

Profitis Capital Services LLC



HOUSING MARKET HANDBOOK: ARE WE THERE *YET?*

FEBRUARY 23, 2011

Executive Summary

This brief presentation is designed for a single purpose: illustrating how far the housing market is from equilibrium. Since this presentation's first publication (September, 2010), home prices have continued to decline. However, price discovery is still hampered by shadow inventory and the nonexistence of the private label MBS market.

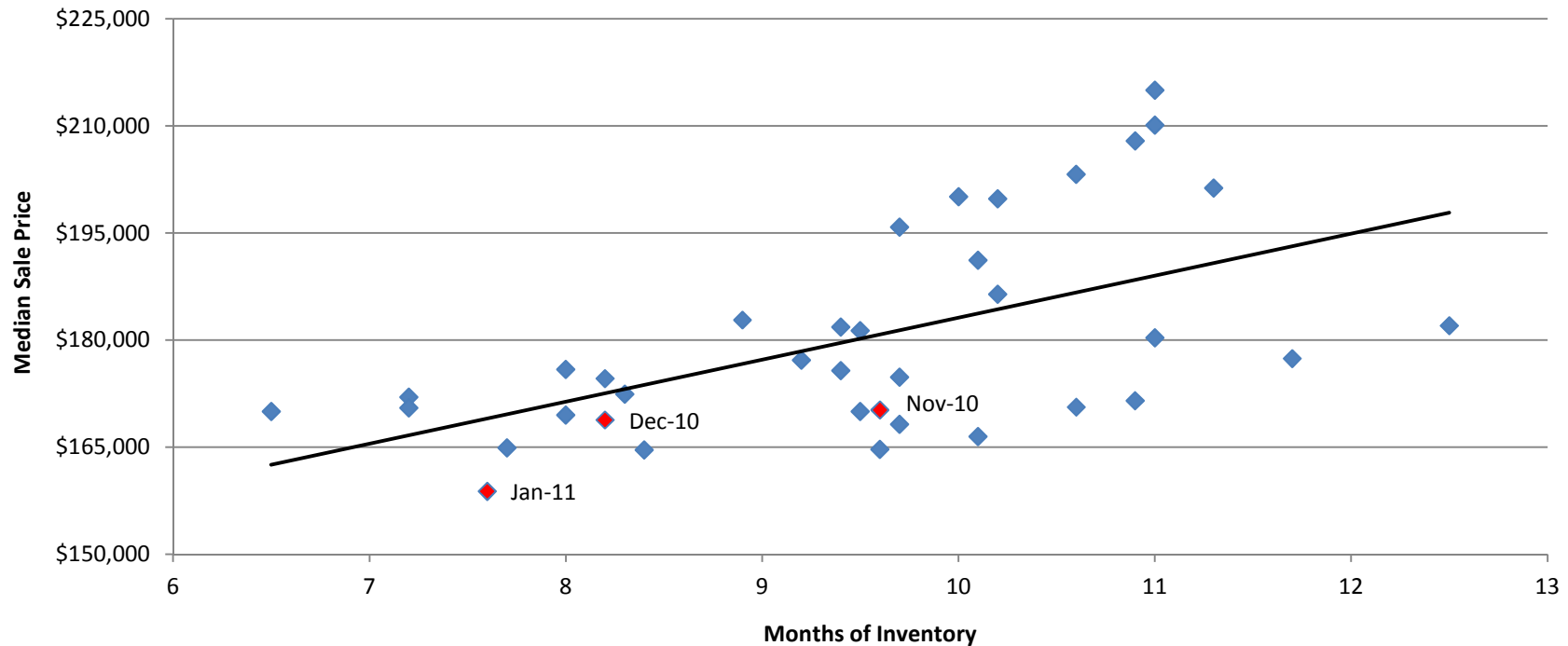
The markets' s disequilibrium is structural in nature. As such, this is not a condition monetary policy (not even "QE2") can rectify. A dramatic equity devaluation (resulting from markdowns of loan values) on behalf of financial intermediaries would be the only solution for alleviating the credit logjam. At that point, normalized underwriting would assist the market in creating a price bottom. The Resolution Trust Corporation model would serve as a template for the necessary restructuring.

Based on current trends, it is unlikely that the housing market will see bottom in 2011. Monetary and fiscal policies are simply delaying the inevitable: 15% - 18% drop in home prices from current levels. Early 2012 is our estimate for the nadir.

Existing Home Sales

Existing Home Sales Since Jan, 2008

(Source: NAR)

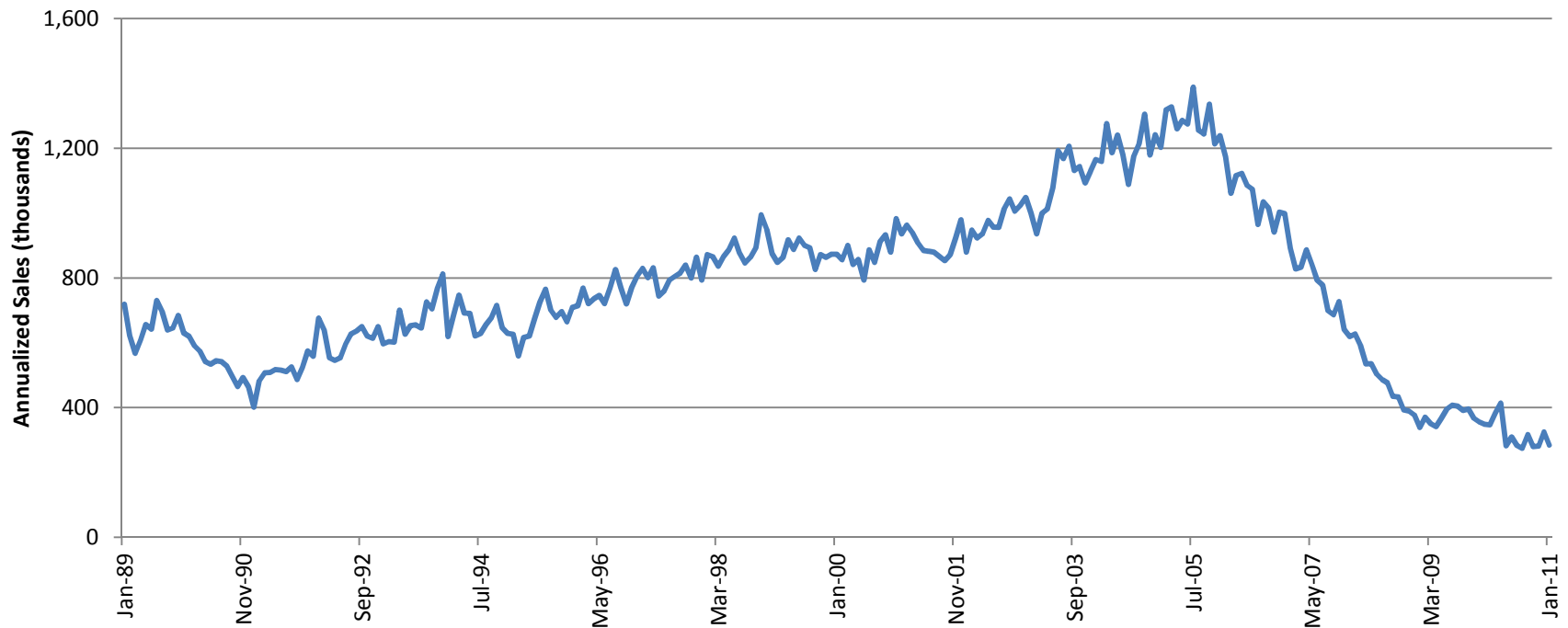


- Inventory (Jan, 2011) stands at 7.6 months **Target: 6 months**
- Trend line indicates a median price of \$159,606 would correspond to an inventory level of 6 months. Yet the Jan, 2011 reported the median sale price at \$158,800.

New Home Sales

New Home Sales

(Source: U.S. Census Bureau)

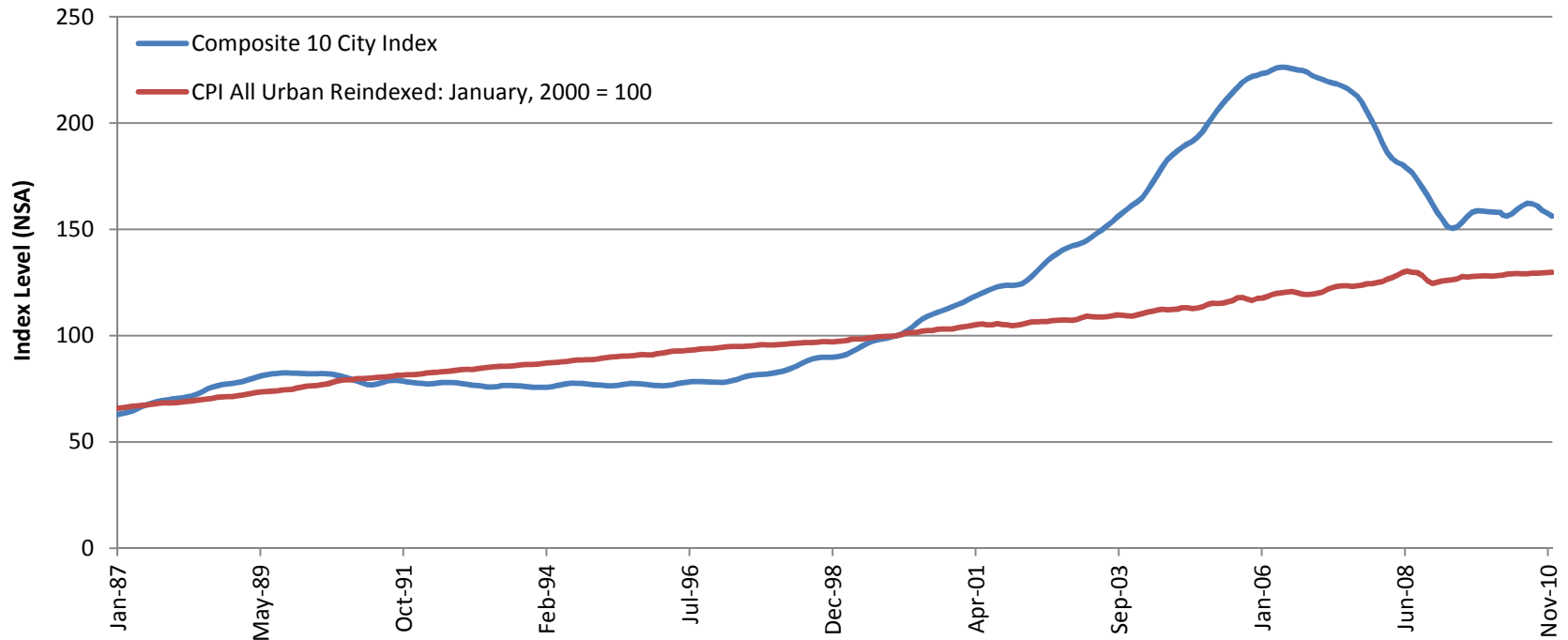


- Average (mean) since Jan, 1989: 769,930 **Target: 540,000**
- Current level (284,000) is 1.9 standard deviations from the mean

Home Prices

CPI & Home Prices

(Sources: BLS, Standard & Poor's, Inc.)



- Jan, 2011 estimation: Home price index stands 18.9% above reindexed CPI
- **Target: Home price index = reindexed CPI**

Mortgage Equity/Debt I

Year End	Home Value (Billions of USD)	Mortgage Debt (Billions of USD)	Owner's Equity
1990	\$6,805.3	\$2,488.8	63.43%
1991	\$6,975.5	\$2,667.0	61.77%
1992	\$7,258.9	\$2,840.0	60.88%
1993	\$7,500.7	\$2,998.7	60.02%
1994	\$7,772.7	\$3,165.3	59.28%
1995	\$8,054.8	\$3,318.9	58.80%
1996	\$8,431.0	\$3,523.8	58.20%
1997	\$8,864.7	\$3,739.3	57.82%
1998	\$9,694.2	\$4,040.6	58.32%
1999	\$10,644.9	\$4,416.3	58.51%
2000	\$12,202.8	\$4,798.4	60.68%
2001	\$13,576.8	\$5,305.4	60.92%
2002	\$14,849.3	\$6,009.9	59.53%
2003	\$16,446.0	\$6,894.4	58.08%
2004	\$18,948.9	\$7,835.3	58.65%
2005	\$22,026.2	\$8,874.3	59.71%
2006	\$22,692.8	\$9,865.0	56.53%
2007	\$20,879.0	\$10,539.5	49.52%
2008	\$17,446.1	\$10,497.9	39.83%
2009	\$17,038.4	\$10,336.7	39.33%
2010*	\$16,393.0	\$10,024.2	38.85%

- 20 year average (1990-2008): 57% Owner's Equity

- Source: FRB Z.1

* PCS year end estimates

Mortgage Equity/Debt II

Year End	Home Value (Billions of USD)	Mortgage Debt (Billions of USD)	Owner's Equity
2010	\$16,393.0	\$10,024.2	38.85%

- Target: Owner's Equity returns to 20 year average
- Scenarios:

Change in Home Value

-10%

-5%

0%

5%

10%

Change in Mortgage Debt to Reach Target

-36.7%

-33.2%

-29.7%

-26.1%

-22.6%

The above scenarios reflect the proposition “If home value changes by a given amount, how much would mortgage debt have to decline by to reach the 20 year average of owner’s equity?”

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