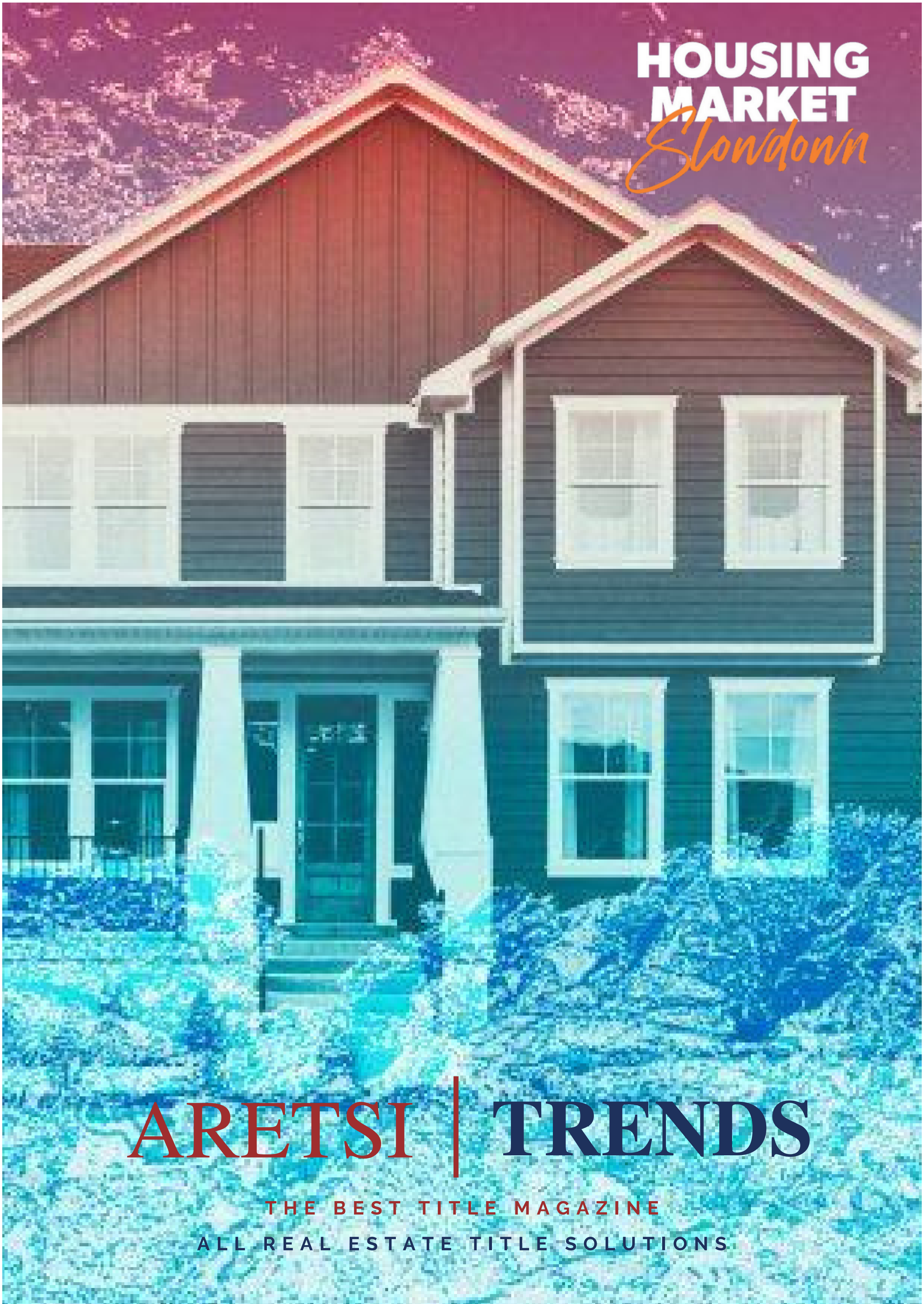

HOUSING MARKET *Slowdown*

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ARE YOU GEARED UP FOR A DOWN MARKET?

If you haven't experienced a buyer's market before, everything you know about selling real estate is about to be turned upside down. Here's how to weather a downturn and keep your business moving forward.

As of July 28, 2022, the U.S. is officially in a recession. The days of multiple offers, short market times, rising prices, and high buyer demand are rapidly becoming a distant memory. If you haven't experienced a buyer's market before, be forewarned: Everything you know about selling real estate during the last decade is about to be turned upside down.

ARE WE HEADED FOR AN EPIC CRASH?

NAR reports that pending sales dropped by 8.6 percent in June, down 20 percent from June 2021. NAR Chief Economist Laurence Yun also predicted,

Contract signings to buy a home will keep tumbling down as long as mortgage rates keep climbing, as has happened this year to date.

ZeroHedge cited 14 signs that the economy is heading for an epic crash, including three factors related directly the real estate:

- *Sales of previously owned homes dropped 5.4 percent during June. That is now the fifth month in a row that we have seen a decline.*
- *In three-fourths of the metro areas that Redfin tracks, at least 25 percent of home sellers reduced their asking price during June.*
- *Blackstone has prepared a war chest of $50 billion so that it can scoop up depressed real estate all over the country after housing prices have crashed in the months ahead.*

THREE PHASES OF THE DOWNTURN

During the four previous recessions, the real estate market went through the following three phases as it moved from a seller's market to a buyer's market.

- ***Phase 1:*** *Prices are still increasing, but sales volume has started to decline. The amount of inventory, days on market, price reductions, and expired listings are also increasing. In previous downturns, Phase 1 lasted at least six months.*
- ***Phase 2:*** *Prices flatten. This typically takes place between six and 12 months after Phase 1 ends. Depending on how bad the economic conditions are, Phase 2 can last for a fairly long period or be as little as 30 to 60 days.*
- ***Phase 3:*** *As the amount of inventory builds to seven months or more, prices begin to drop. The more months of inventory on the market, the fewer sales there are. This translates into even greater price declines as desperate sellers lower their prices to sell before prices drop even further.*

TAKE THESE 5 STEPS NOW TO BE PREPARED FOR A DOWN MARKET

Here are five of the strategies that have worked in previous downturns and will come in handy if your market starts to drop.

1. PREPARE FOR THE 'STICKY PRICING PHENOMENON'

In a buyer's (down) market, you must shift your focus from price appreciation to price depreciation. The pivot point from a seller's market to a buyer's market occurs when there are seven or more months of inventory on the market.

In a seller's market, prices will quickly soar to meet market demand. In contrast, prices are slow to fall in down markets. This is known as the "sticky pricing phenomenon." As noted above, this occurs because price declines lag behind actual market conditions by six to 12 months.

According to First Tuesday, the "sticky pricing phenomenon" is already occurring in six of California's top markets:

- *San Jose's for-sale inventory is up 10 percent and price drops are up 9 percent*
- *Sacramento's inventory is up 39 percent and price drops are up 24 percent*
- *Oakland's inventory is up 43 percent and price drops are up 12 percent*
- *Stockton's inventory is up 58 percent and price drops are up 19 percent*
- *San Diego's inventory is down 4 percent and price drops are up 17 percent*
- *San Francisco's inventory is down 5 percent and price drops are up 8 percent.*

Statewide, home sales volume reached an early peak in March 2022. Since then, sales volume has bucked normal seasonal trends, declining throughout the spring season — typically the busiest time of year for real estate agents.

At this rate, total annual sales volume will fall below the prior two years, but also below 2019 (the last "normal" year for sales volume before the pandemic struck in 2020).

2. HELP SELLERS AVOID 'CHASING THE MARKET DOWN

Anyone who has experienced a buyer's market with few transactions, plunging prices, and high foreclosure rates, is familiar with the concept of "chasing the market down." Here's how it works.

Once your market reaches Phase 3, your MLS comparable sales for August 2022 are based upon sales that closed in May or June. Assuming it took those properties 60 days to sell and then 60 days to close, that means your comparable sales are based upon prices from 120 days ago.
To illustrate this point, Sacramento's inventory as noted above is up by 39 percent with 24 percent of the sellers lowering their prices. Assuming that the market peaked in March 2022, as of August 2022, prices would have already been declining for four months.

- *For a listing taken in August 2022 that takes 60 days to sell, there will be a total of six months of price depreciation.*
- *On a $500,000 listing in an area where the prices will drop by 8 percent this year, that house would decline in value by $40,000 over the next year, or by $20,000 by the time the property goes under contract after 60 days and closes 60 days later. In other words, the property value today would be $480,000 at closing.*
- *Now assume the buyer doesn't qualify for a loan 60 days later due to another increase in mortgage interest rates. The seller must put the property back on the market. At this point, there would have been eight months of depreciation making the property value at that time $473,200.*

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If that seller were to relist at $500,000, the house would be at least $27,000 overpriced. Furthermore, for every month the seller stays on the market, their home is depreciating by $3,333 per month.
To avoid chasing the market down, the seller would need to price their home at least $30,000 under their original asking price ($470,000). If prices are in a free fall, they may need to list as low as $450,000.

3. PREPARE TO SHOW SELLERS THAT THE MARKET IS DECLINING

Helping sellers make the transition from the psychology of an increasing market to a decreasing market is no easy task. The three strategies below can help you do this.

- *Use your local MLS statistics or Realtor.com to pull up a list of all the properties that have been reduced in price and/or have expired in your local area. If it's above 10 percent to 20 percent, your market has peaked, and prices may have already started to slide.*
- *Check the primary Automated Valuation Models (AVMs) such as Redfin, Realtor.com, and Zillow for their pricing. Please note that Realtor.com provides an interactive graph dating back to 2017 that tracks prices from three of the most advanced Artificial Intelligence (AI) AVMs: Collateral Analytics, CoreLogic, and Quantarium (the most advanced AVM since it's the only one that includes over 900 interior features in their pricing model.) Show the sellers the graphs, and if there is a flattening or dip, prices are already heading down.*
- *Once your market has experienced about six months of price declines, the shift will begin to show up in your MLS comparable sales. To gauge how much the market is decreasing, calculate the average price per square foot in your market area for the last 60 days.*

Repeat the process for the preceding 60 days. If the current average price per square foot has decreased, you can gauge how quickly the market has declined over the last 60 days by subtracting that number from the current average. Multiply that by the square footage in the improvements on your listing, and that will tell you how much the house has declined in value during the last two months.

4. MAKE THESE TWO KEY CHANGES TO YOUR PURCHASE AGREEMENTS

Mortgage interest rates are volatile, even though NAR Chief Economist Laurence Yun doesn't see a big swing in interest rates at this time. To make sure your deals close, the interest rate in any lone contingency should be written at least ½ to one point higher than the prevailing rate.

The second step applies when the buyer plans to obtain a fixed-rate mortgage. Be sure to include a provision that states, "If the buyer cannot qualify for a fixed rate mortgage, the buyer agrees to take an adjustable-rate mortgage." Be sure to specify the rate as well as whether the mortgage has a fixed rate component. (A typical example is an ARM where the first five years are at a fixed rate.)

Please note, never write "prevailing rate." For your purchase contract to be valid, it must state the exact interest rate where the buyer can walk away.

5. EMPLOY THIS TRIED-AND-TRUE STRATEGY THAT HAS WORKED IN EVERY DOWNTURN SINCE 1980

The “rate of absorption statistics” coupled with “the probability of selling” script is golden in down markets. Here are the steps to follow:

- *Begin by searching your MLS for how many months of inventory are on the market for the specific neighborhood or zip code where the property is located.*
- *Assume there are currently eight months of inventory.*
- *This means that if no new listings were to come on the market, it would take eight months for 100 percent of the current inventory to sell.*
- *When you meet with the seller, explain that this number means that 12.5 percent of the listed properties will sell each month (1/8) and 87.5 percent will not sell, i.e., still be listed next month.*
- *Close the seller by saying, “For your property to sell in today’s market, it must be priced in the top 12.5 percent of all listings in terms of value and price. Otherwise, you will be in the 87.5 percent of listings that will still be on the market next month.*
- *Two other persuasive techniques are giving the seller a list of the properties that have price reductions as well as those that have expired.*

Based on previous downturns, a buyer’s market with declining prices is the most difficult type of market you will ever experience. On the other hand, agents who are prepared and who understand the dynamics of pricing and negotiating deals in a down market can have their best year ever. That certainly was the case for me in the four previous downturns, and it can happen for you if you’re adequately prepared.

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