



## U.S. Housing Still Weak Amid High Joblessness & Distressed Sales

By Steven Brinkley  
Karen Gemmett  
Structured Products Group  
Standish Mellon Asset  
Management Company LLC  
("Standish")

---

U.S. housing data remains weak with very strong headwinds expected for the near term.

---

### Executive Summary

Given the central role the collapse of the U.S. housing market played in the recent financial crisis, the Structured Products Group at Standish closely monitors developments in U.S. home sales and the mortgage market. As the protracted unwinding of housing debt continues, the group points out that the latest U.S. housing data remains weak, with high unemployment and distressed selling weighing on demand and prices. In their view:

- U.S. housing data remains weak with very strong headwinds expected for the near term.
- Distressed home sales as a percentage of total sales are historically high and should weigh negatively on prices.
- A high percentage of investor and all-cash sales shows lower priced homes have good demand, while demand is weak for higher priced homes.
- The key points from the government's White Paper on Government Sponsored Enterprises (GSE) Reform suggest that mortgage credit will likely continue to tighten, and the cost to obtain a mortgage will likely increase as the government's role in the mortgage market is reduced.
- High unemployment should continue to hamper demand for housing. Employment is improving slowly, but other factors are also preventing improvement in housing.
- Government intervention is a concern. The Obama administration has stated that the housing sector would be its focus once the debt ceiling issue was resolved.
- A possible consequence of mortgage reform is tighter credit. We think the current definition of a Qualified Residential Mortgage (QRM) in the Dodd-Frank legislation is very restrictive. If banks decide to retain originations within that bucket, we believe many potential home buyers will not qualify for credit. This would mainly affect higher priced homes, which already have low demand.

---

Consistent with the seasonal nature of home buying, home prices were steady on a month-over-month basis in the spring 2011 buying season, but continue to fall compared to last year. The four major home price indices (see Exhibit 1) were flat to slightly positive in May compared to April, but are down an average of 6.0%



from June 2010.<sup>1</sup> With the spring buying season coming to an end, home sales were weak in June. Existing home sales are down 8.8% from June 2010, and new home sales continue to bounce around all-time lows.<sup>2</sup> Conversely, some of the forward-looking indices came in better than expectations.

### Leading Indicators

June was a strong month for the leading indicators. All indices had better-than-expected results.

#### Exhibit 1

Series	Period	Bloomberg Survey	Actual	Prior Month Revisions
NAHB Housing Market Index	JUL	14	15	
Housing Starts MoM	JUN	2.7%	14.6%	0.0% from 3.5%
Building Permits MoM	JUN	-2.3%	2.5%	8.2% from 8.7%
Pending Home Sales MoM	JUN	-2.0%	2.4%	

Source: Bloomberg, July 2011

The monthly U.S. Census report on building permits came in stronger than expected for June, up 2.5% from May.

- The NAHB Housing Market Index (HMI) rose in July to 15 from a 2 year low of 13 in June, and slightly beat expectations. "We view the upward movement in the July HMI as a correction from an exceptionally weak number in June that was at least partially attributable to negative economic news and the close of a disappointing spring selling season."<sup>3</sup> The index ranges from 0 (negative) to 100 (positive), so a neutral reading for this index is 50.
- The U.S. Census Bureau reported total housing starts rose 14.6% in June. May was revised down to 0.0% from 3.5%. Single family starts were up 9.4% in June from May, and multi-family rose 30.4% in June from May. Single family starts are up 0.4%, while multi-family starts are up 100.0% from June 2010. Single family starts are at their highest level since November 2010.
- The monthly U.S. Census report on building permits came in stronger than expected for June, up 2.5% from May. Single family permits rose 0.2% in June from May, and are down 6.9% from June 2010. Multi-family permits continue to be strong, rising 6.9% in June from May. Multi-family permits increased 34.0% from June 2010. Strength in single-family permits was centered in the Midwest.
- The National Association of Realtors in their June report said that pending home sales were better than expected, up 2.4% from May, and up 19.8% from June 2010. All regions were better than June 2010: Northeast 19.4%, Midwest 26.3%, South 19.1%, and West 16.4%. Despite the bounce in the Pending Home Sales Index, the Mortgage Bankers Association (MBA) Purchase Index has not increased much, which could be a sign of heavier cancellations in pending sales.

<sup>1</sup> Federal Housing Finance Agency, Seasonally Adjusted Monthly House Price Index, July 21, 2011; RadarLogic, 25-MSA RPX Composite Price Index, July 21, 2011; CoreLogic Home Price Index, July 6, 2011; Standard and Poor's, Case-Shiller Seasonally Adjusted Home Price Index, July 27, 2011.

<sup>2</sup> "June Existing-Home Sales Slip on Contract Cancellations, but Prices Stabilize," National Association of Realtors, July 20, 2011; "New Residential Sales In June 2011," U.S. Census Bureau, July 26, 2011.

<sup>3</sup> "Builder Confidence Gains Two Points in July," National Association of Home Builders, July 18, 2011.

The spring season has largely been underwhelming as existing home sales are down 8.8%, and new home sales are up 1.6% from June 2010, based on a very low 312,000 annualized home sales.

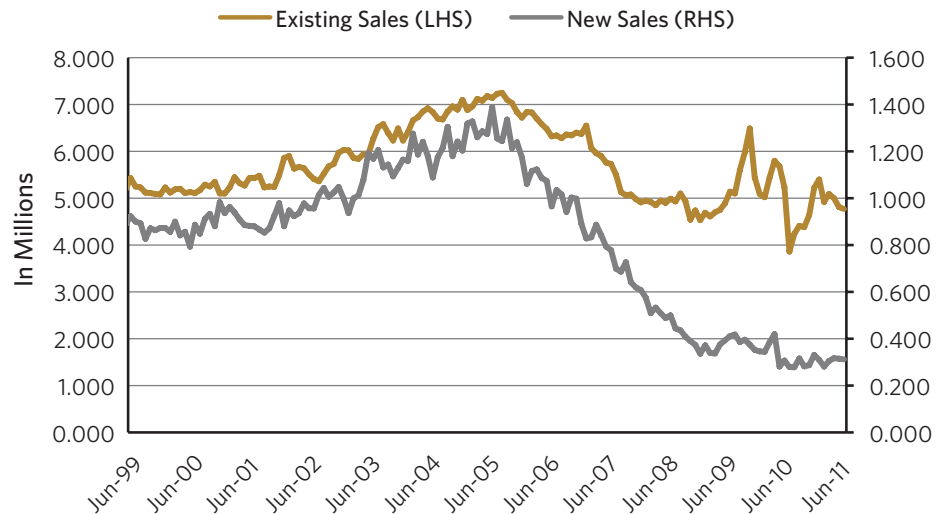
### Home Sales

The National Association of Realtors (NAR) reported that June existing home sales fell -0.8% from May, and are down 8.8% from June 2010. Distressed sales fell to 30%, down 1% from May. Investor sales were flat at 19%, while all-cash sales fell 1% to 29% in June from May. First-time buyers fell 5% to 31% in June from May. Investor and all-cash sales are up 5% and 6%, respectively, from June 2010. First-time buyers are down 12% from June 2010. Demand for non-distressed houses is evident in another rise in the median sale price to \$184,300, a gain of 8.9% in June from May, although prices are only up 0.8% from June 2010. Inventory increased, up 3.3% in June from May. At the current pace of existing home sales, it would take 9.5 months to sell the current inventory of homes for sale. Interestingly, the NAR also reported that there was a sharp increase in the cancellation rate from 4% in May to 16% in June.

The U.S. Census Bureau reports that new home sales fell 1.0% in June from May to 312,000 home sales annualized. In June the median new home price increased for the third consecutive month to \$235,200, an increase of 5.8% from May. The gain price is consistent with what we see in existing home sales, and can be attributed to seasonal effects.

The spring season has largely been underwhelming as existing home sales are down 8.8%, and new home sales are up 1.6% from June 2010, based on a very low 312,000 annualized home sales.

**Exhibit 2 — U.S. Home Sales**



Source: National Association of Realtors, U.S. Census Bureau through June 2011

---

All four home price indices we track were flat to positive in May compared to the prior month.

---

## Home Prices

All four home price indices we track were flat to positive in May compared to the prior month. The indices are still down approximately 4-7% from May 2010. We are seeing a seasonal increase in demand for non-distressed homes which is causing a short-term stall in home price declines. This dynamic is exaggerated in this housing cycle since overall sales are lower and the distressed portion of sales in the winter months has been very large.

The Case Shiller Index reported that 19 of the 20 Metropolitan Statistical Areas (MSA) in the index declined from May 2010. The index is down 4.5% from May 2010. Washington D.C. was the only MSA to post a gain from May 2010. The CoreLogic index in May rose for the second consecutive month. The index declined 7.4% from May 2010, worse than the -6.7% reported in April. CoreLogic reported that 91 of the top MSAs declined from May 2010 levels. RadarLogic's RPX (Residential Property Index) Index fell 6.0% from May 2010, slightly worse than April's 5.8% decline from April 2010. After observing a weak spring buying season, RadarLogic is predicting new index lows this fall. "Given the time of year, the results of our RPX analysis are far weaker than we had hoped. Prices are falling year over year as activity continues to languish."<sup>4</sup>

The median price of an existing home rose 8.9% to \$184,300 in June from May.<sup>5</sup> This was the fourth consecutive monthly increase in the median sale price. In June, distressed sales fell to 30% of existing home sales, the third consecutive monthly decline.<sup>6</sup> Investor sales are at their lowest levels since February, and all cash sales are down for the third consecutive month.<sup>7</sup> We expect to see this seasonal trend reverse in the next few months. In our view, demand continues to be constrained by tight mortgage credit, negative equity, and slow job growth.

---

### Exhibit 3 — Home Price Indices

Index	Period	MoM Change	YoY Change
FHFA (SA) monthly	MAY	0.4%	-6.3%
RadarLogic RPX.28	MAY	0.5%	-6.0%
CoreLogic HPI	MAY	0.7%	-7.4%
Case Shiller HPI (SA)	MAY	0.0%	-4.5%

Source: FHFA, Radar Logic, CoreLogic, Standard & Poor's through July 2011

---

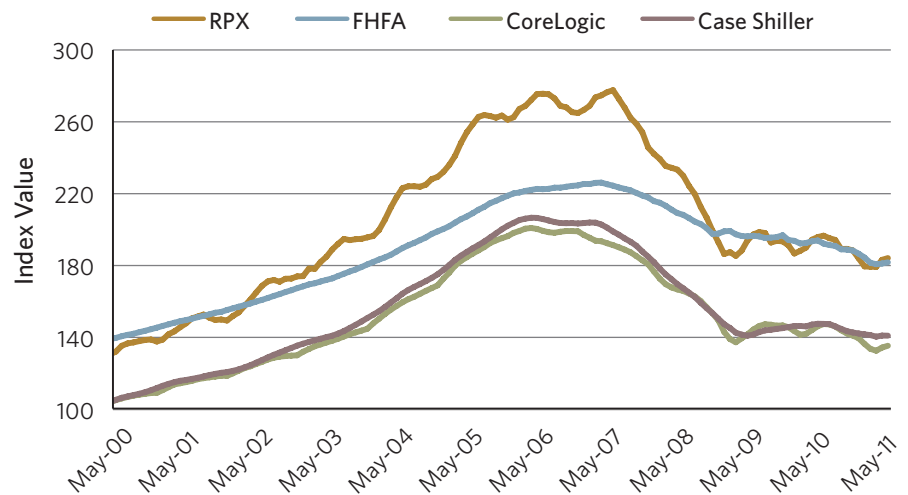
<sup>4</sup> "Weak Fundamentals Undermine Expected Seasonal Strength in Home Prices," RadarLogic, July 21, 2011.

<sup>5</sup> "June Existing-Home Sales Slip on Contract Cancellations, but Prices Stabilize," National Association of Realtors, July 20, 2011.

<sup>6</sup> *Ibid.*

<sup>7</sup> *Ibid.*

#### Exhibit 4 — Home Price Indices



Source: FHFA, Radar Logic, CoreLogic, Standard & Poor's through May 2011

While bills have been introduced in both the House and Senate to delay the change in loan limits for two years, it is unclear whether there is majority support for the delay.

#### Private Mortgage Market

The *Wall Street Journal* reported that RMBS (residential mortgage-backed security) deals are uneconomical due to the extremely conservative methodology now in place from the ratings agencies in order to get a AAA rating.<sup>8</sup> The additional credit enhancement required by rating agencies increases the cost of a securitization. According to the report, BlackRock and Two Harbors Investment Corp said they are considering a securitized deal that does not have a AAA class of bonds, and would look for a AA rating for the most senior class. A double-A rating would require approximately 200 basis points less credit enhancement. Redwood Trust's deal earlier this year had 7.5% credit enhancement on the AAA bonds, but the loans were very high quality and difficult to source.<sup>9</sup>

Maximum conforming loan limits are scheduled to drop to \$625,500 from \$729,750 on October 1st. While bills have been introduced in both the House and Senate to delay the change in loan limits for two years, it is unclear whether there is majority support for the delay.<sup>10</sup>

The Obama administration has said they will focus on housing once the debt ceiling issue has been resolved. The government has not introduced a new plan to help housing since the home buyer tax credit expired last year. Ideas under consideration include principal reductions, renting GSE-owned homes, and helping investors buy foreclosed homes with government-backed mortgages.

8 "BlackRock, Two Harbors Eye Alternative to AAA Mortgage Bonds," *The Wall Street Journal*, July 14, 2011.

9 *Ibid.*

10 Jon Prior, "Senators Submit Bill to Extend Conforming Loan Limits," *HousingWire*, August 4, 2011.

---

In terms of GSE financial reform, the U.S. Treasury issued its GSE Reform Treasury White Paper in February 2011, aimed at reducing government involvement in the agency mortgage market and increasing the role of private markets.

---

### **Mortgage Reform and Legislation**

The following is a summary of the latest developments in housing-related reforms and legislation:

In terms of GSE financial reform, the U.S. Treasury issued its GSE Reform Treasury White Paper in February 2011, aimed at reducing government involvement in the agency mortgage market and increasing the role of private markets.<sup>11</sup> The Treasury Proposal's near-term solutions are to increase guarantee fees, tighten underwriting guidelines, let temporary loan limits expire, and wind down the GSEs' portfolios. The Treasury Proposal's longer-term solution is to more fully privatize the system with some type of government backstop in times of crisis. Given the fragile housing market, we believe all changes will take between five and ten years to implement.

In addition, Republicans have introduced a broad array of bills on GSE financial reform aimed at limiting the government's role in housing and curtailing the authority of Fannie Mae and Freddie Mac. These bills (identified below) have been approved by the House Committee on Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises and were supposed to go before the full House Committee on Financial Services this summer.

- Equity in Government Compensations Act would better align compensation packages of Fannie Mae and Freddie Mac executives with those of other employees of the Federal Government.
- GSE Mission Improvement Act to end the government's affordable housing goals.
- Fannie Mae/Freddie Mac Accountability and Transparency for Taxpayers Act requiring the GSE Inspector General to report to Congress on a regular basis.
- GSE Subsidy Elimination Act aimed at increasing the guarantee fee over two years to eliminate the GSE subsidy.
- GSE Portfolio Risk Reduction Act to cap current Fannie Mae and Freddie Mac portfolios and increase the annual attrition rate.
- GSE Risk & Activities Limitation Act to prohibit Fannie Mae and Freddie Mac from engaging in new activities or businesses.
- GSE Debt Issuance Approval Act aimed at prohibiting Fannie Mae and Freddie Mac from issuing any new debt without approval from the Secretary of the Treasury.
- GSE Credit Risk Equitable Treatment Act of 2011 to prohibit exempting the GSEs from the risk retention requirements under the Dodd-Frank Act.

---

<sup>11</sup> <http://www.treasury.gov/initiatives/Documents/Reforming%20America%27s%20Housing%20Finance%20Market.pdf>

---

## As part of the Dodd-Frank regulations, there is a proposed rule for FDIC Risk Retention.

---

On May 12, House Financial Services Committee members John Campbell (R-CA) and Gary Peters (D-MI) introduced the "Housing Finance Reform Act of 2011," which would wind down Fannie Mae and Freddie Mac and set up a system that allows new entities, called housing finance guaranty associations (HFGAs), to replace them. These privately owned associations would wrap mortgage-backed securities with their guarantee and purchase catastrophic insurance from the government. The associations would be required to purchase mortgages with loan-to-value ratios of at least 80% unless the seller retains 10% or there is private mortgage insurance. Also, the loan may not exceed 150% of the U.S. average home price or 150% of the median home price in the area. This would preserve the forward mortgage-backed securities market. Portfolio functions of the new entities would be limited; affordability goals would be abolished in favor of stability as the new goal; mortgage-back securities would be explicitly government-guaranteed.

As part of the Dodd-Frank regulations, there is a proposed rule for FDIC Risk Retention. This defines QRM that would be exempt from risk retention: 28% maximum front-end debt-to-income ratios (DTI) and 36% back-end DTI; maximum loan to value (LTV) purchase of 80%; maximum LTV refinancing of 75%; maximum LTV cash-out refinancing of 70%; no delinquency on any debt over the past 24 months. Agency securities qualify as QRM since the GSEs already retain the credit risk. Forms of risk retention would include horizontal slices (retaining the first-loss position), vertical slices (retaining a portion of the risk across the capital structure), L-shaped interest (50% horizontal slice and 50% vertical slice) and representative samples (statistically similar sample of loans from the collateral pool). It also prohibits issuers from taking up-front profits on securitizations. In our view, QRM rules are restrictive and may continue to prohibit the private market and securitization from restarting in any meaningful way and work against the goal of limiting government involvement.

In addition, we believe covered bond legislation is likely to pass in early 2012, which would set up regulatory supervision for a covered bond program in the U.S.

In other important developments, in April the Federal Reserve, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) entered into settlement agreements, in the form of consent orders, with 14 mortgage servicers. The agreement requires servicers to take action to address residential loan servicing and foreclosure processing practices by establishing a single point of contact for borrowers and by hiring and training additional staff.

BNY Mellon Asset Management is one of the world's leading asset management organizations, encompassing BNY Mellon's affiliated investment management firms and global distribution companies. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation. • The statements and opinions expressed in this article are those of the authors as of the date of the article, are subject to change as economic and market conditions dictate, and do not necessarily represent the views of BNY Mellon, BNY Mellon Asset Management International or any of their respective affiliates. This article is of general nature, does not constitute investment, legal or tax advice, is not predictive of future performance, and should not be construed as an offer to sell or a solicitation to buy any security or make an offer where otherwise unlawful. The information has been provided without taking into account the investment objective, financial situation or needs of any particular person. BNY Mellon Asset Management International Limited and its affiliates are not responsible for any subsequent investment advice given based on the information supplied.

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When you sell your investment you may get back less than you originally invested. • While the information in this document is not intended to be investment advice, it may be deemed a financial promotion in non-U.S. jurisdictions. Accordingly, where this document is used or distributed in any non-U.S. jurisdiction, the information provided is for use by professional investors only and not for onward distribution to, or to be relied upon by, retail investors. • Products or services described in this document are provided by BNY Mellon, its subsidiaries, affiliates or related companies and may be provided in various countries by one or more of these companies where authorized and regulated as required within each jurisdiction. However, this material is not intended, and should not be construed, as an offer or solicitation of services or products or an endorsement thereof in any jurisdiction or in any circumstance that is otherwise unlawful or unauthorized. **The investment products and services mentioned here are not insured by the FDIC (or any other state or federal agency), are not deposits of or guaranteed by any bank, and may lose value.** • This document should not be published in hard copy, electronic form, via the web or in any other medium accessible to the public, unless authorized by BNY Mellon Asset Management International Limited.

In Australia, this document is issued by BNY Mellon Asset Management Australia Limited (ABN 56 102 482 815, AFS License No. 227865) located at Level 6, 7 Macquarie Place, Sydney, NSW 2000. Authorized and regulated by the Australian Securities & Investments Commission. • In Brazil, this document is issued by BNY Mellon Serviços Financeiros DTVM S.A., Av. Presidente Wilson, 231, 11th floor, Rio de Janeiro, RJ, Brazil, CEP 20030-905. BNY Mellon Serviços Financeiros DTVM S.A. is a Financial Institution, duly authorized by the Brazilian Central Bank to provide securities distribution and by the Brazilian Securities and Exchange Commission (CVM) to provide securities portfolio managing services under Declaratory Act No. 4.620, issued on December 19, 1997. • Investment vehicles may be offered and sold in Canada through BNY Mellon Asset Management Canada Ltd., a Portfolio Manager, Exempt Market Dealer and Investment Fund Manager. • In Dubai, United Arab Emirates, this document is issued by the Dubai branch of The Bank of New York Mellon, which is regulated by the Dubai Financial Services Authority. • In Germany, this document is issued by WestLB Mellon Asset Management Kapitalanlagegesellschaft mbH, which is regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. WestLB Mellon Asset Management Holdings Limited is a 50:50 joint venture between BNY Mellon and WestLB AG. WestLB Mellon Asset Management Kapitalanlagegesellschaft mbH is a wholly owned subsidiary of this joint venture. • If this document is used or distributed in Hong Kong, it is issued by BNY Mellon Asset Management Hong Kong Limited, whose business address is Level 14, Three Pacific Place, 1 Queen's Road East, Hong Kong. BNY Mellon Asset Management Hong Kong Limited is regulated by the Hong Kong Securities and Futures Commission for Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities, and its registered office is at 6th floor, Alexandra House, 18 Chater Road, Central, Hong Kong. • In Japan, this document is issued by BNY Mellon Asset Management Japan Limited, Marunouchi Trust Tower Main Building, 1-8-3 Marunouchi Chiyoda-ku, Tokyo 100-0005, Japan. BNY Mellon Asset Management Japan Limited is a Financial Instruments Business Operator with license no 406 (Kinsho) at the Commissioner of Kanto Local Finance Bureau and is a Member of the Investment Trusts Association, Japan and Japan Securities Investment Advisers Association. • In Korea, this document is issued by BNY Mellon AM Korea Limited for presentation to professional investors. BNY Mellon AM Korea Limited, 21/F Seoul Finance Center, 84 Taeyungro 1-ga, Jung-gu, Seoul, Korea. Regulated by the Financial Supervisory Service. • In Singapore, this document is issued by The Bank of New York Mellon, Singapore Branch for presentation to professional investors. The Bank of New York Mellon, Singapore Branch, One Temasek Avenue, #02-01 Millenia Tower, Singapore 039192. Regulated by the Monetary Authority of Singapore. • This document is issued in the UK and in mainland Europe (excluding Germany), by BNY Mellon Asset Management International Limited, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorized and regulated by the Financial Services Authority. • This document is issued in the United States by BNY Mellon Asset Management.

BNY Mellon holds over 90% of the parent holding company of The Alcentra Group. The Group refers to these affiliated companies: Alcentra, Ltd and Alcentra NY, LLC. Only Alcentra NY, LLC offers services in the U.S. • Ankura, Insight Investment and WestLB Mellon Asset Management do not offer services in the U.S. This presentation does not constitute an offer to sell, or a solicitation of an offer to purchase, any of the firms' services or funds to any U.S. investor, or where otherwise unlawful. • BNY Mellon holds a 20% interest in Siguler Guff & Company, LP and certain related entities (including Siguler Guff Advisers LLC). • BNY Mellon Beta Management is a division of The Bank of New York Mellon, a wholly-owned banking subsidiary of BNY Mellon. • BNY Mellon Cash Investment Strategies is a division of The Dreyfus Corporation. • BNY Mellon owns a 19.9% minority interest in The Hamon Investment Group Pte Limited, the parent company of Blackfriars Asset Management Limited and Hamon U.S. Investment Advisors Limited, through whom Hamon offers services in the U.S. • The Newton Group refers to the following group of companies: Newton Investment Management Limited, Newton Capital Management Limited, Newton International Investment Management Limited, Newton Capital Management LLC, and Newton Fund Managers (CI) Limited. Except for Newton Capital Management LLC and Newton Capital Management Limited, none of the other Newton companies offers services in the U.S. • BNY Mellon Asset Management International Limited and any other BNY Mellon entity mentioned above are all ultimately owned by BNY Mellon.



## BNY MELLON ASSET MANAGEMENT

The Alcentra Group  
Ankura Capital Pty Limited  
Blackfriars Asset Management Limited  
BNY Mellon ARX  
BNY Mellon Beta Management  
BNY Mellon Cash Investment Strategies  
The Boston Company Asset Management, LLC  
The Dreyfus Corporation  
EACM Advisors LLC  
Hamon Investment Group  
Insight Investment  
Mellon Capital Management Corporation  
The Newton Group  
Pareto Investment Management Limited  
Siguler Guff & Company LP  
Standish Mellon Asset Management Company LLC  
Urdang Capital Management, Inc.  
Urdang Securities Management, Inc.  
Walter Scott & Partners Limited  
WestLB Mellon Asset Management