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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

Part of the American dream is home ownership. However, home ownership has felt like anything but a dream recently. The experience of the last few years has home owners asking when will the housing market get better.

Housing Valuations

American home owners historically are accustomed to their properties appreciating in value, it has been just the opposite recently. In the early 2000's inflation adjusted home prices, meaning home prices after removing the effects of inflation, appreciated rapidly and then declined sharply starting in 2007. Inflation adjusted home price data shows dramatic revaluations to historical levels as well. In fact, inflation adjusted home prices are now at levels that they were at roughly 10 years ago. Another widely used metric to judge the affordability of the housing market is the Price-to-Rent ratio which compares the total cost of ownership versus the total cost of renting. Current Price-to-Rent ratio data corroborates the information reported by the inflation adjusted home price data, mainly that the costs of home ownership versus rent is roughly at the same level as it was 10 years ago. The included graph (below) shows home price's relationship to building costs and population growth over time. As the graph indicates home prices have decoupled from their historical relationship with building costs and population growth in recent years and are only now approaching typical levels again.

Of course the real question is, are we at the bottom of the housing market? And when will housing prices increase? The S&P/Case-Shiller 20-City Composite index (CSI) shows some signs of hope that prices have bottomed out. The CSI

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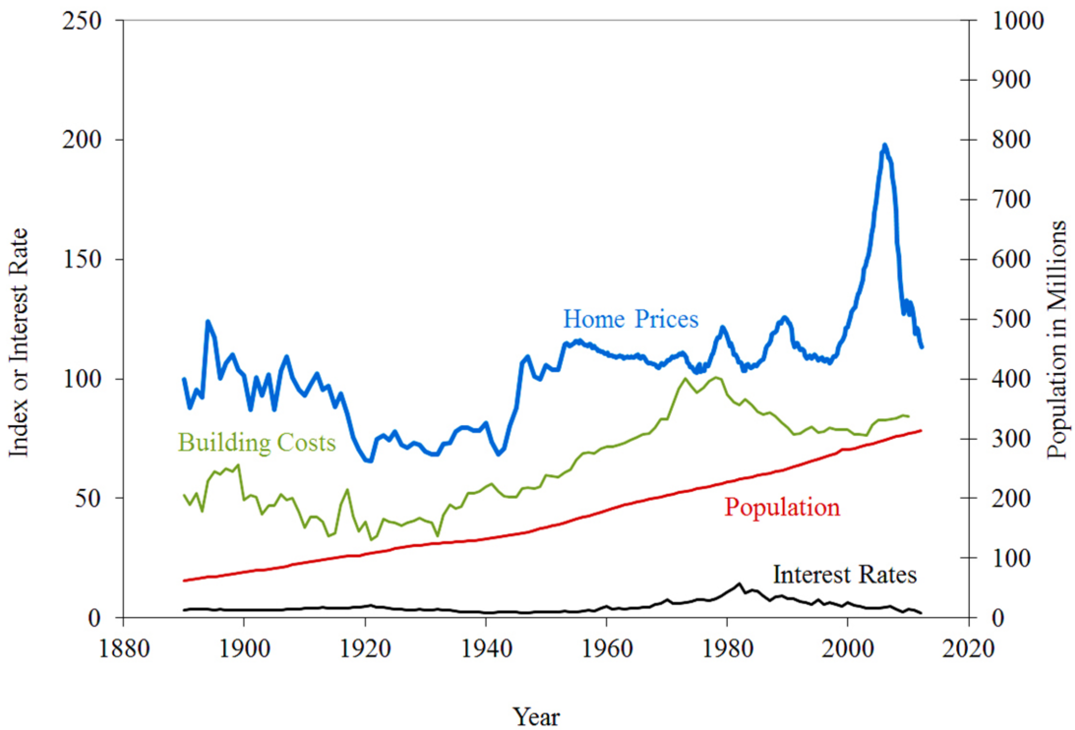

Source: *Irrational Exuberance* by Robert J. Shiller

has improved for the past four consecutive months. Some parts of the country have reported housing price increases. Housing starts have shown improvement over last year's numbers, new home sales are showing similar gains as well and some regions of the country are experiencing gains in housing prices. The National Association of Home Builders Market Index, which measures the sale of single-family homes, sales in the next six months and buyer's traffic, now shows much higher levels of activity than in 2008 through 2011.

Mortgage Rates

The Federal Reserve has specifically targeted the housing market with their easing policies. From November of 2008 to March of 2010 the Federal Reserve conducted their first round of quantitative easing and bought

Current National Mortgage Rates

Mortgage	*Current Rate*	*52 Week Low*	*52 Week High*
30 Year Fixed	3.73%	3.72%	4.72%
15 Year Fixed	3.00%	2.99%	3.89%
FHA 30 Year	3.65%	3.63%	4.43%
Jumbo 30 Year	4.11%	4.04%	5.09%
5/1 Year ARM	2.99%	2.97%	3.37%

$1.25 trillion of mortgage-backed securities to aid the real estate market. More recently, the Federal Reserve is engaged in what has been termed

Operation Twist, which is aimed at lowering long-term rates and to stimulate mortgage loans by spending a cumulative $667 billion dollars on longer-term securities. The Federal Reserve's programs and the current market conditions have produced a very conducive mortgage market.

Mortgage rates have actually dropped to record lows. The average 30-year mortgage has dropped as low as 3.72% which is the lowest on record according to Freddie Mac's records that date back to 1971. 15-year rates also set a record low at 2.99%. Although, it appears that it would be a great time to buy a home qualifying for a mortgage has been difficult.

Credit Standards

For anyone who has applied for a loan recently it is no surprise that lending standards are much tighter than they have been in the past few years. Credit profiles from recently closed loans, from this last May, show that only those potential home owners with good credit are getting financed.

As evidenced by the most recent data from Ellie Mae, a software provider for the residential mortgage industry, approved mortgage applications have had increasingly better average credit profiles. Home purchases financed with conventional mortgages that were closed in the month of May show an average FICO score of 764 and 21% down on the property. For refinance loans using conventional mortgages the numbers are similar, the average borrower had a FICO score of 766 and 28% down. Borrowers using FHA loans, a government sponsored housing program that allows borrowers to purchase homes with smaller down payments, that closed their mortgages in May had an average FICO score of 701 and 5% down. Borrowers refinancing using FHA loans had a FICO score of 713 and 14% down. This is somewhat surprising given the national average FICO score is 711 and home equity is hard to come by for a lot of home owners. The Ellie Mae data shows that typically only potential borrowers of above average credit are getting approved for loans. In fact, the average FICO score of all declined applications for May of 2012 was 702, close to the national average.

Compared to years past, especially before the Great Recession, some of these credit profiles would have represented good potential borrowers. Now, due to tightened lending standards these are merely the average credit profiles of closed loans.

Trends

The higher lending standards have helped lower loan default rates. Of mortgage loans originated in 2009 and sold to Fannie Mae and Freddie Mac 1.3% defaulted in their first 18 months which is dramatically lower than the 22% that were originated in 2007 and still lower than the 3% originated in 2002 as reported by USA Today. The downside of having such strict lending standards is that it is causing friction in the feeble real estate market. The National Association of Realtors reported last year that home sales would jump an estimated 15% to 20% if lending standards were to return to where they were a decade ago, before they became dangerously loose.

S&P 500

3 Month	-2.75%
Year-to-Date	9.49%
1 Year	5.45%
3 Year	16.40%
5 Year	0.22%

International Developed Stocks

3 Month	-7.13%
Year-to-Date	2.96%
1 Year	-13.83%
3 Year	5.96%
5 Year	-6.09%

US Aggregate Bonds

3 Month	2.06%
Year-to-Date	2.37%
1 Year	7.47%
3 Year	6.93%
5 Year	6.79%

As of 6.30.2012

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