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Bank Repo's and Short Sales - How Much do they Really Affect Prices? *by John Dumke*

It's no secret that short sales and bank repos sell for less. These low sales didn't affect sellers until the advent of the HVCC (Home Valuation Code of Conduct). This law, enacted by Andrew Cuomo, is an attempt to mitigate appraisal fraud. However, laws to regulate morality or integrity often do neither. If you want to read my rantings on HVCC go to www.LBRE.com and look for the News Letter Archives, and click the 4th Qtr 2009 article. What HVCC did was to eliminate any discretion that the appraiser had to deviate from the raw numbers when choosing the most appropriate comparable homes. It also provided intense oversight and scrutiny from appraisal management over appraisals.

Before HVCC, distressed sales would not impact our ability to obtain fair market value for my sellers because appraisers had professional leeway when considering condition. Now that HVCC is in place, discretion and common sense have been thrown out and replaced with rigid conformity. Distressed sales now affect our ability to get great properties appraised at fair market value.

A beautifully maintained, well presented home with many expensive upgrades will justifiably sell for a significant premium over a bank repo or short sale. Yet when the appraiser uses comparable sales, this nice home is lumped in with those distressed properties. Accurate consideration is not given to the actual costs of these upgrades because appraisers work off a comparable method of appraising homes and not a cost method. This is where the problem is created.

Appraisers often have the hardest time appraising the nicest homes because there is a push for conformity in the numbers, and nice homes represent the upper end of value. Appraisal management doesn't like it when a home is at the upper end of the range. They like the home to be bracketed with higher and lower priced sales.

Prior to HVCC, the appraiser had professional integrity and interpretation of the data to consider when appraising a property. Most of the time there were comparable sales to justify the price, and a local appraiser, hired by the lender, could see why the buyer was willing to pay more for a special house.

However, now appraisals are ordered by appraisal management companies that oversee the whole process. Appraisers are paid

about 1/2 as much and work twice as hard to make the same money. In addition, they know that their work is going to be scrutinized by management, which will rake them over the coals if their value is out of line with the averages.

Today, appraisers have much less leeway. Yes the nice home being sold may have \$50,000 to \$100,000 in upgrades compared to the short sale or bank repo, but the appraisal reviewer will want them to use the short sale or bank repos as comparable sales, because it is right across the street or it is more comparable in square footage. In this case, the nice home is likely to have an appraisal problem, and have a tough time selling at full value

Since enacting the HVCC, if other agents and sellers under price their listings it now affects my clients home value. Needless to say, this is disturbing because their actions now affect our ability to get my client top dollar for their home.

How do Bank Repo sales negatively affect the market?

Let me first say that I prefer Bank Repo's over Short Sales because banks have clear title and short sales don't. When banks foreclose all liens are wiped out. Agents and buyers know that if an offer is accepted, the sale WILL close in the agreed upon time frame. Even if the Bank Repo is wildly underpriced, multiple offers will pile up within a short period and fair market value will likely be negotiated. The market usually corrects errors made by listing agents pricing homes too low.

The problem with Bank Repo's is not marketability, it is reduced value as a result of poor condition. Most foreclosed homes were over encumbered (more is owed than the home is worth) by the previous owner. Large home payments swallowed a large portion of an owners spendable income, with no money left to improve the property. In addition, owners with no equity are not likely to maintain their homes. That would be throwing good money after bad.

Combine the lack of maintenance and improvement with 3 months to 1 year of neglect with a property being vacant, and on top of that banks don't have the desire, time or expertise to make any select improvements, and you have a home that not only has been neglected, but it is presented in it's worst light. In the 1990's foreclosure market, many lenders at least painted and carpeted

their listings before putting them on the market. That was back when Home Savings, or Glendale Federal foreclosed and it was their property and their responsibility to maximize value. Oh yes, back in the “good old days” of accountability, rather than today’s situation of Collateralized Debt Obligations, where people aren’t even sure who owns the loan. But I digress. The bottom line is this. Many Bank Repos are justifiably worth \$50,000 to \$100,000+ less than well maintained homes.

How do Short Sales negatively affect the market?

Short sales are a whole different ball game. Their values are negatively affected by a reduction in marketability because they don’t have clear title; they are over encumbered.

Pretend that you are a motivated buyer working with an agent. You WANT to buy a home in the next 30-90 days. Because you are motivated you have selected an aggressive agent that knows the market and will get you the best possible home within that time frame. Your agent however lets you know the liability of negotiating with a short sale. The liability is that there is no guarantees of ANYTHING.

With a short sale, the seller is the legal signer to list the property, yet everything is subject to “Lender Approval”. The lender on the home is the real seller, and they approve or disapprove of the proposed sale.

The sellers must complete a Short Sale package (which includes the offer) before the lender will even start negotiations. Short sale properties are listed and negotiated without any indication from the lender (the real decision maker) as to their level of cooperation, unless it is the 3rd or 4th offer the lender has seen.

With this in mind there are a myriad of problems, listed below, that may occur because communication between the lender and seller are often non existent.

- 1) The seller may not qualify for a short sale due to insufficient hardship, which is a requirement for a short sale. Simply not wanting to make a mortgage payment anymore is not hardship. There must be job loss, significant reduction in income, relocation, or divorce to qualify for short sale consideration.
- 2) The seller, listing agent or lender may not be capable or competent enough to work through all of the details of the process to obtain approval within the time required. Short pay departments are overwhelmed and understaffed. They are notorious for losing paperwork making communication difficult.
- 3) The lender may appraise the property at a higher price than what was negotiated. In which case the lender will want the higher price, and the buyer must decide if they want the property at the higher price. With standard listings, buyers negotiate down, but with Short Sales buyers often negotiate up.
- 4) The buyer’s lender can’t get loan approval quickly enough once short pay approval is given by the lender. While short sales packages can sit on a lender’s desk for months while they obtain appraisals, assign negotiators and process paperwork, once a short pay is approved, the lender wants the transaction closed within days.
- 5) While a short sale package is being reviewed by a lender, the foreclosure department is often concurrently proceeding with the

foreclosure process. Often times the property goes to foreclosure before the lender can process the short sale.

6) While gaining approval from one lender is tough enough, when there are two loans on the property, it becomes even more difficult. If the 1st trust deed can foreclose on a property leaving the 2nd trust deed holder no money. Why would the 1st trust deed holder want to give partial payment to the 2nd trust deed holder to incentivise them to release their lien? Yet why would a 2nd trust deed holder release their lean unless they were paid? When there are two loans on a property, both lenders fight over the remaining equity.

Buyers should be aware that the list price on a short sale should be taken with a grain of salt. The price was selected by the listing agent and seller to generate offers, and often has no bearing upon what the lender will accept, because the lender hasn’t been consulted yet.



A sharp agent will understand that buyers and agents avoid short sales because of the uncertainty and unnecessary complication. The listing agent then needs to make a short sale more attractive with a lower list price to generate offers to see what the bank says. And because the net to the seller (zero) is the same no matter what the price is, the seller has little objection to listing and advertising the property at an artificially low price.

The sellers lack of financial incentive also often shows up in less effort expended in preparing the home and maintaining it, just like a bank repo. Why improve the property for sale when there is no financial incentive?

Short sales, like bank repos are affected by an owner with no financial incentive to maintain and prepare their home for sale. In addition, short sales suffer from the reduction in marketability. The best buyers that want to be in a home in the next 90 days, assisted by agents that are committed to making it happen, give first consideration to conventional sales and bank repos. They only look towards the short sale market after the other alternatives are exhausted.

The main reason a buyer will sit patiently waiting for an answer, with no guarantee of anything, is because they are getting the property for a great price. Otherwise they would make an offer on a conventional sale or bank repo with a clear title.

How much have short sales & bank repos affected prices?

To answer this question, I did some investigation on the Multiple Listing Service (MLS), which specifies whether a home is a standard sale, short pay, or a bank repo. As long as the area that I was researching is relatively homogeneous the results should be accurate.

For example, if I were to pull data from all of Long Beach, this might not work, as there will be more foreclosures and short sales in the less expensive areas like North Long Beach, than there would be in the upper end neighborhoods, like Alamitos Heights. This would make it look like bank repos and short sales sold for even less than might actually be the case.

For a consistent area, I choose to compare conventional sales with short sales and bank repos only in the East Long Beach tract areas with a zip code of 90815 and 90808.

The Statistics

Since Jan 1st 2009 - Closed sales - East Long Beach tract areas.

Difference between conventional sales, short sales and repos.

Type	# Sales	Ave Sqft.	Ave Sales Price
Conventional	664	1,511	\$502,000
SS & Repos	199	1,456	\$444,000
Just Short Sales	111	1,472	\$452,000
Just Repos	88	1,436	\$434,000

Observations - Price difference between conventional sales versus Short Sales and Repos - \$50,000+

It does not surprise me that short sales and bank repos sell for less than conventional sales. Originally it was my assumption that short sales might sell for less than bank repos, due to their reduction in marketability, but this was not the case. Maybe, and this is just a hypothesis, short sales sell for more than bank repos because sellers are trying to do the right thing, and minimize the banks loss. Even though there isn't any financial interest in the sale, the home still has a higher level of maintenance and presentation.

Price stability & market share of distressed sales

Type	#Sales	Ave Sqft.	Ave Price	% Market
Conventional 2009	387	1,512	\$506,000	
Conventional 2010	277	1,509	\$496,000	
SS & Repo 2009	112	1,409	\$440,000	20.4%
SS & Repo 2010	87	1,517	\$449,000	23.9%

Observations on price changes and distressed sales

Over the last year it has been my assessment that the market is flat to slightly down. The above numbers bear this out, with sale prices slightly lower in 2010 than in 2009 for conventional sales. Distressed sales actually show a slight gain, but when corrected for square footage, this gain becomes flat.

Another concern I had was that the market was becoming more dominated by short sales and repos, which would not be a good for property values. It looks like this is slightly the case with short sales and repos gaining in market share from 20.4% to 23.9%. But this is still not a huge chunk of the market.

The percentage of the market that are short sales and repos versus conventional sales greatly affects the stability of the marketplace. East Long Beach has been more stable than other areas because short sales and bank repos were few and far between. As contrast, imagine Las Vegas, where I have read that 78% of the homes are under water. Sales are dominated by distressed properties. If you are a conventional seller, your price is going to be determined by these distressed sales.

In our neighborhood of East Long Beach, where 75% of sales are conventional sales, short sales and bank repos are lifted by a healthy conventional market. Unfortunately, the conventional seller that has been fiscally conservative and responsible is the one hurt by the lower priced short sales and bank repos.

Final Conclusions

Short sales and repos are a significant but not an overwhelming issue in the East Long Beach marketplace. The appraisal issue becomes a factor because there is less leeway for appraisers to

adjust price based upon condition. As home owners you and I both know that it is pretty easy to spend \$50,000 fixing up a home, and \$100,000 might easily be a more appropriate difference between a fixer and a well maintained home.

As stated earlier, appraisers don't work off of costs differentials, they have to base their appraisals on comparable sales. The result is better homes often have a hard time getting credit where credit is due, and can be dragged down by distressed sales, through the appraisal process.

Bonus Section - Other interesting Factoids

Current value versus peak values

How do today's prices compare to prices obtained at the peak of the market? For this study, I compared all home sales to prices obtained at the peak of the market. My general assessment if that peak values were obtained during the second half of 2005 and the first part of 2006. This is the time period I defined as the peak.

	Peak \$	Sqft	2010 \$	Sqft	% Drop
All of Long Beach	\$618,000	1,380	\$421,000	1,432	-31.8%
East Long Beach	\$615,000	1,429	\$482,000	1,501	-21.6%
Alamitos Heights/ Belmont Heights	\$946,000	1,897	\$718,000	1,949	-24.1%

While each market is different, some markets have been affected more than others. East Long Beach fared better than Long Beach as a whole. This is due to areas such as North Long Beach, which have lost more value, and brought the city wide average down. Alamitos Heights / Belmont Heights also fared better than the city wide average, but did correct more than middle price areas such as Los Altos, as uncertain financial times makes buyers more price conscious.

As an interesting comparison. My own personal assessment of the last correction from 1990 to 1995 was home prices corrected about 25% for a typical East Long Beach home. The upper end had a greater correction, and income property corrected very aggressively. The good news is that we are close to reaching the previous correction.

Total sales volume

City wide there were 2,782 single family sales. Divided by 12 months this is 232 sales per month. Year to date we have seen 1,617 closed sales, which represents about 9.5 months of activity, or about 170 sales per month, which represent a 26.7% drop in activity by number of units. When corrected for price the dollar volume of home sales has dropped from 143 million per month to 72 million per month, nearly a 50% drop in dollar volume.

Thanks for taking the time to read our newsletter about the Long Beach real estate market. We invite your calls should you have any specific questions. We always enjoy meeting new people, and as always, consultations are 100% free with no cost or obligation.

REAL ESTATE NEWS



Alamitos Heights - 377 Winslow

3 bedroom, 1.75 bath, 1,814sf., great mid-century modern architecture.
\$769,000 [More photos online](#)



Alamitos Heights - 709 Havana

2 bedroom, 1.75 bath, 1,460sf, great condition, extensively remodeled, great house!
\$695,000 [More photos online](#)

Inside.....

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Bonus:

How Much have Home Prices Corrected Since the Peak?



La Marina Estates - 6441 De Leon

4 bedroom, 2.75 bath, 2,389sf, large 8,360sf lot, custom pool home.
\$729,000 [More photos online](#)



La Rochelle - 101 Kingfisher - With 37' Boat Slip

Highly upgraded, 4 bedroom, 4 bath, 3024 sqft home, built in 2002.
\$1,275,000

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