

Foreclosure NEWS Report

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“Shadow” Foreclosure Inventory Continues to Cloud Housing Outlook

By Octavio Nuiry
Staff Writer

Have the foreclosure floodwaters crested or will a massive downpour of bank-owned “shadow inventory” in the coming months further erode an already foreclosure-saturated residential housing market?

The answer depends on who you ask. Some real estate analysts speculate that banks are deliberately holding a vast and growing shadow inventory of foreclosed properties off the market to prevent a flood of low-priced homes from depressing prices. Others argue that banks aren't reselling foreclosed homes because they are hoping for another taxpayer-funded federal bailout. Still others deny the existence of any shadow inventory, claiming that government-imposed foreclosure delays, loan modification programs and other foreclosure prevention

programs are releasing distressed properties from the clogged foreclosure pipeline.

A “Toxic Stew”

Real estate consultant Jack McCabe, CEO of McCabe Research & Consulting in Deerfield Beach, Fla., said a “toxic stew” of conditions — including a growing shadow inventory of foreclosed homes — will continue to depress the Florida real estate market for the next three years, possibly longer.

“In Florida, 23 percent of homeowners are or either in foreclosure or default,” said McCabe. “I think we have a huge wave of foreclosures coming up ahead. In Florida and many other key areas around the country, the tsunami of foreclosures will not only continue, but accelerate in the next

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My Take



Appraisers & Foreclosure Sales Bring Havoc to Housing Markets

Jonathan Miller
President/CEO,
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In many ways, the quality of appraisals has fallen as precipitously as many U.S. housing markets over the past year. Just as the need for reliable asset valuation for mortgage lending and disposition has become critical with fewer data points and more distressed assets, the appraisal profession seems less equipped to handle the changing market, and users of their services seem more disconnected than ever.

The appraisal watershed moment was May 1, 2009, when the controversial agreement between Fannie Mae and New York State Attorney General Andrew Cuomo, known as the Home Valuation Code of Conduct, became effective and the long neglected and misunderstood appraisal profession finally moved to the front burner. Adopted by federal housing agencies, HVCC — or lovingly referred to by the *appraiserati* as “Havoc” — has created just that.

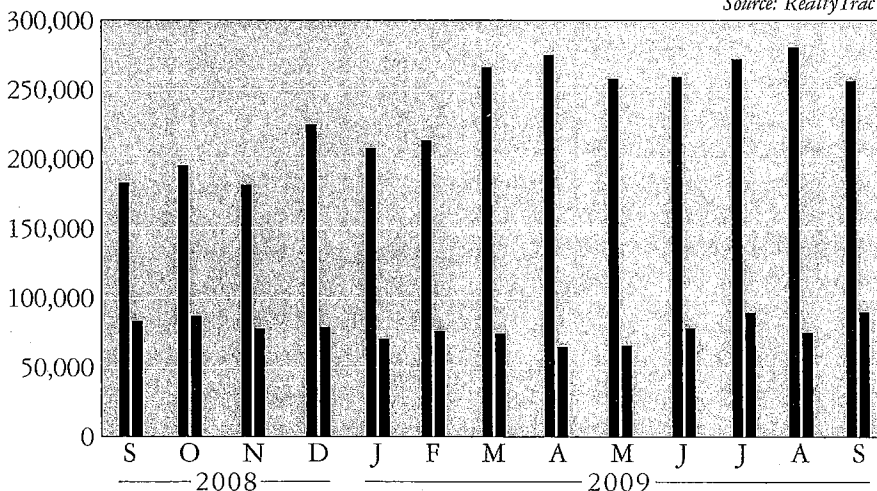
During the 2003 to 2007 credit boom, the disconnect between risk and reward became evident by the proliferation of mortgage brokers in the residential lending process. Wholesale lending boomed over this period, becoming two-thirds of the source of loan business for residential mortgage origination. Mortgage brokers were able to select the appraisers for the mortgages that they sent to banks.

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Overshadowed REOs

█ Defaults & Scheduled Foreclosure Sales
█ REOs

Source: RealtyTrac



In the Cape Coral-Fort Myers, Fla., metropolitan area, Gloria Tate, a real estate broker with Raso Realty, and a Cape Coral City Council member, sees no evidence of shadow inventory in southwest Florida. She said bidding wars are breaking out in the Cape Coral-Fort Myers market. Sales are routinely above asking prices in Florida, from wealthy Collier County towns like Marco Island to harder-hit Lee County northeast of Cape Coral.

"We don't have shadow inventory here in Cape Coral," said Tate, who works with a large clientele of local and foreign buyers, including Canadians, Russians, Germans, Swiss and other European and South American buyers. "We have multiple offers on every property here. It's crazy. The game the lenders are playing here is lowball (asking prices). For example, one waterfront home was listed for \$129,999. It sold for \$190,000 and had 15 offers. That's driving the market crazy. Those are the games we're seeing. And the cash buyer wins the game."

But Los Angeles real estate investor Reggie Brooks, author of *The Abandoned Property Investor's Kit*, argued that despite the apparent short supply in some markets, there's a vast shadow inventory for two reasons: "Number one, the lenders don't want to negatively impact the market, drastically decreasing value by flooding the market with bank-owned properties. And number two, they're waiting for better days."

Paradoxically, by holding huge inventories of vacant properties, Brooks said that the banks are exposing themselves to potential liabilities, including fire, vandalism and theft. He said he sees a "market within a market" to make money in opportunistic ways. "Why not drive the streets looking for abandoned bank-owned properties and write offers directly to the lenders. Everybody's chasing foreclosures, but few are chasing abandoned properties. There's a great opportunity out there."

Another housing expert, Thomas A. Lawler, a Virginia housing economist, agreed with Nordine's assessment that lenders are busy modifying delinquent loans or postponing auctions rather than foreclosing.

"There are a multitude of reasons a lender might not list an acquired property," wrote Lawler in an e-mail. "Some states have rights of redemption, making clear title an issue. There may be other liens. The property may not be in good (or even "up to code") standards. In fact, REO inventories haven't really been rising this year in a meaningful way. However, lenders may be purposely forestalling auction sales – the actual acquisition of the deed to a property – either (1) in the hope that they can get the borrower qualified for a government-subsidized loan modification; or (2) possibly because doing a mod – even if the bank expects the loan ultimately will go bad – pushes back the time when the bank takes a hit to earnings."

While there's no agreement to the size or causes of shadow inventory, there is evidence that it potentially exists. Rising inventories of notices of default and auction properties, compared with a decline in REO activity, hints that the lenders are either modifying delinquent loans or postponing foreclosure.

"Number one, the lenders don't want to negatively impact the market, drastically decreasing value by flooding the market with bank-owned properties. And number two, they're waiting for better days."

Reggie Brooks
Real estate investor
and author



"I'm definitely seeing more banks thinking through their options in a more rational manner," claimed Shari B. Olefson, a Fort Lauderdale, Fla., real estate attorney at Fowler, White, Boggs, and author of *Foreclosure Nation: Mortgaging the American Dream*. "It depends on the bank. Different banks have different strategies on how they process their REOs. One bank I represent has a property next to a Chorus-owned development and they're worried about prices falling. So they might end up selling."

HAMPed

U.S. Treasury Secretary Timothy F. Geithner announced last month that the Home Affordable Modification Program (HAMP) has helped more than 500,000 borrowers enter trial loan modifications with lower monthly payments. Meanwhile there were still more than 700,000 properties that entered default or were scheduled for a public foreclosure auction in the third quarter alone, according to RealtyTrac.

And the question of how successful those trial modifications will be remains very much up in the air. More than 60 percent of loans modified in 2008 are now at least 30 days delinquent, and nearly 43 percent of loans modified in the first quarter of 2009 are already delinquent, according to the Second Quarter 2009 Mortgage Metrics report released in September by the Office of the Comptroller of the Currency and Office of Thrift Supervision.

With jobless rates in September at a 26-year high of 9.8 percent and heading into double-digit levels in California and other states, several analysts believe that the foreclosure crisis will only intensify in the months ahead.

"The favorable seasonals will disappear over the coming months," warned Goodman, "and the reality of a 7 million unit housing overhang is likely to set in."

“Shadow” Foreclosure Inventory *Continued from page 1*

three years unless measures to reduce principal balances of inflated debt are finally instituted.”

McCabe believes lenders are deliberately not placing repossessed foreclosed homes on the market because they are trying to reduce property inventories and artificially control supply and demand. He fears a growing backlog of foreclosed bank-owned REOs threatens to push home prices further down.

“We are seeing some sales increases according to different indexes like the NAR numbers,” added McCabe, referring to the National Association of Realtors. “But I don’t think it covers the thousands and thousands of foreclosures that are somewhere in limbo – that are either at some clerk of courts office awaiting foreclosure proceedings, or sitting at the banks in their REO portfolios that they’re pulling off the market and not selling trying to stem the tide foreclosure sales. Banks are sitting on their non-performing loan portfolios. I think that’s going to continue the flow of the inventory.”

Not only is there a gigantic pool of unsold bank-owned repos currently on lenders’ ledgers, but there’s a massive overhang of likely-to-be foreclosed homes that has yet to hit the market, according a troubling report by Amherst Securities.

“The single largest impediment to a recovery in the housing market is the large number of loans that are either in delinquent status or in foreclosure that are destined to liquidate,” warned Laurie Goodman, a Stanford-trained economist who is senior managing director at Amherst Securities and the author of *Housing Overhang/Shadow Inventory = Enormous Problem*. “The largest problem facing the mortgage market is the ‘shadow inventory’ or ‘housing overhang’ of 7 million units. We are concerned that, in light of this housing overhang, the stabilization we have seen in home prices the last few months is temporary.”

Goodman’s research – if accurate – raises a number of questions and possibilities which real estate experts nationwide can’t agree on, primarily: When will the shadow inventory hit the market? If there’s a huge shadow supply of unlisted vacant bank-owned properties how reliable is the data Realtors post on the MLS? And, if lenders are stockpiling properties, where are all the REOs?

Most of the REOs are being held up by delays in the foreclosure process, according to Wayne Yamano, a senior manager at John Burns Real Estate Consulting in Irvine, Calif.

“A small portion of REOs are sold through auction and never show up in the MLS, but the main reason we don’t see an accurate level of foreclosure supply on the MLS is because of delays in the foreclosure process,” said Yamano. “Foreclosures are taking much longer now because a lot of lenders are trying to modify borrowers, some lenders have staffing issues and simply can’t process them fast enough, some state or local laws and moratoria are slowing the process, and some lenders may even be making a strategic decision to hold off, hoping for better days ahead.”

Underwater: Drowning in the Kiddy Pool or the Deep End

“While subprime and Option ARMs are currently the worst cohorts with underwater, we project the next phase of the housing decline will have a far greater impact on prime borrowers – both conforming and jumbo,” Deutsche Bank analysts Karen Weaver and Ying Shen wrote in *Drowning in Debt: A Look at ‘Underwater’ Homeowners*, which predicts that home prices may fall another 14 percent before hitting bottom. “We project that over the next two years, an additional 11 million households will be underwater, bringing the total to as many as 25 million households. In the meantime, we don’t expect a quick turnaround of the housing market due to weakness in labor markets, excess supply and continued un-affordability in some regions.”

What banks do with repossessed properties is one the biggest unknowns for Realtors nationwide, according to Bryan Pellican, a real estate broker with American Realty & Property Management in Las Vegas, Nev., who sees plenty of evidence of shadow inventory in Nevada, where banks are delaying the foreclosure process to negotiate loan modifications, short sales and bulk sales.

“Anybody in Vegas that bought or refinanced in the last five years is underwater,” said Pellican, one of the top REO agents in Las Vegas. “In Vegas 90 percent of these people are upside down.”

Pellican, who believes further price declines are inevitable and that the housing crisis will last for four or five years, said the Deutsche Bank numbers are “believable” but “right now no one agrees on what shadow inventory is. And the problem is much larger than people want to admit.”

Experts agree that the foreclosure numbers will almost certainly rise. Not since the Great Depression has a larger share of American homeowners owed more on their homes than they are worth. With the collapse of the housing boom, nearly 15 million homeowners, or 29 percent of the 51.6 million total mortgage holders, are underwater.

That’s more than double the percentage just a year ago, according to a new estimate of the damage by Moody’s Economy.com.

But not everyone believes there’s a shadow housing market. In Southern California, Leo Nordine, one the leading REO brokers in Los Angeles, believes federal and local political pressure is redirecting many potential foreclosures into more politically palatable outcomes.

“I don’t see a tidal wave of shadow inventory coming,” predicted Nordine, called the South Bay’s reigning king of REO sales by some and who sold one REO every day last year. “What I am seeing is a lot more bulk sales and loan modifications. And some of the lenders have converted their REO departments into loan modification departments.”