

Gary's Think Tank: What Now?

September of 2008 was marked by one shocking shake-up to the financial world after another. Within the span of one week, Lehman Brothers declared bankruptcy, Bank of America acquired Merrill Lynch, the Dow Jones Industrial Average experienced its most precipitous drop since Sept. 11, the federal government stepped in to rescue AIG from bankruptcy, and the U.S. Federal Reserve pumped \$180 billion into money markets to stave off the seizing up of the credit markets and lending between banks.

Two days prior to the Oct. 3 passage of the Emergency Economic Stabilization Act of 2008, which authorized the U.S. Treasury to spend \$700 billion to purchase mortgage-backed securities and other distressed assets from banks, Gary Keller, co-founder and chairman of Keller Williams Realty, convened a "Think Tank" of real estate industry experts to determine the implications for residential real estate.

The following excerpt from that conversation includes the input and insights from three of the participants: Gary Keller, along with Dave Jenks, vice president of research and development, Keller Williams Realty, and Paul Wylie, founder and former CEO of Metrocities Mortgage. To listen to the complete conversation, go to AgentMountain.com and click on Mountain Radio.

Gary: Let's first review how we got here.

Paul: As we know, there had been a fair amount of pressure over the last decade to expand mortgage lending. There were specific goals that Congress gave to increase home ownership to people who typically wouldn't have qualified for mortgages.

Dave: This led to the proliferation of subprime lending and a general relaxation of mortgage qualification standards.

Paul: Fannie Mae and Freddie Mac, which pool and securitize mortgage-backed securities as well as retain loans in their portfolio, were loosening their guidelines and pushing the envelope slowly but surely. The rhetoric at the time was that home prices nationally had never declined since the Great Depression and the rest of the world bought into that and believed that these were relatively low-risk investments. But the run-up in prices could not be sustained. There was certainly a lot of talk about the bubble, but part of it was rationalized away because of the financing that was available.

Dave: Subprime lending was also a major factor in the drive-up in home prices, because it increased the pool of buyers, which drove up demand.

Gary: What it really boiled down to was over stimulation of the market, driven in part by low interest rates. And it was predictable that at some point prices were going to get out of hand.

Paul: All of the logical metrics were there, but they were ignored by consumers, mortgage professionals, real estate professionals, rating agencies and Wall Street. People rationalized it away rather than focusing on the metrics. There were literally armies of analysts in the back room looking over the assumptions. Up until 2007, the vast majority of subprime loans were rated as investment quality. By and large, mortgage-backed securities were expected to perform. And I am sure much of it was motivated by profit, but I am also

sure that some of it was with the good intention of increasing home ownership.

Gary: So relaxed lending guidelines, the pursuit of a larger percentage of homeownership fueled in part by the good intention of helping individuals who might have been left out of home ownership in the past, an increase in demand, a run-up in prices and all of a sudden, we started running out of buyers. Inventories go up, supply increases, and home prices drop. You could have argued back in 2004 that the boom market was going to come to an end.

Dave: And as you remember, we actually did. We were looking at the housing market affordability curve and watching as home prices went on an upward trajectory that was increasingly out of sync with incomes.

“

We need to point out that affordability is at its highest level that it's been in five years when you look at year-over-year comparisons.

- Dave Jenks
VP, Research and Development

”

Paul: We can go back and look at 2005, which as you know is the height of the run-up in home prices, and when you start taking a look at the percentage of purchases that were made by investors, they were astronomically high. That was another one of those red flags that the "bubble was about to burst." There was just too much speculation.

Dave: So where are we now?

Gary: It's pretty amazing. The real estate industry has been in this free-fall since the end of 2005. We're coming up on three years. That was our recession. So now, all of a sudden, we look up and we start seeing that major institutions and other sectors are in real financial trouble.

Paul: The real estate market has been marching toward its own correction to get prices back in line with affordability, going back to the beginning of 2007.

Gary: The product that we sell has been devalued by as much as 60 percent. We've seen our units go from 7 billion nationally to probably less than 5 billion this year. This is an amazing, astounding drop. When we hear about privately owned real estate businesses losing as much as \$700 million in a year, I think our industry has already taken a massive hit. And we're still standing. That's what's interesting.

Dave: And as long as mortgage money is still available...

Gary: And it is, Dave. Every house out there that's being foreclosed on has financing, because essentially, the bank already owns it.

Dave: So in your sense, Gary, is this a good time to buy, if you've got the credit or the cash?

Gary: If you're asking me what is the health or the opportunity in residential real estate, I can say this:

I just got off of the phone yesterday with an agent who is having her best year ever. Her business is already at \$680,000 GCI for the year and that's not REO based. She said she thinks she could break a million in GCI this year - her best year yet. I asked her how she was managing to have such a great year, and she said, "Well, they need us more than ever." In all of my conversations with agents this week, I didn't have one person tell me that

business wasn't just fine. Now, I can get on the phone and find people who say it isn't fine out there, but that's the choice that they are making.

What's driving the market down right now is that we have a lot of "Have to Sells" - home builders, developers, and foreclosed properties. If I had a seller right now, I'd say, "don't sell unless you have to." I saw Dave Ramsey, the author of *The Total Money Makeover* on TV a few nights ago, and he was asked where he'd put his money right now. He said that real estate was the buy of the century, not just the decade.

Dave: And we know that the market has corrected back in line with the long-term trend of four or five percent annual appreciation in home prices.

Paul: I agree. There are some amazing opportunities out there for those people who have a strategy and do their homework - as you described in *The Millionaire Real Estate Investor*.

Gary: Do you think people understand this?

Dave: Well, the media hasn't reflected it at all. All we hear is that the real estate market is in a recession. We're not hearing that the market may have, in fact, corrected. We need to point out that affordability is at its highest level that it's been in five years when you look at year-over-year comparisons. The latest figures from

the National Association of REALTORS® show a current housing affordability index of 123 - up from 119 the previous month and 106 for the same month the previous year. A housing affordability index of 123 means that the median income is 123 percent of the income necessary to qualify for a mortgage to purchase the median-priced home. The higher the number, the better, and the housing affordability index absolutely appears to be trending upward.

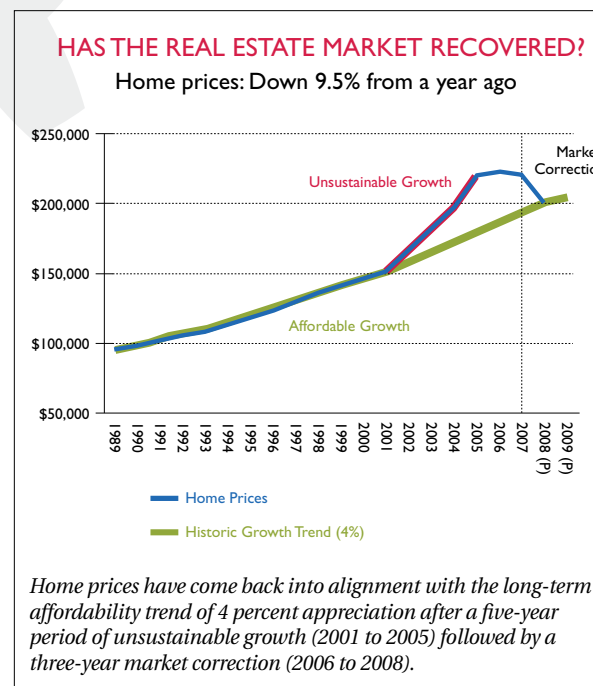
Gary: More people can afford to buy today than could a year ago. This is the time for buyers. This is what they've been waiting for - a buyer's market.

Dave: And not only are prices low, but interest rates are still very low.

Gary: Exactly, but there is always the risk at any moment of rates going up. Now is the time to act.

Dave: So as the local market economists of choice, what should our agents be conveying to their clients right now?

Gary: That it is always a great time to buy the right real estate. That we're seeing historic price drops in many areas. That it is a buyer's market and that means it is a great time to buy that right piece of real estate. Depending on the market or the individual property, it could be either a good buy or an unbelievably, beyond amazing buy.



Lead the Pack with MapTracksSM

Only \$10/mo* for Agents
Only \$20/mo* for MCs

*Includes 2,500 map transactions per month for agents and 5,000 for Market Centers. Additional map transactions are \$.003 each.

- 🐾 Increase Repeat & Referral Traffic
- 🐾 Generate More Leads
- 🐾 Close More Business
- 🐾 Gain a Competitive Advantage

Upgrade to MapTracksSM TODAY!
Receive up to 25% MORE LEADS than with IDX alone!

To upgrade instantly, simply log in to the KW intranet, manage your IDX search and then click the MapTracksSM upgrade advertisement on the right side of the page.

Or, call 1-866-WOLFNET or e-mail solutions@wolfnet.com

Neither Keller Williams Realty nor its affiliated companies warrant any product or service delivered under this program. All products and services are provided by WolfNet Technologies, LCC

