



STONECREST'S REO INVESTMENT PORTFOLIO

Market Recap Report

In 2008, foreclosure filings were up 81% from 2007. The Wall Street Journal reports that more than 2.3 million homeowners have faced foreclosure last year. According to RealtyTrac, a foreclosure listing firm, more than 860,000 properties were actually repossessed by lenders. Economy.com predicts that the number of homes lost to foreclosure will rise this year before tapering off slightly through 2011. Due to a large number of foreclosures coupled with the current economic crisis, consumer confidence in the real estate market has declined, and so have the prices of single-family homes.

The American housing market is far from hitting bottom in the opinion of the Manager. Home prices across much of the country are likely to fall through late 2010, economists say, and in some markets the trend could last even longer depending on the severity of the anticipated recession. In hard-hit areas like California, Florida and Arizona, the grim calculus is the same: more and more homes are going up for sale, but fewer and fewer people are willing or able to buy them.

Adding to the worries nationwide are rising unemployment, falling wages and tightening underwriting standards -- all of which will reduce the already diminished pool of would-be buyers. "The No. 1 thing that drives housing values is incomes," said Todd Sinai, an associate professor of real estate at the Wharton School at the University of Pennsylvania. "When incomes fall, demand for housing falls."

One reliable proxy of housing values -- the price to rent ratio -- indicates that in many cities prices are still too high relative to historical norms. In Miami, for instance, home prices are about 22 times annual rents, according to analysis by Moody's Economy.com. The average figure for the last 20 years is just 15 times annual rents. The difference between those two numbers suggests that a home valued at \$500,000 today might be worth only \$341,000 based on the long-term relationship between prices and rents. The price-to-rent ratio, which provides one measure of how much premium home buyers place on owning rather than renting, spiked across the country this decade.

Additionally, the coming resets in the option ARM loans won't peak until the end of 2009 with very strong numbers of resets continuing through 2010. Rumors are that the lenders will aggressively adjust these borrowers' interest rates to make it attractive to stay in an over-encumbered house. If this strategy succeeds, the long term affect will be a far fewer real estate sales. Even if you can live with the payment, how will you be able to move if you owe more than the house is worth? Statistics have shown that over fifty percent of modified loans go back in to foreclosure within one year.

The current housing downturn is much more national in scope and severe than any other in the postwar period, partly because of the proliferation of risky lending practices. Today, foreclosures are running ahead of the downturn in the economy, a reversal of previous housing slumps. "We are in uncharted waters," said Brian A. Bethune, an economist at Global Insight, a research firm.