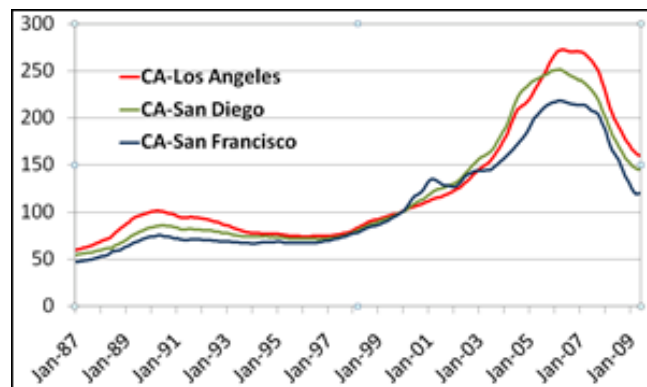


CIRIOS TRENDS

GETTING TO THE BOTTOM OF THE HOUSING MARKET



Chart of the Month:
S&P Case Shiller Index (CA only)



The State of the Markets

If there is a single trend we have been focused on here at Cirios throughout 2009, it's the divergence between high-end real estate markets and broad measures of home prices. That is, even as recent housing market data shows encouraging signs of stabilization, most well-to-do areas continue to see material home price declines.

This divergence has persisted all year, and is now being covered widely in the financial press (See *The Wall Street Journal's* recent article entitled "High-End Homes Miss Out in the Rebound").

Behind this trend is a deterioration in the fundamentals in the Jumbo Prime mortgage market, as well as the impact from job losses among even high wage earners. According to the *Field Check Group*, a mortgage data analysis firm, Jumbo Prime mortgages are now entering foreclosure at a faster clip than any other segment of the market.

In other words, just like subprime mortgages saw a spike in defaults that predated swift home price declines, mortgages held by formerly low-risk borrowers are now going delinquent at an alarming rate. This does not bode well for expensive real estate markets.

And here is where it gets interesting.

The Chart of the Month in the top right corner of this page shows the Case-Shiller Home Price Index, a widely quoted measure of property values, which registered its first monthly increase in 3-years. So that's it, we've bottomed, right?

Not exactly.

The Case Shiller Index is a value-weighted metric, meaning more expensive homes are given more weight than cheaper ones. And as higher end markets become increasingly distressed and sales activity picks up, these more expensive sales will start to drag up broad measures of home prices, like the Case Shiller. This is a dynamic [we discussed back in April](#), which is now becoming reality.

So even as pundits and real estate professionals everywhere scramble to call yet another bottom in the housing market, savvy buyers should be wary of such proclamations. Sure, while certain lower end markets are seeing signs of stabilization (against the backdrop of artificially low supply due to government intervention into the housing market), this is not so for high-end markets.

Real estate will remain, as it always has been and always will be, local. As such, any recovery will be extremely market-specific. In other words, saying the "housing market" has bottomed, or is bottoming, is meaningless.

You don't buy a house that's in the "California" market, or even the "San Mateo" market — homes are in neighborhoods and on streets. No amount of number crunching can tell you the direction of the value of a single house. Keep this in mind next time a real estate professional tells you "It's a great time to buy." It may be — but how do they know?

Housing Data Shows Signs of Life

- APRIL CASE-SHILLER HOME PRICE INDEX: -17.1% Y/Y
- MAY EXISTING HOME SALES: +3.6% M/M
- MAY NEW HOME SALES: +11.0% M/M
- JUNE HOMEBUILDER SENTIMENT INDEX: 17 (UP FROM 15)

"Saying the 'housing market' has bottomed is meaningless."

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Cirios Trends

Getting to the Bottom of the Housing Market

“Supply in Concord, CA is trending towards a more traditional (and healthy) level.”

By The Numbers - Absolute Supply

Several months ago (see *April issue*), we talked about Month's Supply as an excellent measure of market trends. Month's Supply measures the number of properties on the market compared to the current rate of sales to determine how long the current supply would last if sales continued at their current pace. While this method of analysis is extremely informative, it can sometimes mask more subtle trends within the market.

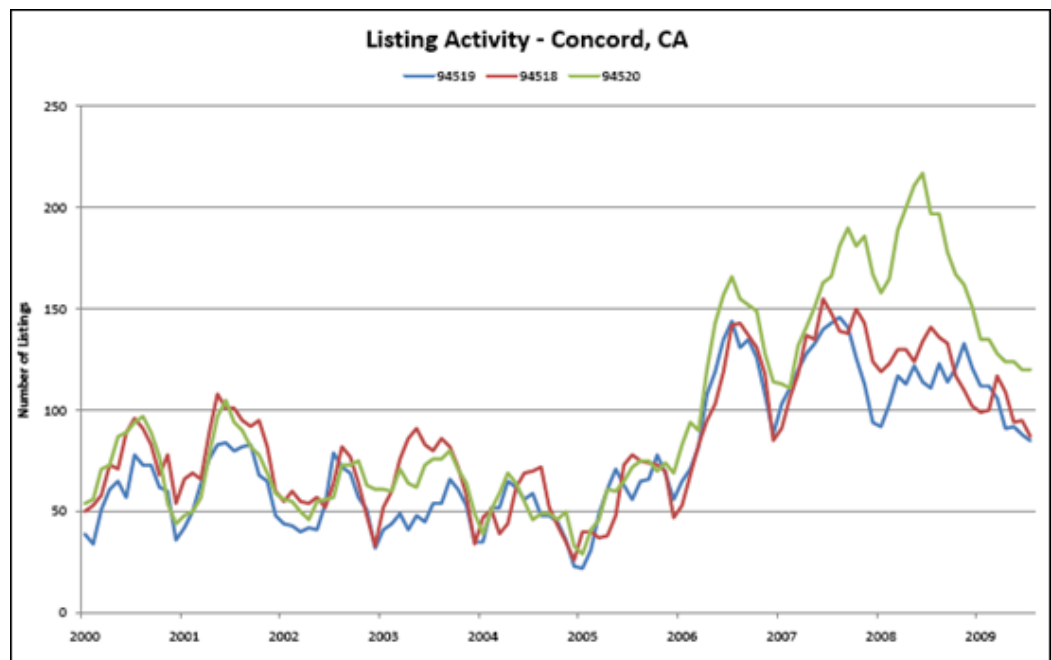
Sometimes in order to fully understand trends within a particular submarket, it is important to look at each part of the Month's Supply calculation to ascertain true market activity. This month, we'll look at Absolute Supply, as measured by total number of listings on the market in a given month, using the three zip codes that comprise Concord, CA as a test case.

Looking at the graph below, the first aspect that pops out is that these three zip codes tended to track very closely to each other on this measurement during the boom years of 2000-2005. All three measures of total listings had trended upward pretty consistently as the housing market weakened materially in 2006, 2007 and 2008. This is consistent with a generalized decrease in sales activity and longer marketing times that have resulted from the economic events of the past three years.

This graph also shows two important facts about the Concord real estate market. The first is that the 94520 zip code (green line) saw increased supply relative to the other two zip codes, to the tune of a 54% increase at its peak. This indicates that this area was seeing extreme increases in marketing time relative to the other zip codes in the area.

The second, and perhaps more important fact that this graph reveals, is that supply in all three areas has come down significantly. The 94520 zip code in particular has seen a 44% drop from the peak in properties listed. This fact, taken alone however, does not necessarily indicate anything particular about the Concord market—more analysis would be needed to make any strong statements about the cause of this supply decrease. What can be said unequivocally is that supply in this area is trending towards a more traditional (and healthy) level of listing activity. To be sure, this shift is partly due to the foreclosure moratoria discussed often on ciriosre.com, but the trend holds, nonetheless.

Looking at the number of listings in an area is only one piece of a very complex puzzle, but is a simple way to monitor and gauge market activity. The professionals at Cirios can help you see all angles of your market of interest.



Cirios Trends

Getting to the Bottom of the Housing Market

Zip Code Spotlight - San Bruno - 94066

This month's spotlight shines on a centrally located, reasonably priced, and easily overlooked section of the Peninsula, San Bruno.

“As supply pressures ease, values tend to stabilize.”



While San Bruno's proximity to San Francisco International Airport and temperamental weather are often viewed as major negatives, its central location and relative affordability compared to many nearby higher priced markets make it worth a second look for anyone looking to buy a home on the Peninsula for less than \$800,000.

Currently listed homes in the 94066 zip code range from a small 2 bedroom near the train tracks listed at \$325,000 to a million dollar plus 6-bedroom mansion. The majority of homes — 78% of all active listings — are priced below \$800,000. Bay views are common and easy access to public

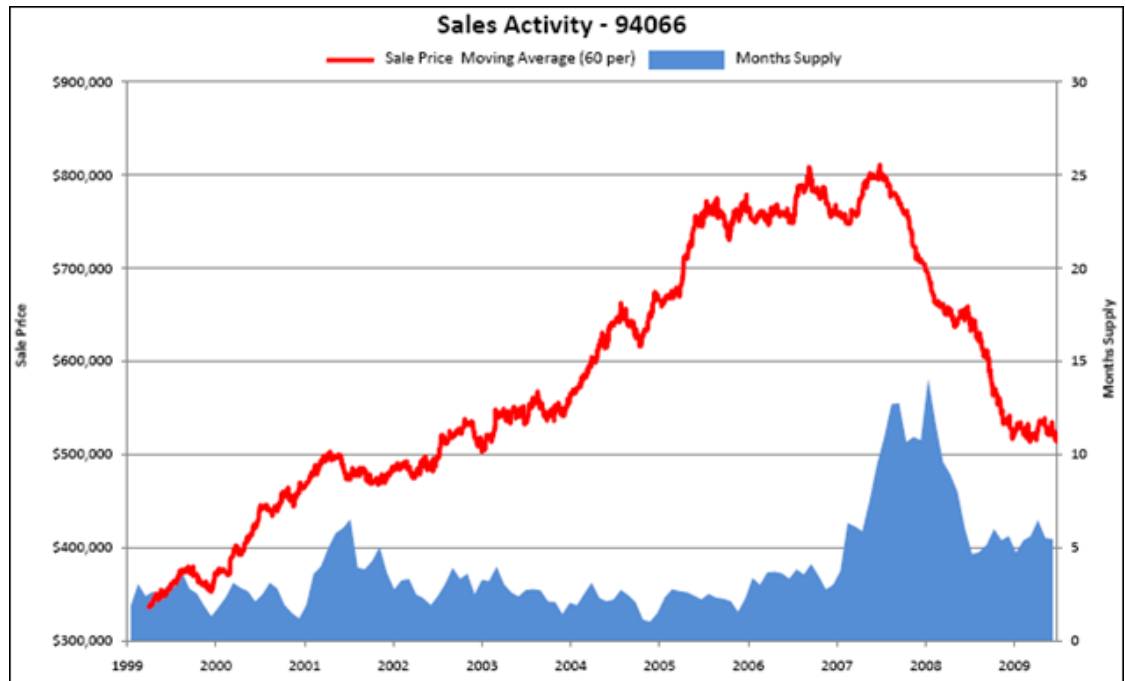
transportation to San Francisco make this area particularly desirable for those looking to live on the peninsula for well under a million dollars. Downtown San Bruno is a quaint, main street style area with several small shops and restaurants.

As can be seen in the graph below, home prices in 94066 have come down significantly since their peak in 2007. Another noteworthy aspect of the sales graph is the enormous spike in supply that occurred in late 2007. As we have explained in the past, these supply spikes correlate strongly with precipitous declines in prices.

On the flip side, as supply pressures ease, values tend to stabilize. Inventory in this area has come down of late, although it seems to have stabilized at a level slightly higher than the historic norm. Prices are likely to come down further in the near future, so a six-month wait may be in order. Savvy prospective homebuyers should probably hold out until inventory approaches lower levels to step into the market.

The public school system in San Bruno is well above average, and several local schools are standouts. Careful selection of location to assure inclusion in the right district could garner an excellent public education for your children.

In terms of commuting to San Francisco, there are several, easy options for commuting, either by car or by train.



Source: Cirios Real Estate, MLS data

Cirios Trends

Getting to the Bottom of the Housing Market

House of the Month: Huge House - Tough Location

The expression "Real Estate is about location, location, location," is well known. However, there is always a point where people will sacrifice a desirable location for an amazing home. This House of the Month tests the theory that real estate is all about location.

Neighborhood Overview: Morgan Hill became a popular southern suburb of San Jose during the housing boom because it offered buyers large new homes with a significant amount of neighborhood amenities (new parks, golf courses, grocery stores, etc). The housing downturn has been very hard on these newer developments as many of the buyers purchased homes with little or no money down. Prices have fallen by at least 50% and up to 65% in some cases. We see home values continuing to decline in the near term as credit markets remain tight and foreclosure activity seems to be increasing in well-to-do areas, like Morgan Hill.

19261 Saffron Dr., Morgan Hill, CA 95037

Original List Price: \$1,290,000
List Date: 8/6/2007
Current List Price: \$675,000
Previous Sale: \$1,026,000
Previous Sale Date: 11/23/2005
Estimated Down Payment: \$23,625
Estimated Monthly Payment: \$4,704.51*
Bedrooms: 4; **Bathrooms:** 4.5
Liv. Area: 4,182 sqft; **Lot Size:** 9,147 sqft

Positives:

- + Updated throughout
- + Huge house with 4 bedrooms
- + Well-maintained, including exterior

Negatives:

- Location: Train tracks directly across the street
- Location: Home looks at 4-lane street and mobile home park
- Location: Long commute time to most job centers

Value Approach:

Step #1 – Location

As mentioned above, the subject's location is very undesirable. This community, however, is not as distressed as other developments in the area, but the subject's particular location has a significant number of negatives — which we have factored into this analysis.

Step #2 – Data Analysis

% of Zip Distressed: 3.05% (High)
% of Zip For Sale: 0.95% (Low)
% of Zip Sold over last 3 months (year-over-year): -17.6%
Elementary School API: 801
AHA (Affordable Home Amount): \$725,062

We are suspect of the income data for this area. Even though it supports relatively high home prices, recent layoffs and a generally weak employment outlook will continue to negatively affect property values in this area. Comparing the distressed level and homes currently for sale suggests that there is a significant amount of shadow inventory in this part of Morgan Hill (for more on Shadow Inventory, please see: [Keepin' It Real Estate: Beware](#))



The False Bottom in Housing). In other words, with foreclosure activity that high, there should be more homes on the market than there are, suggesting banks are not listing all the properties they currently own.

Step #3 – Comparable Properties

Go to www.ciriosre.com to see a CLEAR valuation for this property

Step #4 – Value Analysis

The reoccurring theme in Morgan Hill is that buyers looking for large homes are buying in more established neighborhoods than the subject's. S1 is the only sale from the last three months in the subject's development and it is on a cul-de-sac with a significantly larger lot. However, the subject is one of the lowest listed homes of it's size in Morgan Hill so it will at least catch the attention of potential buyers. It's simply unrealistic to think that there are no buyers out there willing to overlook a poor location to have what is in effect a brand new mansion.

Cirios Value: \$625,000

Over Listed Amount: 7.4%

* Mortgage payments are based on a purchase at the list price with 3.5% down and a 6.00% FHA 30yr fixed rate loan, HOA and monthly tax cost included.

Doing Your Real Estate Homework: The New York Times Rent vs. Buy Calculator

“Determining if it’s a good time to buy requires a full review of the buyer, from their finances to their life goals.”

A common question for all first-time home buyers is – “Does it make sense for me to buy or rent?”

It’s likely that you’ll receive as many different answers to this question as people you ask it to. The majority of Realtors are going to tell you it’s a great time to buy because interest rates are low and numerous media outlets are reporting that the US is at the tail end of the recession. At the other end of the spectrum, there are people who feel like it never makes sense to buy and that you will always come out ahead financially if you continue to rent. The reality is that determining if it’s a good time to buy requires a full review of the buyer, from their finances to their life goals.

Most first-time home buyers want an easy, non-intrusive way to figure out if it’s the right time for them to buy. Cirios has searched the Web for the best rent vs. buy calculator that combines ease of use with a valuable output.

The one we recommend can be found on [The New York Times’ website](#). The basic form of the calculator only requires 5 inputs (Monthly rent, Home price, Down payment, Mortgage rate and Annual property taxes) to give you a reading on when (if ever) buying is better than renting.

Here are our tips and precautions regarding this calculator which will allow you to get the most out of this web-based tool:

Use a rental rate for a home similar to the home you are looking to purchase. If you input the rent of your one-bedroom apartment and want to see if it makes sense to buy a 3-bedroom home, the calculator will tell you it’s never a good time to buy.

Do not use an annual home price appreciation of more than 3%. At this point, it’s unreasonable to expect more than 3% annual appreciation.

Use a higher than a 1% increase in annual rent increase/decrease. If you are thinking about buying a home, it is likely that you are looking to upgrade your current living situation. If you don’t buy a home now, over the next 10 years you are very likely to be renting a larger home. As a result, you’ll probably be paying more than just your standard 1% rent increase.

(NOTE: There are advanced settings on the right side of the calculator which allow you to make the calculator more reflective of your personal situation.)

Did You Know?

Sales of \$1 million plus homes in Morgan Hill have slowed materially from the peak of the market ...

2004: 47 sales

2005: 145 sales

2006: 132 sales

2007: 89 sales

2008: 46 sales

2009: (first 6 months) 16 sales



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