

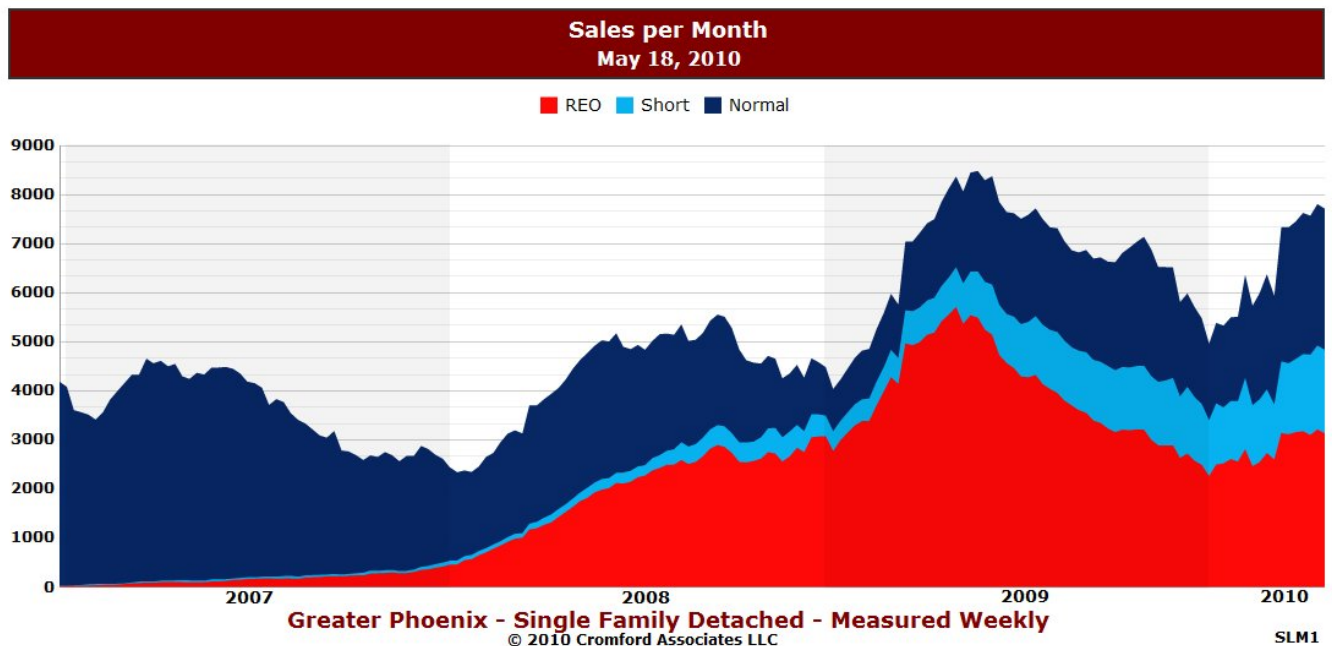
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Greater Phoenix
Short Sale Market Report
Residential Real Estate
May 18, 2010

Market Changes

In the last eighteen months, the residential real estate market in Greater Phoenix has changed significantly. In late 2008, foreclosed properties owned by mortgage lenders, or by Fannie Mae, Freddie Mac or HUD were very numerous and dominated the active listings and sales statistics. Despite the false urban legend of a large "shadow inventory" of bank-owned homes, we can show that REOs are now much fewer in number and trying to buy one requires a great deal of determination, patience and fast action. Access to cash at the ready also comes in handy, as most lenders are not willing to wait for a loan to be approved and they will usually give higher priority to all-cash offers. They know how difficult banks can be and they usually have multiple offers to select from.

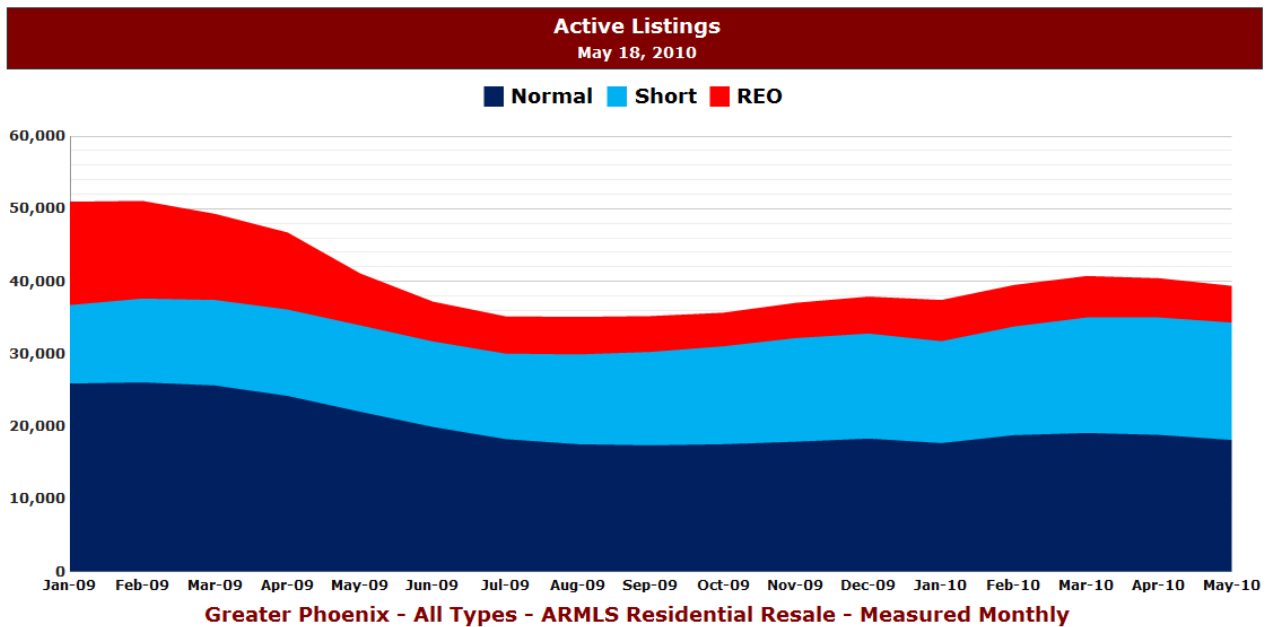


In the above chart we see that REOs peaked in the first half of 2009 while the market is now increasingly turning to the short sale. Why is this?

The lenders have concluded that an effective short sale process usually reduces their investor's losses compared with foreclosure, as well as controlling their expenses. They also become eligible for government incentives which reward short sales over trustee sales. For these and other reasons, many lenders are refining their short sale processes, and making faster and better decisions.

Buyers find that the reduced competition for short sales makes life a little less fraught and that it is usually possible to buy a short sale home using a loan instead of cash. However, even more patience is required as the process still takes several months to complete. A short sale is often better for the seller too, as the impact on credit ratings will usually be less than in a completed foreclosure. Realtors® are becoming more confident and experienced at handling the intricacies of the short sale process and better able to guide their clients.

A large proportion of homes in the valley have negative equity, having been purchased since 2003 or refinanced since then. If the owner wishes to sell in this circumstance they either need to bring extra money to the close of escrow to hand over to their lender, or attempt a short sale. The latter option is by far the most popular with the seller, for obvious reasons. We are therefore seeing short sales comprise an increasing share of the active listings while lender-owned homes are on a downward trend.



In the above chart we see that while the total number of active listings has fallen by 23% since January 2009, the number of short sales offered for sale has grown by 50%.

Geographic Differences - Supply

It is remarkable how different areas are much more affected by short sales than others. Across Greater Phoenix the proportion of active listings that are short sales is currently about 42%. But some ZIP codes are much higher than this. For example, if we look specifically at single family detached homes, among the highest are:

City	ZIP	Short Sales	% of Actives
Avondale	85392	176	71%
Surprise	85379	330	69%
Glendale	85305	37	69%
Maricopa	85139	203	68%
Laveen	85339	350	68%
El Mirage	85335	190	68%
Glendale	85307	28	68%
Gilbert	85295	228	67%
Phoenix	85024	121	67%
Youngtown	85363	29	67%
Queen Creek	85140	254	66%

Other areas have relative low percentages of short sales among the inventory offered for sale:

City	ZIP	Short Sales	% of Actives
Scottsdale	85262	119	19%
Gold Canyon	85118	49	19%
Sun Lakes	85248	63	18%
Scottsdale	85266	55	18%
Carefree	85377	20	18%
Fountain Hills	85268	56	17%
Paradise Valley	85253	57	12%
Sun City	85351	27	10%
Sun City West	85375	30	7%
Wickenburg	85390	15	8%
Rio Verde	85263	8	6%

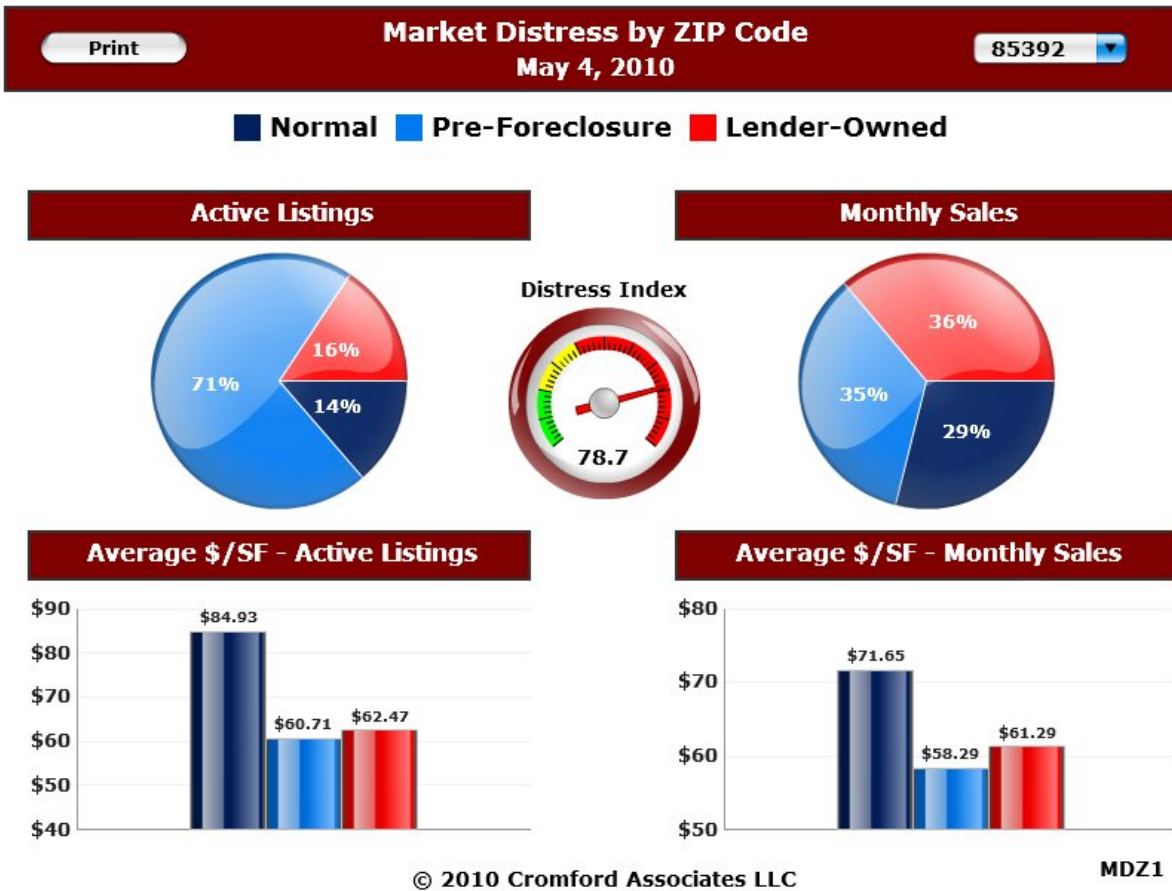
We can see that short sale listings are most dominant in certain low to medium priced areas with a high proportion of new homes, particularly in the west valley. They are least prevalent in high priced areas and in those targeted at the over-55 market, where normal sales are still the majority. It is not the outlying location that is important, since we see that Rio Verde, Gold Canyon and Wickenburg are all near the bottom of the short sale league. It is not necessarily the cheapest areas either, since some of the lowest priced areas of the valley, such as parts of west and south Phoenix, show pretty ordinary rates of short sale listings (e.g. 85009 - 34%, 85033 - 39%). Homes in these areas are more likely to be foreclosed without an attempt at a short sale.

Geographic Differences - Demand

It's one thing to list a short sale. It's quite another to successfully close one. So we should also look at which areas have seen the largest percentage of successful short sales among the monthly sales. For single family detached homes in the month of April, we see the following ZIP codes with high levels of closed short sales:

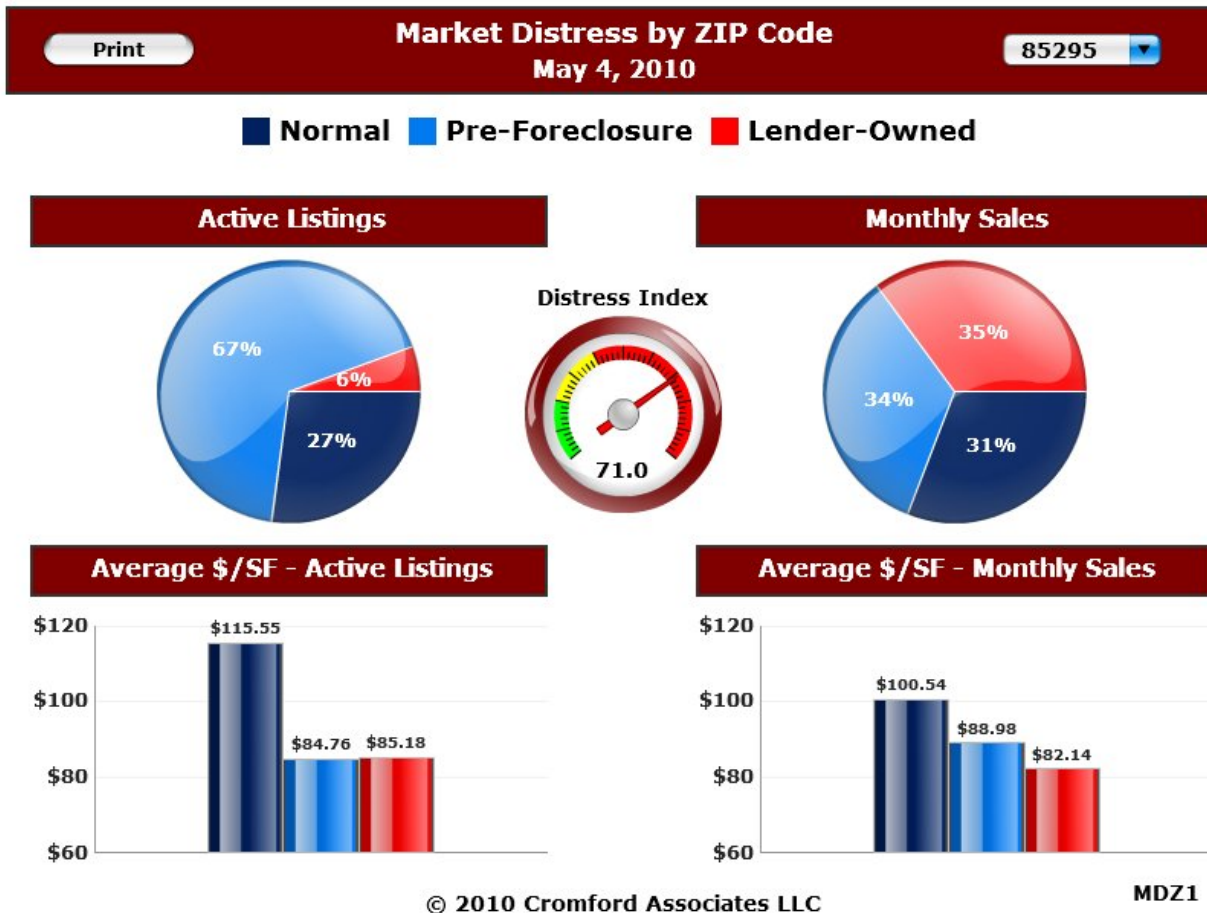
City	ZIP	Short Sales	% of Sales
Phoenix	85012	6	55%
Phoenix	85045	6	40%
Anthem	85086	50	39%
Glendale	85307	5	36%
Avondale	85392	29	35%
Scottsdale	85259	13	35%
Gilbert	85295	32	34%
Phoenix	85024	14	33%
New River	85087	6	33%
Glendale	85310	14	33%
Phoenix	85003	2	33%

A few ZIP codes turn up near the top of both the demand and supply tables. Let's look more closely at two of these - Avondale 85392 and Gilbert 85295. To do this we examine the Market Distress dashboard from www.cromfordreport.com.



Here in North Avondale we see that in April 2010 short sales dominated the active listings and made up more than a third of the monthly sales. More surprisingly, they are priced lower, on average, than lender-owned homes. This is an active ZIP code with significant sales volume, so this is not a fluke. When short sales become dominant the price gap between short sales and REOs tends to disappear. In fact many real estate agents will aggressively price short sales below recent REO pricing in order to attract a contract. What is perhaps even more surprising is that achieved short sale pricing is, on average, lower than for bank-owned homes. This is probably not what the banks were expecting to see.

In Gilbert 85295 the situation is a little different:



The overall level of distress is somewhat lower than for Avondale 85392. Very few lender owned homes are listed for sale, yet they still are the largest group of homes that actually sell. Note that short sales are listed at lower prices per square foot than REOs on average, but among those that actually sell, they achieve higher prices than REOs and higher prices than those that remain active. Clearly we may have a significant number of homes that are priced too aggressively for the lender(s) to approve.

Short Sales by Price Range

If we analyze the short sales that have closed in 2010 by price range we obtain the following figures:

Price Range	Short Sales	Avg List	Avg Sale Price	Avg Sq Ft	Avg \$/SF
\$0 to \$25K	46	\$19,014	\$19,226	872	\$22.04
\$25K to \$50K	410	\$39,181	\$38,527	1,143	\$33.69
\$50K to \$75K	730	\$63,925	\$63,682	1,351	\$47.15
\$75K to \$100K	1209	\$87,533	\$87,209	1,579	\$55.23
\$100K to \$125K	954	\$112,002	\$110,534	1,755	\$62.97
\$125K to \$150K	877	\$137,003	\$135,016	1,924	\$70.18
\$150K to \$175K	562	\$160,836	\$158,526	2,106	\$75.27
\$175K to \$200K	482	\$187,139	\$184,700	2,177	\$84.84
\$200K to \$225K	264	\$212,048	\$209,957	2,320	\$90.52
\$225K to \$250K	249	\$236,455	\$230,856	2,473	\$93.36
\$250K to \$275K	172	\$258,796	\$252,997	2,614	\$96.80
\$275K to \$300K	166	\$286,852	\$277,823	2,704	\$102.75
\$300K to \$350K	196	\$322,910	\$315,129	2,981	\$105.71
\$350K to \$400K	171	\$371,021	\$357,447	3,135	\$114.03
\$400K to \$500K	141	\$447,073	\$433,744	3,353	\$129.38
\$500K to \$600K	71	\$544,287	\$520,087	3,677	\$141.44
\$600K to \$800K	66	\$690,828	\$657,195	4,415	\$148.86
\$800K to \$1M	32	\$916,025	\$838,128	4,588	\$182.69
\$1M to \$1.5M	26	\$1,191,154	\$1,063,269	5,291	\$200.95
\$1.5M to \$2M	17	\$1,648,118	\$1,430,003	6,101	\$234.38
\$2M to \$3M	7	\$2,677,000	\$2,258,000	6,709	\$336.57
Over \$3M	6	\$4,023,333	\$3,202,083	8,678	\$368.99

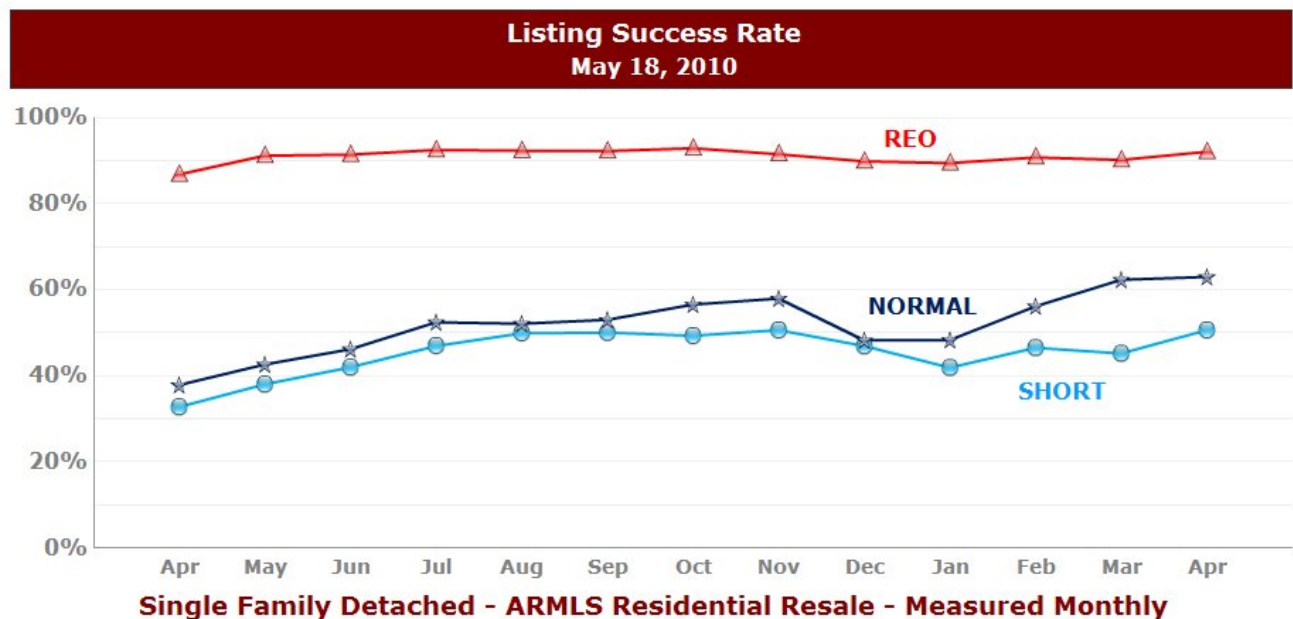
For comparison, the REO sales look like this:

Price Range	REO Sales	Avg List	Avg Sale Price	Avg Sq Ft	Avg \$/SF
\$0 to \$25K	514	\$19,748	\$20,432	1,006	\$20.30
\$25K to \$50K	2,048	\$38,375	\$38,252	1,191	\$32.11
\$50K to \$75K	2,301	\$63,547	\$63,473	1,360	\$46.67
\$75K to \$100K	2,743	\$88,053	\$88,421	1,601	\$55.24
\$100K to \$125K	1,951	\$113,056	\$112,390	1,832	\$61.36
\$125K to \$150K	1,580	\$137,617	\$135,971	1,970	\$69.04
\$150K to \$175K	954	\$162,387	\$159,913	2,141	\$74.69
\$175K to \$200K	670	\$188,189	\$185,105	2,257	\$82.03
\$200K to \$225K	403	\$213,903	\$210,641	2,405	\$87.59
\$225K to \$250K	381	\$237,655	\$234,672	2,672	\$87.81
\$250K to \$275K	221	\$262,588	\$257,771	2,781	\$92.69
\$275K to \$300K	193	\$288,875	\$282,236	2,948	\$95.72
\$300K to \$350K	208	\$325,471	\$318,597	3,200	\$99.56
\$350K to \$400K	145	\$375,709	\$369,331	3,515	\$105.07
\$400K to \$500K	140	\$451,290	\$438,180	3,690	\$118.74
\$500K to \$600K	57	\$558,060	\$545,777	4,006	\$136.25
\$600K to \$800K	74	\$687,976	\$663,494	4,373	\$151.73
\$800K to \$1M	38	\$905,807	\$846,160	4,929	\$171.66
\$1M to \$1.5M	38	\$1,207,138	\$1,102,032	6,058	\$181.92
\$1.5M to \$2M	9	\$1,849,477	\$1,480,000	6,301	\$234.90
\$2M to \$3M	8	\$2,420,438	\$2,188,625	8,354	\$261.99
Over \$3M	0				

We can quickly see that the short sales get relatively more numerous as we move into the higher price ranges, while REOs are very dominant below \$100,000. It is this fact that tends to make the overall average \$/SF much higher for short sales (about \$82 per sq. ft) than for REOs (about \$69 per sq. ft). This is somewhat misleading and we need to look more closely. If we concentrate on a specific price range, the difference in price is sometimes relatively small. For example, short sales priced between \$125K and \$150K are only 1.7% more expensive than REOs. When you consider that short sales are typically in better condition than REOs, and more likely to still have appliances, it appears that short sales are now more of a bargain than many people realize. This is partly because REO prices have been on the rise since April 2009 whereas pricing for short sales has continued to drift downward over the last 12 months.

Listing Success Rates

Comparing the success rates of short sales with REOs and normal listings we see the following trend over the last 12 months:



The success rate of REOs remains extraordinarily high at over 90% while both normal and short sales have improved from the low levels in April 2010 and now sit at respectable levels of 63% and 51% respectively.

Conclusions

The end of the REO market is certainly not here yet but in the last few months we have seen a significant drop in the flow of new Notices of Trustee Sales. An increase in cancelled Trustee Sales also suggests that the supply of bank-owned properties is starting to dry up and will fall back to more normal levels over the next two to three years.

However the situation that creates short sales (negative equity) is here for the foreseeable future. It seems very unlikely that Phoenix real estate will more than double in price anytime soon, which it would have to do to match the peak price levels seen in mid 2006 and eliminate all the negative equity created by the subsequent collapse. It also seems unlikely that sellers bringing cash to the closing table is going to ever become a popular option. I suspect that bargain hunters in the market, who make up the vast majority of buyers, are increasingly going to be looking at short sales to satisfy their needs. The analysis by price range and of the ZIP codes with the highest penetration by short sales both suggest that short sale pricing is getting increasingly competitive with REOs. This information will start to be recognized.

Any buyer (or agent) who is not seriously considering short sales is missing a major opportunity. The main deterrent - a prolonged and uncertain decision process by the lender(s) - is being tackled as the major banks appoint new senior executives in charge of short sale departments, recruit many more staff to handle the high volume of offers and implement new systems to streamline the workflow and provide feedback to the various parties to the transaction.

We expect another period of change over the next eighteen months as the market adjusts to these new factors.

Mike Orr

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