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Hello, everyone … 2 February 2012

We are definitely "in season" now. The pace of real estate activity has picked-up noticeably. Or maybe I'm just giddy. Why? Florida Republican Presidential Primary? Super Bowl? Facebook's $5Billion IPO? Key West Half-Marathon? 79-degrees and sunny? There could be lots of reasons … and the up-tick in local real estate is surely part of it.

Table of Contents for this issue:

I substituted a "Neighborhood Spotlight" (Key Haven) this month in place of the recurring "Multi-Unit Report". You may not have noticed, but you know, full disclosure! Multi-units will be back next month. There's just too much information for one little newsletter. John Burns Real Estate Consulting is a first-time source for articles, seems solid and influencial. Likewise for Bankstocks.com. I'm consciously trying to not fill the newsletter with New York Times content. No offense to the NYTimes, I just want to have a little more diversified point of view.

Mortgage loan interest rates are still historically low. The real estate market may be slowly coming out of its 5+ year tumble. There are many properties on the market for sale, a large percentage of which are distressed (short-sale or bank-owned). The alignment of the stars seems to be creating buying opportunities that don't come around very often … like, lifetime! In many cases you can buy in 2012 at 2002 prices.

There is a LOT of optimism among those in real estate-related businesses (finally!). It's been a long slog. Politics is everywhere. Election year … I wonder what the government will attempt to ease the housing distress for so many millions of citizens? I saw a joke about the government that I hope does not apply.

When the government sees the light at the end of the tunnel, it's time to add more tunnel.

Happy Ground Hog's Day! Yes, there were shadows caused by the sun in the Southernmost City. 79-degrees, partly cloudy, small breeze from the northeast, low humidity. OK, I'll stop.

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JOHN BURNS REAL ESTATE CONSULTING | Trusted Analysis for Executive Decisions

Thoughts About the *National* Condition of Real Estate

FOUR Hurdles to overcome:

Economy – This goes without saying, but the economy has to grow for housing to recover and the best case scenario is that it grows slowly due to the excess leverage worldwide.

Vacancies: – Construction won't return to normal until the excess vacancy clears. We have already reduced it from 3.2 million to 2.4 million and we are on pace to clear it all out in some markets in 2012, but in most markets in 2014. The faster the economy grows, the faster the vacancies clear out.

Distressed Home Sales: This is the real wild card and where government policy can make a huge difference. Lawsuits, understaffing and government intervention have kept many foreclosures stuck inside the loan servicing system. If they allow them to come out quickly, housing will take a huge nose dive. I do not think this is the most likely scenario.

Mortgage Availability: – I am betting on continued aggressive credit being provided by FHA and the GSEs that will become slightly more expensive as Congress increases fees. I am also betting that we will get some more underwriting clarity, which will make it easier to get a mortgage. Right now, the banks don't know what the rules are, so they are lending more conservatively than they would otherwise.

Reasons Why the Housing Recovery will be Slow:

(1) Low entry-level activity due to lack of savings, Debt-to-Income challenges, and uncertainty
(2) Low move-up activity due to high LTVs of existing homeowners
(3) 2.4 million excess, vacant homes (but falling)
(4) Recessions caused by excess leverage take a long time to heal

Upside Potential (Bull Case): Great affordability, low construction, declining resale listings thanks to lawsuits and investors, rising rents

Downside Potential (Bear Case): Huge number of delinquent mortgages will go through foreclosure and be sold under duress. Sovereign and US Fed and local government debt challenges.

Timing: If I had to wager on three things going up in the next 5-10 years, they would be:

(1) Home prices
(2) Mortgage interest rates
(3) Rental rates

Miscellaneous:

(1) If rates increase as expected in 4 years (from 4% to 5.7%), loan payments will increase by 22%.
(2) At the national level, the after-tax cost of owning a home is less than the cost to rent one.
(3) Apartment owners will raise rents faster than inflation for many years to come.
(4) Don't wait for affordability to get better. I would buy now.

JSmith note: These pronouncements were lifted and paraphrased from a 66-page presentation on the condition of real estate at the national level. The JBREC website is www.realestateconsulting.com. He provides real estate information to institutional investors. Must be good … how else could he get that URL? I hope you find a few interesting nuggets to consider!

Lower Keys Real Estate Data: **Just the facts, M'aam ©**

The following statistics are from the MLS database concerning Key Haven, a popular residential area of about 450 single-family, mostly-waterfront homes (canal, lake and open water) at mile-marker 5:

Key Haven sales history (last 14 years):

Year:	# Residences Sold:	Avg Sell Price:	Avg $/sqft:
1998	10	$ 349,300	$ 179/sqft
1999	14	$ 441,700	$ 203/sqft
2000	16	$ 458,000	$ 208/sqft
2001	19	$ 549,700	$ 260/sqft
2002	17	$ 616,600	$ 298/sqft
2003	23	$ 688,700	$ 338/sqft
2004	22	$ 1,009,455	$ 469/sqft
2005	20	$ 1,429,437	$ 660/sqft
2006	10	$ 1,028,150	$ 556/sqft
2007	21	$ 997,207	$ 466/sqft
2008	5	$ 656,980	$ 371/sqft
2009	17	$ 578,629	$ 277/sqft
2010	11	$ 616,727	$ 311/sqft
2011	**10**	**$ 827,400**	**$ 350/sqft**

Prices had a great run-up through 2005, and then fell. The sales in 2008 and 2009 were predominantly smaller, older homes in the A and B sections (four foreclosures, three short-sales, one tear-down). 2011 shows a noticeable bump-up in prices, though only 10 sales. Dollars-per-Sqft is up, too. Have things turned around? In the past few years, the "average selling price" is a little misleading, since it includes many distressed properties … not representative of a true cross-section of Key Haven homes.

There are 24 residences currently on the market in Key Haven: 6 currently under contract and 4 of those are short-sales. Of the remaining 18, none are short-sales or foreclosures.

(1) The average asking-price is $1,386,467 and
(2) The average dollars-per-sqft is $441 and
(3) The range is: (a) *from* $539K for canalfront 3-bed, 2-bath, 1050 sqft home on a 6,000 lot
(b) *to* $7.9M for an openwater-view 6-bed, 5.5-bath, 8100 sqft home that was the setting for the MTV "Real World Key West" television show!

I have compiled year-by-year Key Haven sales statistics for each individual property, for the last thirteen years. If you would like to have the actual data, please send me an Email … I'll be happy to share it.

If you want the facts, you should be talking to ***Realty Executives Keys***. No BS.

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The New York Times

By NICHOLAS D. KRISTOF JAN 18, 2012

Is Banking Bad?

Is it immoral for students to seek banking jobs? Is it unethical to make millions in private equity, like Mitt Romney? My answer to both questions: **NO**.

Finance is not evil. Banking has allocated capital to more efficient uses, laying the groundwork for the industrial revolution and the information revolution. Private equity firms like Bain Capital (Romney) don't just destroy companies and pick over the carcasses. The aim is to acquire poorly managed companies, make them more efficient (sometimes by firing people but often by rejiggering the business model) and then resell them at a profit. That's the merciless, rugged nature of capitalism.

Liberals should be wary of self-selecting out of certain occupations. After Vietnam and revelations of CIA abuses in the 1970s, many university students avoided the military and the intelligence agencies. So slots were filled disproportionately by ideological conservatives in a way that undermined everyone's interests. We would have been better off if more Swarthmore idealists had become generals and CIA officers — and we may be better off if some idealists become bankers as well.

Now for my caveats.

When young people go into finance, I hope that they'll show judgment, balance and principles instead of their elders' penchant for greed and rigging the system. Just as Communists managed to destroy Communism, today's capitalists are discrediting capitalism.

Skepticism of today's capitalism is warranted, in my view. Corporations have vastly overpaid CEOs, rewarding not only success but also failure. Banks that helped cause today's financial mess lobbied successfully for bailouts. Meanwhile, more than four million families have lost their homes to foreclosure. Bankers and shareholders found a safety net, but not working-class families. One reason is that the system allows financiers to buy access and special favors. If you're a tycoon, your best investment often is a lobbying firm in DC.

In 2007, on the eve of the financial crisis, 47% of Harvard's graduating class headed for the financial sector, not to reform this rigged system, but to milk it … a huge misallocation of human capital. Financiers should remember the warning of John Maynard Keynes: ***"The businessman is only tolerable so long as his gains can be held to bear some relation to what, roughly and in some sense, his activities have contributed to society."***

So university students would be wrong to mock their classmates who choose Citigroup over CARE. Banking and private equity aren't evil, and I would never urge college students to stay away. Maybe today's young students can help rescue capitalism from the today's capitalists.

Hello, everyone … This will be a recurring article each month, intended to convey meaningful information from my "Florida Keys Real Estate" internet show on www.KONKNET.com, every THURs noon-to-1:00 PM. What happened in January?

Thursday #1: My guest was Attorney **Manny Madruga**, the Deputy in the Monroe County State Attorney's Office. We discussed real estate scams … especially the rental scam where someone will take a rental listing from a newspaper and put it on Craigslist (without the owner's knowledge). Then the scammer will make bogus reservations and collect the advance deposit. When the vacationers show up, they discover it was all a fraud, and the "perp" is nowhere to be found. It is very difficult to make arrests and prosecutions in these cases. You might check Craigslist to see if someone is trying to rent your property to an unsuspecting person.

Thursday #2: My guest was **Just Me**, your host of www.KONKAM.com and "Florida Keys Real Estate". The scheduled guest was Regina Corcoran, real estate columnist well-known to *Key West Citizen* readers, who currently lives in Ocala. She was due to be in Key West to be "Special Master" at the Value Adjustment Board, but suddenly was reassigned for a Monday, not a Thursday. So, I will reschedule with Regina for later this spring, to coincide with another KW trip for her. I filled the air-time essentially from notes in the last monthly newsletter.

Thursday #3: My guest was **John King**, SVP at Investment Property Exchange Services, Inc. John is a lawyer and "Qualified Intermediary" who spends full-time assisting investors with IRC 1031 Exchanges. That's where an owner can sell one investment property, replace it with another, and defer capital gains taxes. But the owner *must* follow rigid IRS rules … and there are a LOT of them. One slip-up and it's over, as the IRS has allows no slack in the process. To fully defer capital gains taxes, the new mortgage loan must be larger than the old one, and ALL the old equity is transferred to the new property, and that's just the beginning. Identification and Exchange periods must be strictly adhered to. An owner definitely needs an experienced Qualified Intermediary like John to guide her through the bureaucracy of 1031 Exchanges.

Thursday #4: My guest was **Doug Gregory**, Director of Monroe County Extension Services and Marine Sea Grant agent … a complex position with funding from the County and by University of Florida. Our discussion tried to connect Doug's responsibilities (and personal interests) to FL Keys real estate. It converged on how "conservation" is good for homeowners and the real estate markets, with emphasis on energy, climate and oceans. Doug is a founder of GLEE and he has taught classes at FKCC in solar energy. Green is good.

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My Current BUYERS in the Lower Florida Keys:

February 2012

These are a sample of 5 buyers I am currently working with, in no particular order … what they are searching for, what their concerns are, what issues must be overcome, etc. Some of this may resonate with you, too! It will be a challenge to highlight 5 new buyers each month … but, let's see how it goes. By my calculations, the present inventory of buyers will be exhausted in a few short months, so I'll need a steady pipeline of newbies to replenish the inventory and keep this column going. Anyway, if you are a seller (or know someone who is), maybe one of these buyers would be a good match! I hope you find this interesting, even with identities withheld. If you are one of my buyer-prospects, surely you will recognize yourself!

Buyer #1: Partners from (here's a clue: home of the 2011 Major League Baseball World Champions) connected with me via www.keywesthomelistings.com , a lead-generation website with which Realty Executives Florida Keys contracts … very powerful tool. They are looking for a vacation property, preferably with a transient rental license, so that it would earn income while they are not present. They are hoping for something at the $300,000 price level, and there are several currently on-the-market. They will be visiting Key West this month!

Buyer #2: A local professional couple have asked me to help them locate a smaller single-family home in Key West that might be suitable for a disabled person (relative) who is able to live on their own, without live-in care. Several years ago when this couple relocated to Key West, we almost were able to work together on the purchase of their home, but Lady Luck had other plans! It's nice to get another chance ☺. The perfect property would be in the $300,000 range and would not have a pool, the closer to Old Town Key West the better.

Buyer #3: Recently, a listing of mine attracted the attention of neighbors of the property. Were it not already under contract, they would be interested in purchasing it. This is more evidence of the lessons taught in "Realtor School" … the key to success is having listings. I'm searching for a similar property in the $500,000 price range for this couple, with a "value" greater than that! Something with historical architecture, good size (1800 living sqft or more), pool and privacy landscaping. Distressed properties are OK to consider.

Buyer #4: A couple from Pennsylvania were correspondents with me on the www.keywesthomelistings.com website, and they decided to make a *semi*-unannounced trip to Key West! They are looking to buy a vacation home, preferably with a transient license. Acquisition cost is secondary to return-on-investment. Their motivation is primarily that they have hard-earned cash that is earning only pennies in their savings/investment accounts … and they want to better than that (real estate is the answer!). We've seen several strong candidate properties.

Buyer #5: I've been corresponding with a couple from out-of-state for over two years, he being a Viet Nam veteran with service-connected disabilities. I received an email that they would be in town in mid-February and they would like to purchase a condo for winter-time use. That's *winter*-time elsewhere, of course. And that's always a nice email to receive! They are hoping for 2-bedrooms, 2-baths in the $275,000 price range, about which Key West has plenty to choose from. I'll look forward to showing several, nice candidates!

BANKSTOCKS.COM

A Shadow Over Housing's Shadow Inventory

You've heard the "shadow inventory" of foreclosures will prevent price recovery from happening for years. But two key influences will speed absorption of the shadow inventory a lot faster than people realize.

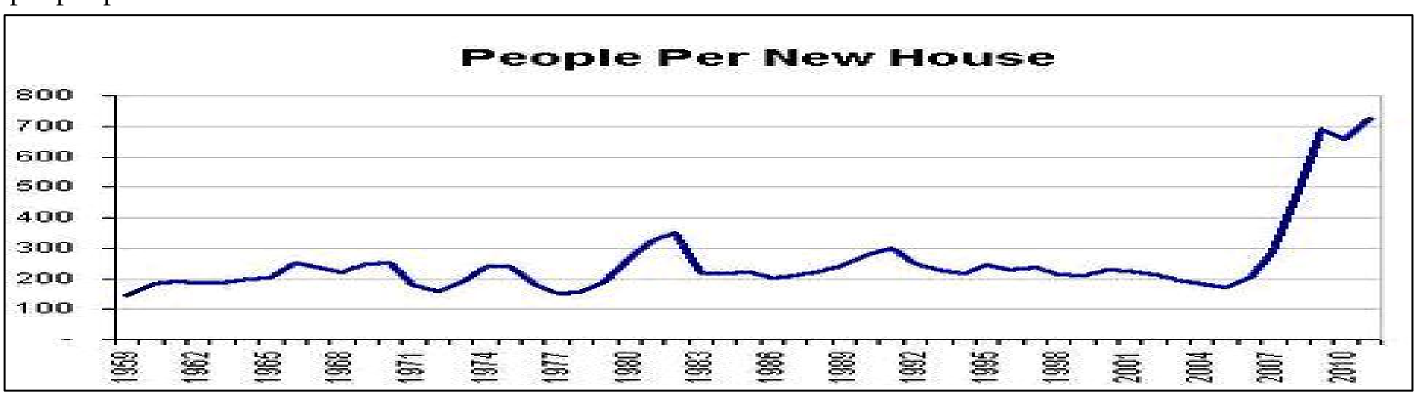
(1) **Pent-up demand**. Household formation has been running below-trend by close to 1 million households per year for three years. Those poor kids are going to move out from their parents' place sooner or later. Once employment improves and they finally do, they'll provide an enormous jolt to incremental demand.

(2) **New housing inventory**. Essentially non-existent recently. Homebuilders built just 428,600 homes last year, down from 1.7 million homes at the peak, and down from and a long-term average of roughly 1.1 million. It's the *lowest level of new-home construction* since the government started keeping records.

But even a drop that large doesn't convey the magnitude of the collapse in the supply of new homes.

(1) The housing-starts figure is a *gross* number. You need to net it against the 300,000 or so homes that are demolished each year (natural disasters, ravages of time). Accounting for that, there have been basically *no* net additions to the country's inventory of single family homes—for three years.

(2) The country's population is steadily growing. Divide annual housing starts by population, and get "people per new house built".

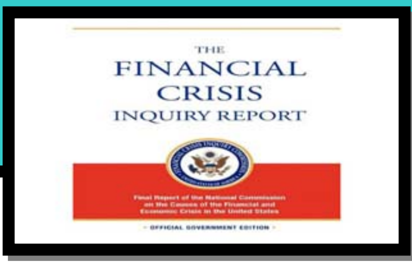


The prior peak in "people per new house built" was around 350, during the brutal real-estate recession of 1982. The current number is 727, more than twice the highest number on record until now.

While the shadow inventory of housing may be looming, newly-built inventory has disappeared, while incremental demand is still pent up, but growing. I somehow doubt that the absorption of all that shadow inventory will end up being the big problem so many people expect.

Financial Crisis Inquiry Commission

post # 10



The Financial Inquiry Commission spent more than a year examining the causes of the financial crisis. It held 19 days of public hearings, interviewed more than 700 witnesses and reviewed millions of pages of documents.

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Parts I and II of the FCIC report were "Setting the Stage". This begins Part III called "The Boom and Bust" with six Chapters: Credit Expansion, the Mortgage Machine, CDOs, All-In, Madness and the Bust. This post covers **The CDO Machine**:

Mortgage originators had difficulty selling the lower-rated tranches of mortgage-backed securities (MBSs). Wall Street came up with the solution … they built new securities called collateralized debt obligations (CDOs) that would buy the lower tranches of the MBSs. Amazingly, the A and BBB rated tranches of MBSs could be pooled and transformed into mostly AAA-rated securities, and be re-sold!

Wall Street argued, and rating agencies agreed, that pooling A and BBB-rated securities would create the safety of "additional diversification" … if one went bad, there was only a very small chance that the second would go bad at the same time. High-powered mathematics by the "quants" at the Wall Street firms said so. Wall Street invented the CDO "investor" who would buy the lower-rated tranches of the MBSs. CDOs became the engine that powered the mortgage loan supply chain … mortgage securitizers demanded more and more loans, volume not quality, in fact the poorer the quality the better (for higher investor returns).

Everyone involved in keeping the machine humming collected fees based on dollar-volume of securities sold. Volume equaled fees equaled bonuses … in billions of dollars. Compounding the problem, the lower-tranches of CDOs were pooled and (following the same script) blessed with high ratings and sold to *other* CDOs. These were called "CDOs-squared".

Most investors felt that the rating agencies AAA-scores for CDOs were an implied guarantee of investment-grade safety. Additionally, other companies (notably AIG) would contract with investors, promising to reimburse them for any CDO losses, in exchange for a fee. The contracts were *derivatives* called credit default swaps (CDSs), which seemed to remove all risk from the CDOs. CDSs are often compared to insurance, but CDSs were not regulated insurance contracts. AIG was not required to set aside a reserve pool of money in case of loss.

Goldman Sachs developed "synthetic CDOs" … they contained no tranches of any other security. They merely *referenced* other MBSs. In effect they were simply bets on whether borrowers would pay their mortgage loans, magnifying overall risk. They allowed speculators to bet on-or-against the housing market.

When the housing market went south, the models on which the CDOs were based proved to be tragically wrong. The MBSs turned out to be highly correlated, meaning they performed similarly. Borrowers began defaulting in large numbers, everywhere. AIG was quickly unable to pay claims.

CDOs were designed to make dangerous subprime debt appear deceptively attractive to investors, through complicated mathematical alchemy and negligence. Wall Street convinced investors that toxic securities were the ratings equivalent of US Government Bonds. Wall Street securities firms earned billions of dollars.

Southernmost Stars: **1 February 2012** The least expensive properties currently on the market on the island of Key West. Changes from last month are in **blue**!

Ten least expensive Condos or Townhomes in Key West:

Address:	Ask Price:	#beds:	#baths:	Living Sqft:	$/Sqft:	Other:
1830 Fogarty #4	$125,000	1	1	388	322	Affordable Housing
1830 Fogarty #7	$144,000	1	1	572	252	Affordable Housing
1830 Fogarty #6	$149,000	1	1	598	249	Affordable Housing
416 Petronia St #3	**$149,000**	1	1	409	**364**	Foreclosure
3312 Northside #204	**$160,000**	**2**	**1**	**736**	**217**	**Conventional**
3312 Northside #515	**$169,000**	**2**	**1**	**800**	**211**	**Conventional**
3312 N Roosevelt #616	$175,000	2	2	831	211	Conventional
3312 N Roosevelt #111	**$169,900**	2	2	952	**178**	Conventional
3317 Eagle Ave	**$176,600**	**3**	**2**	**1032**	**171**	**Foreclosure**
3075 Flagler Ave #20	**$180,900**	2	2	1008	**179**	Short-sale

Missing from last month: 3312 Northside #303 … listing expired
3920 N Roosevelt Blvd #412N … under contract
3029 N Roosevelt Blvd #2 … under contract

Ten least expensive **Single-Family Residences** in Key West:

Address:	Ask Price:	#beds:	#baths:	Living Sqft:	$/Sqft:	Other:
1313 8th St	**$225,000**	**2**	**1**	**1168**	**192**	**Short-sale**
2116 Fogarty Ave	**$229,000**	2	1	838	**273**	Conventional
1701 Johnson #1	**$249,000**	2	1	850	**293**	Conventional
1209 Margaret St	$259,000	3	1	864	300	Conventional
1208 Florida St	$264,500	3	2	948	279	Short-sale
1218-Rear Packer	$279,000	2	1	578	483	Conventional
829 Baptist Ln	$299,000	1	1	414	722	Conventional
1512 18th Terrace	$300,000	3	2	1492	201	Conventionl (needs renov)
1230 5th Street	**$305,700**	5	4	2573	**119**	Foreclosure (needs renov)
2929 Patterson Ave	**$319,000**	3	1.5	1447	**220**	Conventional

Missing from last month: 213 Truman #A … under contract

High-paced real estate activity so far this year … lots of lookers (investors, vacation homes) and lots of sellers lowering prices to entice "in season" buyers. Too early to say whether this is a blip or a trend. But it causes the real estate industry to gain some confidence and restrained optimism!

Least expensive does not necessarily mean *best value*. That is determined subjectively by factoring-in other variables like appreciation potential, amenities, special features, location, condition, age, style, appeal, etc.

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