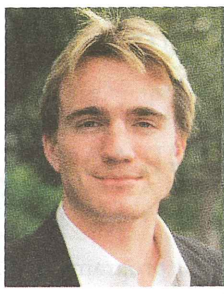
Short sale 101: When homeowners are under water



REAL ESTATE UPDATE

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The Lund Team

Distressed property is expected to keep local real estate values suppressed in 2011. New data shows Carlsbad will experience a steady flow of foreclosure activity into August. More than 330 single-family homes and condos in the later stages of default are set to enter the market over the next six months. This will add roughly 55 homes a month to the current for-sale inventory of new construction, foreclosure and traditional sale homes. Historically, an inventory increase of 10 percent should not notably affect local property values, but these homes will be short-sale homes. which have been found to be extra damaging to a neighborhood's value.

A short-sale occurs when a homeowner owes more than the property is worth. Instead of vacating the property and forcing the bank to foreclose, the owner remains in the property and negotiates with the bank to accept less than what is owed. A short-sale is beneficial to the owner, as it allows the owner to avoid a foreclosure on his credit. Some short sellers have repaired their credit in as little as 18 months. The difference that makes short-sales so dangerous to a neighborhood's value is that the owners have little incentive to sell the home at top-market value. The owner in a short-sale owes more to the lender than the property is worth. If their home sells for $500,000, not $525,000, it makes little difference to the homeowner, whose primary concern is securing an approval from the bank.

The general idea of the free market prescribes that prices will settle in at fair market value. But the current real estate market has an imperfect demand for short sales. DSNews, an industry publication for distressed property professionals, found in a recent survey of 3,000 home buyers and agents that 30 percent of owner-occupant buyers and 20 percent of investor buyers refused to view short sales when looking for a home. This means a significant number of the available buyers wont look at, and thus not offer on property that requires a short sale.

With fewer buyers and a reduced chance to sell, short-sale property is often discounted heavily (as much as 10 percent below current market value) to entice home buyers into making an offer. When more than a few short sales are present in an area, it can have a dramatic effect on the perception of value of a neighborhood. To make matters worse, the bank relies on third-party sources for value and will never physically view the property. This gives a high degree of probability to mis-price the property and approve a lower than necessary value.

Interestingly enough, over the last 12 months many of the short sales have come from owners walking away from homes in "strategic default." This is when a homeowner has the financial capacity to continue making payments on the home, yet chooses to stop making payments and walk away from his debt. This is due primarily to the fact that the homeowner owes more than the market value of the property.

Property values declined 25 percent in Carlsbad and as much as 45 percent elsewhere in San Diego. A homeowner might grab a basic compound-interest calculator and find that a conservative 3 percent yearly appreciation rate will take 18 years for that house to get back to $500,000. For owners who put little-to-no down payment, strategic default is an easy decision. For a briefing of strategic default, watch the May 2009, 60 Minutes story: "Strategic Default: Walking Away from Mortgages." Also, read the white paper by Brent T. White, "Underwater and Not Walking Away: Shame, Fear and the Social Management of the Housing Crisis." This paper challenged norms by encouraging underwater homeowners to reconsider the common thought of staying in your home even though the value has gone down.

La Costa Ridge – Distinctive floorplans atop one of the highest elevations in Carlsbad, La Costa Ridge is the only gated, master-planned community in Carlsbad. In a time where luxury sales have been few in Carlsbad, La Costa Ridge has consistently sold. Homeowners have taken extra care to improve front and rear yard landscaping to create a luxury community that warrants a premium. If available, the single level floorplan in Warmington's Fiori and Shea's Messina are exceptional and sell between $1.2M to $1.4M.

Commercial properties present good market value

REAL ESTATE UPDATE

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The Carlsbad industrial and office market has seen drastic change over the last few years. Between 2006 and 2008 Carlsbad saw a major surge in development in the industrial and office markets. The oversupply in these product types in areas like the Carlsbad Raceway Business Park, Bressi Ranch, and infill projects within the Carlsbad Research Center have had a negative looming effect on the Carlsbad market.

The oversupplied market, combined with a battered economy, made 2009 one of the worst years to be a real estate owner in Carlsbad. These factors forced Carlsbad vacancy rates to spike in 2009 with industrial vacancies peaking near 16 percent and office vacancies peaking at nearly 30 percent.
In 2010, the pain set in and industrial sale prices plummeted 50 percent and lease rates fell 30 to 40 percent from peak years.

Everyone knows commercial real estate has taken a major hit in recent years but a lot of people and business owners don't realize that throughout 2010 and in the first few months of 2011, we have seen a vast increase in activity and improvement in our market.

The Carlsbad industrial market in 2010 showed positive signs with a little more than 400,000 square feet of product absorbed, dropping the vacancy rate to around 13 percent. This is positive change from 2009 when Carlsbad had a vacancy rate of 16 percent. If you look at San Diego County as a whole, in 2010 approximately 940,000 square feet was absorbed, which is a great sign when you compare it to 2009 when we saw negative absorption of 4,150,000 square feet.

The office market also showed some signs of improvement. The entire county absorbed a little more than 1,000,000 square feet in 2010, compared to 2009 when tenants returned 1,400,000 square feet back to the market. In 2010 the Carlsbad office market broke even with almost no negative or positive absorption -- a vast improvement from previous years.

The surge in activity has mainly been price driven. Many tenants who have weathered the recession have taken advantage of the reduced lease rates. There are some very good economic opportunities in the market. Landlords are offering concessions such as free rent, moving allowances and tenant improvement dollars in addition to a reduced lease rate. In the office sector, we are seeing some tenants lock in five-year lease terms while receiving 6-9 months of free rent, bringing the effective rents for prominent Class A office space well below $2/sf. Some of the industrial projects we represent in Carlsbad are offering first-year tenant incentives of lease rates in the $0.50/sf range, which was unheard of just a year ago.

On the for sale side, the good deals are very tough to find. There is pent-up demand from owner-users and investors looking to buy good deals in both the office and industrial market. There is still a lot of product on the market which is overpriced and has been sitting there for a long time. Some of these developers have deep pockets and can afford to sit on their product for years and wait to get their price. The product that is priced aggressively is moving very quickly. We are seeing some bank-owned deals and a few short-sale opportunities that have multiple offers on them before going into escrow. The industrial buildings that are moving well are selling at prices in the $89-$130/sf range, depending on location and office build-out. Owner-user finished office buildings in Carlsbad are selling at prices ranging from $150-$200/sf, which are well below replacement costs.

Judging by all of the real estate signs posted on every other building in business parks throughout the county, one would think that no one is leasing or buying anything. But vacancy rates are slowly decreasing and the well priced deals are getting snatched up. We anticipate the market to show more signs of improvement with continued positive absorption throughout 2011. The speed of recovery in the San Diego office and industrial market will depend largely on the speed of recovery in the U.S economy and overall job growth in San Diego.

There is an unprecedented amount of opportunity out there and tenants and buyers should take advantage of the current market conditions. The deals are hard to find and they will not last forever so interested tenants and buyers should seek the expertise of a qualified commercial real estate broker.

For more information, contact Isaac Little with Lee & Associates at 760-929-7862 or ilittle@lee-associates.com.

An aggressively priced, high-end industrial property in Carlsbad. Prospective business tenants are taking full advantage of the current market's reduced lease rates.