

# United States Housing Outlook

October 2010



The following outlines The Concord Group's ("TCG") analysis and outlook for the national housing market. TCG's conclusions draw from demographic and employment driven demand assessments, as well as various tools for evaluating supply levels and absorption velocity nationally and in 16 new home markets across the country. Housing market recovery timing drives immediate acquisition, planning and disposition decisions.

## Executive Summary

The Concord Group ("TCG") has analyzed the current state of the U.S. housing market and forecasted national and regional dates for recovery. Key findings and conclusions discussed in this report include:

- Unemployment and foreclosures continue to weigh heavily on the housing market, although both have exhibited improving trends over the past 12 months
- New home sales volumes and average prices showed sustained improvement in the first four months of 2010 but have weakened significantly following the expiration of the government housing tax credit in April
- New home sales volume in 2010 projected to reach record-low 400,000 units, down 70% from 2005 peak
- New home pricing down 2% from 2009, 15% from 2007 peak; same product pricing down 30%+
- Improving sales volume in 10 of 16 markets TCG tracks, buoyed by lower-priced properties and foreclosure sales
- Flat or improving sales prices in 11 of 16 markets TCG tracks may signal beginning of national rebound
- Current national supply of homes, finished lots and competitive foreclosures total 1.36 million units
- National new home sales recovery – defined as 3-4 sales per month per project, single digit appreciation and demand for new finished lots – forecasted for end of 2012
- Demand for new finished lots expected to precede recovery by 12 months, forecasted nationally for end of 2011
- Recovery in lower-inventory markets with improving fundamentals forecasted for end of 2011/beginning of 2012

## 2010: Mixed Signals

Thus far, 2010 has been a case of mixed messages for the United States economy. Year-to-date, key indicators such as the unemployment rate and foreclosure filings are up over the prior year, signaling continuing weakness. Despite these trends, consumer confidence has remained significantly up over 2009's historic lows, pointing to optimism amidst the turmoil.

Housing metrics have exhibited mixed signals as well in 2010. The first four months of the year suggested a strengthening market

for new home sales, with volumes up over 10% and prices up 5.6% over the prior year. Consumers were likely spurred on by a combination of historically low mortgage rates and an extended government tax credit, as well as a general sense of an improving economy. Following the expiration of the tax credit at the end of April, however, the new home market has come unraveled, with volumes and prices significantly below their prior year levels: sales volume for the period of May through August was down 26% from the same period in 2009, and prices were down 4.6%.

Indicator	YTD Avg/Sum	Change Y/Y	LTM Trend
Inflation	1.8%	274.7 basis points	Upwards
Unemployment	9.7%	73.8 basis points	Downwards
Mortgage Rate	4.8%	-29.8 basis points	Downwards
Foreclosures	2,318,699	3.9%	Downwards
Consumer Confidence	53.6	10.3 points	Upwards

YTD figures are through August 2010 (through September 2010 for mortgage rate and consumer confidence).  
Sources: BLS, Freddie Mac, RealtyTrac, Conference Board

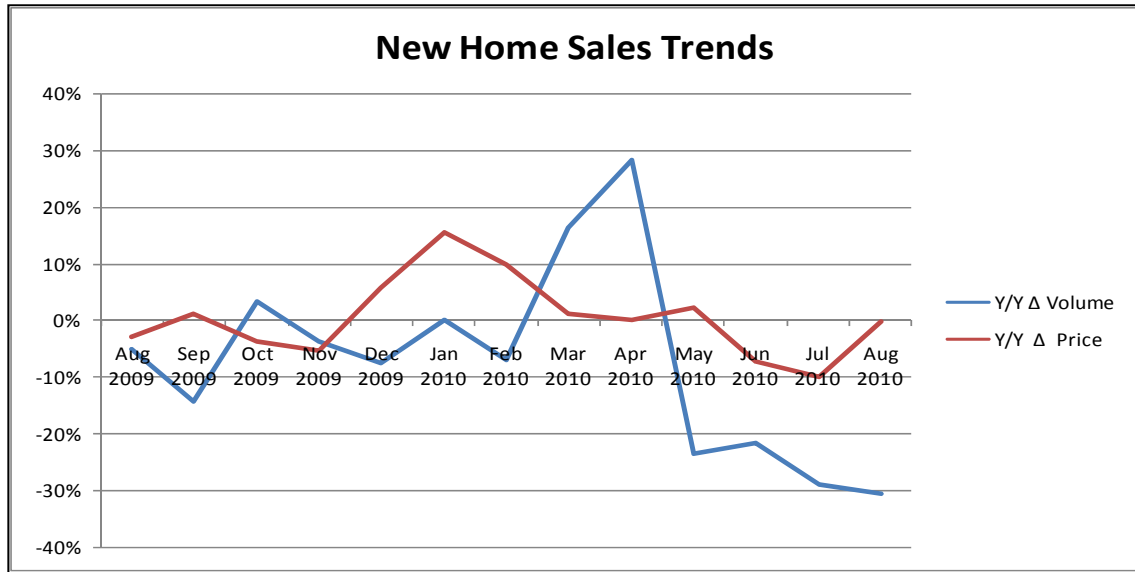
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Some home builders, especially national public builders, have been caught unexpectedly by the stagnation of the past few months. At the beginning of the year, builders began to buy into the larger metro areas and developments on the strength of improving sales volumes and prices, ending up in bidding wars for finished lots. Finished-lot prices rose 20% nationally, and by as much as 60% in some metro areas, relative to early 2009 “trough” prices. As a result of the recent declines seen in the housing data, a number of these builders have been forced to renegotiate deals or walk away altogether.

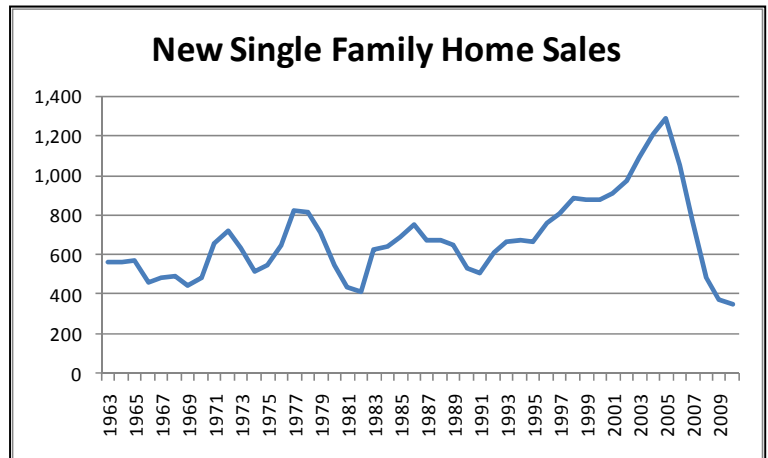


Source: U.S. Census Bureau/HUD

### Is this the Bottom?

With just under 400,000 projected total new home sales (353,000 single family home sales), 2010 will go down as the year with the lowest sales level on record – dating back to 1963. New home sales are down approximately 70% from their 2005 peak levels nationally. In the major metro markets that TCG tracks, new home sales are down between 43% and 86% from their respective peaks. The question on everyone’s mind in the real estate industry is: “when we will hit the proverbial bottom of the market?”

Although declines are projected this year for new home sales and prices, the rates of decline are much lower than in recent years. TCG forecasts that new home sales volume for the year will be down approximately 5% from 2009. This is significantly lower than the declines of the previous four years, which ranged from -22% to -60%. Projected new home price declines (of less than 2%) have also slowed compared to the previous two years, bringing the price of the average new single family home to 2003/2004 levels.



Source: U.S. Census Bureau/HUD

Metric	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 (1)
<b>New Home Sales (000s)</b>											
Single Family Detached	877	908	973	1,086	1,203	1,283	1,051	776	485	375	357
Attached (2)	97	101	108	121	134	143	117	86	54	42	40
Total	974	1,009	1,081	1,207	1,337	1,426	1,168	862	539	417	396
Y/Y Change	-0.3%	3.4%	6.7%	10.4%	9.7%	6.2%	-22.1%	-35.4%	-60.0%	-29.3%	-5.2%
<b>Average New Home Price (\$000s)</b>											
Single Family Detached	\$207.0	\$213.2	\$228.7	\$246.3	\$274.5	\$297.0	\$305.9	\$313.6	\$292.6	\$270.9	\$266.3
Y/Y Change	5.5%	2.9%	6.8%	7.1%	10.3%	7.6%	2.9%	2.5%	-7.2%	-8.0%	-1.7%

(1) 2010 sales annualized based on Jan-Jul data; Average price represents Jan-Jul 2010  
 (2) TCG estimate  
 Source: U.S. Census Bureau/HUD

Sales volume has actually improved in some segments. New single family home sales volume is up year-to-date in the Northeast region, driven in large part by limited supply. In the 16 major metro areas that TCG tracks, new home sales volumes (all product types) were up year-over-year in 10 of the markets in the most recent quarter.

Distressed properties are attracting bargain hunters, especially for attached product. Over a quarter of all home sales in the first half of the year represented properties in some state of foreclosure. For the year, volume for resale condominiums nationwide is projected to grow by 7% from 2009 levels, helped in large part from REO sales.

An emerging segment that has been attracted to distressed properties is the foreign buyer. Representing approximately 7% of all buyers, foreigners have been lured by a weak dollar, price declines, a strong rental market, and the stability of the United States government. This segment may become an increasingly important one for certain metro areas - this year in Phoenix, for example, Canadian home buyers reportedly outnumbered California buyers for the first time.

Market	Y/Y Volume Change	
	Q end 4/10	Q end 7/10
Santa Clarita	-27.6%	166.7%
Orange County	27.3%	78.1%
Las Vegas	25.6%	49.5%
San Diego	3.8%	24.4%
Tampa/Sarasota	-3.2%	16.9%
Washington DC	18.8%	16.7%
Orlando	-10.6%	14.7%
Raleigh	-11.6%	14.2%
Denver	-3.3%	7.8%
Inland Empire	-12.4%	1.1%
Seattle	11.7%	-3.2%
Phoenix	-2.0%	-4.7%
Dallas	-15.0%	-8.2%
San Jose	0.0%	-11.6%
Sacramento	-32.1%	-13.5%
Coachella Valley	-2.3%	-30.5%
<b>Metro Average:</b>	<b>-2.1%</b>	<b>19.9%</b>

Source: The Concord Group; DataQuick; NAR; US Census Bureau

Market	New Home Price		
	New Home Average	Same Product Δ	
		Y/Y	Q/Q
<b>United States</b>	<b>\$268,600</b>	<b>-1%</b>	<b>2%</b>
Orange County	633,000	2%	2%
San Jose	573,700	2%	1%
San Diego	484,600	0%	0%
Santa Clarita	458,300	0%	0%
Seattle	356,900	-3%	0%
Washington DC	414,700	2%	1%
Sacramento	306,400	0%	0%
Inland Empire	309,900	2%	2%
Raleigh	269,300	-2%	-1%
Dallas	204,200	0%	1%
Orlando	214,000	-3%	-2%
Denver	320,100	1%	-1%
Las Vegas (Detached)	240,700	-4%	-1%
Tampa	180,400	0%	-2%
Phoenix	227,500	0%	0%
Coachella Valley	336,200	-4%	-2%

Sources: The Concord Group; DataQuick; Hanley Wood; US Census Bureau

Many potential domestic buyers continue to be wary of purchasing as the employment situation remains bleak. However, unemployment is actually down from its peak at the end of 2009, and has been trending downward over the last 12 months. Forecasts call for a continuing improvement in the jobs market over the next two years, although unemployment is still expected to remain above historic averages. An improving trend over the past 12 months can also be seen in foreclosures filings as well as in consumer confidence, suggesting a potential impending thawing for the real estate sector.

Same-product new home prices were flat or up in 11 of the 16 markets that TCG tracks. This may signal that prices are approaching their bottoms nationally. Speculator-heavy markets such as Orlando and Las Vegas, however, experienced continued price declines as a result of foreclosure properties.

The U.S. government continues to debate ways to turn around the country's housing market. Quantitative easing has helped push mortgage rates to record lows, and a second round of asset purchases by the Fed may be on the horizon. While it is unlikely to make headway given upcoming elections, talk of yet another housing tax credit has recently surfaced. It is unclear at this time what impact either of these steps would have on the residential market.

**Recovery Forecast**

TCG develops forecasts for: a) a recovery in the retail home market and b) renewed demand for new improved land. Home market recovery is defined as an environment where builders can expect 3-4 home sales per project per month and single digit price appreciation. Land recovery is defined as an environment where raw land holders will find a strong market for new finished lots. Both recovery timelines depend on demand recovery and working through the current overhang.

**National**

TCG estimates that the current national overhang totals 1.36 million for-sale units (all product types). This total includes 210,000 currently selling homes and lots, 560,000 completed finished lots, and nearly 590,000 competitive foreclosures (calculated on homes built since 2003).

To get through this overhang and return to a normalized absorption level, TCG assumes 3 different scenarios: (1) continued absorption at recent sales levels from the last 12 months; (2) absorption based on demographically-driven, income-qualified demand; and (3) a “blend” of the current run rate and the TCG demand model.

At the current rate of 400,000 total sales per year, the current overhang represents 41 months of supply, with an expected return to normalized absorption rates by the end of 2013. This is assumed to be a “worst-case scenario,” as national new home sales over the last 12 months have been at historic lows, significantly below the average of the past 45 years. Between 1963 and 1999, sales of new single family homes averaged nearly 630,000 per year, and were over 1 million in the “boom” period between 2000 and 2007 (adding condominium sales would increase figures another 11%).

TCG’s housing demand model incorporates published employment forecasts, structural household growth, turnover and obsolescence. TCG also utilizes conservative financing assumptions to adjust for the tightened credit market. Within this framework, TCG projects long-term annual new home demand potential in the United States to be 890,000 units per year. At this rate, the current overhang represents 18 months of supply, with an expected return to normalized absorption rates by the first quarter of 2012. This demand projection is in line with new home sales performance in the early 2000’s.

With the current economic environment, the market is unlikely to reach this demographically supported demand level for 18 months. TCG therefore assumes that the “blended” forecast of the current run rate and demand model is the likeliest scenario. TCG estimates sales for the next year will continue at current sluggish levels (400,000 units), with a recovery rate of approximately 640,000 units annually in the following year’s first half until the market returns to normalized absorption rates by the fourth quarter of 2012. This timeline is supported by broader economic forecasts (i.e. low job creation will hamper sales independent of underlying household growth) and the amount of pre-selling of current year demand during the peak years.

TCG estimates demand for new finished lots occurs when total lot supply is 18-24 months. This total supply, which includes mothballed or never marketed lots, implies a supply in active communities of approximately 12 months. (Other sources identify additional finished lots – these are generally in less attractive locations, and builders would move forward with a larger than 12 month overhang if lots are not in recovering areas). When supply reaches these levels, builders will begin demanding new finished lots to ensure availability as inventory decreases. Based on the “blended” national recovery timeline outlined above, this framework forecasts demand for new finished lots in late 2011.

	<b>USA Total</b>
<b>Supply</b>	
Standing Inventory	209,000
Lots in Actively Marketed Projects	560,000
Competitive Foreclosures (1)	<u>587,841</u>
Total Inventory	1,356,841
<b>Annual Demand</b>	
LTM Sales (2)	396,667
TCG Demographic Demand (3)	889,832
Near-Term Recovery Rate (4)	643,200
<b>Market Outlook</b>	
Months at sales rate of:	
LTM Sales	12
Near-Term Recovery Rate	6
TCG Demographic Demand	<u>9</u>
Total Months Supply (5)	27
<b>Recovery Timeline</b>	
Market Normalization (6)	4Q 12
New Lot Demand	4Q 11

(1) Based on homes built since 2003 and projected default rates  
 (2) Census Bureau/HUD; Sales increased by 11% to account for attached product sales; NAR  
 (3) Income Qualified demand for homes over \$130K  
 (4) Near-term recovery rate represents blended average of LTM sales and TCG annual demographic demand  
 (5) Represents total time to sell through all inventory given market outlook timeline  
 (6) Defined as 3-4 sales per month per project and low single-digit price appreciation  
 Note: Months Supply is current as of 08/01/10  
 Sources: US Census Bureau/HUD; NAR; RealtyTrac; HanleyWood; DataQuick; TCG

**Regional**

Projected market recovery in the new home market varies amongst the 16 metro areas that TCG tracks. For metros with relatively low levels of inventory and improving fundamentals, TCG projects that recovery (assuming a “blended” recovery rate, as discussed in the national section above) will happen as early as the end of 2011/beginning of 2012. This includes four California markets: Orange County, San Jose, San Diego, and Santa Clarita. At the other end are metro areas with significant levels of competitive inventory coupled with below-average housing prospects. For these markets, recovery in the retail residential market may not come until 2013 and beyond. This includes the sunbelt metro areas of Tampa, Phoenix, and the Coachella Valley. Despite the poor overall forecast for these distressed markets, attractive opportunities that exist in better locations in these growth metros. The remaining markets are projected to reach recovery during 2012.

Market (1)	New Home Sales (2)		Total New Home Competitive Inventory (3)	Q4 2010 Outlook				
				LTM Run Rate		Blended Rate (4)		New Lot Demand Date (6)
	LTM	% Δ 2005	Months Supply	Sales Recovery Date	Months Supply	Sales Recovery Date (5)		
<b>United States</b>	<b>396,667</b>	<b>-72%</b>	<b>1,356,841</b>	<b>41</b>	<b>4Q 13</b>	<b>26.6</b>	<b>4Q 12</b>	<b>4Q 11</b>
Orange County	2,011	-66%	3,421	20	2Q 12	16.5	4Q 11	4Q 10
San Jose	1,953	-44%	3,157	19	1Q 12	17.2	1Q 12	1Q 11
San Diego	3,483	-74%	6,442	22	2Q 12	17.6	1Q 12	1Q 11
Santa Clarita	265	-81%	1,202	54	1Q 15	22.8	2Q 12	2Q 11
Seattle	8,821	-54%	21,324	29	4Q 12	25.2	3Q 12	3Q 11
Washington DC	16,346	-43%	33,660	25	3Q 12	26.1	4Q 12	4Q 11
Sacramento	3,101	-79%	12,279	48	3Q 14	26.1	4Q 12	4Q 11
Inland Empire	6,527	-81%	24,582	45	2Q 14	26.4	4Q 12	4Q 11
Raleigh	6,314	-48%	15,724	30	1Q 13	26.8	4Q 12	4Q 11
Dallas	13,346	-69%	43,240	39	4Q 13	27.0	4Q 12	4Q 11
Orlando	10,049	-80%	33,890	40	4Q 13	27.0	4Q 12	4Q 11
Denver	5,618	-70%	19,481	42	1Q 14	27.1	4Q 12	4Q 11
Las Vegas (Detached)	6,295	-86%	26,062	50	3Q 14	28.2	4Q 12	4Q 11
Tampa	5,282	-80%	25,512	58	2Q 15	30.8	1Q 13	1Q 12
Phoenix	11,562	-79%	60,705	63	4Q 15	33.4	2Q 13	2Q 12
Coachella Valley	743	-80%	10,686	173	4Q 24	56.6	2Q 15	2Q 14

**Notes:**  
(1) LTM information current through July 2010  
(2) TCG Estimates for all sales  
(3) Competitive Inventory includes standing inventory, currently selling lots, mothballed lots and competitive foreclosures  
(4) Assumes LTM sales rate for 12 months followed by recovery rate below long-term demand forecast  
(5) Market Recovery defined as sustainable weekly home sales per project  
(6) Builder demand for newly developed lots occurs 12 months prior to diminution of Competitive Inventory

**Sources:**  
The Concord Group; DataQuick; Hanley Wood; US Census Bureau; RealtyTrac

**Opportunities**

The current economic and housing downturn is creating opportunities for investment in the housing market. TCG is bullish about the long-term opportunities for new for-sale housing in the United States given the high demographic growth for an industrialized nation, governmental support for ownership and consumer preferences. Depending on the region, the high volume of distressed assets, continued reduction in bid/ask spreads and possible overcorrection of home prices will allow for favorable deal conditions. These opportunities are predicated on liquidity in the capital markets. TCG employs a conservative valuation strategy that analyzes both liquidation and going concern assessments, with valuation driving off recovery dates that assume limited finished lot and no raw-land sales prior to recovery. In cases where the discounted cash flow value is above the market liquidation value, TCG identifies a possible favorable investment.

Specific submarkets present opportunities despite challenges to the greater region. For example, prior recovery cycles have demonstrated that absorption and pricing in master planned communities outperform stand alone development. Locations with proximity to quality schools, accessible leisure and entertainment options and diversity of jobs will also outperform recover timeframes. Submarket-level analyses will identify opportunities and constraints that diverge from the regional average.

Regions with strong long-term growth fundamentals and diversified economic bases will emerge earliest, whereas the outlying commuter markets will lag. Development of quality new housing in core employment centers is expected to be an opportunity, particularly if entitlement risks reduce competitive supply. Meeting the needs of baby boomers, including the nascent trend of their transition to urban areas, should remain a focus. In the near term, discretionary purchases for retirement and recreational purposes will continue to decelerate, though TCG supports the long-term opportunity of these assets assuming supportable pricing and appropriate location, product and amenities.

Assuming healthy market fundamentals, the release of new, exciting product has contributed to turning the market towards the end of past down cycles. However, market and consumer preferences should be studied before the release of aggressively innovative product concepts.

#### **About The Concord Group**

The Concord Group is a leading real estate strategy firm with offices in Newport Beach, San Francisco and Boston. TCG's professional consulting staff completes hundreds of assignments annually in the U.S., Europe, Asia and Latin America. Our services include market and consumer analyses, transaction due diligence and asset valuation. Recent assignments have included multiple analyses of distressed assets of commercial banks and new acquisitions for next-cycle development. We also continue to assist developer, builder and financial clients on value maximization of owned-assets. We cover all property types (commercial, residential and land), in all metro areas and work under tight due diligence deadlines.

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