Palm Springs Life

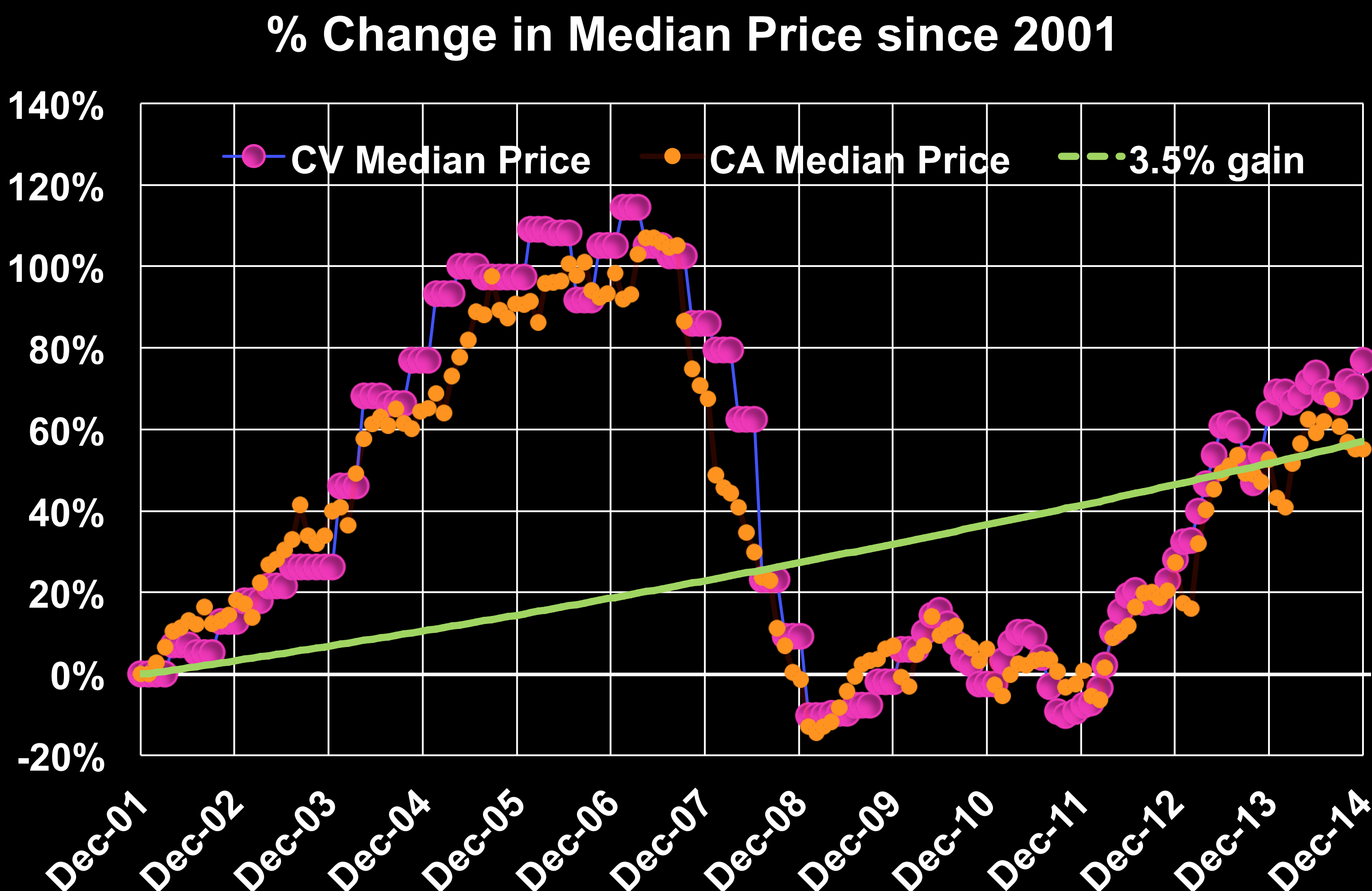
market WATCH

Forecast for the Nine Major Cities

January 22, 2015

sponsored by Toscan Country C Franklin Loan Center

Gains in Coachella Valley home prices continue to parallel those of the state !



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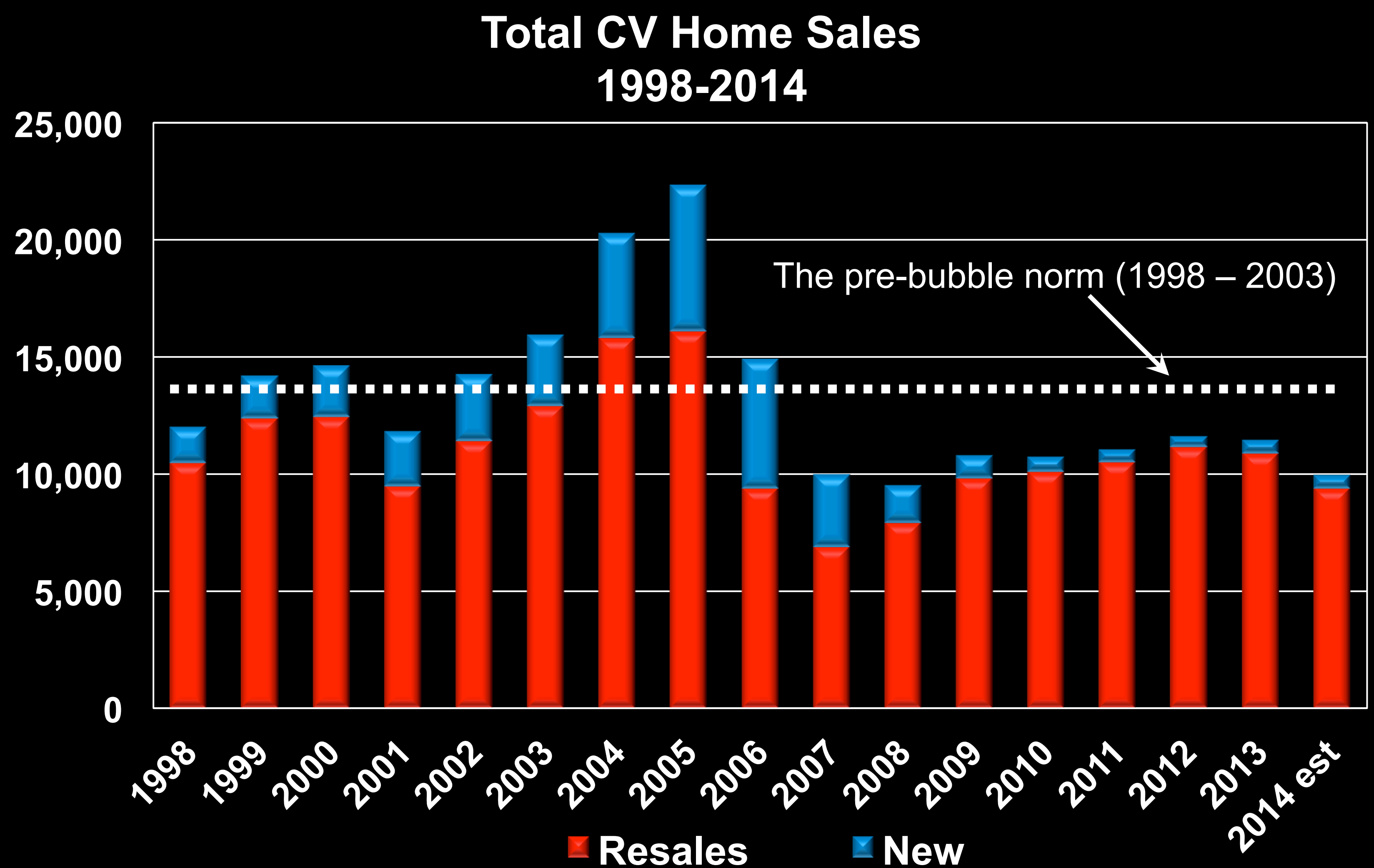
City prices at major turning points

(from the 2006 to 2014)

City	2006 Highs	Oct 2011 Lows	% decline from highs	Dec 2014	3 Yr Gain off bottom	% from Highs
Cathedral City	$237	$86	-63.7%	$155	79.9%	-34.7%
Desert Hot Springs	$187	$56	-70.2%	$99	77.3%	-47.1%
City of Coachella	$215	$66	-69.2%	$115	73.6%	-46.5%
Indio	$216	$81	-62.4%	$141	73.3%	-34.8%
Indian Wells	$359	$196	-45.4%	$331	69.0%	-7.7%
Palm Springs	$307	$172	-43.9%	$267	55.4%	-12.9%
La Quinta	$293	$125	-57.3%	$193	54.6%	-33.9%
Palm Desert	$267	$139	-48.0%	$188	35.4%	-29.6%
Rancho Mirage	$331	$170	-48.8%	$215	26.7%	-35.1%

Prices shown are the median price per sq. ft.

Although prices have recovered, total Valley home sales are 30% to 35% below normal



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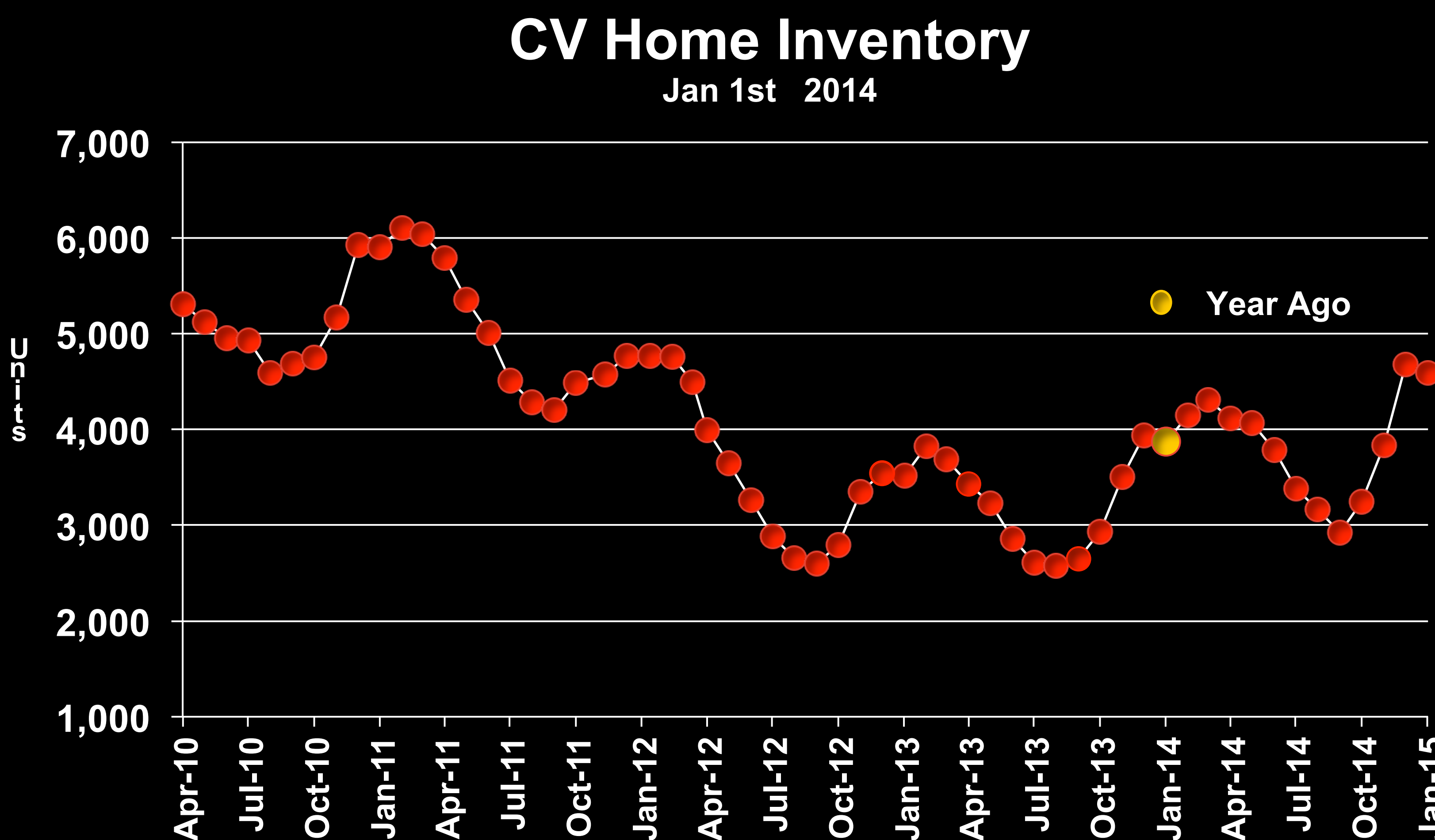
After three years of low inventory, numbers are beginning to rise



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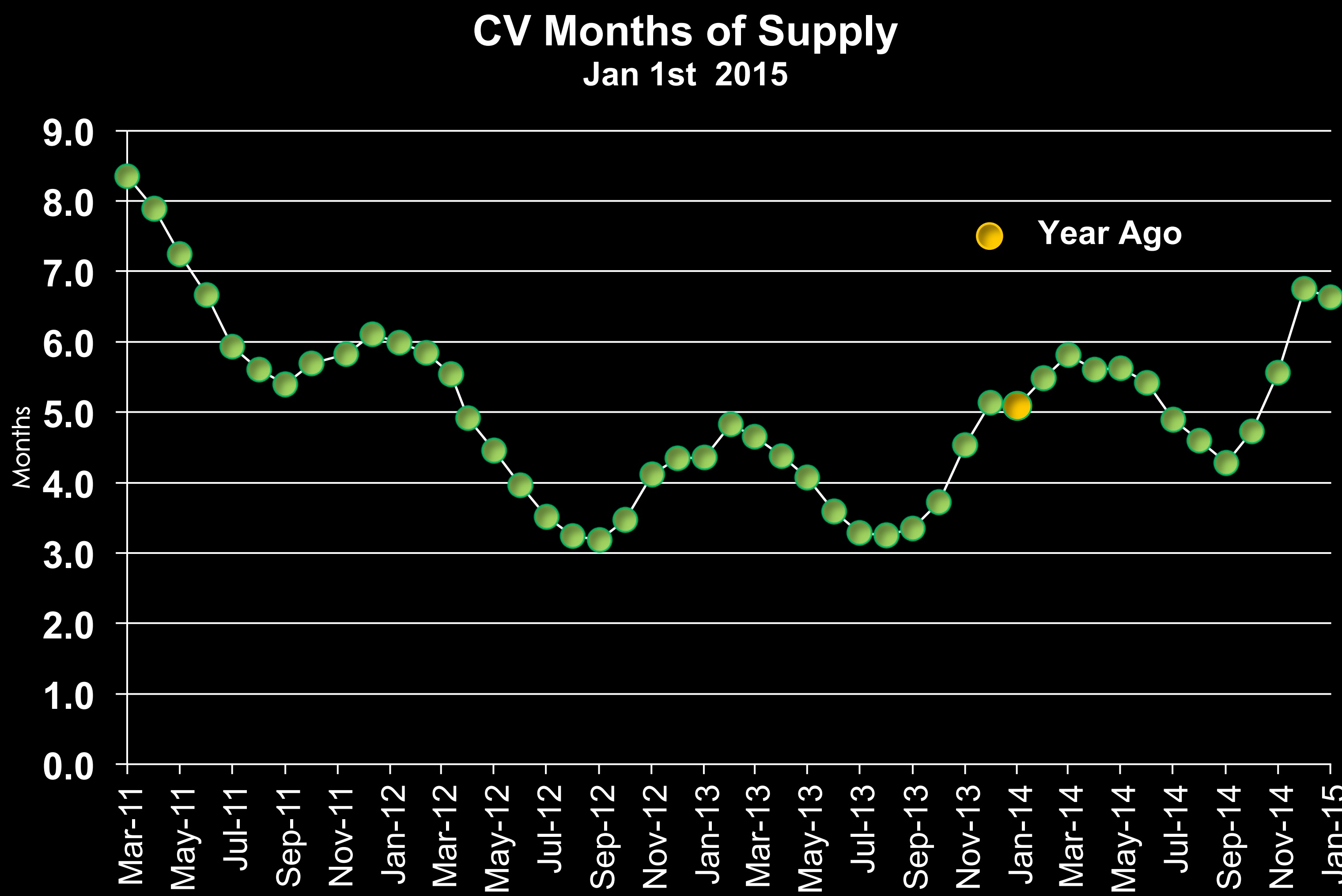
Higher inventory and lower sales are pushing Valley "months of supply" close to 7 months !



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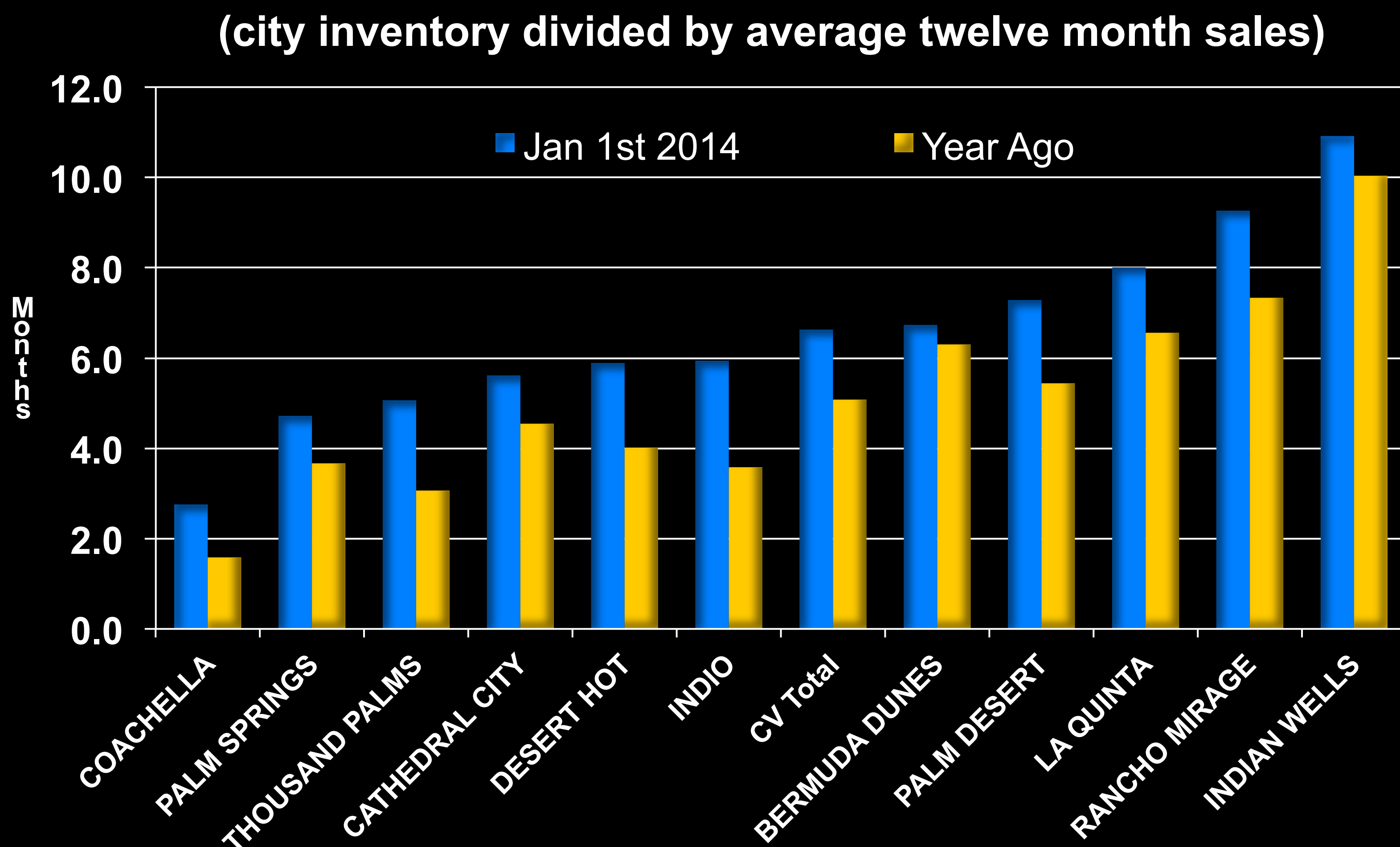
Months of Supply is rising in every Valley city



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“Because home inventories have finally started to increase, if banks don’t lower credit requirements toward safe, pre bubble levels thereby creating more homebuyers, sales will remain below the levels required to continue the housing recovery !”

Why are Valley home sales so low ?

- Higher prices means lower affordability = fewer buyers
- Because of prior foreclosures, 10% of Valley households can't buy homes. This slowly changes starting in 2015 !
- Uncertainty in GSE loan "put back" policies is forcing banks to protect themselves by doing only high down payment and high FICO Score loans. *

We'll investigate each item and also estimate increases in sales if an item is changed or fixed.

* This is the primary reason for low sales. Recent (and hopefully future) clarifications by both Fannie Mae and Freddie Mac could potentially change this.

When measured against past affordability, prices throughout California are historically rather high

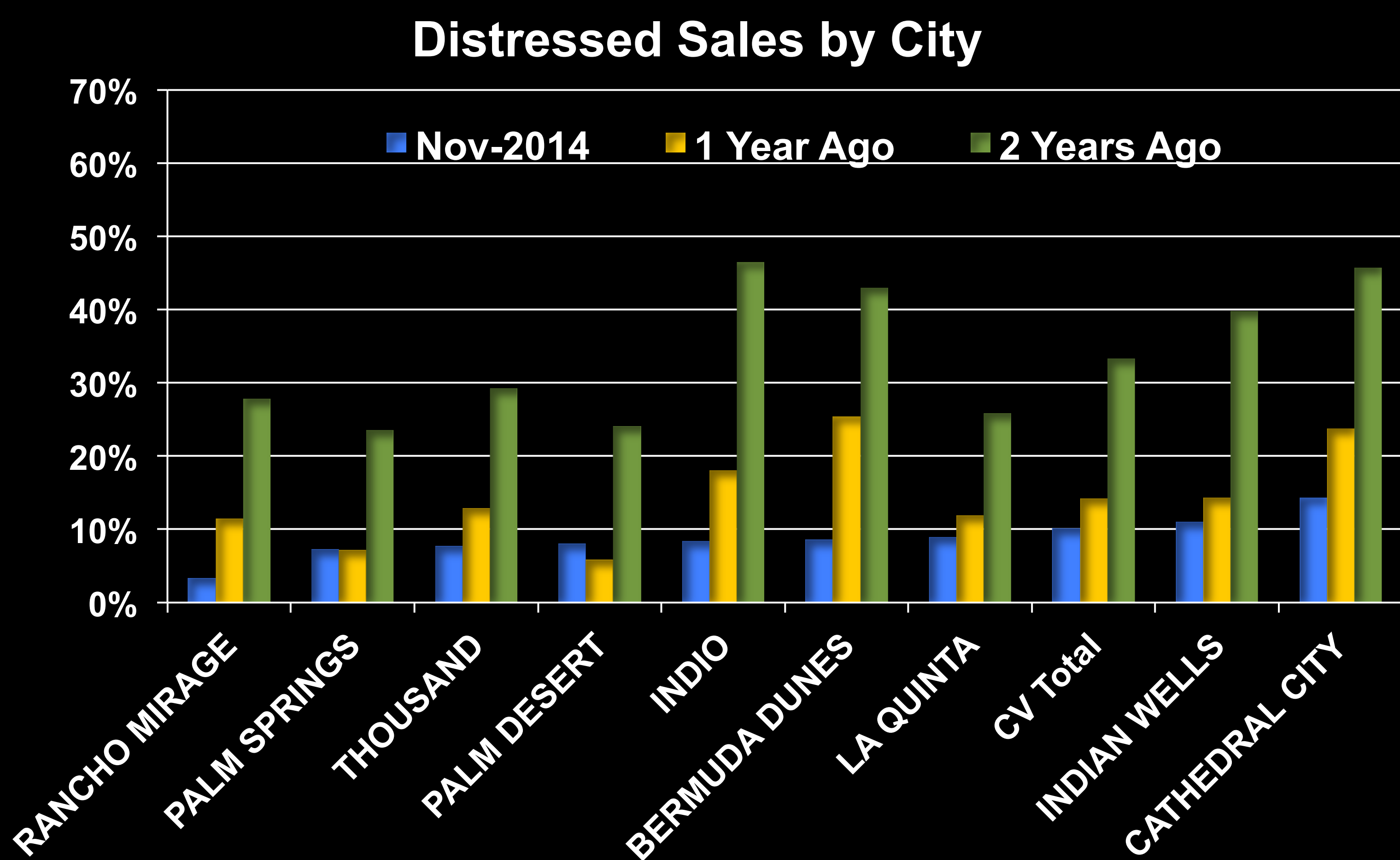
Low affordability creates “price risk” due to too few buyers

			very low affordability									normal				highly affordable								
	Median Home Pr.	Historic Lows	-10	-9	-8	-7	-6	-5	-4	-3	-2	-1	Historic Median	+1	+2	+3	+4	+5	+6	+7	+8	+9	+10	Historic Highs
State of California	$445,280	11%										32%	34%											56%
Los Angeles County	$433,850	9%									30%		34%											51%
Orange County	$689,480	10%						20%					28%											49%
Sacramento County	$266,260	19%									50%		52%											74%
San Diego County	$491,690	8%										28%	31%											46%
San Luis Obispo County	$453,950	7%										28%	29%											44%
Santa Barbara County	$643,290	6%						18%					25%											47%
Santa Clara County	$850,000	11%						21%					27%											45%
Ventura County	$549,440	10%									32%		35%											51%
Alameda County	$710,370	11%					19%						26%											45%
Contra Costa County	$654,410	8%											22%						26%					37%
Fresno County	$200,000	17%											53%		55%									72%
Marin County	$1,111,110	10%					15%						20%											32%
Merced County	$177,650	9%											50%						58%					77%
Riverside County	$320,880	14%								42%			49%											68%
San Bernardino County	$213,780	19%											52%						60%					78%
San Francisco County	$956,320	8%								14%			17%											29%
San Mateo County	$1,092,500	8%			13%								19%											33%
Santa Cruz County	$689,500	9%					16%						21%											37%
Sonoma County	$487,110	7%								24%			28%											51%

- The recent large decline in mortgage rates has increased affordability

* Assumes November median prices and January 8th Freddie Mac mortgage rates

Although numbers are much improved, about 600 local households still enter the 7 year foreclosure penalty box each year.



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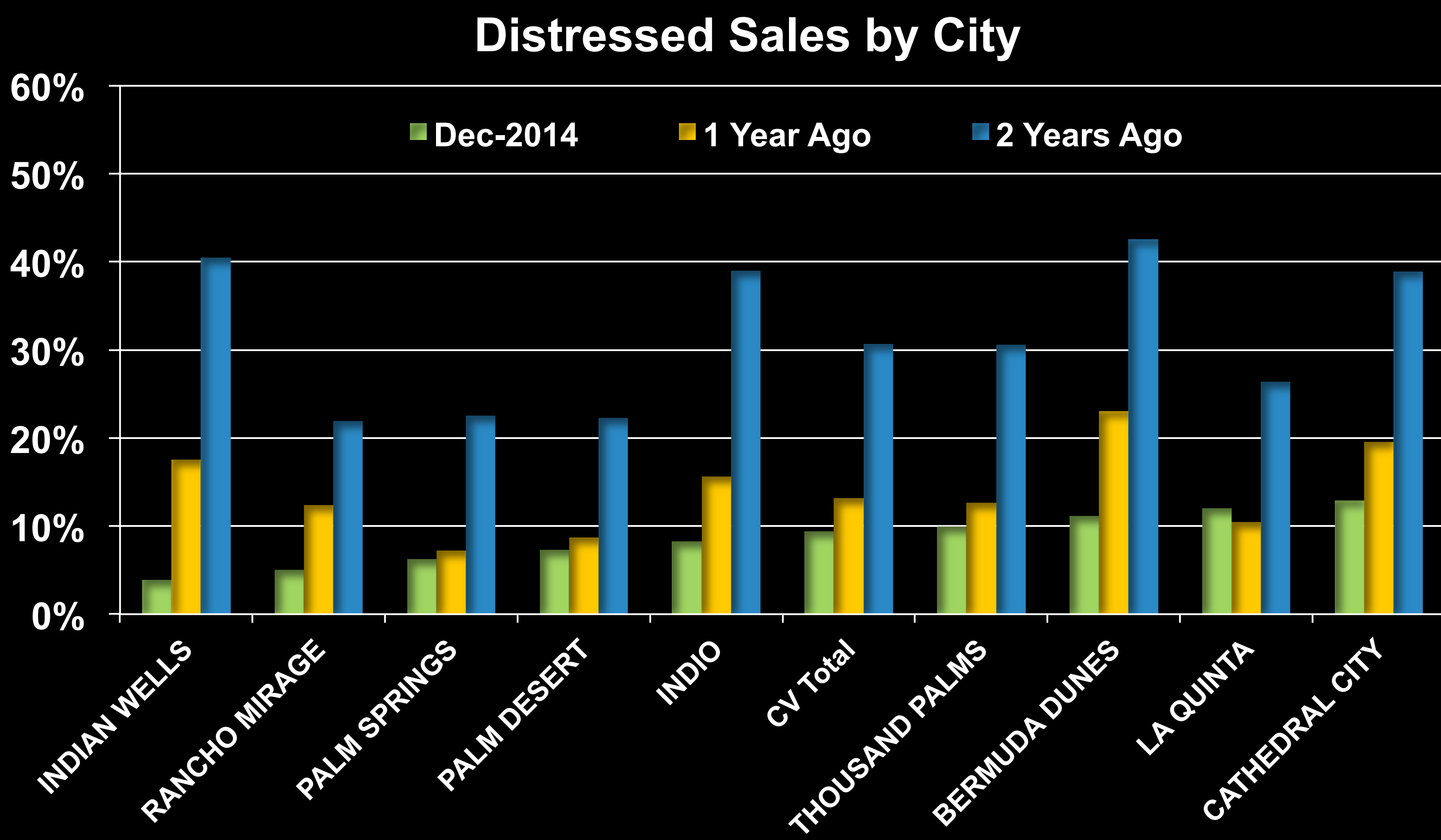

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Starting in 2015, about 2% of Valley households each year will exit the penalty box and can become homeowners again

Total entering penalty box

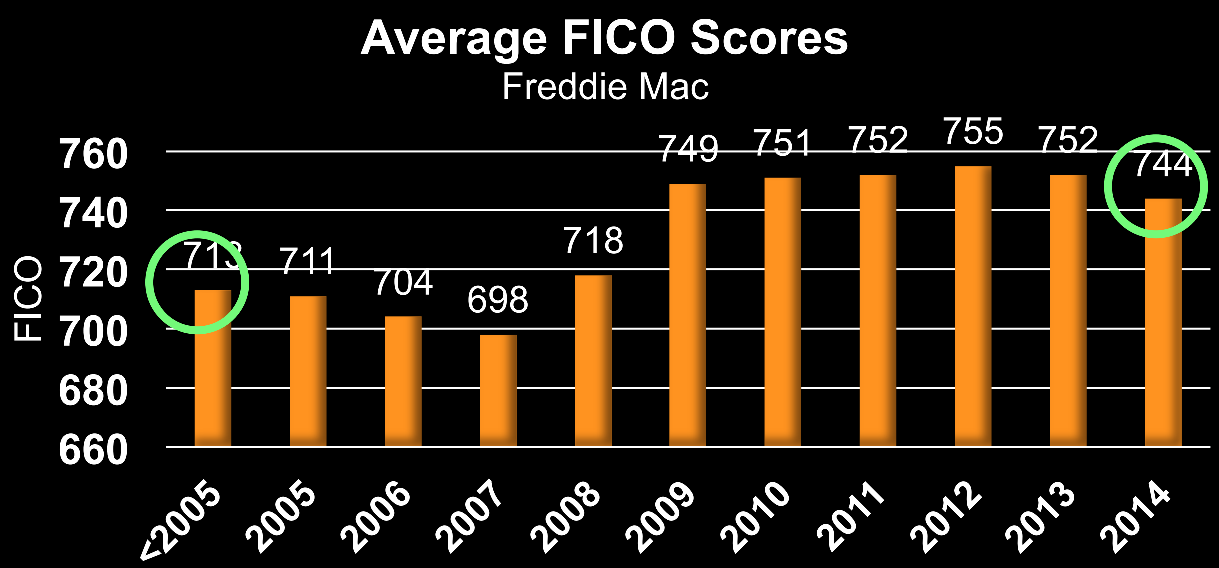
Year	2006	2007	2008	2009	2010	2011	2012	2013	2014 est
REO Sales	66	556	3,008	4,543	3,935	3,850	2,638	1,203	612

Est. local households leaving box *

2013	2014	2015	2016	2017	2018	2019	2020	2021 est
40	334	1,805	2,726	2,361	2,310	1,583	722	367

*Assumes 60% of foreclosures were local owners

Lowering average FICO scores from 744 to pre-bubble levels of 713 would qualify 30% more homebuyers ! !



- This is the major barrier to full recovery ! Just lowering average FICOs scores half the way would increase home sales 15%, <u>with little risk.</u>

- Contrary to popular belief the crash wasn't caused by bad credit. It was caused by the over use of ARM mortgages (50% to 70% of all loans) and then qualifying buyer income only against the starting rate.

- When payments reset higher, waves of homeowners had to sell, crashing prices. The ARM reset risk has been reduced by qualifying income against the higher indexed rate.

Freddie Mac

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Assessing the factors and steps needed for a continuation of the Valley's housing recovery

1. High prices and low affordability = fewer buyers
   a. To increase affordability we need larger incomes, not more jobs. A 1% drop in unemployment increases homebuyers only 1%!
   b. Lower unemployment, higher mortgage rates and the FED paradox.

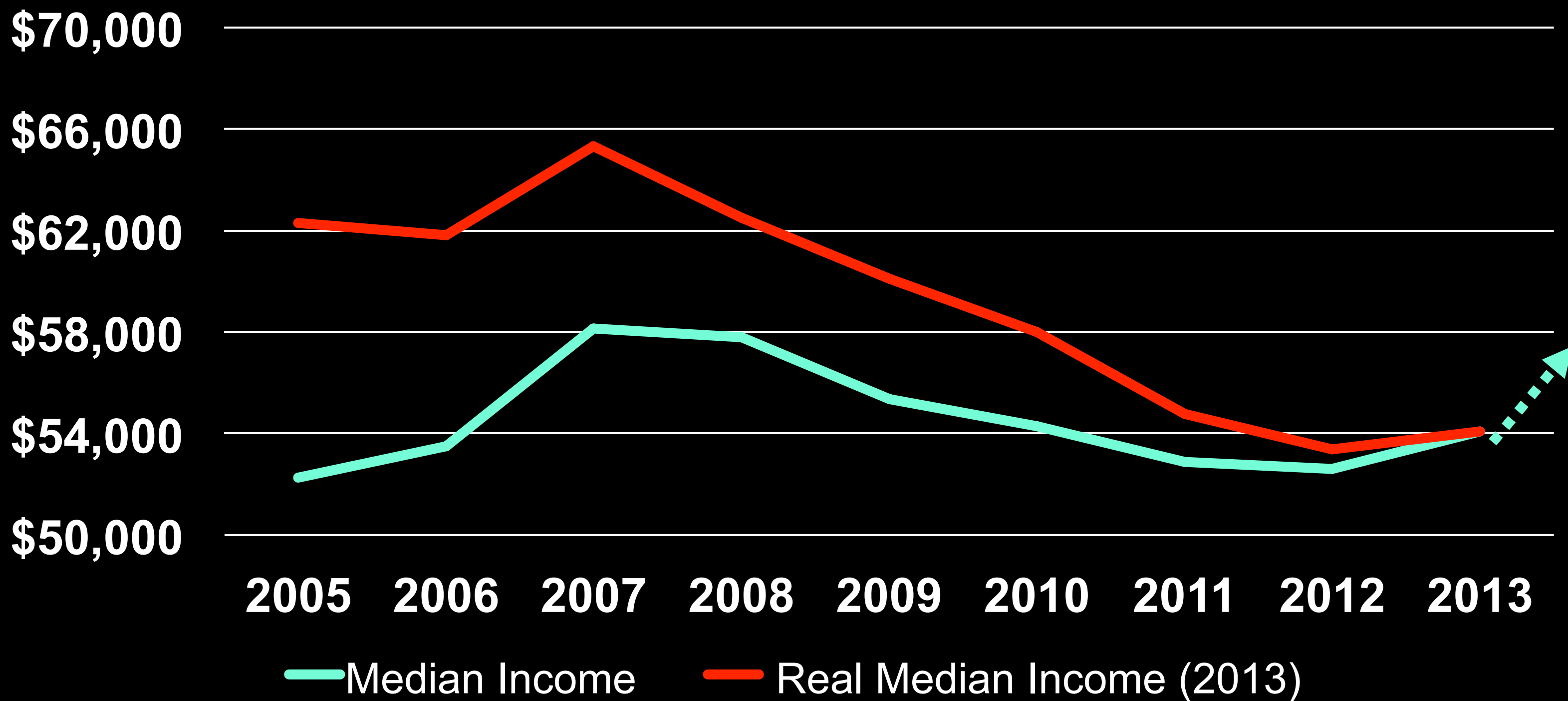
2. More buyers as local households exit the "penalty box" (regional issue).
   a. Between 2015-2019, the number of qualified Valley households grows about 10% (Find, contact and invite them to your office).

3. More buyers - easier credit – reduce bank risk (national issue).
   a. A 10 point drop in average FICO scores would mean 10% more homebuyers !
   b. The new GSE financial products for 1^{st} time homebuyers.

4. The importance of "getting the word out" ! !

Riverside County Median Household Income

(2005-2013)



- To put a solid footing under home prices, household incomes must begin to rise, increasing affordability and broadening the recovery.

Quiz:

Which event creates more potential homebuyers and by how much ?

1. A 1% drop in unemployment
2. A 1% drop in mortgage rates (i.e. 5% to 4%)
3. A 10 point decline in average FICO scores

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3. A 10 point decline in average FICO scores

Answers

#1 - increases homebuyers by 1%
#3 - increases homebuyers by 10%
#2 - increases homebuyers by 12% to 14%

The three housing markets of the Coachella Valley

- The Primary or Local Market
  - Service workers supporting hospitality, medical and retail industries in the Valley. Jobs and affordability driven.
- Second Home/Vacation Market
  - Snowbirds and weekend vacationers. Mix of wealthy and higher income households. Also includes pre-retirees preparing for the transition to full time retirement.
- The Retiree Market
  - Primarily from California but also retirees from the north, mid west and east coasts seeking warmer weather and no longer constrained by job location.

The Primary or Local Markets

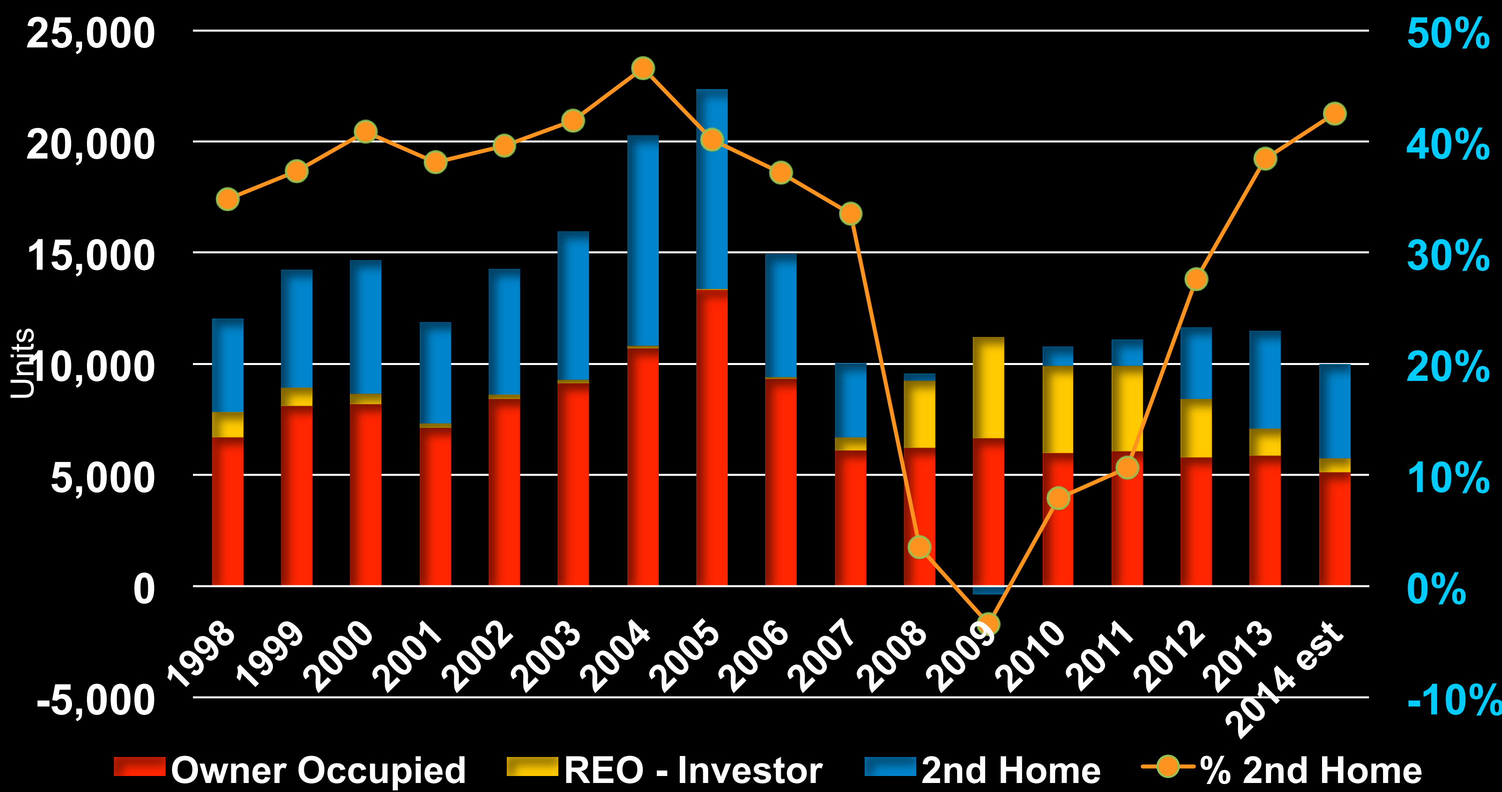
- Should finally “come to life” in 2015

- Size of a resurgence depends on
  - Easier bank credit and loan approval
  - inovative first time homebuyer mortgage products

- Households exiting their penalty box and then re-buying a home will be a constant plus.

- Get the word out ! ! The industry can fail by not notifying every potential homebuyer of changes.

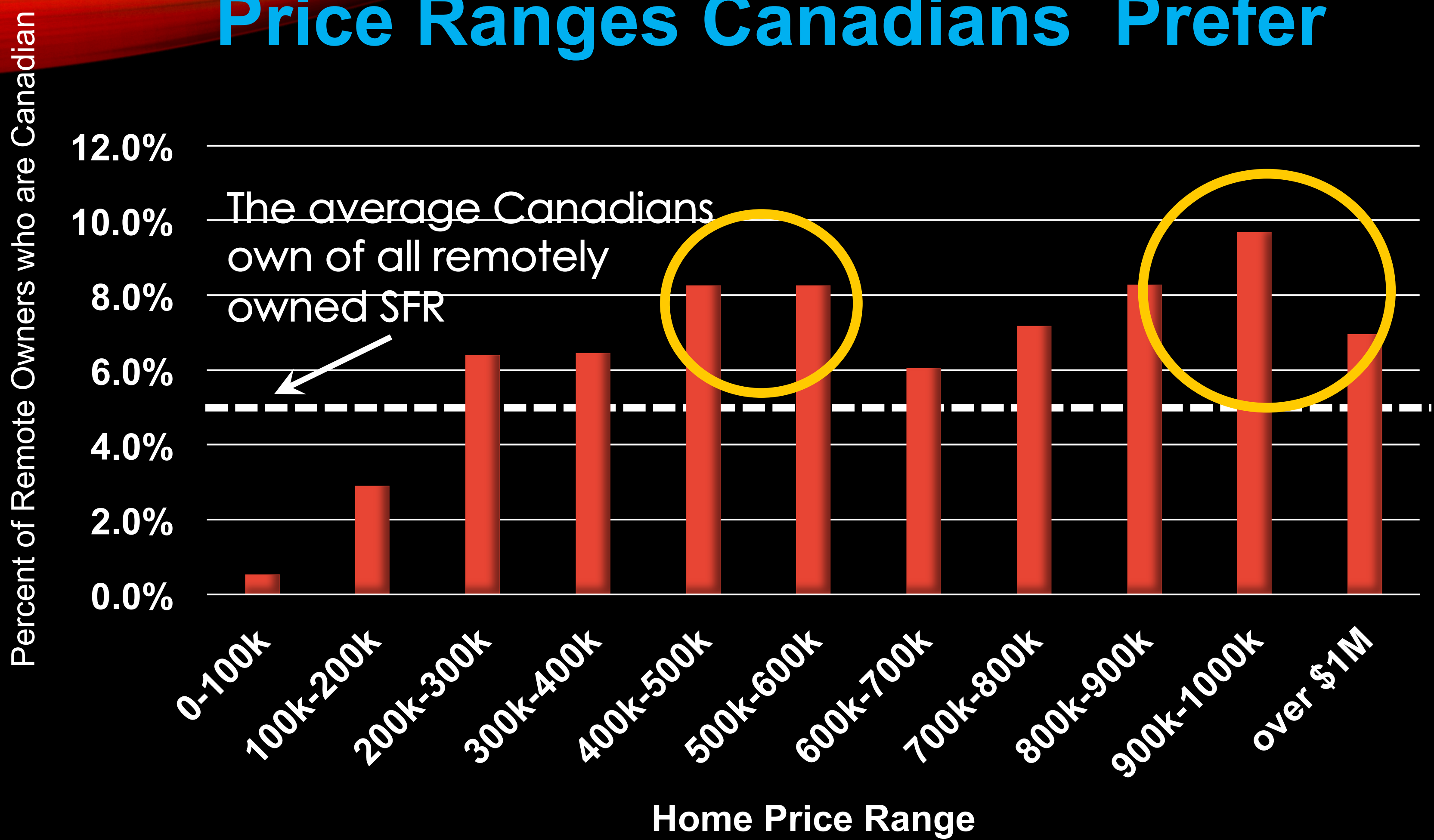
2nd homebuyers are 40% of the Valley market !



- This ratio should continue into 2015
- Note for home builders: *2014 had the lowest number of owner-occupied homebuyers since 1998!*

Source: Dataquick

Price Ranges Canadians Prefer



- **There seems to be two classes of Canadian homebuyers – one focused on mid range homes, the other on the high end.**

Source: First American

The retiree market

- Depends primarily on 60+ migration

- Long term growth in 60 + households has been 1,500 per year. Because of the baby boomer wave, the number today should be around 2,100. Census data, however, shows only a 1,400 increase in 2013.

- We believe low homes sales are the primarily reason. Retirees can’t sell and migrate.

- If average FICO scores decline as hoped, expect a possible 20% to 30% increase in retiree migration.

The Market Watch 2015 forecast

(resale market)

- The 2015 outcome depends on changes in credit conditions more than any other local, economic or financial factor.
- If bank credit loosens significantly, the Valley's median home price could rise 10%. If it doesn't, prices should remain near current levels.
- Because of record household net worth, the wealth based housing markets - Indian Wells, and sections of Rancho Mirage, Palm Springs, Palm Desert and La Quinta – should continue to do well and possibly have their best year. Tight credit is not a significant factor.
- Because of the DMHM, the Cities of Coachella, and possible Desert Hot Springs, should continue their strong 2014 gains, possibly advancing another 15%.

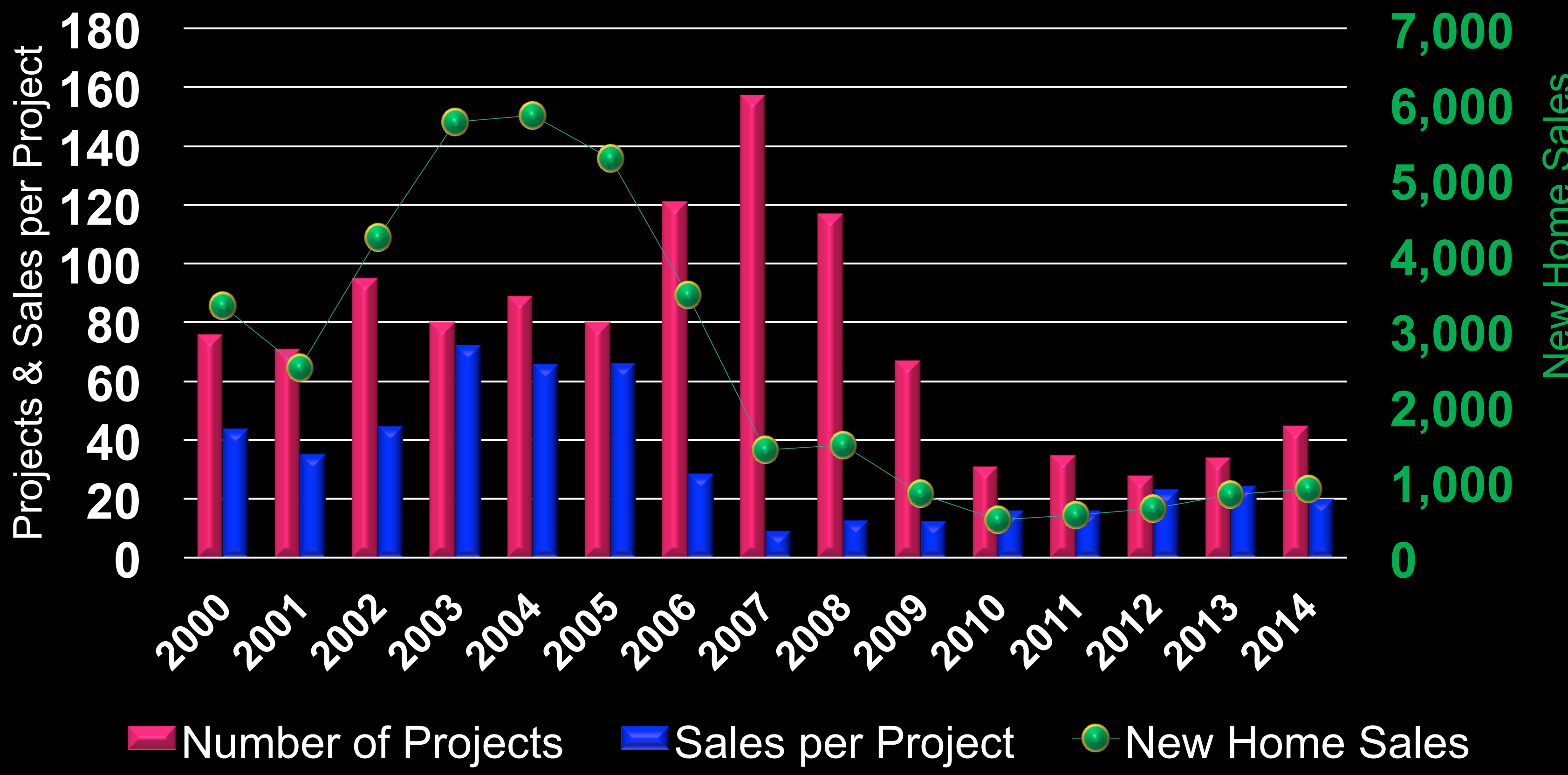
What's ahead for mortgage rates ?

- The consensus view is the FED will begin raising the short term Fed funds rate by this summer, with higher rates to follow.

- While we agree the Fed will act, we believe the increase will be small and affect short term ARM rates very little, if at all.

- 15 and 30 year mortgage rates should not be affected ! In fact, these mortgage rates may even continue their long term decline as they're controlled more by global forces, which have been pushing them down.

The Valley's new home market remains extremely depressed



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The New Home Construction Paradox

- Established Rule: New homes sales are proportional to the increase in the number of new households in a region.

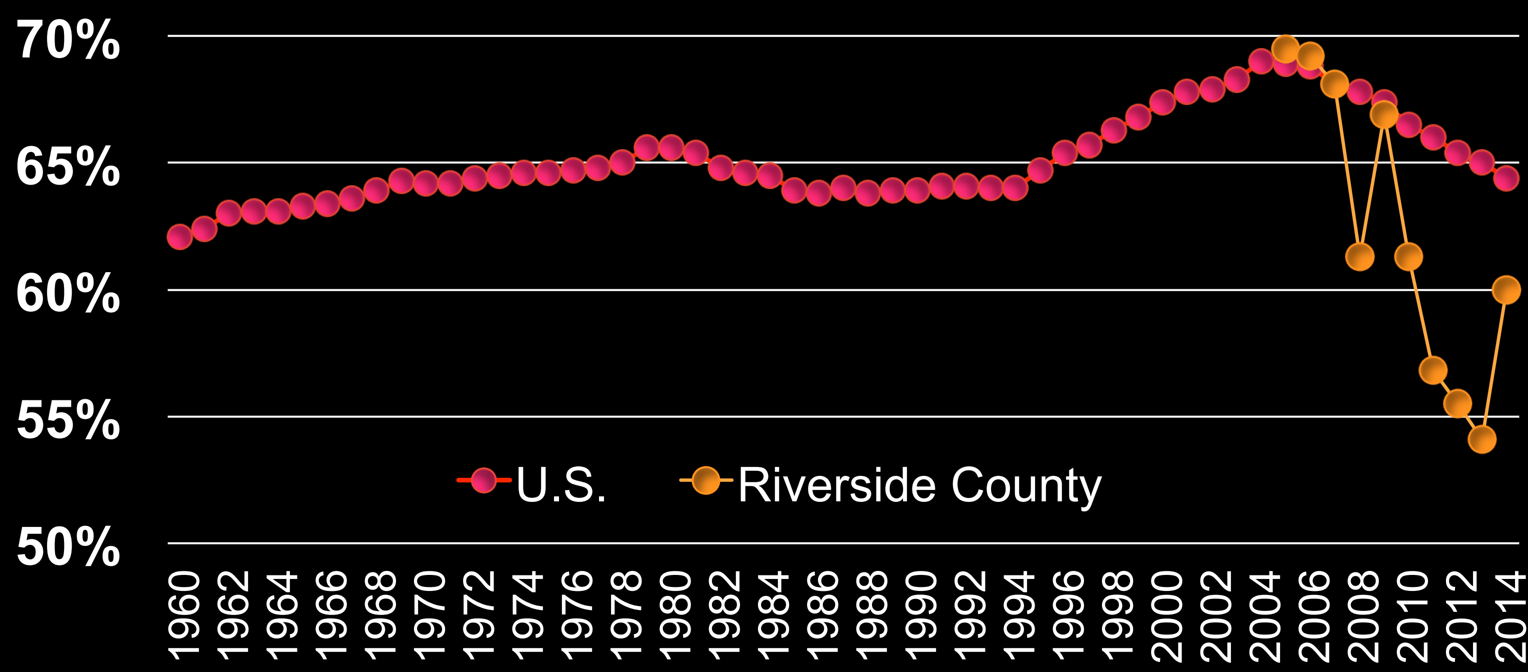
- Since 2007 the Valley has averaged an increase of 2,633 households a year. About 60% or 1,580 buy homes.

- Yet, for the last seven years new home sales has averaged less than 900 units.

Why is the rule no longer working?

The primary reason is the nine year, 15% decline in the homeownership* rate

*Homeownership rate = percent of occupied units owned by occupant



- The County's extreme drop in homeownership rates - and the move to "rentals" - was driven primarily by growing numbers of former distressed homeowners. As their credit restrictions pass, higher homeownership rates and a "rental to owner" switchback should begin this year, normalizing new home sales.

The Market Watch 2015 forecast
(new home market)

- As local households begin exiting the foreclosure penalty box, many will stop renting and purchase homes. 2015 should be the year homeownership rates stabilize and even begin to rise.

- The "household formation rate" in the Valley should also return to normal in 2015.

- If homeownership and household formation increase as we forecast, new home sales should quickly rise to 2,000 units.

- The risk of a "renter to owner" switchback should be calculated for all rental projects. Rental investors should watch for signs of a "switchback."

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The Market Watch 2015 forecast

(new home market)

City	Active Projects	2015 Planned Projects	Lots	2015 Sales Forecast
Bremuda Dunes	0	2	41	15
Cathedral City	1	4	361	70
Coachella	0	0	0	0
Desert Hot Springs	0	3	128	25
Indian Wells	1	0	234	30
Indio	16	0	1,777	517
La Quinta	10	4	741	147
Palm Desert	8	3	675	111
Palm Springs	14	10	1,024	176
Rancho Mirage	4	2	123	31
Thousand Palms	0	0	0	0
Totals	**54**	**28**	**5,104**	**1,122**

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