



REALTY
MORTGAGE
TITLE &
INSURANCE

2006

YEAR END MARKET REPORT





2006 was a year in which the condition of the real estate market was constantly in the news. During the boom years, the confluence of low interest rates, strong job markets and rapidly rising prices created a long cycle of unprecedented opportunity. In Tucson, the average sale price of a house in January of 2000 was \$144,761.¹ By December of 2005, this number had risen to \$266,731.² Homeowner's equity grew right along with increased prices, and this "piggy bank" of found money contributed to record consumer spending. The wealth created by the real estate market enriched every corner of our economy.

By January of 2006, we seemed to have turned a corner. Throughout the country markets fell off their super-heated pace. Beginning in 2004, interest rates increased 17 times, with a resulting modest increase in retail mortgage rates. Inventories grew. In Tucson, sales fell back to a rate comparable to those achieved in the four years between 2000 and 2003.³ This is by no means a catastrophic decline, and there has been no appreciable decline in median sales price. Still, it's no wonder that we feel compelled to follow the news whenever the topic is real estate.

For most of us, a home is still our biggest investment, and one we plan to count on in our retirement. We have begun to think of our houses not only as dwelling places, but as a very important investment. Any change to recent trends can seem disquieting or even threatening. Our nation's economic well-being and our own personal prosperity are tied to continued demand for residential housing, and the good jobs and low interest rates that support it.

This report will discuss some terms that are most often used when describing changes in real estate markets. We also address the questions that we are most commonly asked about the market. In addition, we'll talk about current market conditions and how to make the most of them.

Sincerely,



Rosey Koberlein, CRB
Chief Executive Officer
Long Companies

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Are prices really falling?

Reports often talk about the median sale price in an area, which is the mid-point in a series of numbers. For example, the median price of a house in Tucson in November of 2006 was \$218,000.⁴ Of the 982 houses that sold in November, half sold for more than \$218,000 and half sold for less.

The average sale price is also a common reference point. This is simply the sum of all prices in the period in question, divided by the number of sales. Our average sales price in Tucson in the month of November was \$267,493.⁵

Although changes in the median or average sales price are some indication of the health of a market, it is housing affordability that is most likely to stall markets. In contrast to most other West Coast market, our house prices in Tucson are well in line with median incomes, which continue to give access to homeownership to the widest possible numbers of buyers.

The median and the average sale price can be affected by activity at the high end or low end of a market. Several very high sales (over a million dollars, for example) can skew the average sale price. Since higher numbers of sales can occur at the low end of a market, even in slower markets, the median price may decline without meaning that specific houses are losing value or that property values are actually dropping.

As homeowners, most of us are more concerned with the value of our own property more than we are with market trends in general.

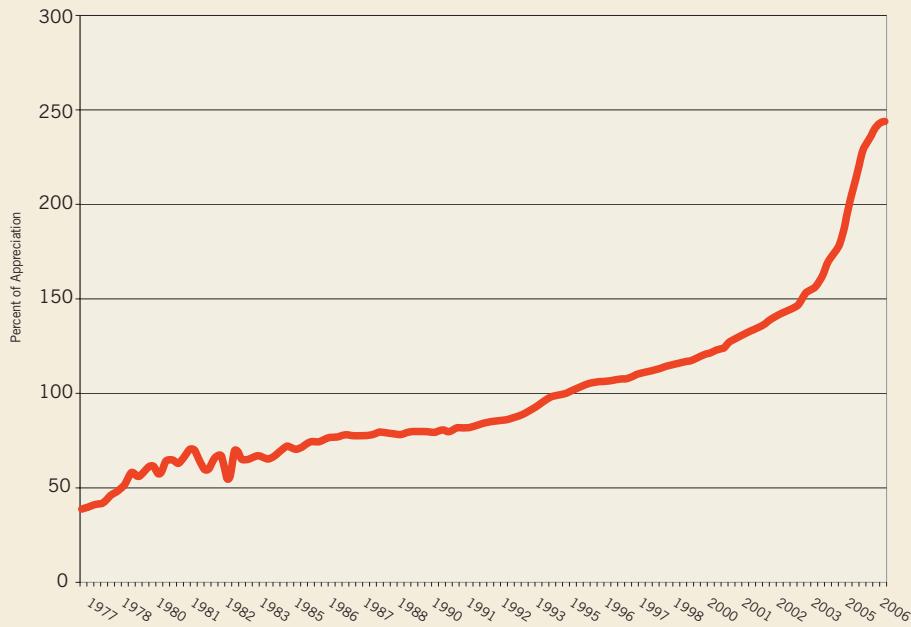
The Office of Federal Housing Enterprise (OFHEO) publishes a House Price Index that looks at the average price changes in repeat sales or refinancing on the same properties, giving a much more accurate view of how current market conditions impact the price of your own home.

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OFHEO's index is based on analysis of data obtained from more than 31 million repeat transactions over the past 31 years. OFHEO analyzes the combined mortgage records of Fannie Mae and Freddie Mac, which forms the nation's largest database of conventional, conforming mortgage transactions.

Cumulative Appreciation in Tucson, AZ since 1977



As this chart shows, houses have appreciated in Tucson at a steady rate over time. We have recently passed through a time of rapid appreciation with prices increasing 85.14% over the last five years.⁶

The good news in Tucson is that we are still seeing excellent appreciation. According to OFHEO, the most recently calculated annual appreciation (between September 30, 2005 and September 30, 2006) was 14.90%.⁷ Appreciation slowed in the second quarter to 1.01%, which may not be a blistering pace of growth, but does represent reasonable price stability in a challenging market.⁸

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Aren't sales much lower this year than they were last year?

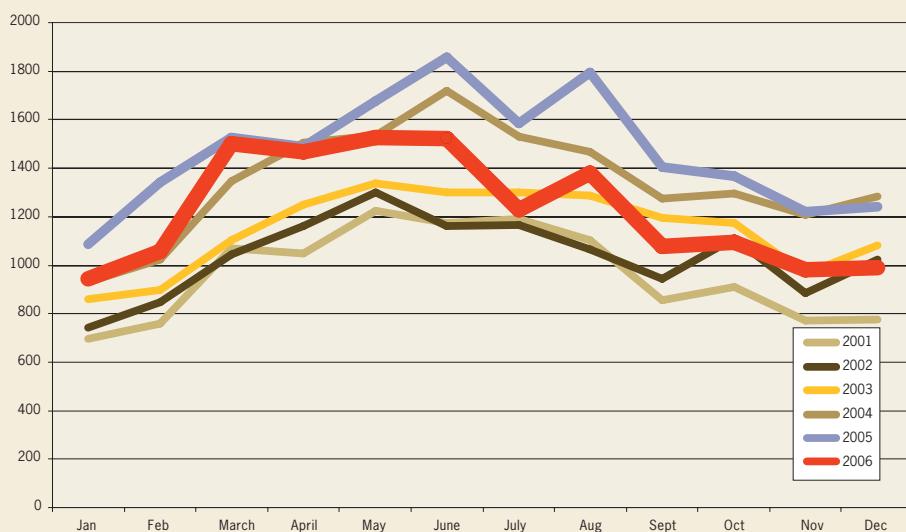
As with all comparisons, it is always discouraging to contrast current performance with record performances. Such comparisons can lead to the conclusion that things are much worse than they are. Record-low interest rates brought many buyers to the market in 2004 and 2005, and their purchases occurred when other sellers realized equity and bought bigger homes. This natural chain of buying and selling is usually driven by life events such as expanding families or job changes.

Strong economic conditions tend to accelerate the move-up cycle. After a period of acceleration in any market, there tends to be a time of equalization. People typically stay in a second or third house for a longer corresponding period (between 7 and 10 years) than they did in their first home. While these factors have slowed the pace of sales in 2006, sales are still very strong. As noted in the chart below, Tucson sales in 2006 were higher than each of the years between 2001 and 2003.⁹

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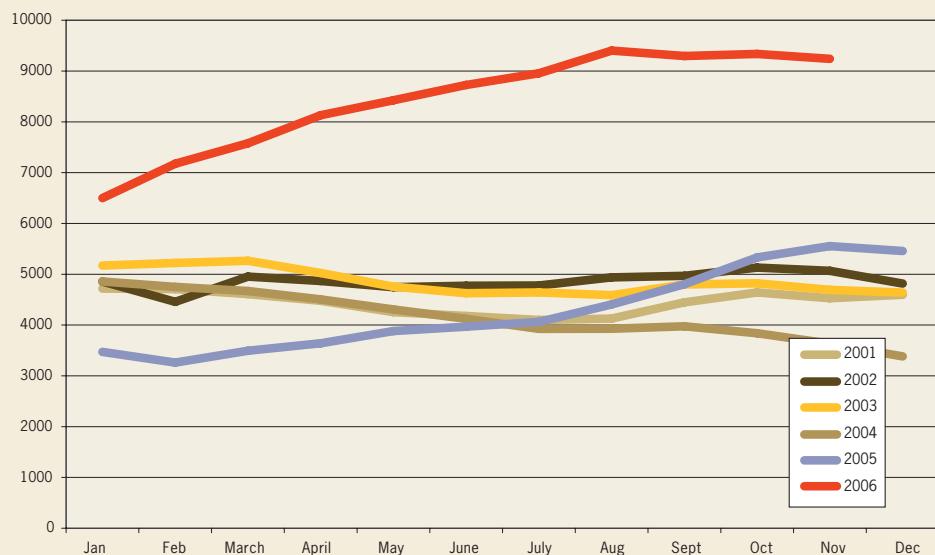
Tucson MLS Unit Sales Seasonality



It seems to me that there are many more real estate signs in my neighborhood than I have seen in a long time.

If you have noticed more signs, and also noticed that some houses are listed with a series of different real estate companies over time, then you are observing a couple of the most interesting aspects of our current market.

Tucson MLS Active Listings Seasonality



There are indeed more real estate signs in all of our Tucson neighborhoods. The current inventory in the Tucson MLS stands at about 9,300 houses¹⁰, which represents nearly nine and a half months of standing inventory. This is the highest inventory level we have had since January of 1997.¹¹ High inventory levels have a dampening affect on price appreciation.

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How are sellers coping with this new market?

While houses are continuing to sell at a very good pace, many sellers are experiencing longer times on market. In spite of steady sales, low interest rates and capable buyers, some houses linger while others welcome new owners.

This year, three and a half times as many listings expired as last year. This is a sure indication that some sellers have unrealistic goals or have been given poor advice when bringing their property to market. Rather than resorting to taking the property off the market with one agency and bringing it back on with another, it is more prudent to make a careful evaluation of the marketing choices presented to you in the initial interview process.

Although over 14,000 sellers completed sales in 2006, 3,700 listings expired and over 3,000 became inactive.¹² In the second group, some sellers have taken their houses off the market for the time being. Others have re-marketed with a new listing agency and will continue to try for a sale.

Sellers are also reducing list prices. A price reduction isn't the same thing as a falling price. A seller may have selected a price based on unrealistic profit goals, poor advice or many other factors. In any case, if a much lower price is accepted to achieve a sale, it doesn't mean that prices are dropping – it only means that the seller over-estimated the market when first listing the property.

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If I am really serious about selling my house, what should I do?

Property condition and property location have never been more important to achieving a sale. Over-priced properties will be ignored by market-savvy purchasers and sellers may have to dig deeper and deeper for a price reduction to compensate for the market-worn status of their property. You can't do anything about the location of your property, but you can certainly do something about the price and the condition.

Buyers buy with their emotions. In preparing your home for sale, you want to make sure that buyers can fall in love right away, feeling at home as soon as they enter the house. In the retail business, this is called "merchandising". In the real estate business, it is called "staging".

For most of a house's life, it is our home. We don't notice the clutter, scratches and over-stuffed closets because they are part of the vitality of the life that we live inside our houses. When our house is on the market, however, it is a stage, not a home.

To make the most of this stage:

- Emphasize the natural feature in every room. Highlight a fireplace, a beautiful window, or a family eating area in the kitchen.
- Balance furnishings to suit the scale of the room and create a sense of spaciousness and flow throughout the house.
- Neutralize and harmonize colors throughout the house.
- De-clutter everywhere. Closets, bookshelves, decorative pieces will seem twice as large if they are half as full.
- Manage natural and artificial light to show each room at its best.
- Make sure every surface is sparkling clean. Mirrors, windows, floors, counters should gleam.
- Repair all minor defects. A loose doorknob, a cracked window, a missing tile can give the impression that the house isn't sound.

When you have completed the pre-marketing evaluation with your agent, the next step is to make a thorough evaluation of all of the marketing media your agent intends to use in presenting your unique property to the marketplace. Consumers enter the marketplace through many channels and your agent should have a plan to reach them wherever they are.

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Why is it so important to have representation in a real estate transaction?

The relationship between you and your real estate agent is unlike that of other service providers.

Your agent's job is to understand your goals and to explain how current market conditions could interfere with or support them. You will be presented with all the information you need to determine the best strategy for achieving your goals. You will receive counsel so that you don't attempt to achieve the impracticable or the impossible. Beyond facts and figures, you will learn of other client's experiences in similar circumstances and will continue to see information about changes in the market. You can expect to be kept up to date on recent comparable sales, competitive new listings and other market shifts.

When the marketing plan has been successfully executed, you enter another critical phase of the transaction, where you will be negotiating about financing, inspections, repair, occupancy and other conditions that may be presented by the buyer. Your agent's local market knowledge and understanding of the complex nature of the real estate transaction will ensure that you understand and evaluate the risks in counter-offers or other strategies that might be appealing to you.

Throughout the transaction, your personal information is held strictly confidential and your agent acts only under your instruction. Selling a home isn't like selling a car or a stock portfolio. Both buyer and seller can be buffeted by emotions. Your agent's job is to be sure that you continue to stay engaged with practical considerations so that you can deal with the stress of making important life decisions and the disruption of moving.



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What does 2007 hold for Tucson and for Arizona?

Arizona benefits from the nation's most exciting demographic and economic trends. According to the U.S. Census Bureau, our population grew by 3.6% in the past year, making us the most rapidly growing state in the nation.¹³

We will continue to see migration from other Western States as people seek favorable employment conditions and better housing prices.

In addition, there are two very promising demographic trends that are particularly beneficial to Arizona.

The first is the emergence of the boomer generation into the “pre-senior” years of 55-64. As we know, boomers have a distinctive approach to lifestyles, consumer preferences and social attitudes. This postwar generation has profoundly influenced school systems, labor, housing and stock markets and transformed institutions in its path. They have not followed trends set by the Depression generation which preceded it. They are more financially secure, better educated and more mobile. This is especially evident in the growth of pre-senior populations in Western States, and Arizona is no exception. Through migration specifically, our pre-senior population will grow by 9.5% by 2010, and by an additional 7.5% in the following decade.¹⁴

Pre-senior newcomers are very likely to be in the work force. They bring diverse accomplishments, job skills and financial strength to our area. Although many pre-seniors intend to work beyond the traditional retirement age, there is no denying that within fifteen years the youngest of this group will be past their peak earning and spending years. Nevertheless, they can be counted on to contribute to our economic growth through 2020.

The second important opportunity for Arizona is the continuing growth of our minority population. Predominately Hispanic, this population is younger than average (median age of 27.3 compared to 40.3 for whites).¹⁵ The Hispanic population of Tucson stood at

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32% in 2005.¹⁶ Latino households may represent up to 50% of Arizona's new home market over the next decade.¹⁷ Immigrant populations represent an important engine of growth. As the younger members of this community wed and start families, they will increase demand for consumer goods and transform marketplaces, replacing the dollars that are no longer being spent by our older populations. There is a very important complementary relationship between these two demographic groups.

We can also anticipate some migration from Hispanic populations in California. Los Angeles, Riverside, Fresno and Bakersfield are the most Hispanic cities in California, with populations in excess of 44%.¹⁸ As newcomers achieve job status and increase earnings, they will want to purchase homes. Sadly, they are priced out of the markets in California so Arizona will continue to be an attractive place to settle as long as housing affordability stays within its current range.

According to the U.S. Census Bureau, Arizona is now the fastest growing state in the Nation. Newcomers are drawn by the economic climate, physical beauty of the desert, weather and way of life in Arizona.

All in all, we have come through a year of change with our market still reasonably intact. Inflation appears to be under control, and interest rates are unlikely to change in any appreciable way in the coming year. If sales continue at their current rate we should work through some of the large inventory over-hang and we anticipate that the market will be moving toward a better balance by mid-year.



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Endnotes

- ¹ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
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- ³ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ⁴ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ⁵ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ⁶ Office of Federal Housing Enterprise Oversight (OFHEO); 30 November 2006; <http://www.ofheo.gov/HPI.asp>
- ⁷ Office of Federal Housing Enterprise Oversight (OFHEO); 30 November 2006; <http://www.ofheo.gov/HPI.asp>
- ⁸ Office of Federal Housing Enterprise Oversight (OFHEO); 30 November 2006; <http://www.ofheo.gov/HPI.asp>
- ⁹ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ¹⁰ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ¹¹ Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ¹² Tucson Association of Realtors, Multiple Listing Service; 15 December 2006 <http://www.tucsonrealtors.org/>
- ¹³ Bernstein, Robert, Public Information Office, U. S. Census Bureau News, released December 22, 2006
- ¹⁴ America's Regional Demographics in the '00 Decade: The Role of Seniors, Boomers and New Minorities. William H. Frey, The Brookings Institution, Research Institute for Housing America. November 27, 2006; http://www.housingamerica.org/docs/6694_00Demographics_WP_WB.pdf
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- ¹⁷ Urban Land Institute, Arizona Report, June 2004.
- ¹⁸ America's Regional Demographics in the '00 Decade: The Role of Senior, Boomers and New Minorities. William H. Frey, The Brookings Institution, Research Institute for Housing America. November 27, 2006; http://www.housingamerica.org/docs/6694_00Demographics_WP_WB.pdf