership units, so this classifies as a 6.3 percent total vacancy rate. At the same time, we have a competing rental vacancy rate of nearly 11 percent, and the homeownership sector is also battling it out against an apartment market, where median asking rents have come down an average of 3.5 percent over the past year and the decline is accelerating. Inflation indeed."

Rising mortgage default rates are hiding a mountain of delinquencies that threaten to bury banks and undermine the government programs offering mortgage relief, according to the December survey by **Lender Processing Services** (LPS), which compiles data and provides mortgage processing services to many of the country's largest banks.

"The problems are mounting so quickly that any policy changes will be swamped. It's like trying to drink from a fire hose. One in seven loans is seriously behind and the number is growing," said Ted

Jadlos, head of LPS' analytics division.

At the end of 2009, LPS identified 6.5 million borrowers with serious delinquency problems or in some state of foreclosure or bank sale — nearly twice the number of homes in the MLS. Even more alarming, of the 6.5 million problem loans, 2.3 million or 35 percent were in good standing earlier in the year. According to LPS, "the rate of deterioration is roughly six times the 2006 level."

None of this bodes well for housing values. And that's before we mention the April 30 expiration of the first-time homebuyer's credit, the decline in mortgage applications or an inevitable increase in 5 percent mortgage interest rates.

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