

Gary London >>REAL ESTATE

Measuring Where the Home Market Now Stands



Last week a key index reported that home prices in San Diego (and four other cities) have slowed in their declines.

The Standard & Poor's/Case-Shiller

Home Price Index for December reported price declines of 18.5 percent nationally from year-ago levels, the drop in San Diego from November to December was 2.1 percent, compared with a negative 2.3 percent from October to November. December's year-over-year decline was 24.8 percent, compared with 25.8 percent in November. This is the second straight month in which the decline was slightly less than for the month before, both on a monthly and year-over-year basis.

The S&P/Case-Shiller Home Price Index has become popular because it measures changes in the value of single-family housing markets in 20 metropolitan regions across the United States. The index collects data on single-family home resales, capturing resold sale prices to form sale pairs. The data is calculated monthly and published with a two-month lag.

I am not particularly fond of this index for several reasons, including:

- It tracks monthly. Analysts then get transfixed on monthly movements. But real estate can't really be tracked monthly — month-to-month changes mean way less in real estate than, say, in the stock market. That's not Case-Shiller's fault. It's the fault of the interpreters. The new report suggests that numbers seem to be stabilizing. I know better than to see it as some sort of a trend until a few more months pass.

- It purports to measure the market, but in reality it only measures the transactions that have actually occurred. The problem here is that in our presently distressed environment, this index mainly tells us about distressed sales, including foreclosures, short sales or price dumps. Because actual transaction levels are roughly half what they are in "normal" times, most people are on the sidelines and not participating in the market. One would assume that the market behaves rationally, and that these consumers know that if they list a home, they will take a big hit on their sales price, and in

any event current buyers are conditioned to look for bargains.

Hence, Case-Shiller is measuring a low activity market, which isn't much of a market.

- Analysts tend to use this measure — because it is national in scope — as a basis to say something about the "market" when, in fact, there is no "the market," like the stock market. The real estate market is incremental. It is sliced and diced by geography and use types.

- Current pricing is also skewed by the fact that homes being sold right now are certainly drawn from an inventory that is priced lower than the median in our region, in terms of quality, location and size.

- Case-Shiller does not measure new home prices. Normally this would be a big flaw. Right now it doesn't show because even though new home prices are mostly stable, there are not many new homes being built.

Having said that, I have no doubt that regional real estate values are down. I just do not fundamentally believe they are as "down" as the Case-Shiller index suggests, which is roughly 40 percent off since the peak 3.5 years ago.

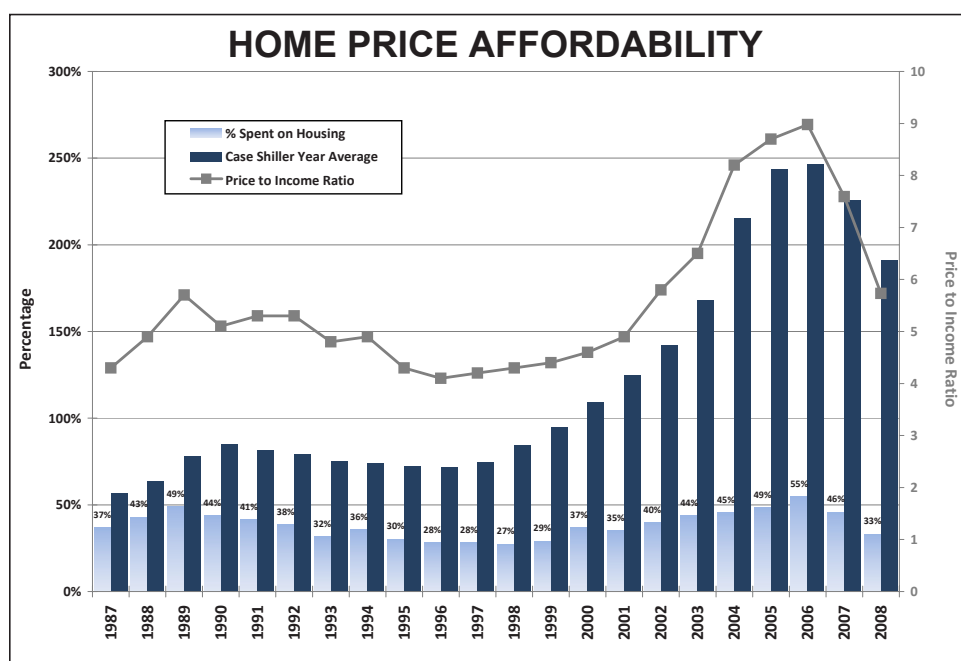
This only becomes an issue if we try to do something with this index, other than use it as a basis for which to start a conversation. If you are drawing conclusions about San Diego from national numbers, or applying these numbers to try to explain any single neighborhood, beware! You are bound to be wrong.

Still, with its deficiencies, the trend of this index has to be right. Even if the dip in valuation is certainly not this sharp, the market is more affordable than it has been for a very long time, indeed.

Understanding Affordability

There is, however, a good use of this data and it lies in our effort to index affordability. The accompanying chart measures a housing "price-to-income ratio" based on Case-Shiller. This chart, created by my business partner, Nathan Moeder, shows the Case-Shiller annual home price average in San Diego County from 1987 through 2008. It depicts the pricing peaks experienced in the 2005-2006 period and the drop-off since then.

It then overlays the price-to-income ratio, determined by the median price divided by median household income. This



Source: The London Group Realty Advisors, S&P | Case Shiller

ratio in 2008 has dropped to 5.7, suggesting that we are back to 2002 levels of affordability. This is also in sync with Case-Shiller's current index of 152 (2002 level of sale prices).

This is a good application of the Case-Shiller index because it doesn't look exclusively at the housing price, but rather the relationship between price to income. In the end, what really matters is whether consumers can afford homes, regardless of the actual price of homes.

But This Will Not Last

This down market will not last. What I am putting out here is that this is a clear buy signal. Now is the time to purchase a home, if you can qualify, because home values may be nearing the bottom, or perhaps are at the bottom.

The critical "if" is your ability to get a loan. I have explained many times in this column that the "stated income" era has ended. We have entered the "prove your income era." Loan underwriting standards will be much more strict, as they should be (bad underwriting standards were, after all, what got the housing market in trouble in the first place).

It is important to keep perspective as a buyer. Homes cannot generally be viewed as an investment vehicle other than to responsibly build equity. It's best to decide to buy a home when the loan

terms are affordable based on income. This is more important than attempting to exactly time the bottom in search of an additional \$30,000 or \$50,000 in savings. This should not be a factor to the buyer with a long-term perspective.

The unknown is when lenders will be putting money out again. In effect, home values or timing do not matter if you cannot participate in the market. The ability of many consumers to pass lending standards and the willingness of lenders to actually make the loans will ultimately determine the shape of the curve that moves us out of this down market.

So, while we may be at the bottom, we could stay there awhile. The measurement of the success of the president's housing package may be more about the impact it has on overall lending practices, than on the money he is putting out to help those who qualify under his program.

If it all works, prices rise again and the recovery is U-shaped. If they don't, it could be a long, drawn out slog to price appreciation again.

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Cherin explains share prices at below or near companies' book value, or the value of their assets if businesses had to liquidate today, make for attractive buys.

Cherin says he anticipates more market volatility in the near term, or at least until the government provides a clearer picture of its financial rescue plan.

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SRE Jumps On Earnings Report:

Shares of **Sempra Energy**, traded under SRE on the New York Stock Exchange, gained 6 percent Feb. 24 to close at \$41.41, after the local utility reported quarterly net profits and revenue that beat Wall Street estimates.

For the fourth quarter, Sempra reported net income of \$319 million, up 10 percent from the 2007 fourth-quarter results. Revenue was \$2.29 billion, down from \$3.11 billion in the like quarter

of 2007. For the full year, Sempra had net profit of \$1.1 billion on revenue of \$10.7 billion, compared with net profit of \$1 billion on revenue of \$11.4 billion in 2007.

Sempra was able to increase profits in four of its six subsidiaries, with big gains from San Diego Gas & Electric, its generation unit, and pipelines unit.

Sempra earlier said it was raising its annual dividend this year 11 percent to \$1.56, as part of its goal to return up to 40 percent of profits to investors.

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AMN, Founders Bury Hatchet: AMN **Healthcare Services**, a local nurse staffing firm, is apparently no longer quarreling with its founders, Steve and Gayle Francis.

AMN said Feb. 17 that the parties have agreed to settle a dispute regarding the firm's corporate governance policies, which twice-failed mayoral candidate Steve Francis challenged.

In the settlement, AMN said its board

agreed to restrict the ability to adopt a stockholders' rights plan, or poison pill, without stockholder approval.

Francis agreed to dismiss a civil suit he filed in a Delaware court against the company, and to withdraw another proposal to vote out three directors who are up for election at the shareholders meeting April 9.

The company said earlier that Francis was organizing a proxy battle in a bid to return to the board after resigning his chairmanship in April.

An AMN Healthcare spokesman wouldn't comment on what's behind the dispute, saying the agreement calls for no further disclosures.

Francis and his wife jointly own less than 1 percent of the outstanding shares.

AMN, which touts itself as the largest health care staffing firm in the nation, is on track to break \$1 billion in revenue when it reports its 2008 results Feb. 26.

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Kelly Buys Auto Painter: Kelly Capital,

a local private equity firm that owns the Ivy Hotel, is buying longtime car painter and collision repair shop chain Earl Scheib for \$8 million in cash.

Sherman Oaks-based Earl Scheib was founded in 1937 and has 85 shops in 77 cities, including five in the county, and had been exploring "strategic alternatives" since March 2008.

This is Kelly's third foray into acquiring a publicly traded company. Scheib is traded on the Pink Sheets exchange.

Last year, Kelly tried to buy **Rubio's Restaurants** for \$50 million, but the chain, known for its fish tacos, nixed that deal. In 2003, Kelly acquired National Service Industries, an Atlanta firm that provided linen services, and manufactured envelopes. Kelly revamped the business and sold it off. The pending deal is scheduled to close before April 15.

Send any news of locally based public companies to Mike Allen via e-mail at mallen@sdbj.com. He can be reached at 858-277-6359.