



Staying In Touch With Today's Real Estate

How the Sub-Prime Loan Crisis May Affect Our Local Market

September 2007

In the August issue, we defined the sub-prime loan crisis and how loose underwriting guidelines created it. Many loans originated in 2005 and 2006 had a below-market interest rate for the first two or three years, after which the interest rate would reset. This results in a significantly higher payment that some cannot afford. Since lenders have substantially tightened underwriting guidelines, and the cycle of rampant appreciation has ended, some homeowners are finding themselves without any options.

When the homeowners cannot meet the new payments, and cannot refinance because they don't have enough equity, one of two things will happen: either the lender will take the property through foreclosure and put it on the market, or with lender approval, the owner will sell the property as a "short sale", meaning the lender will accept a payoff that is "short" of the loan amount. Both result in a new listing.

How this affects our local real estate market is simple - each of these homes will be another listing on the market. Regardless of the source of the listings, when there is an abnormally high number of listings, compared to the number of sales, prices can decline.

The Unsold Inventory Index shows how long it would take to deplete the existing housing inventory at the current sales rate. It is a measure of supply and demand, expressed in time. When the Index is between 6 and 8 months, prices are stable, and when the Index is much lower, appreciation occurs. An abnormally high Index is usually an indication of declining prices.

A dramatic difference has developed between the different areas of Santa Cruz County (see chart, calculated on August 30). Much of the county has a stable Index, whereas South County and Watsonville have a very high Index. We see a similar pattern in both Santa Clara County and Monterey County,

where more expensive areas are stable, and less expensive areas have excess supply compared to demand. How the sub-prime loan crisis affects the local market may well depend on the "big three" determinants of real estate value: Location, Location, Location. You can always find current statistics at ror.com.

In the October issue, we will discuss how we think these dramatic differences in market conditions developed, and what the future holds.

**Unsold Inventory Index
By Area**

