

Focus on Residential Mortgage Backed Securities

September 12, 2012

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Inventory and Home Prices

Home prices have been on the rise over the past several months. Recently released CoreLogic Index (including distressed sales) increased by 3.8% from July 2011. Also, 77 out of the top 100 CBSAs (measured by population) have experienced YoY increases in HPI. While these developments may signal that the housing market is rebounding, we caution that the positive changes in home prices have mainly resulted from a dramatic decrease in listed inventory, and not necessarily from improving fundamentals.

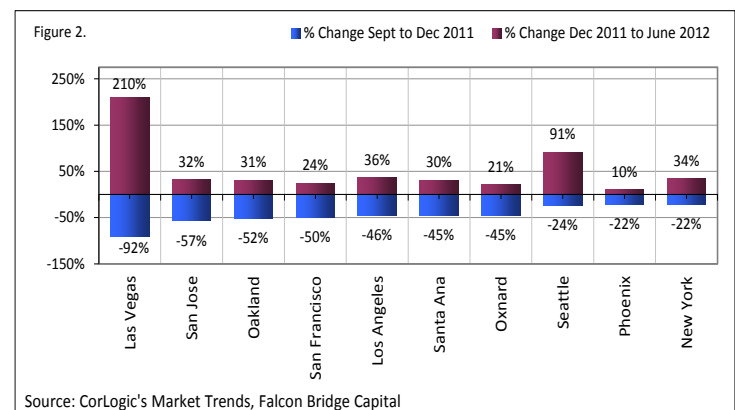
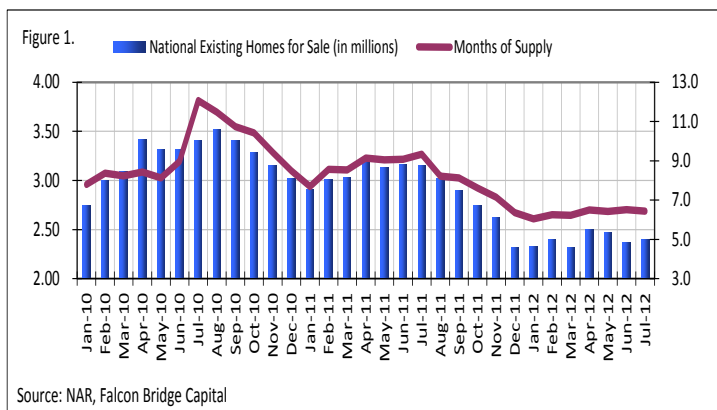
On the national level, inventory of homes for sale has dropped over 28% YoY (Figure 1), with many areas in California dropping roughly 60% in the same time period.

There are fewer distressed properties on the market since smaller number of Notices of Default (“NODs”) was filed at the end of last year. Figure 2 shows a significant decline in NODs (a leading indicator of pending foreclosures) filed in the 4th quarter of 2011 for selected CBSAs.

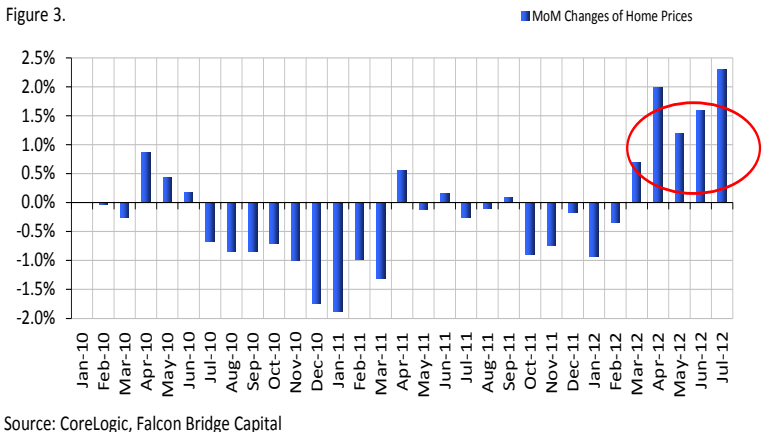
Also, the quantity of conventional listings has been down, as many existing homeowners are underwater and simply cannot sell their properties.

We examine two areas, Sacramento and Las Vegas, in an effort to illustrate the relationship between the supply of homes for sale and prices.

Foreclosure starts are expected to begin climbing following the AG Settlement, which in turn will spur more REO, foreclosure and short sale activity contributing to an increase in the “For Sale” inventory.

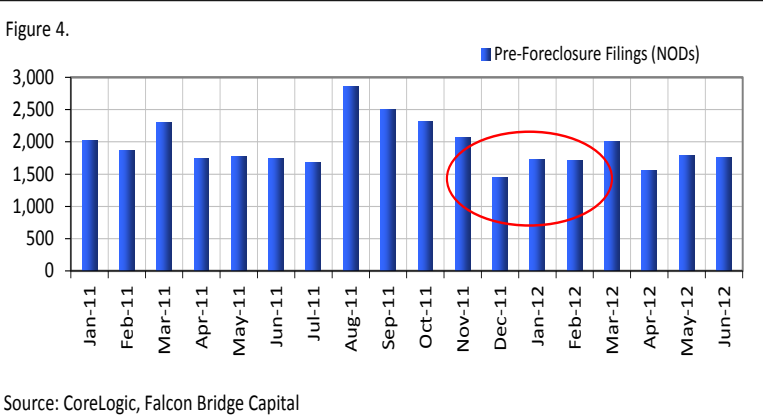


Overview of Sacramento Metro Area

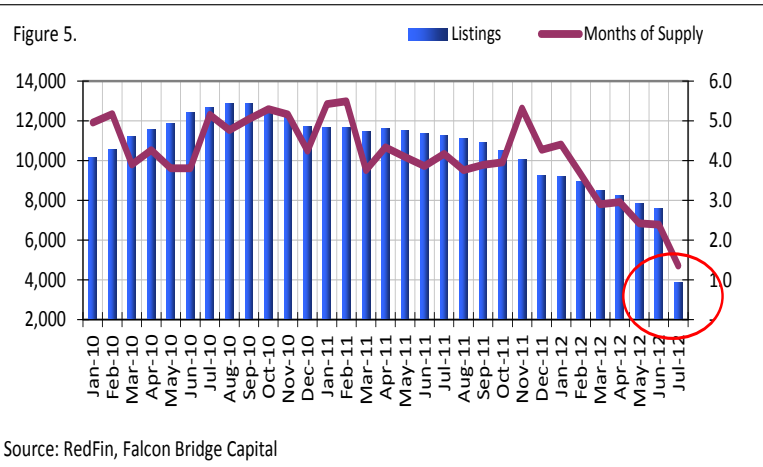


The recent run-up in home prices in Sacramento metro area (Figure 3) can be attributed to seasonal factors, large drops in homes for sale inventories, as well as decreasing number of distressed properties in the area.

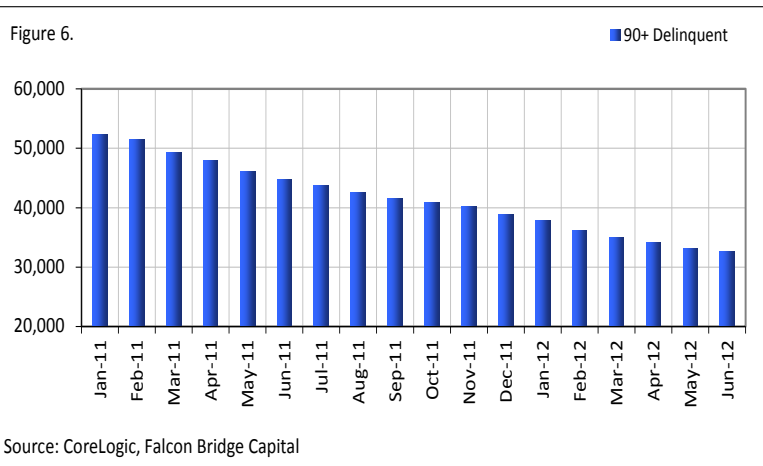
The recently announced AG settlement and increased servicer focus on loan modifications initially resulted in a drop of filed NODs, especially in the latter part of 2011 (Figure 4). This in turn affected inventory levels (Figure 5), as well as the number of distressed properties being offered, positively impacting home prices in the short-term.



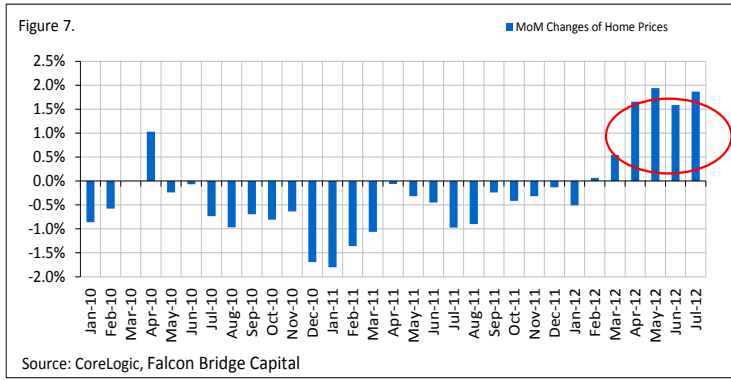
Another factor contributing to lower inventory levels is the growing number of bulk sales to investor groups performed by the banks. These properties don't go through the ordinary sales channels; they are not being represented by the realtors or offered to individual homebuyers and therefore are excluded from the quoted inventory numbers.



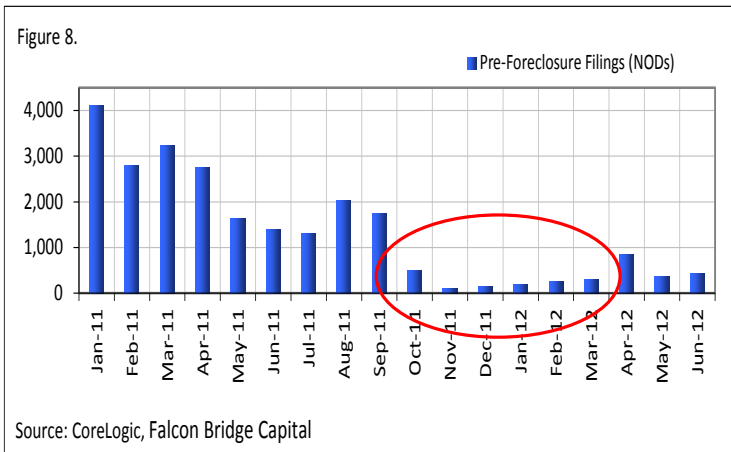
On the positive side, figures representing seriously delinquent borrowers awaiting modifications or impending foreclosure proceedings in the Sacramento area have been steadily decreasing (Figure 6). The continuation of this trend will result in lower levels of liquidations in the long-run, but in the near-term the pipeline of distressed properties entering the market cannot be ignored when evaluating home prices.



Overview of Las Vegas Metro Area

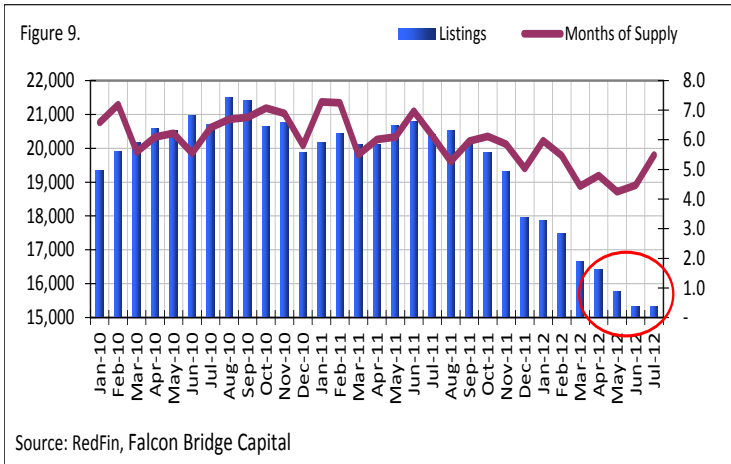


The recent uptick in home prices in Las Vegas (Figure 7) is a result of limited supply of homes for sale, as well as seasonal factors, and may not be sustainable.

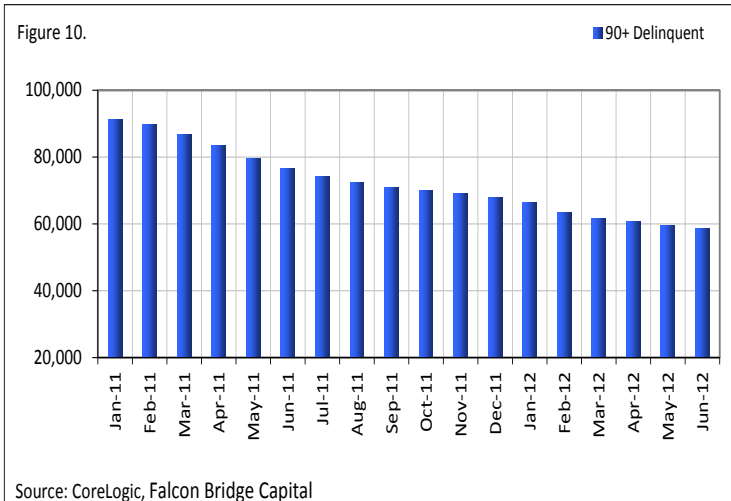


Due to Nevada Assembly bill AB 284 becoming effective as of October 1st, 2011, servicers are now spending more time reviewing and verifying documentation, which caused a sharp drop in the number of NOD filings (Figure 8). NODs decreased from over 1,700 in September 2011, to under 500 for the month of October and dropping further to under 100 in November.

Due to the time lag between NOD filing and listing of the property, the shortage of the housing supply didn't become apparent until recently (Figure 9).



Furthermore, lenders in Nevada have the ability to choose between non-judicial and judicial process when pursuing foreclosures. Historically, non-judicial (usually faster and more efficient) route was favored in this part of the country, however it seems as though this trend may be reversing. According to July's edition of Southern Nevada Realtor newsletter, "lenders are now looking at the judicial method of foreclosure to sell or take possession of properties". This may extend liquidation timelines even further and contribute to a low supply of homes in the near-term.



Although the number of delinquent loans has declined considerably from the peak of the housing crisis (Figure 10), the absolute number remains very high. In fact, if the servicers put more properties on the market once they work through the documentation, home price in Las Vegas may experience downward pressure again.

Conclusion

Recently observed rise in home prices in the vast majority of U.S. metro areas has prompted many to call the bottom of the housing and declare that a recovery is underway. While we recognize the development of certain positive trends (i.e. improving delinquencies), we stress the importance of looking at all the variables that contributed to the recent rally.

Many of these factors may be short-lived and are not representative of a healthy housing market. There is a large pipeline of distressed homes that have yet come to market and still need to be absorbed, which may negatively affect prices over the long-term.

Also, recent bulk-buying of distressed properties by institutional investors, while beneficial to prices in the short-term, may eventually put downward pressure on home values as investors decide to liquidate in the next few years.

In the short-term, a recently observed uptick in foreclosure filings may add more distressed inventory to certain markets and possibly push prices down.

Disclosures

The underlying loan data is provided by CoreLogic (subscription-based data repository) for a specific subset of loans. Our access to CoreLogic data includes approximately 95% of all U.S. Option ARM, Subprime, and Alt-A securitized product. Unless specified, Prime, Jumbo, or Agency Backed loans are not included in the graphs and charts.

Algorithms and analysis to access the information and any interpretation are proprietary to Falcon Bridge Capital, LLC.

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