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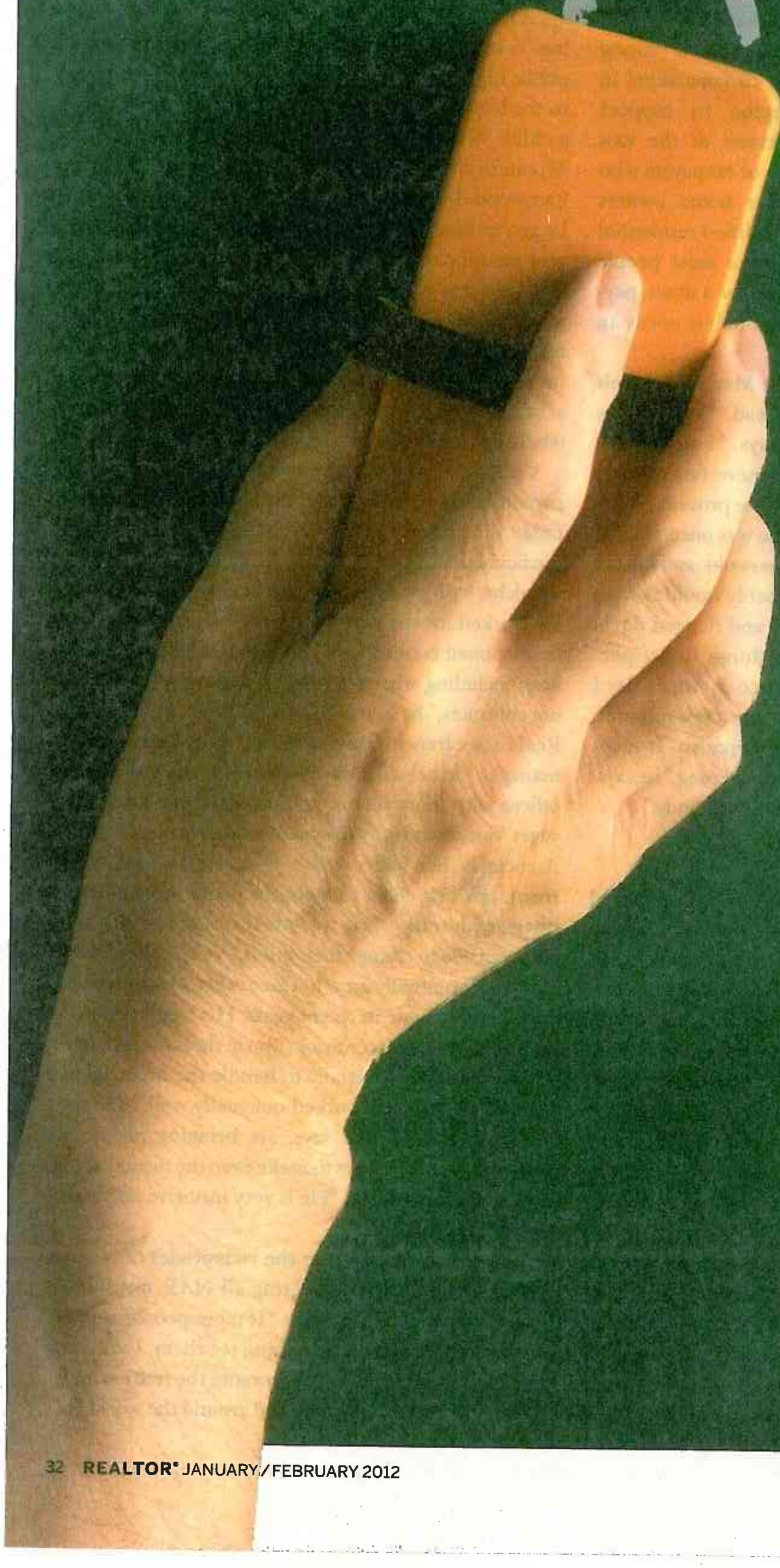

Expect two to three years, at least, before markets are back into balance.

BY KEN FEARS

Until the amount of distressed inventory returns to a normal level, under 5 percent, real estate pros face the unenviable task of clearing these sales as efficiently as possible.

Distressed listings typically sell for 15 to 20 percent below market value, which can cause a drag on home prices overall, according to data assembled by the NATIONAL ASSOCIATION OF REALTORS®.

The sharp price discount on today's distressed sales is a symptom of an imbalanced housing market. In better times, a distressed property might be snapped up at market value. Consequently, the market needs stronger home sales volumes to reduce the number of homes on the market and to stabilize prices. As rising prices allow troubled and underwater home owners, who account for roughly 22 percent of mortgaged home owners, to refinance, their hopes are raised. Robust home sales and home price growth also breed confidence in the market for would-be buyers.

By far the best remedy for the ailing housing market is a stronger economy. Job growth and stock market gains are closely tied to consumer confidence, with consumers commonly citing concerns about jobs as the main reason for not purchasing a home.

Behind the Drag

Ongoing concerns that Europe's debt crisis could spread and reduce domestic economic growth, a lack of consensus in Congress over the deficit reduction plan, and a major revision to economic growth in the first half of 2011 combined to send stocks on a roller coaster

an Slate

ride in the second half of 2011. In August, consumer confidence fell to its lowest level since the recession began in 2007, and neither businesses nor consumers appear willing to drive the economy. Indeed, job creation has averaged less than 150,000 jobs per month over the last year, below the amount needed to absorb college and high school graduates entering the workforce.

The economy isn't the only factor restraining the demand for housing. Credit standards and down payment requirements have been ratcheted up in recent years at the FHA and government-sponsored enterprises, but banks have raised their standards even further in an attempt to limit potential lawsuits. As a result, FICO scores on loans backed by Fannie Mae rose from an average of 719 in 2005 to a peak average of 756 in the second quarter of 2011. Likewise, FICO scores on loans originated through the FHA averaged 632 in the second quarter of 2007 but reached 700 in the second quarter of 2011. And anecdotal evidence suggests that down payments greater than 20 percent are the norm outside of the FHA. Although traditional credit standards are a good thing, the pendulum has swung too far in this direction. Punishing quality borrowers for the mistakes of the past is not good for the health of the markets or the economy.

Another factor keeping the level of distressed properties high is the so-called "shadow inventory," the cache of homes not yet on the market but already—or likely to end up—on the balance sheets of banks, the FHA, Fannie Mae, or Freddie Mac and thus for sale.

Rain Delay

On the bright side, both MLS inventories and shadow inventory showed signs of easing in 2011. In September 2011, an estimated 3.5 million homes appeared on MLSs across the country, 13 percent fewer than a year earlier. Meanwhile, from February 2010 to July 2011, the shadow inventory dropped from 1.9 million to 1.6 million, according to calculations by NAR researcher Selma Hepp. The reduced inventory was partly a result of firming home prices and employment growth that carried into 2011. Taken together, these factors lowered the national 90-day delinquency rate from 5 percent of all mortgages in the first quarter of 2010 to 3.5 percent in the third quarter of 2011. However, the foreclosure rate remains historically high. Not only that, the temporary moratorium on foreclosure sales by many large banks in the latter half of 2010 and early 2011 to correct processing problems held up the sale of a large number of properties that will eventually be sold.

In all, short sales rose by 26,000 last year while foreclosures fell by 255,000, according to Hope Now, a mortgage industry alliance. September 2011 marked the 12th straight month in which foreclosure activity decreased on a year-over-year basis, according to RealtyTrac. In October, however, filings spiked 7 percent from the previous month, and the month-over-month activity was much higher in the housing markets of California, Nevada, Arizona, and Florida, where the downturn was sharpest, as well as in markets where the judicial process held up foreclosure sales. In a Nov. 10 press release, RealtyTrac CEO James Saccacio said, "The October foreclosure numbers continue to show strong signs that foreclosure activity is coming out of the rain delay we've been in for the past year."

Government programs aimed at helping struggling home owners haven't had the effect many hoped for, but some retooling is underway. In November, the Home Affordable Refinance Program program was revised with relaxed criteria that observers hope will double the number of home owners who'll eventually benefit. Meanwhile, private loan modifiers have shifted their strategy to focus on reducing monthly payments; the share of loans that are six or more months in default 12 months after modification has improved, from 58.1 percent in 2008 to 26.6 percent in 2010.

It's not too late to make distressed sales part of your repertoire. This special report looks at how these sales have changed since the wild, wooly days of 2008 and provides insights on how to run a successful short sale or foreclosure operation. ■

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