



in the
shade

The economy is showing signs of recovery, but some experts warn that a looming shadow inventory could stall a housing market turnaround.

By Daniel Rome Levine

Since the Cincinnati real estate market slowed down two years ago, Larry A. Whited Sr., CRS, has been doing a lot of waiting. About 80 percent of potential sellers he deals with in the suburb of West Chester, Ohio, end up telling him they want to wait until the market recovers to put their homes up for sale. “Nobody wants to sell their home in today’s market if they don’t have to,” says Whited, owner of *www.WebMLS.net*, an online real estate company.

A case in point is client Jim Trout. Two years ago, Trout and his wife decided they wanted to move from their four-bedroom house in West Chester because it was starting to get too crowded. Their three young children, Trout says, “were bouncing off the walls.”

Whited showed them several larger homes, but after six months of looking, the family decided to stay put when they realized they weren’t likely to get the \$280,000 for their house they were hoping for. “We felt like we would be leaving money on the table,” Trout says. “As soon as the market rebounds, we’re going to be out of here.”

That sentiment is exactly what has Whited and many economists and real estate experts worried. They fear there are millions of homeowners like Trout around the country who are simply waiting for the housing market to start turning around before putting their homes up for sale. This mentality — and the number of homes it represents — might just be the biggest impediment to a housing market turnaround. Experts call it shadow inventory. And if this flood of shadow inventory hits the market, it could dramatically increase supply and suppress prices, thus stalling a recovery in home values just as they are beginning to pick up.

The good news is that, on a national basis, the inventory of unsold homes on the market is receding. There were 3.6 million existing homes for sale in October 2009, according to the most recent data available from the NATIONAL ASSOCIATION OF REALTORS®, down 14.9 percent from the 4.2 million homes available in the same period a year earlier.

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LOWERS

That represents a seven-month supply of homes on the market, just about what is considered normal.

And while nobody can say with certainty how shadow inventory might impact the housing market in the coming months, a growing chorus of real estate professionals are mindful of this potential challenge. For example, at a news conference in Chicago last summer, RE/MAX International co-founder and chairman Dave Liniger said, "These shadow sellers will be feeding housing inventory for the next five years."

A Two-fold Problem

People waiting to sell their homes could be just the tip of the iceberg. Another type of shadow inventory has experts equally, if not more, concerned: the large supply of foreclosed homes that banks are holding and homes that are on the verge of foreclosure. (See graphic on page 33.) Lurking beneath the water line and waiting to hit the market are foreclosed homes that are currently being held by banks — as many as 600,000 homes, says Rick Sharga, senior vice president at Irvine, Calif.-based foreclosure research firm RealtyTrac Inc. — and homes headed toward foreclosure.

Laurie Goodman, senior managing director at Amherst Securities Group LP in New York, estimates there are 7 million homeowners in the United States who are currently not paying their mortgage and are likely to go into default. "This huge shadow inventory," she wrote in a September report, "is the single largest impediment to a recovery in the housing market."

Stan Humphries, chief economist at real estate Web site Zillow.com in Seattle, sees both types of shadow inventory as "quite a large potential problem lurking out there." Zillow's most recent quarterly survey of homeowners, released in November, found that nearly a third of those questioned would be at least somewhat likely to put their homes up for sale in the next 12 months if they saw signs of a turnaround in the real estate market. That translates into 11 million to 20 million homes perched on the sidelines waiting to hit the market, Humphries says.

"It would be horrible if everyone pulls the trigger and puts their homes on the market at the same time that banks are also flooding the market with a bunch of foreclosures," Whited says.

In the Trenches

The Phoenix housing market has been one of the nation's hardest hit by the real estate downturn — Arizona ranks second among states with the highest foreclosure rates — and Brett Barry, CRS, of HomeSmart Real Estate in Scottsdale, Ariz., has been right in the middle of the action.

Barry has been representing buyers of bank-owned homes for the past two years and has never been busier. Phoenix is seeing 5,000 new foreclosures each month, he says, and sales of bank-owned properties as well as short sales represent more than 75 percent of all transactions in the area. And foreclosures are only going up, he adds, pointing to a recent report from Deutsche Bank showing that more than 60 percent of Phoenix homeowners owe more on their houses than they are worth.

"All these upside-down homeowners are like bullets in a gun just waiting to go off," Barry says. "They are all potentially capable of walking away from their mortgages, which will mean even more foreclosures."

Banks in possession of foreclosed homes, Barry says, have no incentive to unload them because a recent change in federal accounting rules allows banks to hold these homes on their books at valuations from three to five years ago, when prices were much higher, thus making their books appear healthier. The banks don't have to report a loss until they sell the properties. That's why Barry and many other experts believe banks may be holding the bulk of their foreclosed homes off the market until prices recover and they can get more for them. There is also speculation that banks may be waiting to see if the federal government steps in and creates a new agency to purchase these foreclosed homes, the way it has done with other so-called toxic assets.

With foreclosures increasing in Phoenix and in other parts of the country, Barry says, these bank-owned homes are building up like water behind a dam. When banks do finally start placing them on the market, it is going to take years to offload all of them, he says, and that will dampen home prices the entire time.

"Unwinding this is going to take a lot longer than most people suspect," Barry says. "I think it's going to be five-plus years until we work through all these homes. We're only in about the third inning of this game."

Coping Strategies

When potential sellers tell Alexis Bolin, CRS, that they want to wait until the housing market recovers to put their homes up for sale, she goes on the offensive.

Bolin, with ERA Legacy Realty in Pensacola, Fla., does everything she can to convince these clients that it's a bad idea. "Most of these people have '06 prices on their brains," she says. "They think prices are going to go right back up next year."

Bolin believes home prices could continue dropping 12 to 15 percent in her area for another two years and says it could take a total of 10 years before prices recover to the point where people actually make money on the sale of their homes.

Bolin relies on her 30 years of experience as a REALTOR® in Pensacola when dealing with these clients and spends considerable time with them going over historical sales figures, absorption rates and other market research data to make her point. In the end, she says, she convinces about 75 percent of them that they are better off selling now.

"Once I apply some logic, they move forward," she says. "It's really a matter of education. It's our job as agents to be consultants and paint the big picture for clients using all available numbers and facts."

Shadow of a Doubt

Not everyone agrees that shadow inventory is a problem. Bruce Slaton, CRS, of Keller Williams Realty in Sacramento, Calif., says concerns about foreclosures and shadow inventory are being overblown by the media and others who are misinterpreting data.

Slaton says they are incorrectly looking at so-called notice of default filings, or letters sent from lenders to homeowners warning them that they are about to foreclose, and equating this with the number of foreclosed homes. But, Slaton points out, many of those who receive these letters end up staying in their homes for six months or longer as the foreclosure process drags out, or they end up in their homes indefinitely by modifying their loans or pursuing other means. "I don't think this [shadow inventory] will affect the market in a bad way," says Slaton.

Only time will tell whether Slaton or those with the opposite view are right. 🏠

Daniel Rome Levine is a writer based in Wilmette, Ill., and is a frequent contributor to *The Residential Specialist*.