RADAR LOGIC UPDATE

Don't be Misled by Gains in Home Price Indices and Pending Home Sales; Housing Recovery is Still a Long Way Off

New York, NY – June 29, 2011 – The Pending Home Sales figures for May, released this morning by the National Association of Realtors, exhibited an increase of 8.2 percent relative to April's figures. While some housing market observers may interpret this increase as a sign of improvement in the nation's housing markets, we remain circumspect. May's gains appear substantial in part because they come off weak pending sales figures for April. If we put May's pending sales figures in their larger context we see that they have remained essentially flat relative to the beginning of the year, and are down some 20.4 percent relative to the cyclical peak last April, when buyers were rushing to beat the contract deadline for the home buyer tax credit.

Regardless of what may happen to sales contract activity in any given month, the fact remains that the inventory of homes for sale and in the foreclosure pipeline far outstrips current demand. Potential buyers are cognizant of this fact and the negative impact it will have on future home price appreciation, and are therefore choosing to stay out of the market. As long as the supply overhang persists it will weigh on housing demand.

This morning's Mortgage Bankers Association Applications index bears this out. Mortgage applications continue to be very slow which suggests the buyers who need money to close are staying on the sidelines. The buyers with cash appear to be participating more in the distressed home sector of the market.

The S&P/Case-Shiller 10- and 20-City Composite Home Price Indices for April, released yesterday by Standard & Poor's, showed their first gains in eight months. While this may appear to be a positive sign, one month of positive data does not indicate a housing recovery is under way. The improvements in these indicators are almost certainly seasonal phenomena and a lasting recovery in the nation's housing markets is most likely a long way off. Housing demand typically increases during the spring, bolstering sales and driving gains in home prices. But seasonal gains in demand during the spring give way to weakness in the fall, causing sales and prices to fall.

Moreover, the increases in the S&P/Case-Shiller Composite indices reflect, in part, a seasonal decline in the percentage of distressed sales relative to total sales. As we discussed in the RPX Monthly Housing Market Report for April 2011, sales of foreclosed homes declined to 30 percent of all sales in April from 33 percent in March. As real estate owned (REO) by lenders and servicers and homes sold at foreclosure auctions sell at a significant discount (39 percent as of April), the decline in such sales as a percentage of total helped to buoy home price indices beyond the actual appreciation in the prices of individual homes.

The shift in the mix of distressed and non-distressed home sales is a seasonal occurance. The supply of and demand for foreclosed homes are more consistent throughout the year than supply and demand in the rest of the market because the financial institutions that sell foreclosed homes and the investors who buy most foreclosed homes are less sensitive to seasonal factors, such as weather and school schedules, than owner-occupants. As demand and supply fluctuate less over the course of the year for foreclosed homes than for other homes, foreclosure and REO sales typically increase as a percentage of total during the fall and decrease as a percentage of total during the spring.

If we are right, the activity in non-distressed homes will diminish in the fall and the result will be a greater influence of distressed sales in the mix. This alone will cause the indexes to fall. If the market remains weak, that fall could be significant.

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