THE IndependenceVoice

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With the national and local real estate markets turning positive, questions remain about the “shadow inventory” that was supposed to be holding down the market. Concerns over shadow inventory re-entering the market has kept some on the sidelines of the real estate market, while over the last five years big investors have been buying foreclosures for rehab and rental – what effect will this have on markets going forward?

Let’s understand the definition of shadow inventory:

- the number of properties owned by banks and lenders, plus
- the number of additional homes that have been foreclosed but are not yet on the market
- Properties where the owners are behind on their payments and will probably end up in foreclosure.

Real estate professionals, potential buyers, and homeowners care about ‘shadow inventory’ because it gives an idea of the amount of time it might take before the housing market returns to “normal”.

Shadow inventory in Texas

Foreclosures, shadow inventory, and short sales will always be a part of any market, even when the market is good. However, with foreclosures in Texas being less than .015 of the total number of units available, shadow inventory and short sales have not had the impact that they have had in other states.

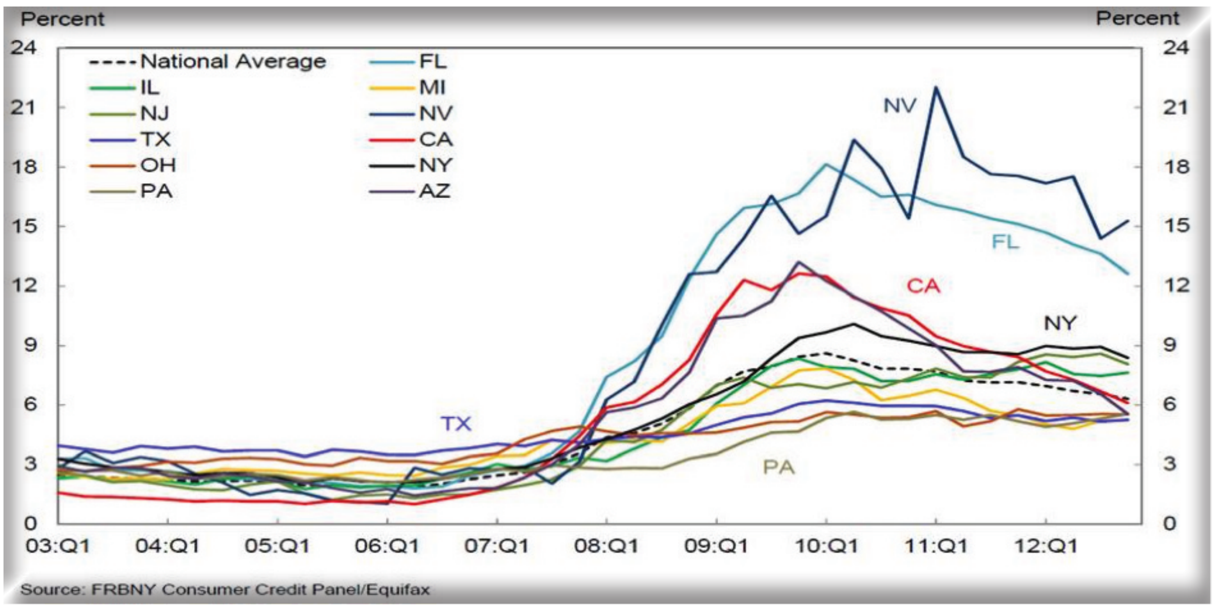
Shadow inventory has been somewhat of a non-event over the last few years. Lack of inventory, market labor, land, and material shortages will have a greater impact on values. Also the reluctance of the banks, equity groups and lenders to give discounts in Texas. It is an exception presently due to market pressures.

Let’s understand where foreclosures and ‘shadow inventory’ have a historical affect on residential sales ranked by percentage of the state markets last year;

- Georgia: 43 percent of all residential sales
- Nevada: 43 percent
- California: 40 percent
- Michigan: 35 percent
- Arizona: 33 percent
- Illinois: 27 percent
- New Hampshire: 24 percent
- Colorado: 22 percent
- Wisconsin: 22 percent
- Minnesota: 22 percent
- Oregon: 21 percent
- Florida: 21 percent

Remember, over 55% of all foreclosures in this recession were in just 32 counties - none of which are in Texas. Yes, Texas will occasionally pop up on the national top ten or 20 list of the number of foreclosures but it is due to the total volume of home sales in Texas, which far outstrips the rest of the nation. So comparatively it is a smaller amount than the other states.

One of the numbers I follow is the percentage of mortgage debt that is over ninety days late. Here is the fourth quarter of 2012, as charted by the Federal Reserve of New York comparing the last ten years. As you can see, Texas has had fewer delinquent foreclosures than most states. Another good sign of the lack of substantial 'shadow inventory'. The concern is that shadow inventory will challenge improving values. Potential buyers may sit on the sidelines, anticipating shadow inventory coming to market and driving down prices further. As you can see it is somewhat of a smaller factor for sales in Texas. Most lenders are holding foreclosures longer, because home price appreciation may help them recover or reverse their losses. So, the concern of 'shadow inventory' affecting values is minimal presently.



The worst of the foreclosure crisis may finally be behind us. Nationally, foreclosure activity fell 3% in 2012 from the year prior, with 1.8 million homes receiving one or more foreclosure-related filings, according to a new RealtyTrac report. 2012 activity was 36% lower than 2010, when filings peaked at 2.9 million properties. At first glance, it sounds like more proof that the housing rebound is here. But before you make the mistake of calling the foreclosure crisis quits, take a moment to look at your local market. Despite a lower national average, foreclosure activity is actually still on the rise in half of the country.

Before we forecast 2013, let's look at last year. In 2012, the housing market experienced a tale of two markedly different foreclosure patterns. Twenty-five states welcomed decreases in foreclosure filings including some of the hardest hit markets of the downturn. Among them: former foreclosure capital Nevada (55% decrease compared to 2011), Utah (40% decrease), Oregon (40% decrease), comeback market Arizona (33% decrease), California (25% decrease), and Michigan (23% decrease). Yet 25 states did experience upticks in foreclosure activity last year. The biggest surges occurred in New Jersey (55% increase), Florida (53% increase), Connecticut (48% increase), Indiana (46% increase), Illinois (33% increase), and New York (31% increase). Not surprisingly many of these states use judicial foreclosure, meaning the foreclosure process took a while to circulate through the court system.

The judicial process takes considerably more time than the non-judicial, hence the fact that activity has been so markedly split. Nationally, the time taken to process a foreclosure from default notice to bank repossession averaged 414 days in the fourth quarter. In nonjudicial states like Texas, Delaware and Virginia, the time frame averages less than five months; in the states with the most rigorous guidelines — like New York, New Jersey and Florida — it can take up to three years.

That's why twenty judicial states saw increases in 2012: lenders finally began processing backlogged defaults that had been in part delayed by the robo-signing scandal of late 2010. In other words, a surge in brand new defaults isn't the culprit behind increases in 25 states; the long overdue processing of delayed defaults stemming from earlier years of the housing downturn is.

Lenders repossessed fewer homes in 2012, allowing more defaulted borrowers to sell their properties in short sales. The number of bank repossessions totaled 671,251, down 17% from a year earlier. With the extension of the Mortgage Forgiveness Debt Relief Act, the short sale surge is likely to continue in 2013. Short sales typically sell for less of a discount and allow a property to avoid bank repossession.

Last year 1.1 million homes began the foreclosure process. RealtyTrac (a national group tracking foreclosures) forecasts that between 500,000 and 600,000 homes will end up being repossessed by banks nationally this year. Nationally, about 10.9 million homeowners, or 26% of all homeowners with a mortgage, were underwater (carrying bank notes worth more than the current value) on their homes by 25% or higher.

As you have heard me say time and time again, "All real estate is local." Don't make assumptions about your local market based on what the national market is doing. With that in mind, let's look at the local county numbers which continue to improve.

- Bastrop – 1 / 827
- Bexar – 1 / 1344
- Comal – 1 / 827
- Guadalupe 1/ 1561
- Hays – 1 /1377
- Travis – 1/ 2136
- Williamson – 1/ 1014
- Texas – 1 / 1824

These Texas numbers have improved every month for more than fifteen consecutive months. More good news, all numbers are filings and not actual foreclosures.

What does shadow inventory mean to Texas homeowners?

As you know, many markets in Texas are becoming seller's markets because of low home inventory. Home sales in 2008, 2009 and 2010 were sluggish all over America despite low interest rates because of job losses and falling home prices in many parts of the country. Job growth started to increase in 2011, but home buyers were still skeptical because of the possibility of falling prices. As we passed through 2012, job growth continued, mortgage rates were low and the fear of falling prices began to fade into the mist of history. With low mortgage and bank rates, there is not a better time to buy!

Inventory levels of homes for sale (as reported by the local Multiple Listing Services in each metro) are extremely low in all four metro and surrounding markets and at manageable levels elsewhere across the state. When inventory levels are high, prices can fall. Obviously the opposite is true – when inventory levels are low, prices can rise.

If you are in the process of buying or selling a home, should you be concerned with shadow inventory? Realize that although the general Texas metro markets have turned positive, each has submarkets that remain challenged, primarily due too much inventory.

Ask your realtor to pull the percentage of foreclosures and short sales in the area. They may not be able to pull it for your specific neighbor hood, but you can get a general idea if that will be a factor in your transaction.

If you are someone who likes to know hard numbers, you should find out these things from your realtor.

- What the local market area is for the home in question (which neighborhoods, subdivisions, areas)

- How are homes selling in this area? Then ask to chart it out over the last 5 years. Most homeowners hold their home for at least that amount of time. And with the recessionary market, it would be a good comparison to know how your chosen neighborhood stands against the rest of the market.

- What is the average days on market (DOM)? Take time to understand if an area's high DOM may be due to stale listings of homes that are overpriced, distressed, and/or in inferior condition.

- What is the sales price to list price ratio? In many submarkets that I review, I have seen these trend higher just in the past year.

- Track the number of pending sales in relation to the number of listings. One analyst friend of mine tracks this and calls this "market velocity." Right now, I see some areas where there are more pending sales than listings in a given submarket.

- Are the pending sales priced higher than homes that have sold recently? This is another indication of an increasing market that we are seeing in many submarkets.

- If your market had less than 10% foreclosures over the last 12+ months, there is a good likelihood that shadow inventory is a non-factor.

If you are selling your home, you should also determine:

- How many comparable homes are currently for sale? How many have sold in the last couple of months (three months, six months), and how does this compare with the number of homes that sell in a typical month?

  What you're asking about is the **absorption rate** and inventory. If six houses sold in the last six months and three are currently for sale, then your absorption rate is one home per month (six in six months) and your area has three months of inventory. You care because if you want your home to be the one most likely to sell in a given month, it has to be the best one for the best price. In general, six months of inventory in your area is considered equilibrium, and above that it is a buyer's market, below that a seller's market.

- Ask about the foreclosures that are comparable to your property and how they might affect the ability of my house to sell quickly and for top dollar.

So, is shadow inventory an issue in Texas markets? This analyst's response is 'not really.' Each submarket needs to be reviewed for its own inventory challenges and opportunities. However, it is less than 5% in most markets – a negligible amount. The Texas market is not fully recovered, but it seems to be ahead of its counterparts.

For more reading, check out Dr. Mark Dotzours article on shadow inventory in this quarter's **Tierra Grande**.

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