Mortgage Market Note

Recent Evidence on Housing and Mortgage Market Conditions in California

May 27, 2009

MORTGAGE MARKET NOTE 09-2

I. Introduction

With about 10 percent of the US housing stock and about 17 percent of its total value, California's housing market has a large impact on the economy of not only California, but also the nation as a whole. To get an accurate picture of real estate market conditions in the state, it is necessary to evaluate multiple market indicators. This Mortgage Market Note attempts to provide a comprehensive look at the most recent available data on housing market conditions in California.

On balance, the data reveal that conditions remain very weak. While inventory levels and the rate of sales have improved significantly since late 2007 and early 2008, other data suggest that those apparent signs of normalization occurred in large part as a result of a sharp increase in distressed sales. Also, data suggest that true inventories may be understated because discouraged sellers have taken their homes off the market as they await a rebound in prices.

Although conditions remain weak and some of the positive indicators certainly can be caveated, when taken collectively, the data also provide some signs that the rate of deterioration in California markets may have slowed in the latest quarters. These improvements, while modest in scale, came before the impact of recent stimulus efforts. The effects of these measures, which include the American Recovery and Reinvestment Act and the Making Home Affordable program, will be felt in coming months.

II. Empirical Evidence

Figure 1 plots quarterly price changes in California as estimated by FHFA's purchase-only house price index, which is constructed using data from home sales. The graph shows very significant price declines in recent quarters, both on a seasonally adjusted and unadjusted basis. In the most recent quarterly period, between the fourth quarter of 2008 and the first quarter of 2009, prices fell an estimated 4.0 percent on a seasonally adjusted basis. This was the 12th consecutive decline in seasonally adjusted prices, but does represent a reduction in the rate of decline; in each of the prior two quarters, seasonally adjusted prices declined approximately six percent.

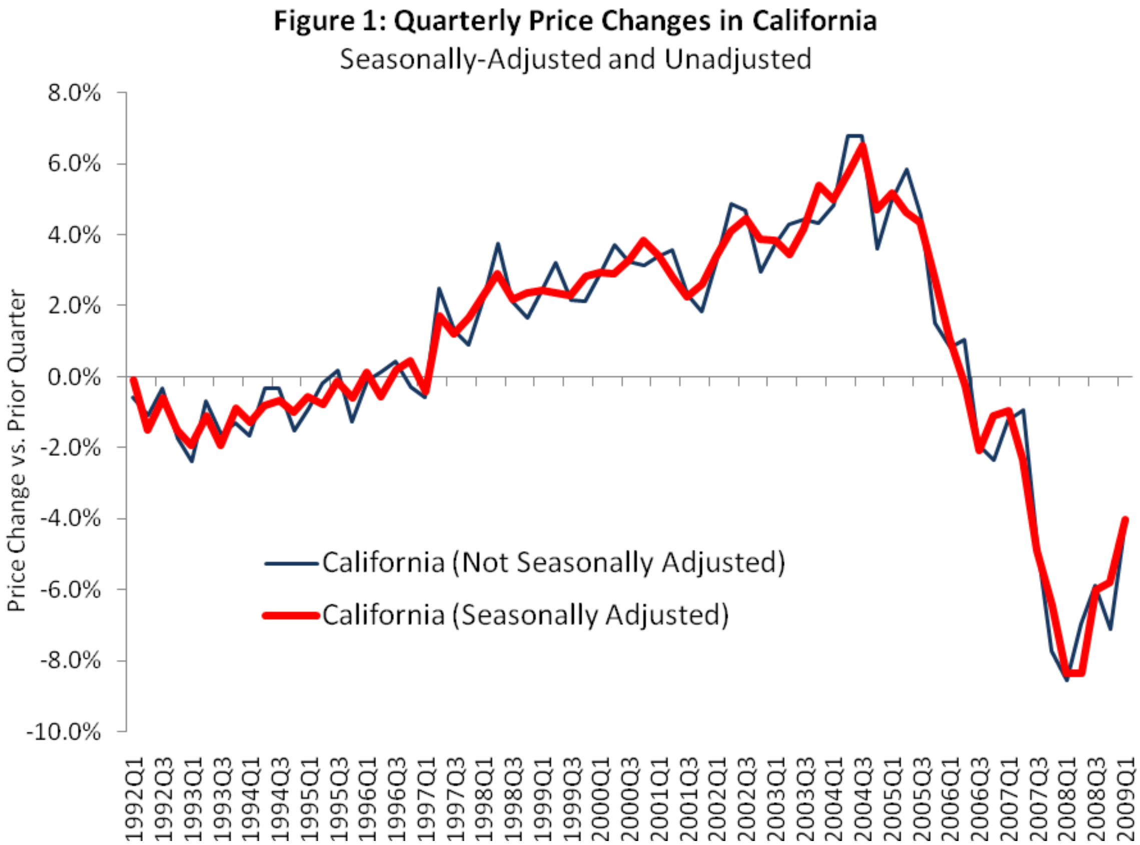
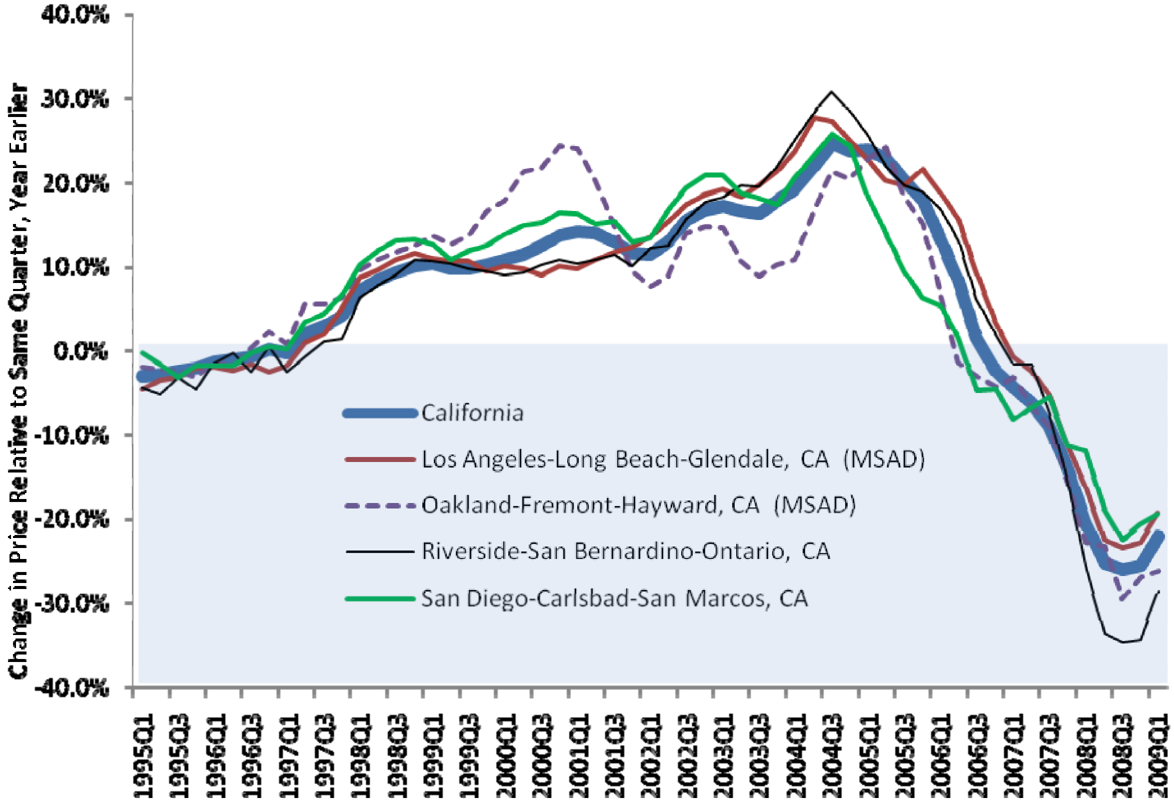


Figure 2 reveals that declines have been geographically diffuse throughout the state. The graph plots four-quarter price changes by quarter for California as a whole and four metropolitan areas within the state. Between the first quarter of 2008 and the first quarter of 2009, the price decline for California as a whole was 22.1 percent. For the four metropolitan areas, the decline ranged from 19.3 percent for the Los Angeles-Long Beach-Glendale Metropolitan Division to 28.6 percent for the Riverside-San Bernardino-Ontario Metropolitan Statistical Area.[1] As with the state as a

[1] Note that the metro-area estimates were obtained from a series of purchase-only indexes provided with the latest HPI release. While purchase-only indexes typically have not been provided for metropolitan areas, the latest release

whole, the rate of decline for the four quarters ending in 2009Q1 was less than the rate for the period ending in 2008Q4.

Figure 2: Four-Quarter Price Changes for California and Component Cities (Estimated Using Homes Values from Purchase Mortgages)



In part as a result of the continued (although more modest) price declines, the pace of home sales has increased sharply in the state in recent quarters. The data in Figure 3, which are assembled by the California Association of Realtors, reveal that the seasonally-adjusted annualized pace of sales has steadily increased since the Fall of 2007. The sales rate bottomed out in late 2007 at an annualized pace of about 250,000 units, but has grown sharply since. The annualized sales rate jumped to over 400,000 units by the Spring of 2008 and grew to between 525,000 and 625,000 units in early 2009.

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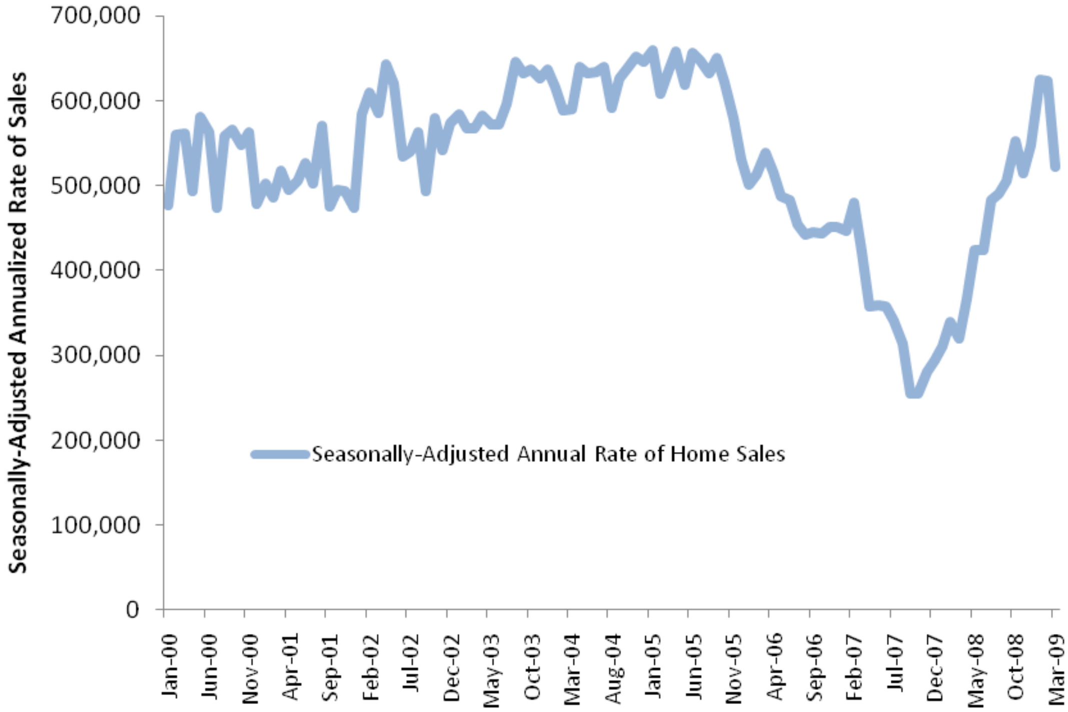
published such a measure for the 25 most populated areas in the United States. The data are available at: http://www.fhfa.gov/DataTools/Downloads/Pages/House-Price-Index.aspx.

Figure 3: Rate of Existing Home Sales in California

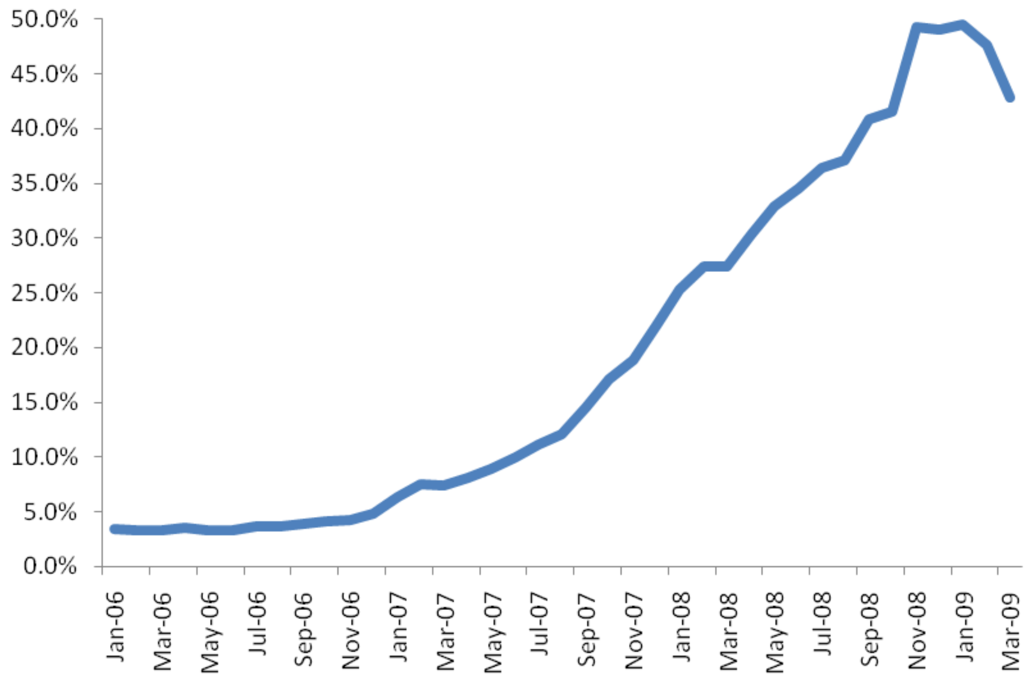


Source: California Association of Realtors

The increasing sales activity has been in part the result of increased volumes for distressed sales. Short sales and sales of bank-owned properties have increased sharply in recent quarters.

Figure 4 provides an estimate for the share of California home sales that resulted from borrower financial distress. Using data from county recorder offices, the graph identifies the share of property sales that occurred within one year of an indication of borrower distress, where distress is evidenced by the filing of a Notice of Default (NOD) with the county. The NOD filing is the first step in the foreclosure process in California and typically occurs after the borrowers are more than three months delinquent on their mortgage payments. By identifying sales occurring after NOD filings, the data in Figure 4 will capture both short sales and REO sales, both of which arose because the homeowners had difficulty paying their mortgage payments.

Figure 4: Estimated Share of California Home Sales Occuring as a Result of Distress



Note: Property sales that: (a) occur within one year of a Notice of Default (NOD) filing for the same address and (b) do not have preceding sales activity in the interim since the NOD filing, are flagged as "distressed." NOD and sales transaction data were provided by DataQuick Information Systems.,

The figure shows a dramatic increase in the share of distress-related sales in California. While the distress share was below 10 percent through all of 2006, the share steadily grew to about 22 percent by the end of 2007. Even as foreclosure mitigation efforts increased in 2008, the share of distressed sales grew further, rising to approximately 50 percent by late in the year.[2] The distressed sale share did flatten out and decline somewhat thereafter, however, and was at about 43 percent in March 2009.

Using data from the Mortgage Bankers Association's National Delinquency Survey, Figure 5 shows trends in underlying mortgage distress in the state. The figure reports data on serious mortgage delinquencies and foreclosure starts since the first quarter of 2006.

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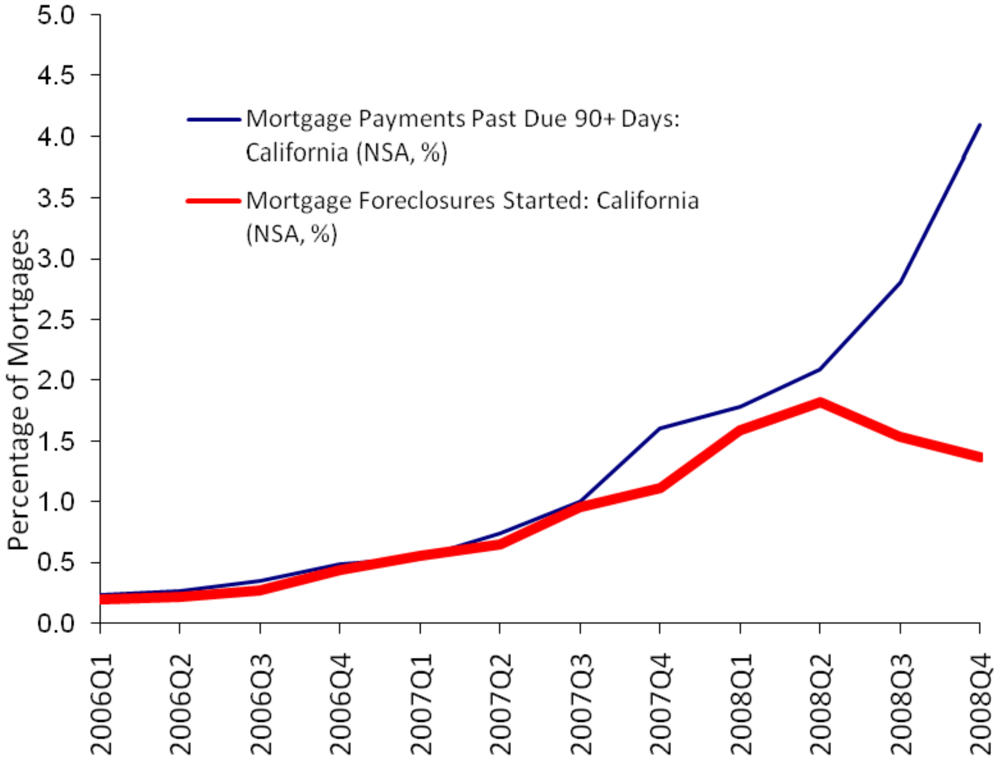
2 The underlying Notice of Default information used in this estimate (as well as the others) was provided by DataQuick Information Systems. Sales data were also provided by DataQuick.

Figure 5: Foreclosures and Serious Delinquencies in California as a Share of Outstanding Mortgages

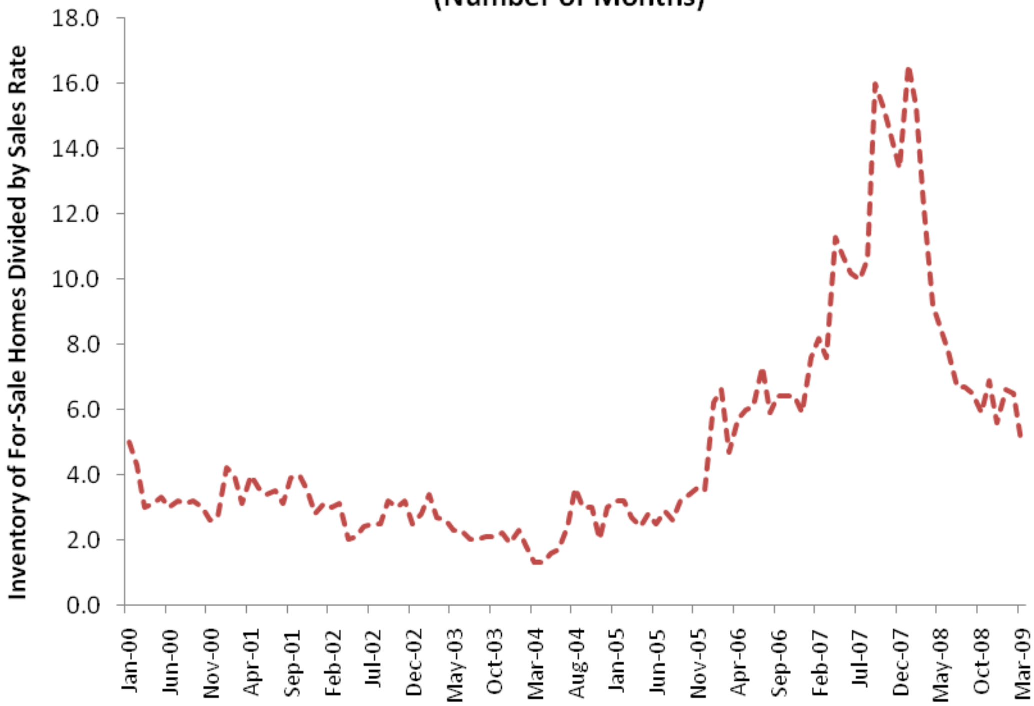


Source: Mortgage Bankers Association

Both indicators have risen sharply in the last three years. The share of seriously delinquent mortgages, for example, rose from about .23 percent of loans in the first quarter of 2006 to over 4 percent of mortgages in the fourth quarter of 2008. While foreclosure starts have fallen relative to their peak in the second quarter of 2008, they still are well above their 2006 levels. In the fourth quarter of 2008, foreclosure starts amounted to about 1.4 percent of all mortgages, about seven times the rate exhibited in the first quarter of 2006. The decline in the fourth quarter may partly reflect foreclosure moratoria put in place by some loan investors and servicers.

Just as closer inspection of the home sales data suggests that "improvements" in that statistic are not unambiguously positive indicators of market conditions, decreases in relative inventories of for-sale properties are also susceptible to nuance. While Figure 6 indicates that the number of months worth of for-sale inventory (defined as the number of for-sale properties divided by the sales volume in the most recent month) has improved in recent months, the relatively modest 5-7 month range evidenced in early 2009 does not necessarily signal a stable market. In addition to the fact that a very significant proportion of the current sales are distress-related, other issues that shade the interpretation of the statistic include the high number of properties in the foreclosure process and the potentially large number of discouraged sellers waiting on the sidelines.

Figure 6: Relative Inventories over Time in California (Number of Months)

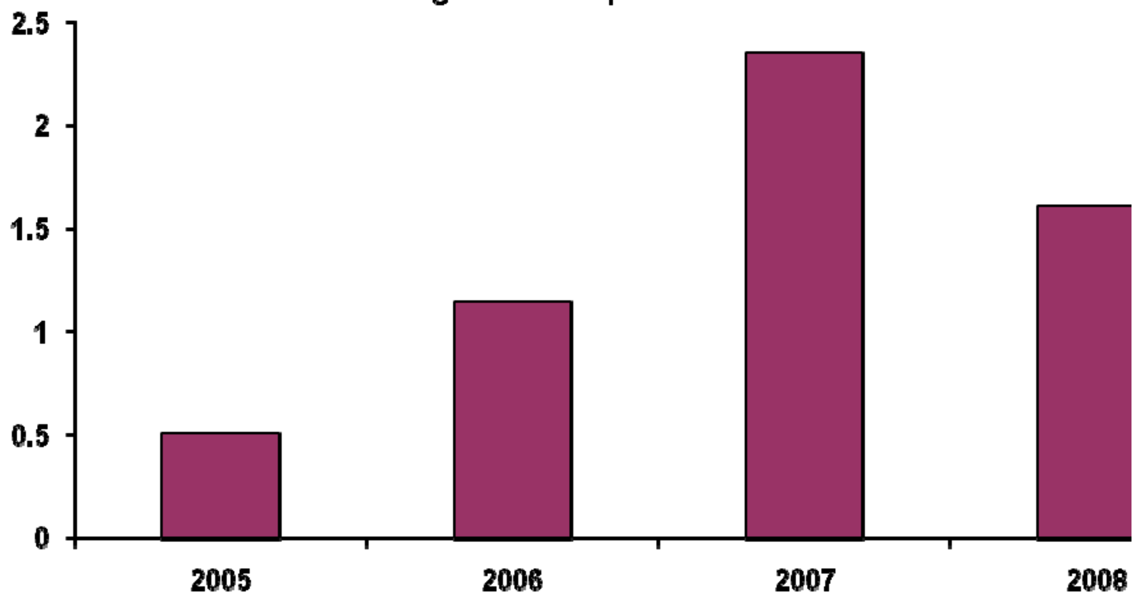


Source: California Association of Realtors

Put simply, the current inventory of unsold homes may be misleading because: (a) many homes in the foreclosure pipeline may come to market in coming months and (b) a substantial number of discouraged sellers have taken their properties off the market after unsuccessful attempts to sell. With regard to the latter, economic literature and evidence from prior real estate downturns indicate that, because homeowners derive a benefit from their homes while they wait to sell (i.e., homes provides shelter) and are often strongly averse to selling at a loss, sellers often remove their homes from the market to "wait out" downturns. Accordingly, the number of properties that are actively for sale may understate the total number of properties that homeowners want to sell.

Statistics showing the extent of this type of "shadow inventory" are not readily available, but FHFA has obtained a rough proxy for it in the form of an "off market" activity indicator from Collateral Intelligence, a private data vendor. The firm's proprietary "off market" metric is calculated using data from multiple listing services (MLS) and is the ratio of unsuccessful sales listings to total sales. Specifically, it is the sum of MLS expirations, cancellations, and withdrawals to sales. The firm calculates the statistic for individual zip codes in California.

Figure 7: Ratio of "Off-Market" Activity to Sales
Average across Zip Codes in California



Source: Collateral Intelligence, LLC. Copyright 2008-2009 Collateral Intelligence, LLC

Figure 7 shows the average of the off-market metric across California zip codes for 2005-2008. The relatively significant off-market activity in the most recent two years is evident in the graph. During the height of the housing boom in 2005, for every 100 home sales, there were about 50 unsuccessful listings (expirations, cancellations, or withdrawals). By contrast, the figure shows that in 2008, there were about 160 unsuccessful listings. While this is down substantially from 2007, the data still suggest that the number of discouraged sellers awaiting better prices is quite high.

III. Conforming Loan Limits and Stimulus Considerations

A great deal of stimulus has been provided recently for housing markets and the economy as a whole. It should be noted that, for many of the most recent efforts, the impact likely will take several months to be observable in housing market data.

In mid-February, for example, the American Recovery and Reinvestment Act of 2009 (ARRA) raised loan limits and provided for first-time homebuyer tax credits of up to $8,000. The law stipulated that Fannie Mae and Freddie Mac loan limits for 2009-originated loans would be the higher of the levels originally calculated for 2009 ($625,500 on one-unit properties in much of California) and the 2008 levels (up to $729,750 on one-unit homes). The limit increases, which amount to over $100,000 in many areas, have only recently been implemented by the Enterprises; Fannie Mae and Freddie Mac began accepting the higher-balance loans on May1st and May 4th respectively.[3]

Another recent effort is the "Making Home Affordable" program. The program is a dual-pronged attempt to prevent foreclosures on loans whose borrowers are having trouble and to facilitate refinancings for borrowers who have been current with their payments. To the extent that this program may help to stabilize California's housing markets, like the provisions of the ARRA, the direct and indirect effects will likely be felt in the coming months.

IV. Conclusion

With the effects of stimulus yet to be measured and some data points suggesting market improvements, there are some indications that the rate of deterioration in the state's housing and mortgage market situation may

[3] See https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2009/0908.pdf and http://www.freddiemac.com/singlefamily/2009-04-10_advisory.html for details.

be slowing. Given current rates of price decline, the relatively large number of foreclosures underway, and uncertainties stemming from recessionary pressures in the economy, the California market remains quite weak. However, sellers' ability to find buyers for most of the enormous volume of distress-related supply flowing to market provides some encouragement that if the pace of foreclosures can be significantly slowed, prices will stabilize.