FOCUS ON REAL ESTATE

Caution! Not All House Prices Have Declined

BY PAUL G. JOHNSON, CRE, MAI

A DAY DOES NOT GO BY WHEN THE NATIONAL and international press do not report with great authority that house prices, typically a median, have declined significantly—across the board, for all markets, for all price ranges, worldwide. Wall Street blames most of its woes on the "subprime" problem, alleging that [delinquent] mortgages are now higher than the declining house values. This is misleading. The reality is that today's databases include an extraordinary number of distressed (subprime) transactions, which distorts the true price behavior, especially as compared with historically healthier property markets—or at least, healthier property owners.

My Uncle Joe, a past national president of the former United States Savings & Loan League and an advisor to presidents, had a simple underwriting mantra, "Paul, the only time a loan goes bad is when the borrower can't make the payments." If only Wall Street had listened to Uncle Joe!

The problem with these headlines, as is often the case, lies in the databases from which these dire circumstances are calculated. Most databases are based upon county assessor or county recorder public records (assuming disclosure) which, best case, include all recorded transactions regardless of validity. Usually, every foreclosure, every short sale, every quit claim deed, every bailout, every payoff, etc., is included in the unfiltered, unexamined, global databases relied upon by the media and their sources. Let's call this Dirty Data.

Real estate professionals recognize that the legal definition of Market Value assumes, among other things, that sellers are "willing." Clearly, many of the transactions in these Dirty Databases did not include willing sellers, and said transactions should not be included in any analysis addressing "Value." Thus, when microscopically examining the market, it would be appropriate to recognize that the national and local media are dealing with Dirty Data when comparing median prices over time.

Regardless of Dirty Data for the moment, by definition there are as many sales above the median as below. So, when contemporary databases with distressed transactions are processed by various software programs, the resultant median includes the Dirty Data—much more than might be found in the same databases two or more years ago.

The practical problem is that it is impossible or, at a minimum, too costly to filter all the data in order to exclude the distressed and non-market transactions which distort historic median comparisons.

This is not to suggest that there is not a serious problem on Wall Street. There is. Securitization, new products and

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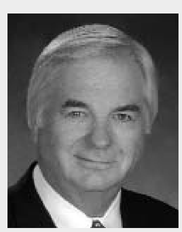

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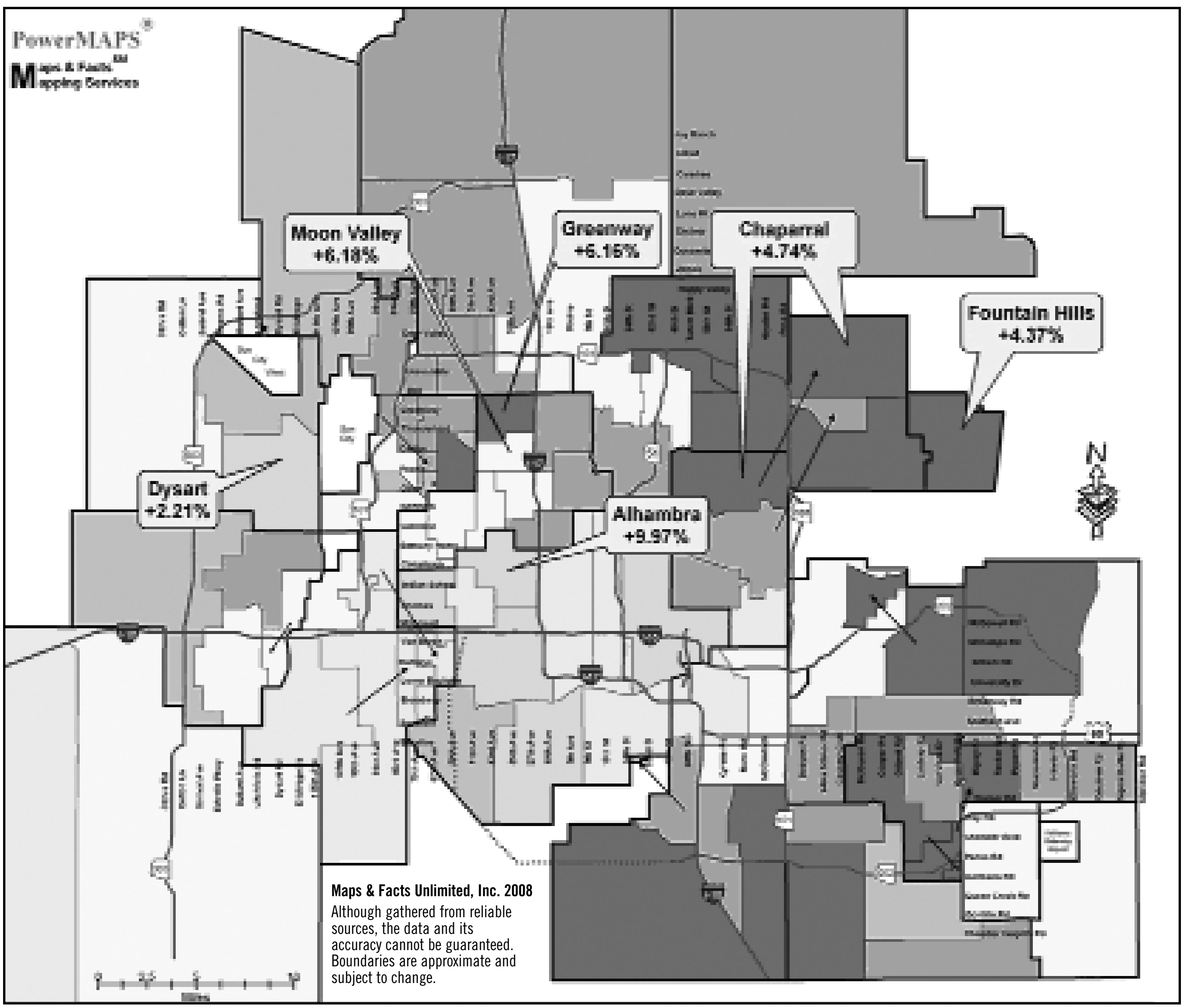
relaxed regulations have enabled the unsound lending and underwriting practices which have led to our current crisis. However, at the Main Street level, not all property values have declined. If the distressed, non-market transactions were excluded from the databases relied upon by the national press and/or their sources, the comparative results would be far different and less frightening. Believe it or not, absent distress, some sub-markets may have appreciated.

Maps & Facts Unlimited, Inc., in Phoenix, Arizona, has been tracking residential appreciation rates based upon paired (not median) sales since the early 1990s. Paired sales compare sales and resales of the same property expressed as an annual change rate or percentage.

In December 2007, Maps & Facts examined paired sales in six geographically diverse high school districts in Metropolitan Phoenix to study their respective paired appreciation rates from January 2005 through November 2007. These districts were selected geographically based upon their size and the number of paired sales during this comparatively narrow time period. Initially, the raw Dirty Data mimicked the national press reports that prices had declined significantly. However, on closer examination, it was apparent that a significant percentage of the "sales" (perhaps 25 percent) were not sales but represented distressed (subprime), non-market transactions and outliers.



The map shows that after excluding the Dirty Data, from January 2005 through November 2007, prices actually increased.

In conclusion, absent a distressed seller or lender, housing prices have not only held steady since early 2005, but may have experienced the historical normal appreciation rate of three to six percent per year.

While the data is Metro Phoenix-centric, given Metropolitan Phoenix's size, record new construction, resales, and population growth statistics, Phoenix is easily an excellent proxy for the U.S., if not international markets with similar subprime lending practices. ■