July 30, 2010

Vantium HPI Review

2010 Q2

Vantium Capital Inc. offers end-to-end customized loss mitigation services and specialty mortgage servicing through its Acqura Loan Services business. Vantium's other core business channel, Strategic Recovery Group, has provided charged-off asset and distressed debt services for lenders and investors for over 10 years. For more information, visit www.vantiumcapital.com.

According to the Vantium House Price Index (HPI)[1], national house prices increased 3.6% this quarter after two previous quarters of decline which totaled 3.4%. Not surprisingly, much of this most recent quarter strength was driven by the home purchase tax credit. Not only do we expect that housing prices will be essentially flat or down over the next several months but likely over the next several years since there appears to be no political appetite for additional policy responses, like the tax credit, and national housing prices are still overvalued by 10% or more. Flat prices will allow inflation to play catch up over the next several years similar to what we saw happen in areas like California during the 1990's; most forecasts show continued declines.

Outside of the national numbers, there have been some notable surprises. San Francisco and to a lesser extent San Diego and Los Angeles have shown unanticipated strength. Prices are up as much as 21% (San Francisco) since the low water mark in the first quarter of 2009 and have not shown a down quarter since. Although that trend may be about to change…

We expect housing prices to decline as much as 10% before rebounding. Most forecasts using different indices of housing prices suggest that at a national level there is still some decline remaining, 10% or more.

National Housing Prices

National housing prices have been trading in a fairly narrow range of about +-2.5%. 2nd quarter index values shows we are at the high end of that range. With all signs pointing toward lower prices in the third quarter, we may remain in this range but likely near the bottom.

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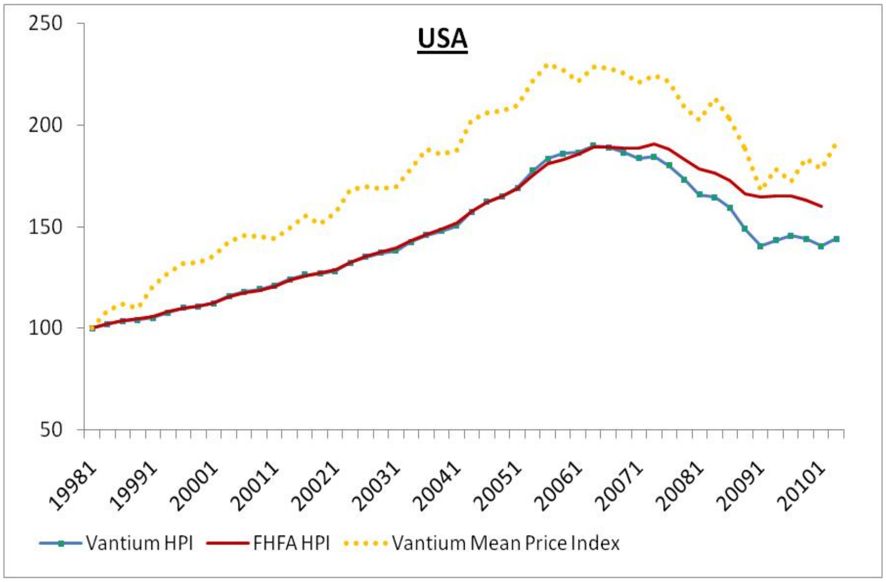
The Vantium HPI is an index produced quarterly using a paired sales method. An index is created for 80 regional areas and 50 states and while the index itself is quarterly, it is updated monthly yielding advance index values during the most recent quarter. Index values are created within the first two weeks of each month making it one of the freshest available house price indices, however, we do not publish individual index values.



We measured the incremental change in prices with each successive month of new data for the 2nd quarter. Prices were up 4.7% with only April sales data added. As expected, by the time June data was added, prices were only up 2.4% for the full quarter.

Somewhat surprising is the level of increase in average sales prices on all transactions. This is partially due to more sales in higher priced areas. More so it is due to a surge in higher priced properties, regardless of geography.

Uneven rebound across the US.

The map depicts the amount of house price increases in the Vantium HPI by state since Q1 2009. States exhibiting the greatest signs of strength (darker green) are concentrated in the center of the country and scattered across the north east. California is of most notable strength. It experienced much of the strength in prices at the height of the housing bubble and is now showing some of the strongest areas of price rebound, the highest of which is the San Francisco region.

Regional House Prices

While national prices have recently been trading in a fairly narrow range, the same cannot be said for many individual areas. Four of the top ten price decline regions are in Florida while four of the top ten price increase regions are in California. For the top ten price increase regions, house prices have increased to levels last seen in 2003.

TOP 10 PRICE DECLINE REGIONS *(Table 1)*

CBSA	2009q4 HPI	2010q1 HPI	2010q2 HPI	q4 -> q1	q1 -> q2	q4 -> q2
Palm Bay-Melbourne-Titusville, FL	109.79	95.85	95.91	-12.7%	0.1%	-12.6%
Wilmington, NC	151.05	143.92	134.12	-4.7%	-6.8%	-11.2%
Deltona-Daytona Beach-Ormond Beach, FL	99.37	90.65	88.78	-8.8%	-2.1%	-10.7%
Allentown-Bethlehem-Easton, PA-NJ	141.87	128.11	132.38	-9.7%	3.3%	-6.7%
York-Hanover, PA	152.57	143.86	143.00	-5.7%	-0.6%	-6.3%
New Haven-Milford, CT	107.34	98.00	100.67	-8.7%	2.7%	-6.2%
Portland-South Portland-Biddeford, ME	114.67	106.69	107.94	-7.0%	1.2%	-5.9%
Fort Collins-Loveland, CO	112.42	105.72	105.88	-6.0%	0.1%	-5.8%
Orlando-Kissimmee, FL	81.85	76.11	77.24	-7.0%	1.5%	-5.6%
Lakeland, FL	85.31	82.17	80.52	-3.7%	-2.0%	-5.6%

TOP 10 PRICE INCREASE REGIONS *(Table 2)*

CBSA	2009q4 HPI	2010q1 HPI	2010q2 HPI	q4 -> q1	q1 -> q2	q4 -> q2
Modesto, CA	60.68	63.67	65.57	4.9%	3.0%	8.1%
Indianapolis-Carmel, IN	99.91	96.38	107.54	-3.5%	11.6%	7.6%
San Francisco-Oakland-Fremont, CA	92.79	92.31	99.61	-0.5%	7.9%	7.4%
Shreveport-Bossier City, LA	124.75	127.93	133.32	2.6%	4.2%	6.9%
Nashville-Davidson--Murfreesboro--Franklin, TN	111.74	115.99	118.97	3.8%	2.6%	6.5%
San Jose-Sunnyvale-Santa Clara, CA	99.42	99.04	105.77	-0.4%	6.8%	6.4%
Milwaukee-Waukesha-West Allis, WI	108.09	110.35	114.46	2.1%	3.7%	5.9%
Minneapolis-St. Paul-Bloomington, MN-WI	82.57	82.50	87.02	-0.1%	5.5%	5.4%
Riverside-San Bernardino-Ontario, CA	82.05	83.66	86.45	2.0%	3.3%	5.4%
Pittsburgh, PA	123.92	120.99	130.39	-2.4%	7.8%	5.2%

Surprise!

Given the level of foreclosure and inventory levels plus the fact that most forecasts suggest nearly all of California is still overvalued, and any meaningful price increases in California would raise a flag. Even more surprising is that fact that the major areas within California, San Francisco San Diego and Los Angeles, have been subject to significant price increases since bottoming in 2009 Q1.

There are several things that could be driving this turnaround -- from increased investor activity to better economic conditions or buyer/seller expectations and, of course, the tax credit. All of these play a role, but it is also possible that our surprise in the turnaround in this market is driven by housing price models that have simply overestimated the length and depth of decline for most of California. However other long term economic trends seem to indicate otherwise. One of those trends shows that house price inflation is strongly correlated with general inflation. If we review these inflation rates since 1998, these three areas have all experienced at least 5.5% average annual housing price inflation -- far above general inflation or income inflation and with the possible exception of San Francisco, far above long term historical averages. From this perspective as well, it seems doubtful that this past year of price increases can be sustained and we thus stick by the forecast model results which suggest further declines.

TOP 10 REBOUND SINCE 2009 Q1 *(Table 3)*

Geography	Vantium	Shiller	Date Equivalent
San Francisco	20.8%	16.2%	Pre-2000
Boston	14.4%	3.8%	2002 q2
Cleveland	12.6%	6.7%	2002 q4
San Diego	10.3%	10.8%	2001 q1
Washington	10.0%	5.6%	2003 q4
Denver	9.3%	4.1%	Pre-2000
Minneapolis	7.7%	6.5%	2002 q1
Los Angeles	7.4%	6.0%	Pre-2000
Dallas	4.6%	3.0%	2000 q1
Atlanta	4.5%	-1.3%	2002 q2

As can be seen in Table 3, among the Shiller Composite 20 San Francisco has enjoyed the strongest rebound in house price valuations since most areas bottomed in Q1 2009. This table shows differences in Vantium and Shiller results and is due to differences in data and modeling which are more fully described in the Appendix. Even with a rebound, some of these areas are still at pre-2000 house price levels.

What's going on in San Francisco? The San Francisco region is a reasonably diverse economy with strong employment in technology and health care and some resurgence beginning in financial services. However, according to Economy.com, ¾ of the volatility in the San Francisco economy is due to the health of the rest of the nation which is still very much in question. On a positive note, the area is beginning to experience net positive migration unlike some other large metro areas that also experienced excessive housing price inflation. With limited availability of land for new housing construction, there may be enough contra positive indicators to suggest that housing prices could stabilize in the coming quarters but continued strength is doubtful.

Looking to the Future

Using a snapshot of the entire Acqura portfolio as weighting, we forecast an additional 6% remaining decline before stabilizing and subsequently seeing price rebounds. Rebounds should continue at a normal inflationary rate of 2% - 4%. There is nothing to suggest a stronger rebound particularly with general inflation being so low. This national decline is unevenly spread across the country as is shown in Table 4 below.

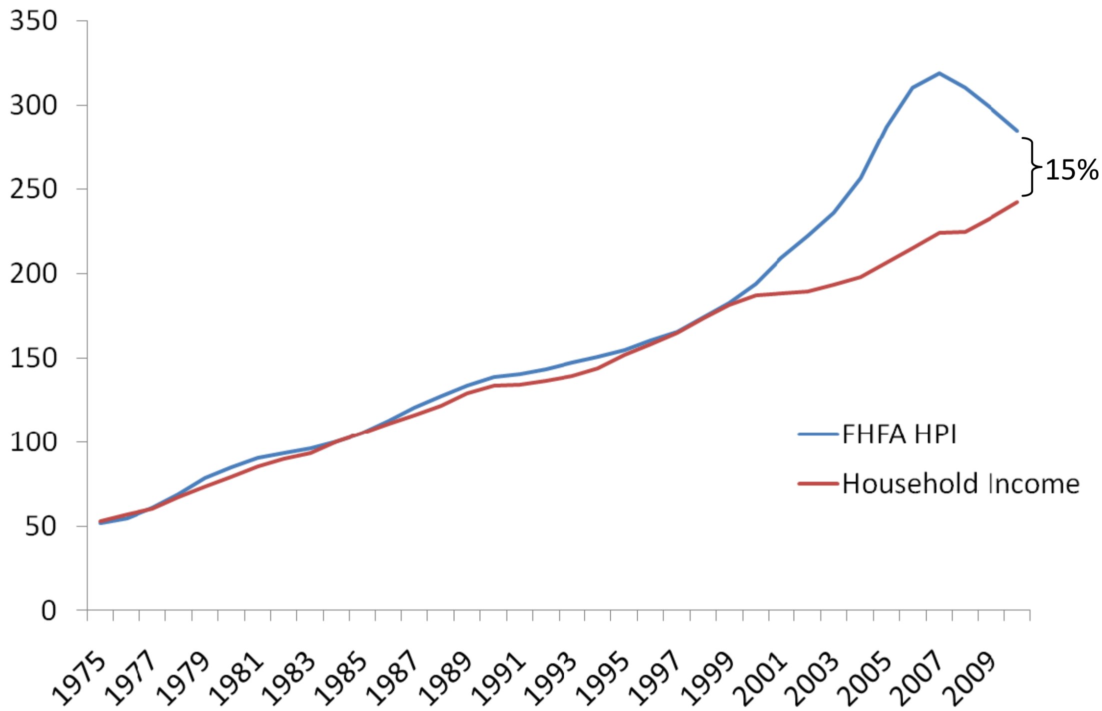
TOP 5 NEXT YEAR DECLINE STATES, Acqura Portfolio Weighted *(Table 4)*

STATE	Peak to Current	Current to Trough	Peak to Trough	HPI 1 year forward	HPI 2 years forward	HPI 3 years forward
Aggregate	-21.4%	-6.3%	-25.7%	-6.0%	1.0%	2.1%
FL	-37.6%	-16.4%	-47.7%	-9.9%	2.0%	3.3%
DC	-21.4%	-7.8%	-27.6%	-7.8%	1.2%	1.2%
CA	-33.5%	-8.9%	-39.4%	-7.1%	2.0%	3.1%
AZ	-37.1%	-11.3%	-44.1%	-6.0%	1.9%	2.8%
NV	-50.0%	-12.1%	-56.0%	-5.2%	1.8%	8.3%

The Relationship of Income and HPI

There are other metrics that we believe also provide insight into the direction of future housing prices. Despite the fact that different price indices show differing levels of price changes, they have at least a few things in common: 1) all show the boom and bust, 2) all are generally correlated with gross median household income prior to 2000.

Gross income rises at an average of no more than about 4% per year. Using the FHFA index, since it has a long history, we see near perfect correlation with gross median household income (Census Bureau) from 1975 until 2000, see chart on page 6. The divergence seen since 2001 has not fully come back into line. On this basis alone, this relationship would imply housing prices still have 15% decline remaining. Because inflation will play some catch up while prices decline and because the FHFA indexes tend to be lagging, we expect actual declines of closer to 10% which is in line with our normal (household weighted) forecasts.



So we have several different perspectives on house prices -- the elimination of tax credits which temporarily boosted the market, the correlation of income to house prices, the economy, market specific forecasts and the relationship of general inflation to house price inflation. What these perspectives all have in common is that they suggest we have more room for house price decline. Specifically, the future scenario looks to be flat housing prices now and a subsequently approximate 10% decline nationally (households weighted average) in the future.

If you would like additional information, please contact Vantium Capital Inc or feel free to contact us directly.

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Appendix
Housing Price Indices 101

There are many housing price index vendors. Each vendor has access to different transaction data and may use a different methodology to calculate their HPI. There are generally three common different ways to calculate house price changes: 1) repeat sales, 2) statistical model, 3) median prices.

Repeat Sales: Compares price changes on the same property over time and despite other drawbacks is generally recognized as the best pure price change measurement. However, many transactions are lost since the property must have sold twice and must be available both times through whatever data source is used. Varying techniques in this category are used by the FHFA, Shiller, and Vantium.

Statistical Model: Typically a model that estimates prices for a given time period and geography based on things like square footage, bedrooms, etc. The difficulty is in measuring prices over time which can appear volatile or be complex due to the number of models necessary. Techniques of this general category are found in price metrics such as Zillow.

Median Price: The price point at which there are the same number of sales above and below that price. This method is heavily influenced by the price ranges that happen to be selling in any given area. This method is typically used/supplied by the National Association of Realtors.

Four common housing price metrics with key features of each:

Index	Type	Weighting	Transaction Source	Pros	Cons
Vantium	Repeat Sales Index	Price	Subset of MLS transactions	Timing (2 weeks + early advance numbers)	Limited to only a subset of transactions
Shiller	Repeat Sales Index	Price	All county records	Most complete transaction data	Limited areas published
FHFA	Repeat Sales Index	Unit	Conforming loan data (purchase & refi)	Complete list of geographies (50 states, 380 CBSA's)	Limited to conforming loan financed properties; price changes dampened and delayed by refi data
NAR Median	Median Prices	NA	Sample of all MLS transactions	Nationwide	Biased by property mix in any given period