

Highlights

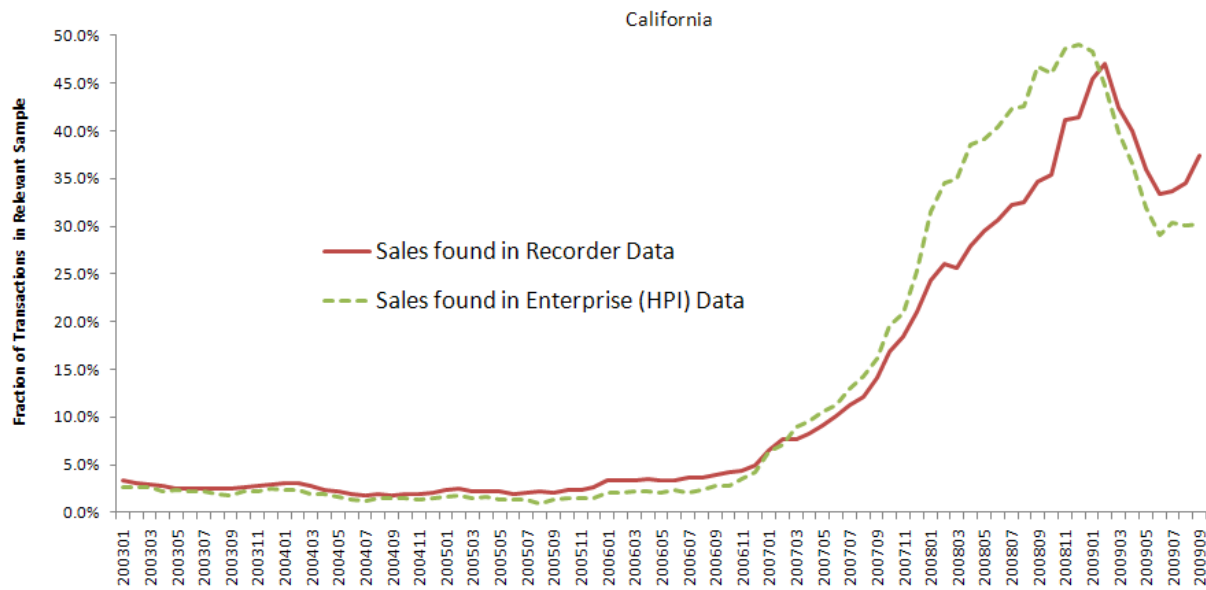
With the release of HPI data for the first quarter of 2009, FHFA published a short analysis of the impact of distressed sales on measures of house price trends. The research paper studied the direct effects of short sales and REO sales on price measures for California. The empirical findings suggested that, for both the FHFA index as well as an index constructed using sales prices obtained from county recorder offices, the impact of removing distressed sales from the data samples was not dramatic. Measured declines in home prices through the first quarter of 2009 were only slightly less severe when distressed sales were removed from the data sample.²

While the apparent effects found in that study were not substantial, other data sources have suggested that the impact could be larger. This analysis updates the basic analysis performed in the research paper to determine whether the impact remains modest, or whether changes in the impact might be a cause of improvement in home price behavior. Some market observers have suggested that much of the recent price stabilization reflects a shift in relative transaction volumes toward nondistressed sales. With relatively strong sales volumes in the “traditional” property markets, in part reflective of government market stimulus efforts, the conjecture has been that the shift in the mix of sales activity toward nondistressed sales can explain much of the recent firming of prices.

The presupposition of the argument—that distressed sales have accounted for a smaller fraction of sales activity—is indeed supported in the recent data for California. In two separate datasets—one comprised of mortgages financed with loans acquired by Fannie Mae and Freddie Mac (the Government Sponsored Enterprise, or Enterprise series) and the other comprised of transactions recorder at county recorder offices (the recorder series)—the share of distressed sales in recent periods seems to have declined. Figure 1, which reports the monthly share of distressed transactions for both series, shows peaks in the respective series in late 2008 and early 2009 and substantial reductions through June 2009. At that point, the contribution of distressed sales to the Enterprise series leveled off at about 30 percent and remained relatively steady through September 2009. The share of distressed sales in the recorder data rebounded somewhat during the summer, but as of September, was still 10 percentage points below its peak.

² See Leventis, Andrew, “The Impact of Distressed Sales on Repeat-Transactions House Price Indexes,” FHFA Research Paper, available at http://www.fhfa.gov/webfiles/2916/researchpaper_distress%5b1%5d.pdf.

Figure 1: Estimated Share of Sales Transactions that are "Distressed"



"Distressed Sales" are defined as sales for which:

- (a) a Notice of Default (NOD) was filed less than a year before the transaction and
- (b) no other sale occurred between the NOD date and the sale date.

Sources: DataQuick Information Systems (Sales and Notice of Default filings from recorder offices) and Enterprise HPI data submissions.

Identifying "distressed sales" is an imperfect exercise. To flag such transactions for this analysis, sales were identified that occurred within one year of the filing of a Notice of Default (NOD) for the property address.³ This simple approach, which was used in the analysis published earlier this year, is useful in that it identifies both REO sales and short sales and "distressed."

Figures 2a and 2b then analyze the impact of removing the distressed sales from the indexes constructed using these data samples. The graphs show month-to-month price changes for indexes constructed with the Enterprise and recorder data samples. In each case, alternative versions of the respective indexes are constructed after distressed sales have been removed.

³ In the event that multiple sales transactions occurred for a given property within a year of an NOD filing, only the first was flagged as a distressed sale.

Figure 2a: Effect of Removing Distressed Sales from Recorder-Based Index for California

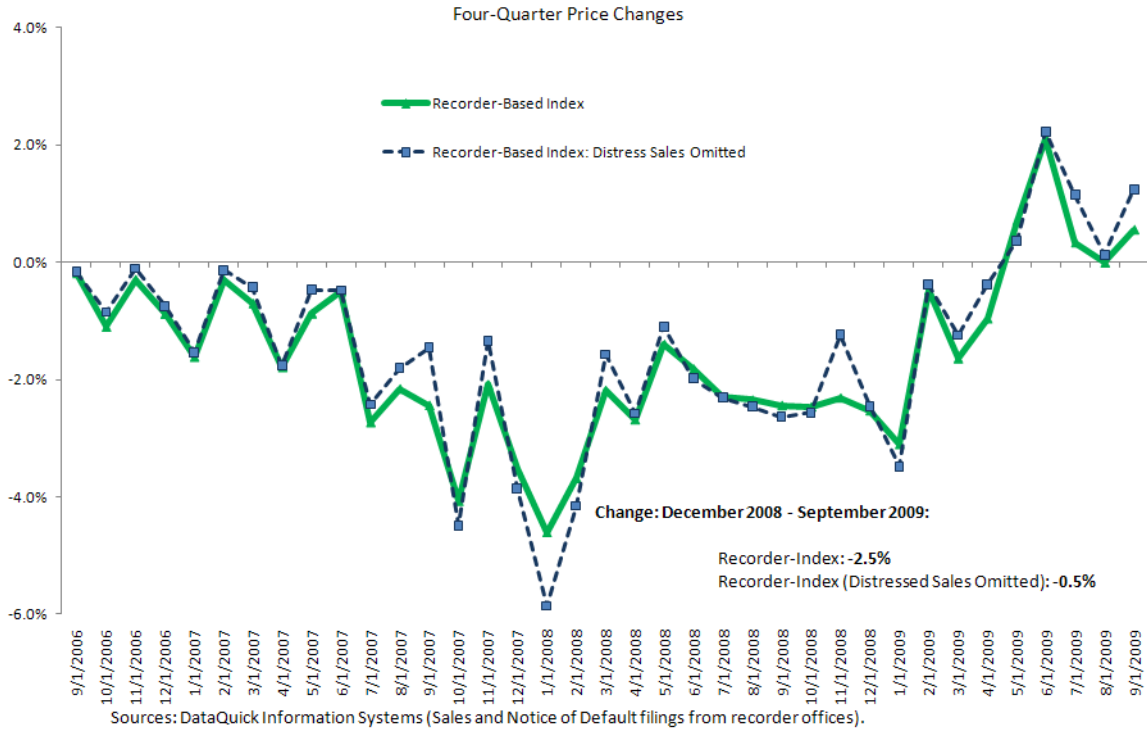
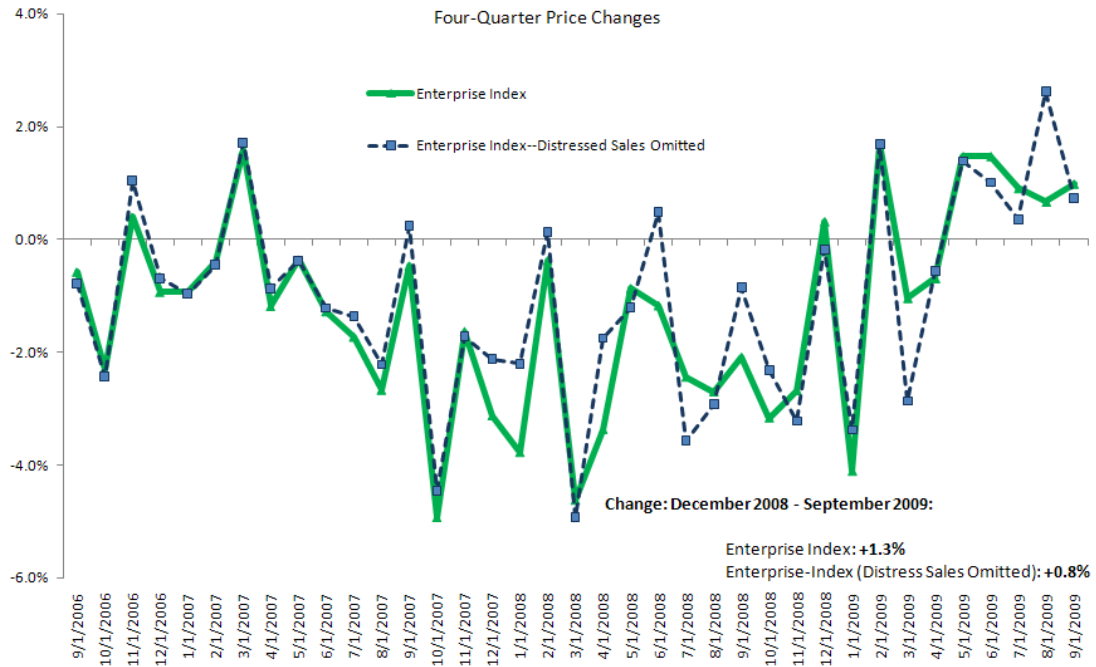


Figure 2b: Effect of Removing Distressed Sales from Enterprise Index for California



As reported in the research paper published earlier this year, the graphs generally reveal little systematic effect of distressed sales on long-term trend measurements. Removing distressed sales from the data sets can materially affect specific monthly price change estimates, but longer term measures are not systematically impacted.

The figures indicate that, over the latest nine months, the effect of distressed sales has differed across the two data series. Contrary to some expectations, removing the effect of distressed sales actually has the effect of improving measured price changes for the recorder-based series. Between December 2008 and September 2009, for example, that series evidences a 2.5 percent price decline when distressed sales are included, but only a 0.5 percent decline when such sales are stripped from the sample. By contrast, distressed sales have the effect of improving measured price trends in the Enterprise series. While the Enterprise-based index shows a 1.3 percent price increase over the December-September interval when distressed sales are included, it only rises 0.5 percent when such sales are removed.

There are no obvious explanations for the differing effects of distressed sales. In evaluating the results, however, it should be recognized that the overall effect of distressed transactions on the respective indexes reflects a complex mix of factors. These include not just changes in the shares of distressed sales in the respective samples, but also changes in the relative price discounts for distressed properties. For example, although the share of distressed sales in the recorder sample fell somewhat between December and September, the observed finding (that stripping such sales from that index lessens the measured price decline) is consistent with declining price discounts for such sales vis-à-vis other transactions.