

# U.S. Structured Finance Newsletter

Volume 5, Issue 14, April 6, 2009



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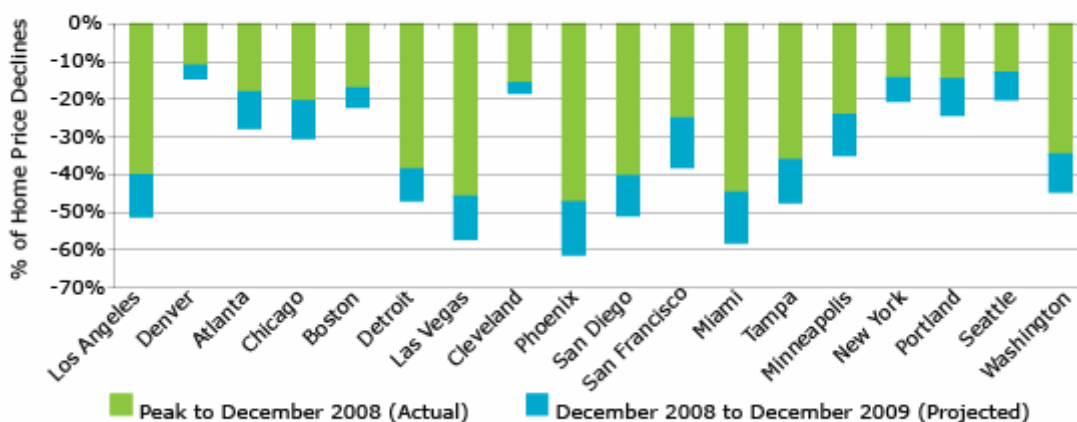
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## HISTORICAL HOME PRICE VOLATILITY AND RATING STRESSES

The latest Case-Shiller Home Price Indices showed a record decline in U.S. housing prices. As of December 2008, real estate prices in the top 18 metropolitan areas dropped an average of 27.9% from their respective peaks. Regional markets such as Phoenix and Las Vegas were particularly hard hit: home prices in these two areas have fallen by nearly 50% since mid-2006. The Case-Shiller Home Price Indices also project a further decline of 9.2% on average through December 2009 in all 18 metropolitan areas (see the graph below).

Home Price Declines in Major Metropolitan Areas



Source: Case-Shiller Home Price Indices.

Some of the more fabled real estate busts in the past were a result of the Texas oil-belt recession of the mid- to late-1980s, when the collapse of oil prices cascaded through to both the commercial and residential markets, and Southern California's peace dividend recession of the early 1990s, when defense cuts sent upper-tier prices down about one-third. However, during those crises, home price declines generally averaged about 20% to 25% and did not exceed 35%, even in the worst property tiers. Economic diversity, or lack thereof, has historically been part of the story of excessive home-price volatility in these markets.

In the more recent past, we have witnessed an unprecedented level of market excesses, followed by record declines in home prices. The erosion of home equity and fewer refinancing options have led to significant borrower defaults and increased foreclosure inventories. Furthermore, a housing-induced economic recession and high unemployment rates further limit consumers' ability to make mortgage payments and, as such, have exacerbated the real estate slide, especially in housing markets such as California, Florida and Arizona.

DBRS's single-B market loss (or market value decline) criteria approximates a quick- or distressed-sale discount on property, representing the shift in negotiating leverage from seller to buyer in default situations but reflecting minimal market-level stress beyond the individual property's distressed state. These losses range from approximately 25% to 35% across the credit spectrum. For the highest investment-grade ratings, which reflect the worst cases of historically observed home-price declines, DBRS's market loss criteria increase to the range of 45% to 60%.

In addition, DBRS recalculates the combined loan-to-value ratio using conservatively updated property values to reflect both the current and projected home-price declines. DBRS first updates properties to their present values based on the original appraised value and loan age using the Case-Shiller Home Price Indices by metropolitan statistical area (MSA). Moreover, DBRS further stresses the appraised values to the MSA-level housing trough based on Case-Shiller projections for the next 12 months, with no credit given to possible price appreciation during this period.

DBRS will continue to monitor volatilities in home prices and adjust its market loss assumptions as necessary. For questions or comments, please contact Quincy Tang at [qtang@dbrs.com](mailto:qtang@dbrs.com).