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Plaza Park Office
900 Washington Ave.
San Diego, CA 91234
619-555-1234
yvonne@yvonnesmith.com
www.yvonnesmith.com

*Yvonne
Smith*

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REAL ESTATE UPDATE

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www.yvonnesmith.com



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HERE COMES THE SUN

We have good news to examine. We'll need to look at this with a bit of healthy skepticism—but that won't be a problem. It seems as if most of those who speak or write about real estate have forgotten how to find even the silver lining in the apparently dark clouds of real estate-related data. It may well be time to look at real estate very differently. Be aware, as we'll discuss later, that generalizations about the national marketplace rarely pertain to specific markets. Instead, they remind us what to look for in local markets.

The catalyst for this change in perception, in any case, is not earth-shaking. It is a simple statement from the sober, esteemed editors of *The Economist*. We may be looking at the real estate sector's "darkest hour before the dawn," they say. Recovery is quite likely gaining strength.

WHAT A DIFFERENCE THESE WORDS MAKE

It's remarkable how a statement like that can cause many analysts to look back at the current crop of economic indicators and find importance in what they were too easily overlooking.

In this newsletter, we'll look first at the various reasons a few journalists and economists are increasingly certain that we're on our way out of the swamp in real estate—no matter if many surveys and indices conclude that sales could contract still more and home prices decline between now and the end of the year. The second large area of discussion, considering those surveys and indices, is the question of how the respected surveys could be slightly off the mark at this point.

Third, we'll look at some decisions you will want to make, based on your growing understanding of what is happening in the real estate market. Clearly, if we can gain an accurate view of the marketplace and where it is headed, we can probably save—and make—a great deal of money in our real estate transactions and home financing decisions.

SOME REASONS FOR RENEWED OPTIMISM

1| "House-ownership is beginning to look more affordable by many measures," asserts *The Economist*. Prices have returned to the trend of the early 2000s. In many



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cases, homes are selling for about what they would have fetched in, say, 2003. Similarly, when you compare the cost of owning a home vs. the cost of renting, owning is once again a very attractive alternative; the amazing difference between the cost of owning and renting that we experienced in the last decade has faded, and is now smaller than it was in 2001.



2| At the same time, the number of vacancies among apartments has fallen to a three-year low. Rents, as a result, have been rising. (By the way, As Tamara E. Holmes writes in *realestate.MSN.com*, “experts say low home prices combined with low interest rates make this the best time in years to become a real-estate investor.” This is a subject well worth discussing together.)

3| “The credit markets are healing.” Here we have several indicators that suggest improvement to us—though they don’t necessarily convince us the situation can truly stay on the mend. (But see our further discussion later in this letter.) “Mortgage borrowing actually rose in the first quarter, according to the Federal Reserve Bank of New York. New foreclosures were 17.7% lower in the first quarter than they had been at the end of 2010, and household delinquency improved for a fifth consecutive quarter.”

The good news here, of course, is that interest rates remain enticingly low. But even that raises a bit of skepticism, since rates have been extremely attractive for quite some time, but that hasn’t noticeably increased the number of real estate purchases. Further, as Lawrence Yun, chief economist of the National Association of Realtors® frequently argues, “Although existing-home sales are expected to trend up unevenly through next year, unnecessarily tight credit is continuing to restrain the market, along with a steady level of low appraisals that result in contract cancellations.” It is, he says, unjustifiably difficult to qualify for a mortgage loan.



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Still, the numbers are improving in the credit sector, and we may—if *The Economist* proves correct—expect home sales to increase, perhaps sooner than might have been expected.

4| “Perhaps the best news for housing has come from the labour markets.” Granted, we read that, though the number of new jobs each month has been improving steadily, we need many more jobs if we are to bring



down the unemployment rate to levels seen before the recession. But focusing on where we were before the recession minimizes each positive step toward recovery. “In the first quarter of this year, for the first time since 2007, more mortgage borrowers caught up with their payments than fell further behind.” The real estate economy, in this respect, is clearly healing.

5| To the obvious fact that there is a large pent-up demand for housing, *The Economist* adds the notion of “shadow demand,” noting that “some households, especially young workers, shared homes during the recovery to economize but can now afford to move out.” Many of those workers, it turns out, are in the construction industry; “The construction business has been so depressed that even a minor spurt in demand from new households could give prices a lift.”

The Economist concludes: “If that [lift], in turn, boosts construction employment, a vicious housing cycle could turn virtuous.”

SURVEYS SOMEWHAT OFF THE MARK

It’s important to note that there are several mathematical methods used in computing the rising and falling prices of homes, and all of them have their weaknesses. Without diving into the math, let’s just look at the most consistent weakness. It provides one of the most important hints for those of us who wish to buy a new personal residence or start a portfolio of investment properties. Or both.

The issue is location, and the problem is the simple fact that most surveys and indices of real estate performance cover



GOVERNMENT SUPPORT

“Since the Great Depression, the government has had a hand in the U.S. housing-finance system, which has featured an odd blend of public and private roles. The loans Fannie and Freddie buy from lenders are primarily long-term fixed-rate ones that banks are less willing to hold on their balance sheet. They repackage them for sale to investors as securities, offering guarantees to make investors whole if borrowers default. Investors were willing to buy those securities in part because the shareholder-owned firms had an ‘implied’ government guarantee.” [Nick Timiraos, *The Wall Street Journal*]

broad regions of the country. Most potentially baffling, of course, are average or median or like-property analyses of homes all across the nation. The high-priced San Francisco homes, for example, just don’t compare well with the houses in Little Rock or Missoula. Comparing them serves only to give the roughest idea of the health of the nation’s real estate market. But that tells you little about the homes in the area where you actually want to buy one.

VARIED NUMBERS OF FORECLOSURES

Notice, for example, what is currently happening to foreclosure data. We continue to read that a huge number of further foreclosures may be on the way, adding up to a very large percentage of homes in our nation. Here’s an obvious problem with such an assertion. Roughly 24% of all foreclosures in the U.S. are located in Florida. What that means is that the huge weight of Florida’s approaching foreclosures all but crushes the data for other areas, and the entire nation ends up—mathematically—looking like it is sinking under the weight of foreclosures. It isn’t.



This is not to say that the foreclosure problem is no longer slowing the recovery of the real estate. It is to suggest that our nation is experiencing a wildly varying marketplace. There are, in fact, local areas where foreclosure is not much of a factor, as well as areas where the market seems already to have recovered, prices are firming, sales are reasonably strong.

DECISIONS YOU WILL WANT TO MAKE

It’s reasonably obvious that, though we will do well to remain aware of state and national real estate trends, the first decision we will want to make is the location of the property we want to buy—where we want to live and invest in real estate.

According to the S&P/Case-Shiller index, home prices fell by 3.3% over the course of the last year (to February). Other indices found even larger declines. We could enter a lengthy

discussion of the mathematical reasons these indices are slow to turn around, but clearly that is not what matters here.

What matters is what is happening in the specific real estate market you are exploring, the one in which you want to buy a home. Here, you will soon begin to intuit strengths that you don’t find in national indices. You will see how long it is taking for a property to sell, whether the sales price seems to be firming over time, and how likely real estate values are to remain strong for the foreseeable future. If appropriate, you will see what is happening with rents, with vacancy levels, and with the lengths that renters tend to stay in their homes.



In short, you will gather the specific and relevant information that will tell you where to look in the market for the home you want and what you can reasonably offer once you find that home. With the help of a real estate professional who hears and understands your goals, you will become far more of an expert in the area’s real estate market than any staff member of S&P/Case-Shiller or other experts on the nation’s pricing trends.

What do we get from the analysis provided by *The Economist*? For one thing, it gives us a solid hint regarding the approaching health of the real estate sector. For another, it tells us the questions we should ask about the specific locales that interest us the most. And it helps us look out for potential problems in the markets we become most interested in.

Our goals will differ. The investor may actually want to look in a high-foreclosure area, making sure it has potential for recovery. The first-time personal residence buyer may want the most stable neighborhood he or she can find that also provides good value for the money spent.



The markets are opening to a broad range of buyers. Let’s talk about what they have to offer specifically to you. Please call soon.



RECENT HOUSING DATA

“Existing-home sales, which are completed transactions that include single-family, townhomes, condominiums and co-ops, eased 0.8 percent to a seasonally adjusted annual rate of 5.05 million in April from a downwardly revised 5.09 million in March, and are 12.9 percent below a 5.80 million pace in April 2010; sales surged in April and May of 2010 in response to the home buyer tax credit.... The national median existing-home price for all housing types was \$163,700 in April, which is 5.0 percent below April 2010. Distressed homes – typically sold at a discount of about 20 percent – accounted for 37 percent of sales in April, down from 40 percent in March; they were 33 percent in April 2010.” [National Association of Realtors®]