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House Price "Bubble" Now Deflated, Setting Stage For Mild Recovery

The housing "bubble" – whose bursting triggered the current mortgage credit crisis – has now fully deflated, according to a new study published today by SMR Research Corp.

This sets the stage for a mild housing recovery, which SMR said would begin prior to yearend 2008.

The recovery is likely to be gradual, with house prices merely firming up or increasing slightly, rather than returning to the strong growth they showed from 2002 to mid-2006, the firm said.

SMR specializes in mortgage and home equity loan industry research. An SMR study was among the first to declare (in 2002) that a housing price bubble existed, defined as prices rising faster than consumer incomes. In a 2004 study, SMR forecast that a "perfect storm" in credit quality would cause an explosion in foreclosures within two years.

"Our prior forecasts were accurate but widely disbelieved when issued," noted SMR President Stuart A. Feldstein. "We similarly expect a skeptical reaction now to a recovery forecast, which is not the common view. But the numbers are what they are."

The new recovery forecast was published within SMR's annual Spring study on mortgage industry trends and leading players: **Giants of the Mortgage Industry, 2008**. More than 230 pages this year, **Giants** has been in continuous publication since 1986.

A special section in the study used home price and consumer income data from several sources to show how the bubble grew from 2002 to 2006. The same data now show the bubble has evaporated at current mortgage interest rates after 18 months of rising incomes and falling home values.

"Homes are now affordable again," Feldstein said. "Consumer psychology is the biggest remaining hurdle to recovery."

Prospective home buyers, still hearing predictions that prices will fall further, keep waiting to buy, SMR noted. This becomes a self-fulfilling prophecy, as scant demand pushes home prices lower.

"The stage is set for recovery, but the play won't go on if no one buys a ticket," Feldstein said. "Consumers must believe prices have bottomed out, or nearly so, before they will buy in larger numbers."

SMR noted that home price depreciations always do come to an end eventually, as occurred over the last 20 years in California, New England, New York, and Hawaii. Falling mortgage interest rates could trigger the end of this one.

The recovery in housing will be tempered by three negatives, SMR said.

First, borrowers with low credit scores may be unable to participate. Second, existing home owners who owe more money than their homes are worth may find it difficult to move until prices firm up.

Third, there is another type of housing "bubble" that may still exist, SMR said. It is the difference between home purchase downpayments and household savings.

SMR cited IRS data showing a big increase over 10 recent years in the percentage of tax filers reporting zero taxable interest income, implying no available cash savings. It is more difficult and expensive today to get 100% home purchase financing, so most buyers must have some downpayment funds.

Still, even though these problems will make the housing recovery modest, they will not prevent it from coming, SMR said.

In its analysis of the house price/income bubble, SMR used gross household income data from the Census Bureau as well as per capita disposable incomes from the Commerce Department's Bureau of Economic Analysis.

The firm used house price data reported separately by the Census Bureau on newly constructed homes and from the National Association of Realtors on existing homes.

In addition, SMR compared income trends to required average monthly mortgage payments under prevailing annual interest rates from 1990 through February, 2008. Results showed that gaps created from 2002 through 2006 are now closed.

SMR's annual Giants study also includes the firm's complete coverage of full-year 2007 mortgage originations and servicing data by lender and for the industry, plus new measures of loan delinquency, foreclosure, and other industry and company statistics.

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Founded in 1984, SMR Research Corp. is the nation's largest provider of industry research studies on mortgage and home equity loan subjects. More details about the new study's content can be found under the "mortgage" subject button at www.SMRresearch.com.