



Underwater borrowers further constrain low-inventory housing market

By SAMANTHA HENRY, The Daily Transcript
Wednesday, October 17, 2012

Underwater borrowers in San Diego County are contributing to pent-up demand resulting from a lack of inventory, which is causing multiple offers on homes and prices to increase slowly, according to local real estate experts at a roundtable discussion hosted by *The Daily Transcript* and sponsored by the San Diego Association of Realtors.

“Twenty-five to 30 percent of the market is in negative equity. If you count closing costs and transaction costs, it’s probably a higher percentage than that,” said Michael Lea, director of the Corky McMillin Center for Real Estate at San Diego State University. “Those people aren’t going to be trade-up borrowers. They’re not moving, and so that’s going to be a drag on inventory on the overall market for some time to come.”

There are 178,000 homeowners in San Diego County mathematically upside-down, said John Altman, owner and broker at **JT Altman & Associates**. That’s going to keep the supply constrained and positive for prices, according to Lea.

Lou Galuppo, of **Galuppo & Blechschmidt**, said the shadow inventory of the underwater borrower is “artificially constraining” the market.

“Banks can hold onto properties today. They can hold on for a very long period of time and keep dealing with them, and it exists today. How do I know? I deal with them every day,” Galuppo said. “I deal with banks in San Diego with borrowers in San Diego that we’re trying to do a work-out on or do something else without the filing of the NOD (notice of default). There’s a tremendous shadow inventory out there that is either going to get absorbed at some point in time or, it’s going to get worked out. How long that’s going to be, I don’t know. We’re seeing it anywhere from six to 18 months just in the work-out process with one person.”

Countywide, there are 1.9 months of inventory, according to Altman. For homes less than \$700,000, there are only 1.3 months of supply, and for homes priced at more than \$700,000 there are 6.3 months.

“The under \$500,000-\$600,000 is a seller’s market, as it appears, and over it is a buyer’s market,” Altman said. “So the seller moving down is competing with first-time buyers and the cash investors — the flippers. Year to date, 27 percent of the deals through MLS (multiple listing service) have been cash transactions.”

The flippers are buying homes and causing prices to rise, and creating a competition that first-time homebuyers can't beat.

“The buyer flippers are coming in, they're flipping these houses. Well, now you see first-time homebuyers trying to get a house in Clairemont for under \$450,000 and there are eight offers on it, and there's absolutely no supply,” said Brian Nelson, president and principal of **South Coast Commercial**. “And how are [first-time homebuyers] going to come up with 20 percent, 30 percent down to compete with all of the flippers? It's just not going to happen.”

Mark Riedy, executive director of the Burnham-Moores Center for Real Estate at the University of San Diego, said the demand right now may be artificial, and the houses purchased by investors are going to come back on the market, possibly quicker than if a homebuyer had purchased the property.

Investors are also starting to look at the higher priced homes, Altman said, and 26 percent of the deals on homes priced more than \$700,000 were cash deals.

“They have to because there's so much competition down below,” Galuppo said.

The competition among multiple offers is slowly bidding up the prices in some areas.

“Every market is going to have its own price trends and they're going to move more than others, and some are going to come down more than others. So the percentage increases don't mean the same thing, necessarily,” Riedy said. “They are going to go up at varying paces across the county and not nearly what you'd expect, given the limited inventory of for-sale houses.”

David Bright, founding partner of **White & Bright**, referred to the competition as a “feeding frenzy.”

“I can't see the prices not increasing as a result of the pent-up demand and the feeding frenzy that's going on,” Bright said.

Appraisals are another obstacle for the housing market, Altman said.

“How do you appraise a house that's a market-rate house and not bring the value down? I have to believe that's still a drag on the market,” Riedy said.

Altman gave the example of a house that was purchased for \$310,000 and the buyer put \$50,000 into it and is trying to sell it for \$425,000, but the \$310,000 comparable is being put into the transaction — “that's not a comp anymore,” Altman said.

There are 127,000 owner-occupied properties that were bought between 1997 and 2002, Altman said, and those people are potential candidates for the move-up market.

There were 35,000 transactions in the last 12 months through the MLS, according to Altman, and at the peak there were between 38,000 and 40,000.

“The market is coming back with no inventory,” he said.

The Realtors are having a difficult time competing with the multiple offers as well, and are forced to make offers look more attractive and making sure the buyers are preapproved.

“I think it’s a difficult world out there for a Realtor today. You write a lot of offers, and it’s a struggle just to get one of them accepted,” said Donna Sanfilippo, president of the San Diego Association of Realtors. “And it’s not necessarily the flippers that are buying them out; it’s their fellow buyers out there, the first-time buyers. The pent up demand is just incredible, and the Realtors see it.”

Bright works with the California Association of Realtors and asked the hotline attorneys about trends in the marketplace. One of the biggest complaints they receive, he said, are pocket listings. In these situations, the brokers sign an agreement with the seller, but do not place the listing on the MLS and don’t cooperate with other brokers.

“Offers are made and submitted to that agent, but you never hear again because the agent is waiting to double in both sides,” Bright said. “Buyers agents are calling up [the hotline] and saying ‘my offer disappeared in this black hole.’”

Sanfilippo said SDAR hasn’t gotten many complaints about pocket listings, but they do exist.

“I teach ethics for the association and I get agents coming through, both renewal for license and affiliation, and that is one of our major problems that is mentioned,” Altman said. “And one of the questions I ask the agent is, ‘Have you filed a complaint?’ and the answer is ‘no,’ and I say, ‘If you’re not part of the solution, you have to recognize you are the problem. You have to do something about this.’”

The recovery is more prolonged than what was experienced in previous cycles, Riedy said, because the market is “more dysfunctional” than it had been.

“It’s kind of like coming out of L.A. rush hour when you’ve been stuck in traffic and it’s pretty bad — the recession — and then you take off and you think you’re going to pick up speed. You don’t know ahead of you is another traffic blockage, and so you’re just barely moving forward and all of sudden you start slowing down,” Riedy said.

The underwater mortgages, without job growth and income growth, are inhibiting growth in the economy, he said. The Federal Reserve keeping short-term interest rates low shows that it’s probably not seeing good times ahead.

“We’re in a liquidity trap. You can push all the money into the economy you want with a QE3, but if people don’t have the confidence to spend it, or if they’re just concerned where that blockage on the highway is, they’re going to sit on it for a while longer,” Riedy said. “We don’t know how long or how far that traffic jam is going to go on, but I think it’s there and I think

we're still in it. We haven't gotten up to cruising speed and I don't know that we're going to for another few years in the residential business.”

Roundtable Participants

John Altman, Owner & Broker, *JT Altman & Associates*

David Bright, Founding Partner, *White & Bright*

Lou Galuppo, Managing Shareholder, *Galuppo & Blechschmidt*

Michael Lea, Director, *Corky McMillin Center for Real Estate, San Diego State University*

Brian Nelson, President/Principal, *South Coast Commercial*

Mark Riedy, Executive Director, *Burnham-Moores Center for Real Estate, University of San Diego*

Donna Sanfilippo, President, *San Diego Association of Realtors (sponsor)*