BLACKROCK®

In the Home Stretch? The US Housing Market Recovery

BlackRock Investment Institute

June 2012

What Is Inside

So What Do I Do With My Money?™

Equities

- Large mortgage lenders stand to profit from a housing market recovery. Competition is down and profit margins are up—but regulatory and legal risks loom large.
- Homebuilders with the right strategy focused on the right areas could do well. Warning: Stock prices are often driven by sentiment and the business is intensely competitive.

Fixed Income

- The future of the government-sponsored enterprises (GSEs) is critical to the direction of the entire fixed income market.
- Non-agency mortgage-backed securities (MBS) are underpinned by high yields and dwindling supply. Agency MBS are attractive because of frequent mispricing. Government policy, however, can hit high-coupon MBS as people refinance at lower rates.

Real Estate

- Buy, bundle and convert to rentals single-family homes bought at deep discounts in areas with many foreclosures.
- Develop land for homebuilders in “A” locations that are close to jobs and quality schools and have low foreclosure rates.

For detailed investment opportunities, see pages 18-19.

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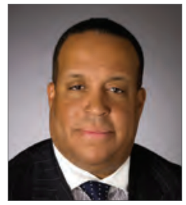

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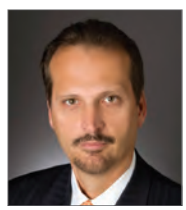

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BlackRock’s Housing Forum

About three dozen BlackRock portfolio managers and public policy executives recently debated the outlook for the US residential housing market at the BlackRock Investment Institute’s US Housing Forum. The mission was to review the bull and bear cases for a market recovery, identify the major issues confronting housing policy and assess investment opportunities in equities, fixed income and real estate.

First Words and Summary

Everyone is optimistic in the spring—not just baseball fans. This year, the phenomenon even has percolated parts of the abysmal US housing market. Various indicators are teasing investors and homeowners that real estate prices may finally have scraped bottom.

If this is true, it has been a long and traumatic journey. With millions of homeowners losing their homes to foreclosure, the Great Recession crushed the bedrock of the American Dream: (profitable) homeownership. At least $7 trillion in home equity has been lost, the US Federal Reserve estimated in January.

Even after these declines, homes remain the largest and most important asset of most Americans. Housing dominates sentiment and behavior of the consumers who power 70% of the world's largest economy. It is a key reason why the US Federal Reserve is keeping rates at record lows and has loaded up on mortgage assets, leading a global wave of central bank quantitative easing. And housing weighs down the US national balance sheet like an undigested meal.

We explore when, how and why this critical market will recover; offer a roadmap for housing policy; and assess investment opportunities. Our main conclusions are:

- **Supply Economics:** Getting a handle on the inventory of vacant houses—supply that will hit the market—is crucial for any long-term projection. We present a model to determine this supply-demand equilibrium. The model projects it will take at least three years—but more likely six to seven years—to reach a new equilibrium. It also shows the importance of new household formation and the overall homeownership rate.
- **Sighting a Housing Bottom:** We believe we are at or near the housing market bottom after national housing prices slid 36% from their peaks. We see little additional downside beyond declines of up to 5% over the next year or so after factoring in inflation. We do not expect a quick rebound to the heady levels of the early 2000s. The recovery will likely take the form of a long, flat "U." It may even resemble the stagnating shape of a drawn-out "L" for a while, we believe.
- **Regional Differences:** Analysis of and sentiment toward the housing market are largely fed by national data. Yet most investment opportunities are local. There are huge disparities between and within metropolitan areas—in price levels, inventories and foreclosures. Local employment and land scarcity also make a big difference. Real estate truly is about location.
- **Policy Uncertainties:** Housing policy and the mortgage market are joined at the hip. Uncertainty over future policy is vexing homeowners, potential buyers, lenders and especially investors. A key question is the future of government-sponsored enterprises (GSEs) Freddie Mac and Fannie Mae, entities that currently underpin the mortgage financing market. We believe a full privatization is not advisable—nor feasible—at this time, but agree the mortgage market's over-reliance on public support needs to be reduced in the long run.
- **A Housing Policy Recipe:** A holistic approach is needed to put the housing market back on solid footing. Ingredients include the need for the government to guarantee mortgages (a service for which it should be compensated); reshaping the GSEs as market intermediaries for credit support; transparent and simple rules for mortgage servicing, securitization and foreclosures; prioritizing and synthesizing public policy; and respecting investor rights to attract private capital.
- **An Embarrassment of (Program) Riches:** The multitude, complexity and scattershot approach of housing initiatives and regulations make it tough to see the forest through the trees. We highlight four programs that could potentially help distressed homeowners and reduce foreclosures. We support their objectives—except where they encroach on the rights of first-lien holders.
- **People Matter:** Demographic trends are posing a profound challenge to the housing market. A tidal wave of baby boomers is expected to retire and downsize in the next decade, adding to an already graying population. People are marrying later (or not at all) and college graduates are groaning under student debt and unemployment, depriving the market of its traditional source of demand from first-time homebuyers.
- **Other Housing Challenges:** The wobbly state of the highly indebted, lucky-to-be-employed and underpaid US consumer is a big impediment to a sustained housing market recovery. Tough lending standards are another hurdle. The "fiscal cliff" of deficit reduction and the expiration of tax cuts looms large—one more reason for the question mark in our publication's title.

The opinions expressed are as of June 2012, and may change as subsequent conditions vary.

Shadowboxing to Gauge Supply

Markets are about supply and demand. To get a handle on the first part of this equation, it is crucial to quantify US housing inventory that may hit the market in the future or excess supply. This is easier said than done. Data vary greatly, especially on the vast overhang of current and potential foreclosures known as "shadow inventory."

Here is what we know: The US is home to 132.5 million housing units, according to 2011 Census Bureau data. Some 75 million are owner-occupied, 39 million are rental units and 18 million are vacant. The vacancies include 4.5 million seasonal homes and an additional 7 million listed for "occasional use" or "other."

The official housing inventory is straightforward: properties publicly listed for sale, including do-it-yourself "for sale by owner" listings. Shadow inventory, by contrast, consists of properties that are either in foreclosure or likely to end up there.

Estimates of shadow inventory range from 1.6 million (research firm CoreLogic) to 4.3 million (Mortgage Bankers Association) or even higher. See the charts below. The one thing we can say for sure is that the trend is down. This is a positive for the housing market and jibes with other indicators.

The inventory declines are coinciding with data showing fewer homeowners are falling behind on mortgage payments (delinquencies) compared with one year ago. Foreclosures appear to be bottoming out, but this may be the result of delays due to legal challenges, foreclosure moratoria and new regulations, as opposed to a true stabilization in the number of distressed properties.

Deep Underwater = High Default

Default Rate Assumptions of US Home Loans

Loans at Risk		Default Rate		Homes in Jeopardy	
Loan Status	Loans	Low	High	Low	High
Nonperforming	4,500,000	80%	90%	3,600,000	4,050,000
Re-performing	3,800,000	50%	65%	1,900,000	2,470,000
Performing >120% Loan to Value	2,800,000	25%	40%	700,000	1,120,000
Performing 100-120% Loan to Value	5,500,000	10%	15%	550,000	825,000
Performing <100% Loan to Value	38,400,000	4%	5%	1,536,000	1,920,000
Total	**55,000,000**	**15%**	**19%**	**8,286,000**	**10,385,000**

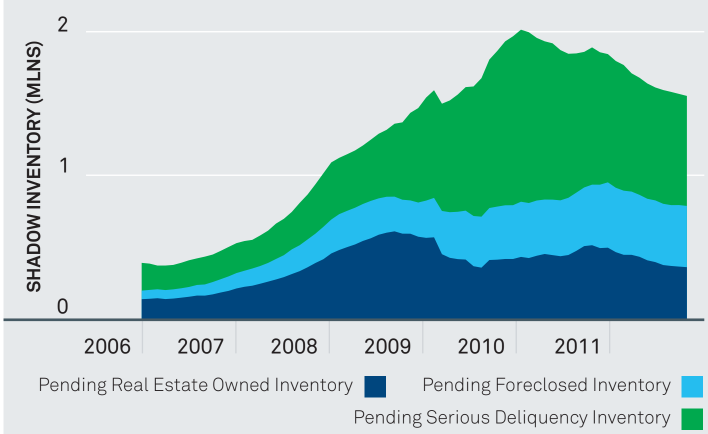
Source: Amherst Securities Group, Refocusing the QRM/Securitization Debate, July 26, 2011.

To gauge future foreclosure trends, it is important to analyze how many home loans are at risk. Some 8 million to 10 million loans could default, according to Amherst Securities Group. The estimates take into account that homeowners who are "underwater"—i. e., owe more on a house than it is worth—are much more likely to default than those who have equity. See the table above.

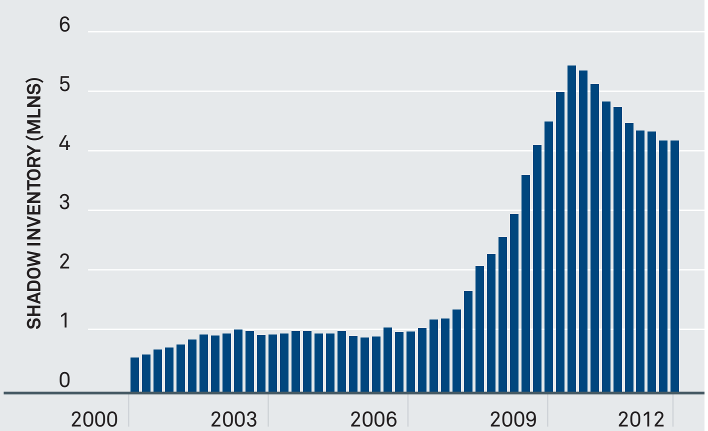
Other data show even greater numbers of homeowners underwater as prices in most markets are still declining. Some 11 million residential properties with a mortgage, or 23% of the total, currently have negative equity, according to CoreLogic.

Where No Light Will Reach: Shadow Inventory

CoreLogic and MBA Shadow Inventory Estimates



Source: CoreLogic. As of October 2011.



Source: Mortgage Bankers Association. As of March 2012.

Modeling a Supply-Demand Equilibrium

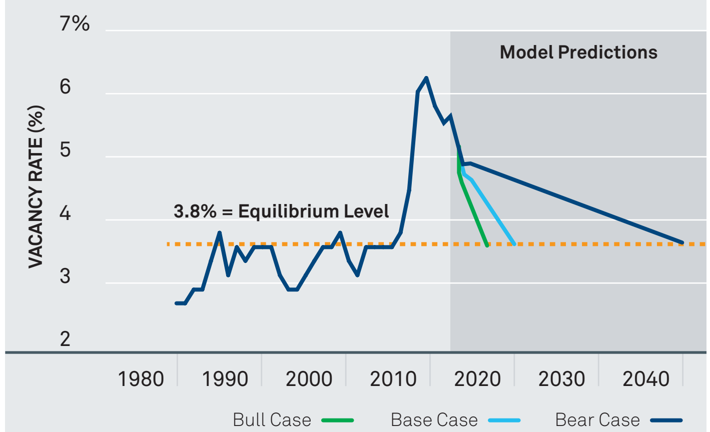
We recognize the importance of inventory and have developed a model to gauge supply coming to market and how long it will take for vacancies to reach normal levels—the housing supply-demand equilibrium—under three scenarios.

We start by calculating a current vacancy rate. Many homes identified as vacant by the US Census Bureau will simply never be sold, we believe, so we exclude them from our calculations. Our vacancy number combines houses that are listed for rent and for sale (without double counting). We then add the number of houses pulled off the market because the owners could not get the price they wanted to arrive at a grand total of 6.7 million vacant homes.

This equates to a 5.1% vacancy rate, compared with an average of 3.8% in the period 1980 through 2010, according to Bloomberg data. We view the latter as a "normal" level, as it includes both very low rates in the early 1980s and sky-high rates in the late 2000s. We then calculate how long it will take for the market to reach this target rate or equilibrium by using various inputs for base, bull and bear cases. See the table below.

Are We There Yet?

Housing Vacancy Rate Under Various Scenarios, 1980-2040



Sources: BlackRock, Federal Reserve, Bureau of Economic Analysis, US Census Bureau, CoreLogic and Mortgage Bankers Association.

A Model Prediction

Projecting a Housing Supply-Demand Equilibrium

	Bull Case	Base Case	Bear Case
Total Housing Stock	132.4 mln	132.4 mln	132.4 mln
For Rent	2 mln	2 mln	2 mln
For Sale	1.8 mln	1.8 mln	1.8 mln
Held Off Market	2.9 mln	2.9 mln	2.9 mln
Total Currently Vacant	**6.7 mln**	**6.7 mln**	**6.7 mln**
Current Vacancy Rate	5.1%	5.1%	5.1%
Equilibrium Vacancy Rate	3.8%	3.8%	3.8%
Shadow inventory	1.6 mln	2.5 mln	4 mln
Current Excess Inventory	**3.3 mln**	**4.2 mln**	**5.7 mln**
Housing Starts	425,000	425,000	450,000
Housing Destruction	425,000	425,000	425,000
Home Ownership Rate	65%	64%	64%
Household Growth Rate	1.2%	1%	0.6%
Baby Boomers Retiring	400,000	400,000	400,000
Baby Boomers Selling	–	100,000	200,000
Net New Homeowners	896,000	635,000	241,000
Annual Home Reduction	**896,000**	**635,000**	**216,000**
Years to Reach Equilibrium	**3.7**	**6.6**	**26.4**

Sources: BlackRock, Bureau of Economic Analysis, Federal Reserve, CoreLogic, Mortgage Bankers Association, Bureau of Labor Statistics, US Census Bureau.
Note: Figures in thousands are annual.

The scenarios have different estimates of shadow inventory or how many distressed homes will come to market, tracking the range of CoreLogic and MBA estimates. The base, bull and bear cases also use different levels of household growth (household formations) and homeownership rates. It is remarkable how much leverage these two factors exert.

The bear case, for example, shows a level of household formation that is close to current levels—which we believe will improve. This change in input helps push back the housing market supply-demand equilibrium a quarter of a century! See the chart above.

Our base case takes into account competing market forces. On the one hand, many indicators are pointing upward. These include slowing price declines, increasing affordability, an uptick in loan demand and a reduction in supply. This is counterbalanced by factors such as the effect of retiring baby boomers, the weak financial health of the US consumer, the difficulty of obtaining a mortgage and regulatory uncertainty scaring off investors.

As a result, the market recovery will likely take the form of a long, flat "U" rather than a "V." It may even flatline for a while. In all, we expect further national housing price declines from 3% to 5% in the Case-Shiller Index in the next year after factoring in inflation. After a 36% price fall this is a relief—but not a full-blown recovery.

With this model in mind, we will discuss the current state of the housing market based on national metrics. We will then highlight regional differences and impediments to a recovery.

Are We (Finally) Nearing the Bottom?

Prices Are Stabilizing...

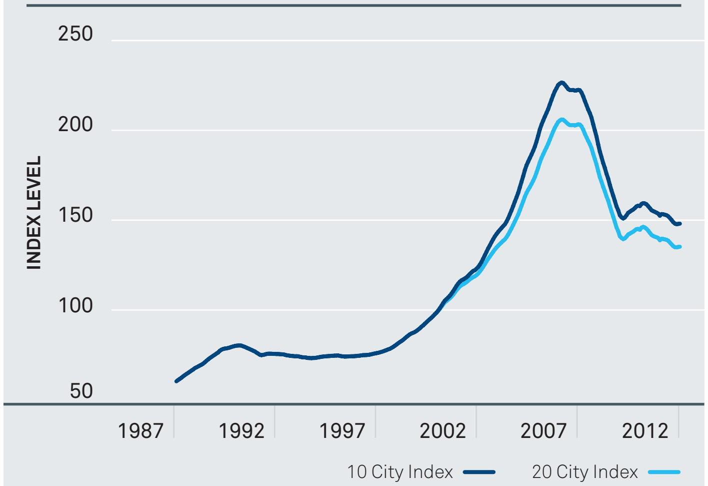
Home prices have fallen 36% from their peaks, as measured by the benchmark Case-Shiller Index, a price decline not seen since the Great Depression. See chart below. Our view is the decline is slowing—and perhaps on the cusp of reversing itself.

The Case-Shiller Index lags the housing market because it reports houses sold in the three-month period ending in the month the index is published. This is another example of the challenges of national housing data: The index drives sentiment and markets, but is about two months behind the current pace of events.

The index also obscures huge differences between new and existing home prices. The latter group has taken a much bigger hit than the first, according to Moody's Analytics. New home prices have risen 4.5% above their 2009 troughs while existing home prices linger near decade lows. The spread between new and existing home prices is at a record high. See the chart at right.

The Long Decline Is Leveling Off

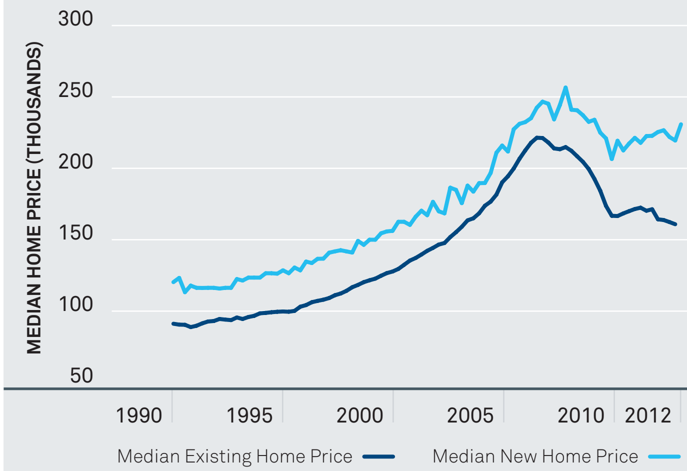
Case-Shiller Indices, 1987-2012



Sources: Case-Shiller and S&P.
Notes: Seasonally adjusted. As of May 31, 2012. The S&P/Case-Shiller Home Price Indices are calculated monthly using a three-month moving average and published with a two-month lag.

A House Divided

Existing Home vs. New Home Prices, 1990-2012



Sources: Moody's Analytics, US Census Bureau and National Association of Realtors.
Notes: Seasonally adjusted. New home prices as of March 31, 2012. Existing home prices as of December 31, 2011.

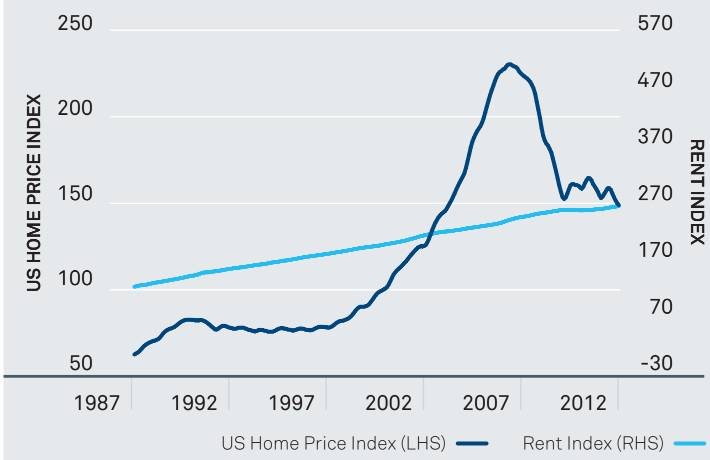
Underpinning pricing are two trends: Both new construction and sales have crawled to a halt. Just 304,000 new homes were sold in 2011, the lowest number on record since 1963, according to the US Commerce Department. And homebuilders are cherry picking, targeting prime locations only. This again shows the regional nature of the US housing market.

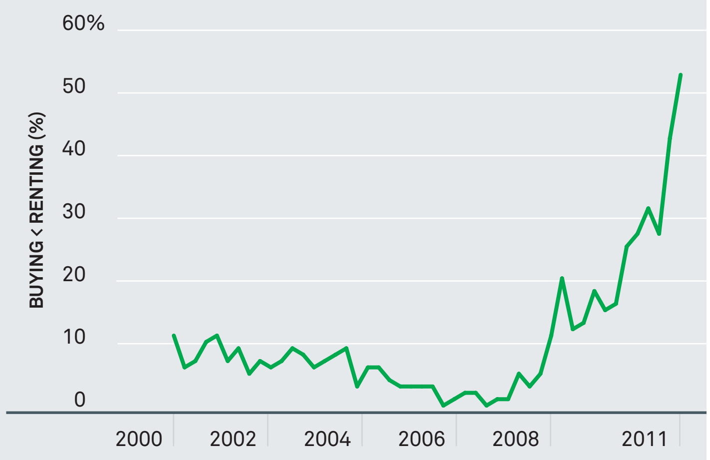
Affordability Is Up...

Owning a home has become much more affordable than during the boom thanks to the price drops, record-low mortgage rates (if you can get them) and the effect of inflation. The affordability index, which measures the ratio of the median income to the median mortgage payment, is at a record high, according to J.P. Morgan. Rents have steadily risen due to strong demand. This is swaying the "rent or own?" question closer to "own." In fact, J.P. Morgan estimates it is cheaper to buy than to rent in more than half of metropolitan areas. See the charts on the following page.

To Buy or to Rent?

Home Prices and Rental Rates, 1987-2012; Rent-or-Buy Comparison in Metro Areas, 2000-2011





Sources: Case-Shiller and US Bureau of Labor Statistics.
Note: Seasonally adjusted.

Sources: J.P. Morgan, AxioMetrics and CoreLogic.
Notes: Percentage of metropolitan areas where buying is cheaper than renting. Assumes a 30-year fixed-rate mortgage, 20% down payment, 1.25% property tax and 0.5% PMI.

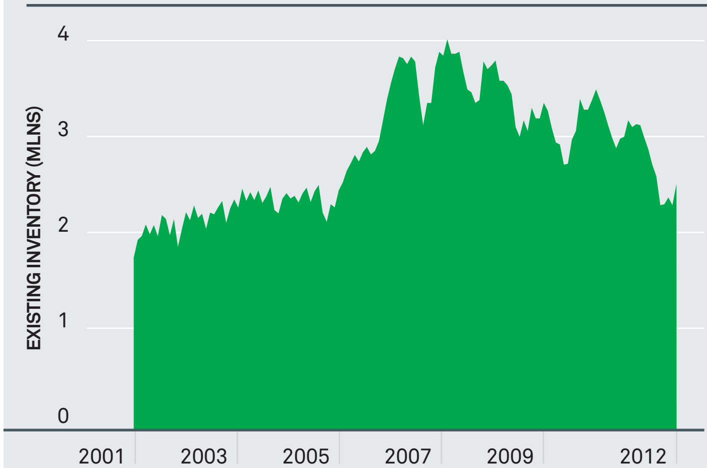
And Supply Is Shrinking...

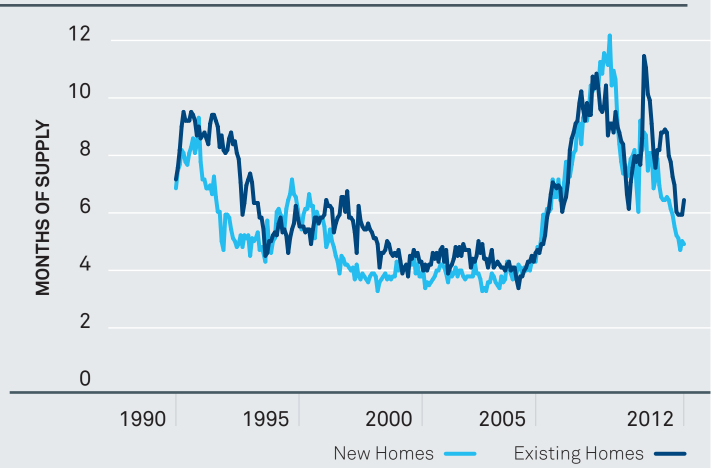
The overall supply of existing homes has fallen below long-term averages. See the chart at left below. This reflects dwindling numbers of distressed sellers (the worst appears to be over), but also factors such as a slowing of the foreclosure process in many US states due to legal challenges and regulatory uncertainty. Inventory has dropped to its 20-year average of about six months' worth of sales, down by half from the depths of the crisis. See the chart at right below.

The trend is not clear-cut: Many homeowners have pulled their houses off the market because they cannot get the price they want.

When Declines Are Good News

Existing Home Inventories, 2001-2012; Months of Supply, 1990-2012





Sources: Bloomberg, US Census Bureau and National Association of Realtors.
Note: As of April 30, 2012.

Sources: Moody's Analytics, US Census Bureau and National Association of Realtors.
Notes: New homes supply is seasonally adjusted, existing homes supply is not. As of April 30, 2012.

But Demand Is Shifting

As prices stabilize, affordability rises and supply falls, new housing starts appear to be bottoming out. They went from a peak of more than 2 million in 2005 and 2006 to less than 700,000 in 2011. The recovery is lagging overall sales. See the chart on the right. A recent paper by the Harvard Joint Center for Housing Studies estimates demand for new homes should reach 1.6 million to 1.9 million in a normal year (based on population and household formation trends).

But what is "normal" these days? Profound demographic forces and homeownership trends are reshaping the housing market. While growth in the population and number of households has marched on, total employment and the homeownership rate have plummeted. See the charts below.

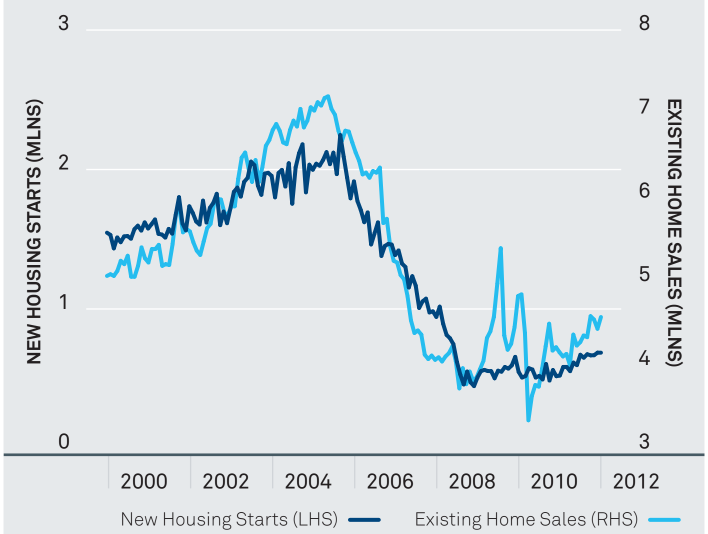
The homeownership rate has fallen from a 2004 peak of 69% to a 15-year low of 65%, according to the US Census Bureau. We believe it is likely to shrink further until the market has worked off the inventory of unsold homes, credit becomes more widely available, and job and wage growth accelerate. As discussed, a small change in the homeownership rate can lead to big differences in the projected time it takes for the market to reach equilibrium.

Employment is back at 2004 levels—when there were 5 million fewer households. The labor participation rate is at a three-decade low of about 64%, according to the US Labor Department. This highlights a key underlying reason for weaker housing demand.

Demographic dynamics represent another can of worms—one that we crack open in the next chapter.

A Delayed Start

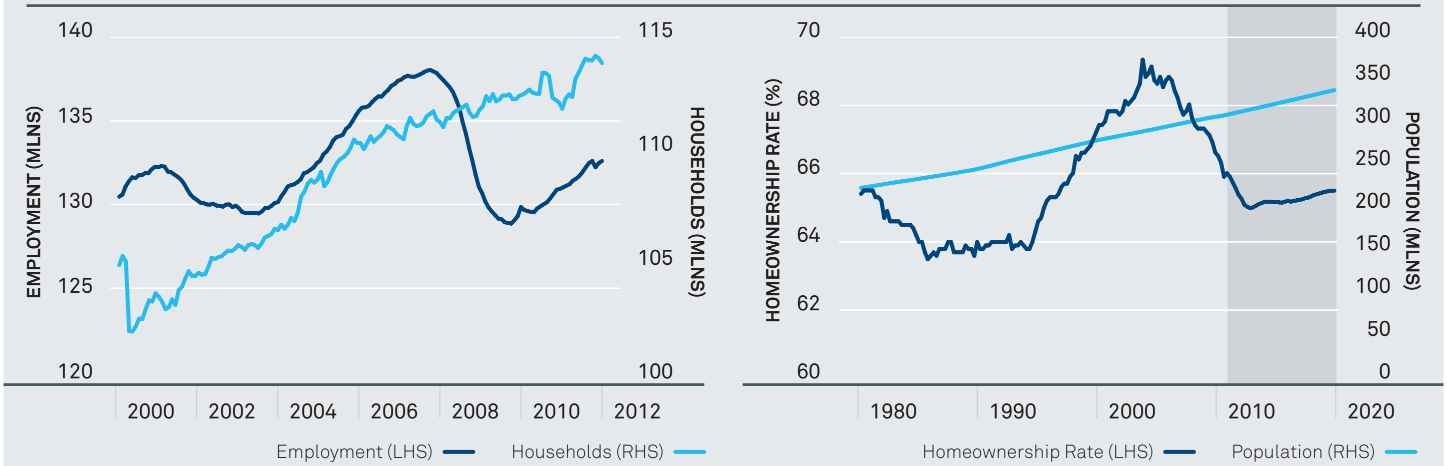
New Housing Starts vs. Existing Sales, 2000-2012



Sources: Bloomberg and US Census Bureau. As of April 30, 2012.

Different Demand Dynamics

Households and Employment, 2000-2012; Homeownership and Population, 1980-2020



Sources: Moody's Analytics and US Census Bureau.
Notes: Total nonfarm employment, seasonally adjusted. Number of households is not seasonally adjusted. As of March 31, 2012.

Sources: Moody's Analytics and US Census Bureau.
Notes: Homeownership rate is seasonally adjusted. Population is not seasonally adjusted. Forecast through December 31, 2020.

People and Psychology

Aging baby boomers are triggering a dramatic shift in the US population. Record numbers will reach the retirement age of 65 in the next decade. See the chart below. This graying trend is estimated to result in retirees making up one-fifth of the US population by 2050, according to the United Nations. This is bad news for sales of existing family homes: Retiring boomers often downsize to smaller homes or shift to renting.

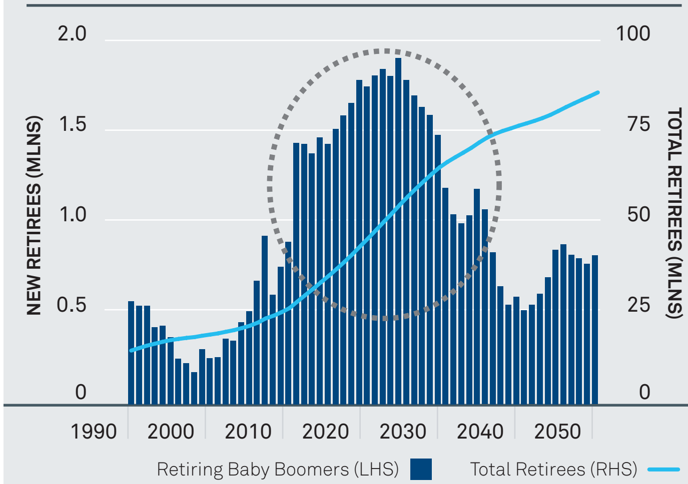
The younger generation is not picking up the slack. The financial health of entry-level buyers between 20 and 34 years old is weak because of low employment and high debts. Overall student loan debt is about $1 trillion, more than either car or credit card debt, according to the Consumer Financial Protection Bureau. Students graduating in 2010 owed about $25,000 in debt on average, according to the nonprofit Institute for College Access & Success. Young people find it tough to come up with a down payment, and will veer toward renting.

Anecdotal evidence abounds of "boomerang kids," bright college graduates with good jobs who are perfectly happy to live at home. A parental solution to this particular housing conundrum? Do not feed them.

People also marry later or not at all, making for fewer traditional households looking to buy a home to raise children. These demographic changes are powering a long-term downdraft in growth in new households, the critical lever to create demand and absorb inventory. See the chart on the right above.

A Boomer Backlash Hits Housing

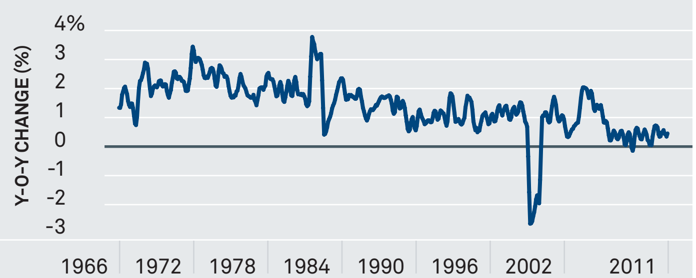
Baby Boomers Entering Retirement, 1990-2050



Sources: US Census Bureau and International Database.

Fewer Families = Less Demand

Growth in New US Households, 1966-2011



Source: US Census Bureau.
Notes: Year-over-year change in 3-month moving average. Data as of December 31, 2011.

Why Buy Now?

Most Americans have become gun shy about buying a house. It is the mirror image from the boom years when aspiring homeowners were chomping at the bit. Then, they could only see upside because house prices would always rise. These days, most consumers focus on the downside—even if they have a perfect credit score, can come up with a down payment and have calculated buying would save money in monthly payments. Why buy now when prices will be lower next year?

Whereas potential buyers are sensitive to downside risk, renters worry about missing an upswing in prices. This tug of war plays into the buy vs. rent debate.

The challenge is to understand and anticipate the tipping point for a shift in psychology. Other signposts are wage increase expectations (wages have effectively remained flat for two years now) and consumer purchasing plans for homes and autos (these have only recently stabilized from a downtrend).

Sentiment is improving—slowly and from a very low base. The majority of consumers expected only a modest decline in housing prices of up to 5% in a March survey and almost a fifth anticipated price rises, according to J.P. Morgan. A year earlier, a majority expected declines between 5% to 10% and fewer than 5% believed in price gains.

Homebuilders are positively ebullient. This could point to an improvement in business conditions, but also likely underscores regional differences. Homebuilders tend to see the glass as half full, especially in the beginning of the year. Just compare the rosy public pronouncements of leading homebuilders in February of each of the past five years with what actually happened in those years.

Location, Location, Location

National housing indicators are key drivers of sentiment, but we believe they obscure the reality that all real estate is local.

For example, national housing prices were still falling in February, according to the Case-Shiller indices. Look inside these indices, and a different picture emerges. Certain markets are recovering rapidly. See the table at left below. This dynamic is critical: The investment opportunities are local.

One factor driving regional prices is (perceived) value: The metropolitan areas that stomached the steepest peak-to-trough price falls appear to be in recovery mode. See the table at right below. Other factors include local inventory, the jobs market, proximity to the city center, transport and school quality.

Inventory will take longer to burn off in states with tough foreclosure laws such as New Jersey and Florida. It is hand-to-hand combat there over each mortgage, likely resulting in soft pricing over the medium term. States that have bank-friendly foreclosure rules are likely to see rapid declines followed by a quicker recovery, we believe.

Nationwide, foreclosures are selling at huge discounts. The difference between a foreclosure sale to the market price was $67,000 in February, according to Morgan Stanley. This equates to a 28% differential, compared with a historic average of 5%. Again, regional variations make all the difference. See the map on the next page.

Recovery Is a Regional Event

Case-Shiller Regional Price Indices, May 2012; Metro Areas by Peak-to-Trough Price Changes, December 2011

Metro Area	Monthly Change	Annual Change	Index Level
Atlanta	-0.9%	-17.7%	82.53
Boston	-0.2%	-1.0%	145.92
Charlotte	1.2%	**0.4%**	109.4
Chicago	-2.5%	-7.1%	102.77
Cleveland	0.4%	-2.4%	94.65
Dallas	1.6%	**1.5%**	114.49
Denver	1.5%	**2.6%**	123.66
Detroit	-4.4%	**2.3%**	66.66
Las Vegas	0%	-7.5%	89.87
Los Angeles	0.1%	-4.8%	159.73
Miami	0.9%	**2.5%**	140.76
Minneapolis	-0.9%	**3.3%**	109.21
New York	-0.9%	-2.8%	157.87
Phoenix	2.2%	**6.1%**	106.38
Portland	-0.5%	-2.8%	129.01
San Diego	0.4%	-2.7%	149.68
San Francisco	1.0%	-3.0%	125.94
Seattle	1.7%	-1.3%	131.23
Tampa	1.3%	-1.0%	125.49
Washington	1.0%	-0.6%	176.48

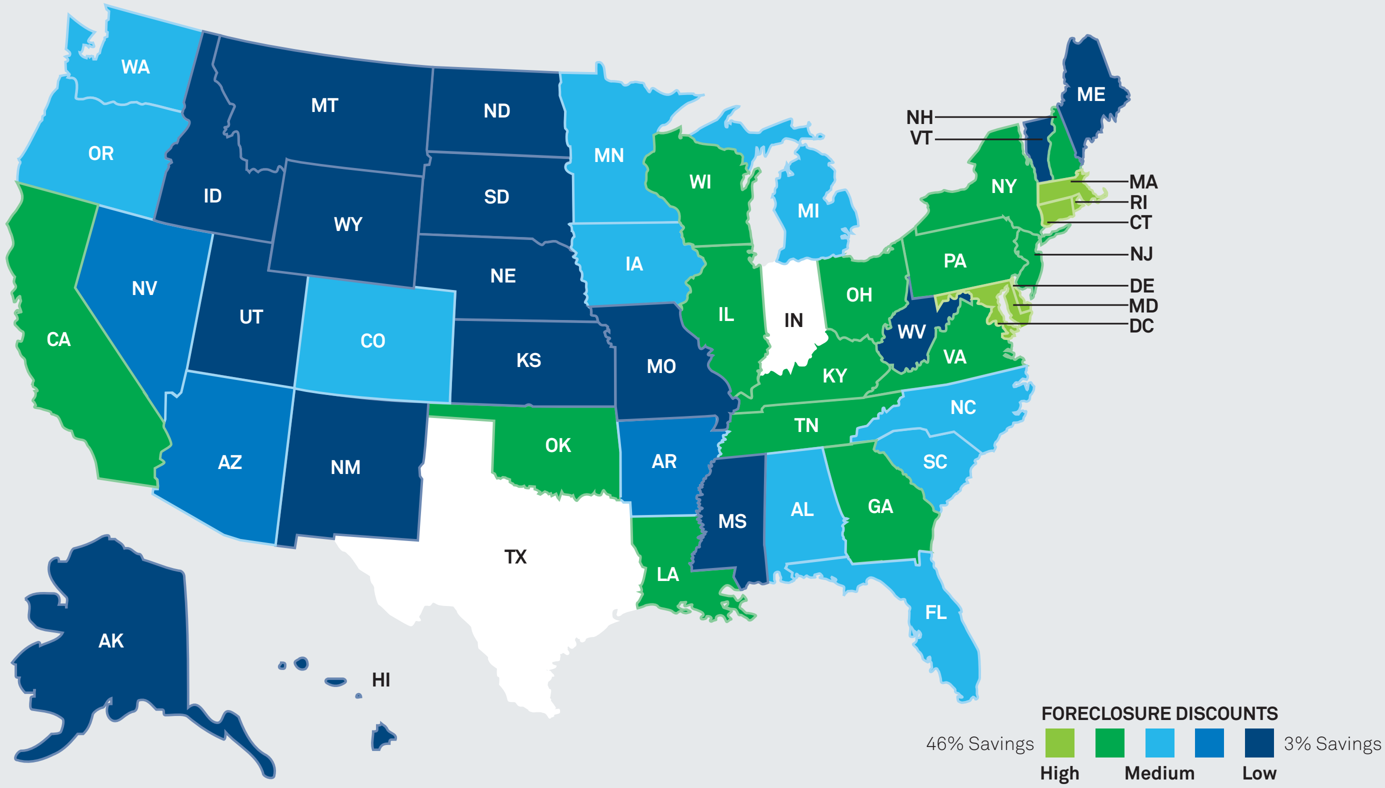
Sources: S&P Indices and Fiserv.
Notes: Index levels at 100 in 2000. Seasonally adjusted. The S&P/Case-Shiller Home Price Indices are calculated monthly using a three-month moving average and published with a two-month lag.

Metro	Peak to Trough	Increase From Trough
Detroit	-71.5%	6.6%
Las Vegas	-62.2%	0.0%
Riverside	-60.0%	5.0%
Miami	-59.3%	11.2%
Phoenix	-58.7%	3.9%
Sacramento	-57.3%	0.1%
West Palm Beach	-56.1%	3.1%
Fort Lauderdale	-56.0%	10.1%
Orlando	-55.6%	4.7%
Los Angeles	-53.2%	5.8%

Sources: National Association of Realtors and Moody's Analytics.

Looking for Bargains

Foreclosure Discounts by US State, February 2012



Source: Renwood RealtyTrac.
Note: Data for Texas and Indiana not available.

Within states such as California and Florida, some counties report much higher discounts than others. Within counties, some towns … the list goes on to the last house on the block.

Declines in inventory usually herald a rise in prices. We believe markets reporting falling inventory and price declines, such as Atlanta, could be in for a rebound. See the table below.

Clearing Inventory—One City at a Time

Year-Over-Year Inventory Changes in Top 20 Metro Areas, April 2012

	Inventory Change		Inventory Change
Phoenix	-43%	San Diego	-24%
San Francisco	-43%	Minneapolis	-24%
Atlanta	-34%	Las Vegas	-20%
Denver	-34%	Los Angeles	-18%
Detroit	-33%	Washington	-15%
Tampa	-31%	Chicago	-13%
Seattle	-29%	Cleveland	-13%
Portland	-27%	Boston	-7%
Dallas	-25%	New York	-4%
Miami	-24%	Philadelphia	14%

Sources: Department of Numbers and Citigroup.
Note: Based on multiple listing service (MLS) listings.

Policy: No Certainty

Markets do not like uncertainty. This is evidenced by the current state of play in the housing and mortgage markets. Policy uncertainties are giving homeowners, lenders and especially investors pause on pulling the trigger on a new purchase, loan or real estate investment. Businesses and investors need certainty. They may not like the rules, but they respect clarity and the rule of law.

Knowing the GSE Future Is the Holy Grail

There are many, many questions on the policy front: What is the future role and shape of GSEs Fannie Mae and Freddie Mac and other public entities that now back up the vast majority of newly originated home loans? What will happen to their portfolios of mortgage securities, loans and foreclosed properties? Which of the many government initiatives to blow life into the housing market will gain traction? How will the tidal wave of new financial regulations and legal settlements affect credit availability and the rights—and obligations—of market participants?

We have not even discussed larger macro-economic policy issues such as the future of temporary tax benefits or the reduction of the US budget deficit. This looming "fiscal cliff" will have a profound effect on key drivers of the housing market such as employment, consumer spending and available credit.

We do not expect any firm answers to most of these questions until at least 2013, or probably 2014 in the case of the GSEs' future. Some progress may take place before then on the regulatory front. This is likely to be piecemeal, but could affect markets. Overall policy, however, will diverge greatly depending on who will reside in the White House and the composition of US Congress after the national election.

A true consensus on how to create a healthy housing market appears far off. This lack of clarity about housing policy and regulations is a big challenge for homeowners and investors alike. This much we know: Any housing policy discussion starts with the role of the GSEs. What happens to these agencies is arguably the Holy Grail of US fixed income markets.

The GSEs fulfill a pivotal role in the residential mortgage market by buying mortgages, pooling them and selling them as mortgage-backed securities (MBS) to investors. These agency MBS conform to the GSE lending standards. This process lowers mortgage rates and frees up banks to make more loans—fulfilling the historic mission of the agencies to provide liquidity in the home lending market and support homeownership.

Ginnie Mae, which primarily securitizes Federal Housing Administration-insured and Veterans Administration-guaranteed loans, has always *explicitly* guaranteed the principal and interest payments on the underlying mortgages. Fannie and Freddie used to have an *implicit* guarantee: Investors expected the government would bail them out if they got in trouble. Under current conservatorship, the GSEs now carry an explicit guarantee as well.

A Crucial Guarantee

Between them, the GSEs guarantee nearly half of the $11 trillion outstanding residential mortgage debt. Their portfolios of MBS have been pruned since the crisis, but still make up 11% of the total. See the charts on page 13. In all, government-linked housing entities including the Federal Housing Administration (FHA) currently back about 95% of all new mortgage originations. Public support does not end there: Purchases by the Fed and US Treasury also underpin the market.

This means the US government effectively backstops pretty much every new mortgage loan. Investors "reward" this guarantee by accepting much lower yields for agency MBS than for private-label ones. The reason is agency MBS are considered safe-haven assets—similar to US Treasuries except for a perennial prepayment risk. The agency MBS have become core holdings of international and domestic institutions such as pension funds and asset managers, who manage the retirement savings of millions of Americans. This group holds more than a quarter of the agency MBS market.

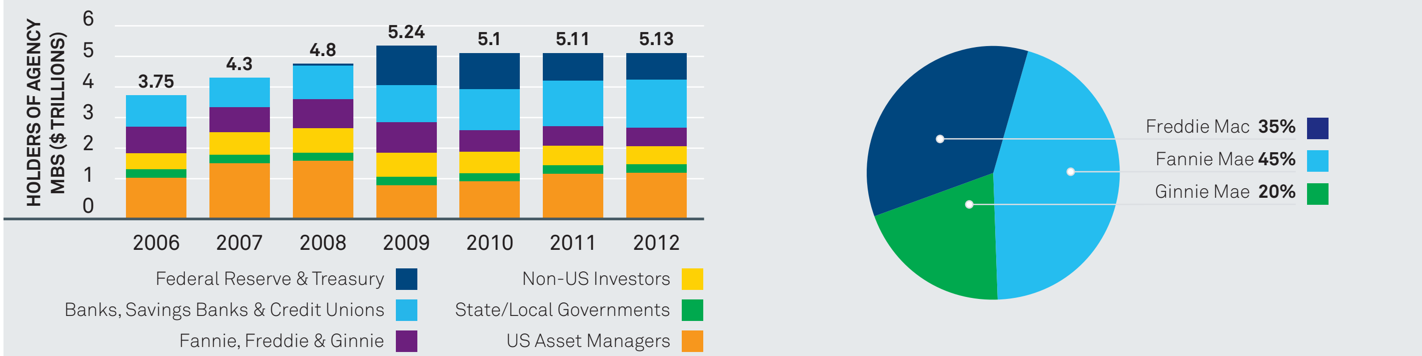
The government guarantee helped prevent mortgage markets from seizing up during the recent financial crisis. Tighter underwriting standards made getting a mortgage a lot tougher—but not impossible. The GSEs' mission was accomplished (albeit hundreds of billions of dollars in taxpayer money were needed to support their pre-crisis obligations).

Taking Off the Training Wheels

Consensus has emerged that it is time to wean the housing financing markets from over-reliance on the GSEs—although the agencies remain key in channeling the flow of credit to the mortgage markets. The US Treasury and Department of Housing and Urban Development (HUD) in February 2011 laid out three options to wind down the GSEs. The third option—creating private entities with strict regulatory oversight that would guarantee mortgages while the US government would provide re-insurance—

Inside the Agency

Composition of the Agency Mortgage Market by Holders and GSE Backers



Sources: SIFMA, Nomura Securities, Fannie Mae, Ginnie Mae and Federal Reserve. As of March 2012.

appears to have the most traction, as we discussed in our *ViewPoint* paper **"Getting Housing Finance Back on Track"** in February 2011. The Federal Housing Finance Agency (FHFA) floated its proposal for the immediate future of the GSEs in February this year.

The plan includes creating standardized securitization and loan servicing; gradually diminishing GSE activity in both the single- and multi-family housing and secondary mortgage markets; and maintaining the agencies' role of providing liquidity.

A Recipe for Housing Finance

Here are the key ingredients we believe are needed to put the residential housing market on solid footing. This recipe is more complicated than it looks and takes years of preparation and gestation time.

1. **A Guarantee that Does Not Come for Free**
   The market needs some sort of a government guarantee that gives investors comfort they will be made whole in case of default. The government, in turn, needs to get paid for this service. The higher the risk, the higher the fee. Can GSEs price this risk? They do it all the time—and can get outside help if needed. The government should not be in a first-loss position; private capital should share the risk.

2. **Wanted: Intermediaries, Not Players**
   GSEs should further cut their portfolio holdings of mortgage securities. Securities with a government guarantee attract enough investor interest to support the market. The GSEs will need a cash portfolio to buy out delinquent loans and provide the market's supply and demand when needed. This business, however, should never again morph into a profit (or loss) center as we saw before the financial crisis. GSEs should be true intermediaries and market makers, not hedge funds and proprietary traders. The financial incentives of GSE staff and management should be aligned with this role.

3. **Transparent, Simple and Sensible Rules**
   We need standardized and clear underwriting criteria for down payments, income verification and credit scores for government-guaranteed loans. Limits for these loans should be based on mean housing prices in various regional housing markets. For example, loan limits in the San Francisco area should be higher than those in Orlando. We should synchronize limits for all government-guaranteed loans to avoid the current bizarre situation of the FHA guaranteeing higher loan amounts than the GSEs. Mortgage loans, origination, servicing and securitization should be simple, clear and transparent to all participants.

4. **Focus Public Policy and Respect Investors**
   There are simply too many competing government programs to support housing—without an overarching objective. We should prioritize the programs, align them with the interests of all participants and ensure they do not infringe on investor rights. What is needed is a holistic approach to solve the housing conundrum. In other words, the housing recipe is meant to create one well-balanced meal—not an à la carte menu with hundreds of disparate dishes.

The FHFA in May put out a four-year strategic plan that includes the GSE blueprint.

No clear consensus has emerged on the GSE plans (there is little consensus about anything these days in Washington), but it is fair to say there is momentum to remove the market's training wheels.

We do not believe full privatization of the GSEs is advisable—nor feasible—at this time. We believe the government guarantee is needed to ensure smooth functioning of the housing finance market—especially in its current frail condition. There are many ways to structure this guarantee, but we expect the GSEs to be around for a while given the political stalemate and feeble economy. The training wheels need to be replaced by other support—and we need to be ready to put them back on if necessary.

A Program for Every Homeowner

Programs and government initiatives to resuscitate the housing market abound. Their sheer multitude—and accompanying array of acronyms—illustrates the piecemeal nature and scattered approach to solve the housing crisis. The resulting complexity makes it tough to see the forest through the trees.

We highlight four programs and developments: The Home Affordable Refinance Program (HARP), the latest update to the Home Affordable Modification Program (HAMP), the Real Estate Owned (REO) initiative and the fallout from the $25 billion bank foreclosure settlement. The table below provides a synopsis of the four programs.

All four aim to offer relief to hard-pressed homeowners, reduce the supply of foreclosed properties and create incentives to entice private investors back into the market. We support their objectives, except where they—perhaps unwittingly—encroach on the rights of holders of first liens. As we have seen, first liens are often held by investors such as pension funds, mutual funds and other institutional investors through agency MBS.

The foreclosure settlement and the revamped HAMP give incentives to write down first-lien loans ahead of second liens. They give mortgage servicers partial credit toward loan principal

Housing Programs to Watch

Selected Government Housing Programs

Program	Overview	Mechanics	Bottom Line
Home Affordable Refinance Program (Oct. 2011 Update)	‣ Designed to remove impediments to refinancing. ‣ Offers financial relief for deep underwater homeowners. ‣ Incentivizes lenders by reducing liability for bad loans (put-back risk). ‣ Extends program to end 2013.	‣ Borrowers who owe more than 125% of the value of their homes now qualify. ‣ Eliminates some "reps and warrants" for lenders, or obligations to take back bad loans from the GSEs. ‣ Streamlines process by eliminating appraisals for most homeowners.	‣ Expected to boost loan refinancing and prevent properties from going into foreclosure. ‣ Gives lenders incentives to refinance. ‣ Increases prepayment risk for high-coupon MBS.
Home Affordable Modification Program (2012 Update)	‣ Allows loan modifications for more homeowners. ‣ Increases incentives for mortgage servicers and GSEs to modify loans. ‣ Financial relief for homeowners, but uncertainty for investors and inherent conflicts of interest for mortgage servicers. ‣ Extends program to end 2013.	‣ Triples incentives to mortgage services for loan reductions to 18-63 cents on the dollar and offers new incentives to Fannie Mae and Freddie Mac. ‣ Non-owner-occupied homes now qualify, as do people with low debt-to-income ratios (<31%) if they owe on secondary mortgages or large medical bills.	‣ May boost loan modifications and prevent properties from going into foreclosure. ‣ Risks benefiting holders of second liens over investor-held first liens. ‣ Discourages private capital.
Real Estate Owned (REO)-to-Rental Program	‣ Aims to reduce the supply overhang of foreclosed single-family properties and provide more rentals. ‣ Allows prequalified investors to buy pools of foreclosed single-family homes and rent them out.	‣ Investors are required to rent out the properties at least two years. ‣ First pilot program by Fannie Mae consists of 2,500 homes in hard-hit markets such as Las Vegas and Florida. ‣ Homes in the pilot program are 80% occupied.	‣ Helps reduce supply and provide rentals for those who need them. ‣ A good investment opportunity, but operational acumen or an ace property management company is a must.
$25 billion foreclosure settlement	‣ The top five mortgage servicers pay $25 billion in fines and loan modifications to settle allegations of sloppy and abusive foreclosure practices including "robo-signing." ‣ Mortgage servicers change how they service loans, handle foreclosures and ensure accurate information. ‣ Financial relief for homeowners, but downside for investors due to inherent conflicts of interest for mortgage servicers.	‣ Settlement includes $20 billion in borrower relief and $5 billion in penalties paid to federal and state governments. ‣ Financial relief for homeowners through reduction of principal balance and refinancing. ‣ Establishes new servicing standards. ‣ Mortgage servicers receive partial credit for writing down investor (first-lien) loans.	‣ Sets standards for mortgage servicing and foreclosures. ‣ Does not protect rights of first-lien holders and gives banks an incentive to write down loans they do not own. ‣ Likely to slow down the foreclosure process and increase costs for investors.

Source: BlackRock.

reduction quotas. This raises the specter of large-scale reductions of first-lien loans (including loans mortgage servicers do not own). This in turn helps second-lien holders—who often are the mortgage servicers themselves. Even the most earnest and honest mortgage servicer has an inherent conflict of interest in this respect.

The settlement and HAMP turn the pecking order of creditors upside down, placing first-lien holders in a "first-risk" position. We believe servicers should get no credit toward any quotas for investor loans and that first-lien rights should be respected. Private investors, who often represent the savings of Americans, "should not pay the price for the mistakes of others," as Senators Sherrod Brown and Bob Corker wrote in a May 14, 2012 open letter to HUD. Indeed, this approach discourages private capital from entering the sector.

Forgive or (Temporarily) Forget?

Solving the housing conundrum is a huge undertaking. Even basic questions about whether it is better to forgive or defer debts of people who are at risk of losing their homes are tough to answer. There are passionate advocates on each side. This is important for many initiatives now gathering steam, including the updated HAMP as described above.

We tend to side with proponents of deferring payment in this so-called forgiveness vs. forbearance debate. Deferral at least gives creditors the (theoretical) ability to recover the original loan amount. It also reduces the risks of moral hazard and "me-too" defaults—homeowners who stop paying their mortgage to get a debt reduction. The FHFA has flagged how debt forgiveness could spur more defaults with a material financial impact on the GSEs.

Ideally, we would like to see a change that would take into account the distressed homeowner's total debts—not just the first mortgage—as we argued in the December 2009 *ViewPoint* paper **"Keeping Homeowners in Their Homes."** This approach (judicial mortgage restructuring, as we called it) would respect the rights of first-lien creditors over others, prevent many foreclosures and bring about sustainable improvement in the distressed homeowner's health.

Does it make sense to take anything off the table at this point? If nothing else, the option to forgive—under those circumstances—should be one of many arrows in our quiver to fight the housing downturn and more foreclosures.

There are also legions of housing bills kicking around on Capitol Hill. None of these are likely to be adopted as they are, but they provide insights into the thinking on housing policy by key players. We highlight a set of bills from lawmakers Scott Garrett and Jeb Hensarling. They are worth watching because either one could chair the key House Financial Services Committee when Spencer Bachus' term as chairman ends in 2013. We also review two bipartisan bills that accept the principle of a (realistically priced) government guarantee for mortgage securities. See the table below.

Inside Capitol Hill

Selected US Congressional Bills on Housing Reform

Bill	Overview	Mechanics	Bottom Line
GSE Reform Bills by Garrett and Hensarling	▸ Introduced in 2011 by House Financial Services Committee members Scott Garrett and Jeb Hensarling. ▸ Speed up the timetable for reduction of GSEs' portfolio holdings, abolish risk retention for securitizers and standardize securitization. ▸ Bills H.R. 1223, H.R. 1224 and H.R. 3644 have not yet progressed.	▸ Shrinks size of GSE portfolio holdings to $700 billion after one year and $250 billion over five years. ▸ H.R. 3644 abolishes risk retention rules that securitizers must retain a portion of a loan while H.R. 1223 overrides the GSE exemption to these rules.	▸ Most aggressive plans to wind down GSEs. ▸ Potential to disrupt markets.
Miller-McCarthy Housing Finance Reform Bill	▸ Introduced in July 2011 by House Financial Services Committee members Gary Miller and Carolyn McCarthy. ▸ Creates one wholly government-owned housing agency that provides an explicit guarantee on mortgage securities. ▸ Bill H.R. 2413 has not yet progressed.	▸ Limits share of mortgage market covered by the new agency to 50%. ▸ Agency to be funded by guarantee fees charged to lenders and investors. ▸ Does not task the agency with affordable housing goals.	▸ Provides the government with greatest policy control. ▸ Arguably the least disruptive way to wean the market off over-reliance on the GSEs.
Campbell-Peters Housing Finance Reform Act	▸ Introduced in May 2011 by House members John Campbell and Gary Peters. ▸ Replaces GSEs with a consortium of private companies. ▸ Bill H.R. 1859 has not yet progressed.	▸ Provides for licenses to new mortgage guarantors. ▸ Guarantors pay for re-insurance by newly formed Mortgage Re-insurance Corporations that are explicitly backed by the government.	▸ Fair re-insurance pricing is crucial. ▸ Reduces the government's role, but provides the guarantee. ▸ Requires new regulatory framework.

Source: BlackRock.

The US Consumer Is Still in Sickbay

A big obstacle to a housing market recovery is the wobbly health of the US consumer. Consumers have cut debt and are spending a bit more, but the headline numbers are much rosier than reality.

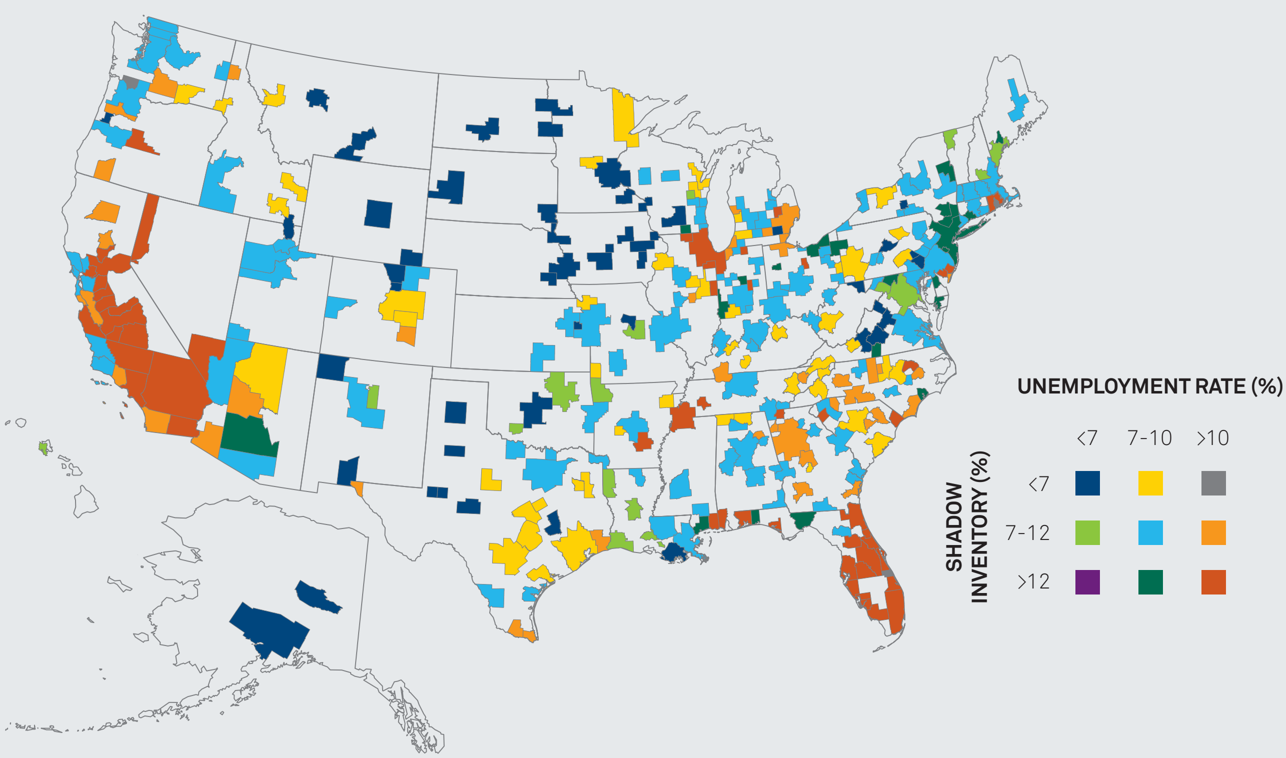
Consumers have deleveraged since indebtedness peaked in the third quarter of 2007. Overall, total mortgage and other consumer liabilities had fallen from a record 123% of disposable income to 105% by the fourth quarter of 2011, according to the US Federal Reserve and the Institute for Housing Studies. Strip out the highest income group, however, and it becomes clear most people are much more indebted, as we showed in our publication "The Status of the US Consumer" in September 2011.

Employment, or rather lack of it, is another key driver of housing demand and prices. The US jobs market has been improving, but gains have been modest and wage growth minimal. The labor participation rate hovers near a 30-year low. High unemployment often translates into more foreclosures and distressed properties, and vice versa. The shale oil and gas boom, for example, has made North Dakota a very different place than Florida (beyond climatological variations). See the map below.

Until we have sustained improvement in employment, coupled with real wage growth, it is tough to see the national housing market booming again. A slow recovery is the most likely outcome.

Joined at the Hip

Unemployment Rates and Shadow Inventory Estimates



Metropolitan Area	Unemployment	Shadow Inventory	Metropolitan Area	Unemployment	Shadow Inventory
Fort Lauderdale, FL	9.3%	30.3%	El Centro, CA	29.3%	16.3%
Miami, FL	12.2%	30.3%	Nassau-Suffolk, NY	7.1%	14.1%
Orlando-Kissimmee, FL	10.3%	26.1%	New York-White Plains, NY	8.5%	14.1%
Las Vegas, NV	13.5%	26%	Memphis, TN	10.4%	14.1%
Stockton, CA	16.9%	18%	Chicago-Naperville, IL	10.3%	13.7%
Riverside-San Bernardino, CA	13.9%	18%	Santa Barbara, CA	9.2%	11%

Sources: J.P. Morgan, Case-Shiller, Mortgage Bankers Association and CoreLogic. Data as of April 30, 2012.

Credit Is Cheap—If You Can Get It

Easy mortgages helped boost the US homeownership rate to unsustainable highs during the boom years. Tougher access to credit is bringing it back down. Credit appears to be a much bigger factor than affordability in boosting homeownership. In other words, what drives the market is not how cheap it is, but how easy it is to get a mortgage.

Banks have upped their mortgage standards: bigger down payments, tougher appraisal standards and higher FICO credit scores. And the banks have become gun shy about lending because of stringent capital standards and risk controls. The result is a drop in mortgage applications with no end in sight—even with interest rates at record lows. See the chart below.

We're Sorry, Your Application Has Been Re ...

Willingness to Lend, 2007-2012

Sources: ISI and Federal Reserve. Data as of April 30, 2012.

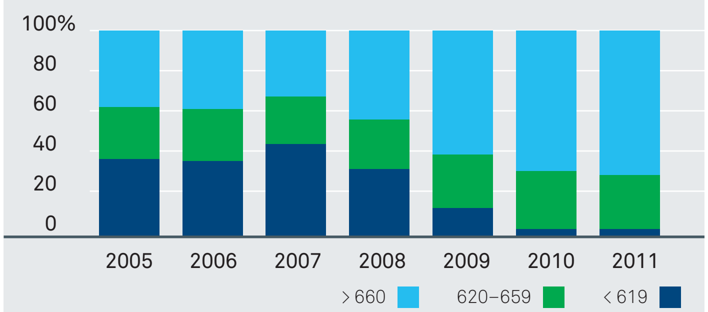
Demand for residential mortgage loans had been weak, but nearly 40% of banks reported "moderately" to "substantially" stronger demand in the first quarter, according to the April 2012 Senior Loan Officer Opinion Survey by the Federal Reserve Board. Lending standards remained tight, however, with a majority of banks reporting they would be much less likely to extend loans to people with a less-than-perfect FICO credit score of 620 than during the boom—even if they provided a 20% down payment.

Tight lending standards are also reflected in the makeup of loans guaranteed by FHA. These loans typically are used by people with weak credit or by first-time homebuyers. FHA-backed loans are about the only game in town for people who can only come up with a down payment of 5% of the loan amount.

The percentage of first-time homebuyers with high credit scores receiving these loans doubled to 70% in the past five years, showing lenders tightened standards. See the chart above.

The First Time Has to Be Perfect

FHA First-Time Homebuyer FICO Credit Scores, 2005-2011



Sources: HUD and FHA.

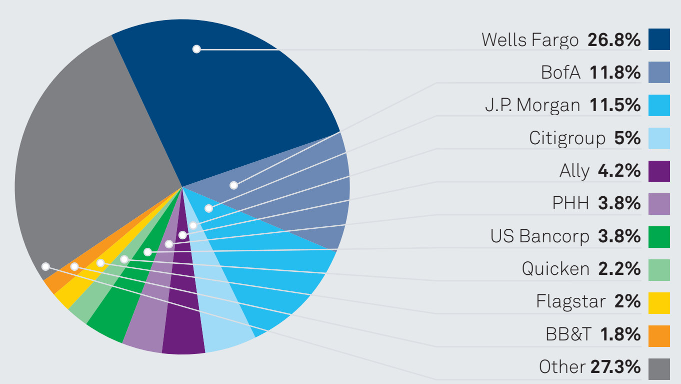
Why? Banks worry the FHA will throw back poorly underwritten loans to them. These "putbacks" are costly, so lenders play it safe. This has dampened demand for entry-level single-family houses, depriving the market of its natural influx of new buyers.

This also means the easy loans (the ones to the most creditworthy borrowers) have been made, with no evidence yet of fringe buyers being able to break in.

Ultimately, market dynamics should fix this: Originating mortgages has again become a profitable business. One reason is industry consolidation and less competition. Five banks accounted for 59% of residential mortgage originations in 2011, according to research firm Inside Mortgage Finance. The top 10 banks accounted for 73% of the $1.35 trillion origination market last year. See the chart below.

Cornering the Market

Bank Shares of Residential Mortgage Originations, 2011



Source: Inside Mortgage Finance.

Investment Opportunities

Equities: Few Ways to Play

There are few pure plays in equities to bet on a housing recovery. Listed homebuilders have a tiny 0.2% weighting in the S&P 500. Homebuilders give exposure to new single-family homes—a segment that represents just 15% of the residential housing market. The business is highly competitive and fragmented, while brands do not really matter. As a result, it is tough to raise prices beyond inflation.

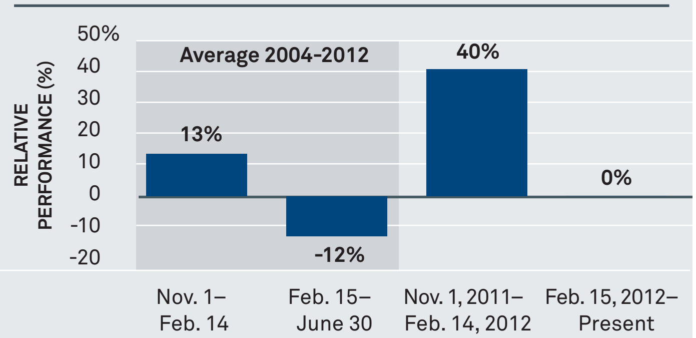
The key to homebuilders is to analyze their land bank—they tend to hold three to five years of inventory. When prices rise, profit margins increase. Since the depth of the crisis in 2009, listed homebuilders have managed to improve margins even in the face of price declines. The reasons are "value engineering" (rejigging the construction process and using cheaper materials) and cherry picking prime locations. History suggests competition will wipe out these benefits in time, and margins again will closely track land and housing appreciation.

Homebuilders receive outsized attention because of their scarcity value and perceived barometer of the state of the housing market. Stock prices are volatile and driven by sentiment, often resulting in a disconnect between valuations and economic reality. As discussed, homebuilders often offer upbeat forecasts at the beginning of the year only to disappoint later. This "hope and hangover" trade has played out in good and bad times. See the chart below.

Construction equipment makers, household goods companies and home improvement chains are other ways to gain exposure to the housing market. These categories also make up just a sliver of the overall market. The combined market value of giants Home Depot and Lowe's, for example, is less than 1% of the S&P 500. Foreign players such as UK-listed building materials supplier Wolseley, which derives 43% of revenues from the US market, are also relatively small. (Wolseley's market value is just over $10 billion.)

The Hope and Hangover Trade

Seasonal Performance of Homebuilders vs. S&P 500, 2004-2012



Sources: BlackRock and Bloomberg. As of June 4, 2012.

Lastly, mortgage lenders are prime beneficiaries of a housing recovery. Banks have pricing power due to less competition and higher concentration. As we have seen, the top five lenders originate more than half of all residential mortgages. Lending spreads are wide with funding costs near zero and delinquencies are trending down. Banks are bursting with cash from prepaid loans.

This rosy picture is offset by regulatory risks and legal battles over foreclosures. Many of the biggest and strongest lenders also have sizable other operations, diluting their exposure to housing. In addition, average borrowers these days have much better credit scores than in the boom times, suggesting that the easy loans have been made.

Fixed Income: Yield and Limited Supply

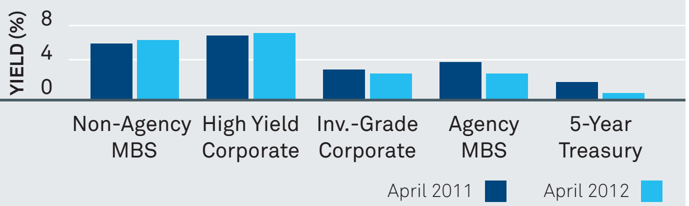
In general, MBS offer opportunities because of improving underlying economic trends, limited supply and structural demand in a world where many government bonds offer investors negative yields after factoring in inflation. MBS yields remain attractive vs. other bonds. See the left chart on page 19.

Prices of agency MBS, which are issued and backed by the GSEs, have rallied in the past year and yields are now comparable to investment-grade corporate bonds. We believe there are, however, opportunities to take advantage of bouts of temporary mispricing caused by shifting market expectations about the likelihood and timing of a next round of quantitative easing by the US Federal Reserve.

Prepayments, which hurt because the proceeds need to be reinvested at lower yields, are modest because it is still tough to obtain credit. Supply is limited because of the wobbly housing market, while demand is strong from real estate investment trusts, banks and money managers. The Fed remains a buyer because it needs to reinvest mortgage paydowns. With the possibility of an additional round of quantitative easing focused on the mortgage market, this demand could carry on.

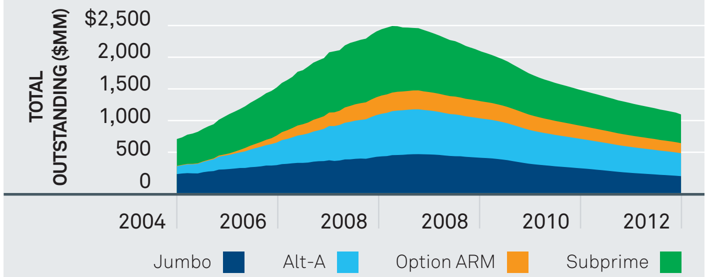
Watch government policy. HARP, which we support, could increase prepayments because it allows deep underwater homeowners to refinance at lower rates. This could hit MBS trading at a premium—a category that makes up 99.8% of the overall MBS agency market. See the chart at the bottom of the next page.

Got Yield?
Yields of US Bonds, 2011 vs. 2012



Sources: Barclays, BlackRock, Bloomberg.
Notes: Non-agency MBS represented by Wells Fargo CMO 6% as modeled by BlackRock; high yield represented by J.P. Morgan Domestic High Yield Index; investment grade corporate represented by Bank of America Merrill Lynch 1-10 Year US Corporate Index.

A Disappearing Market
Outstanding Non-Agency MBS, 2004-2012



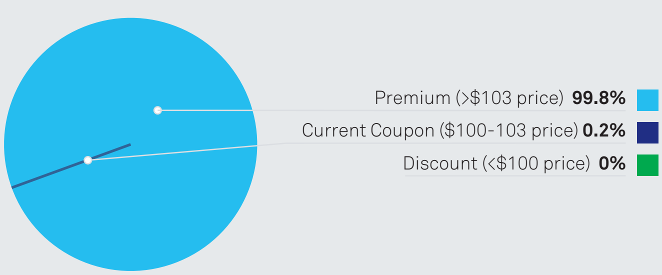
Source: Intex.

Non-agency MBS, securities issued by financial institutions that do not conform to GSE underwriting standards, currently offer attractive loss-adjusted yields of 6% to 8%, according to our calculations. The sector trades on an absolute yield basis as opposed to a spread over US Treasuries, making it much less sensitive to rising interest rates than corporate credit. Concerns about creditor rights need to be addressed, as we discussed earlier.

The non-agency MBS market also is an effectively disappearing market. See the chart above, on the right. The top five mortgage issuers are scaling back, and anecdotal evidence points to regional and community banks becoming more active in lending. The latter groups typically do not securitize the mortgages, but hold them to maturity.

Another strategy is to buy batches of non-performing loans (NPLs) at deep discounts to the underlying home value, and restructure the loans or liquidate the properties to capture the value. There is enough supply: Banks have been shedding NPLs to free up capital and avoid foreclosure litigation or regulatory scrutiny. The upside is the returns are not dependent on a housing market recovery because they are primarily driven by liquidity and operational acumen. The latter also is a big hurdle: Expertise in loan servicing is a must.

A Premium Market
Segments of Agency MBS Market, May 2012



Source: BlackRock.
Notes: Excludes adjustable rate mortgages, 10- and 20-year mortgages, and non-deliverable 15-and 30-year mortgages.

Real Estate: Fixer-Uppers and Prime Land

The Real Estate Owned (REO) market—properties owned by lenders as a result of foreclosures—offers opportunities. As we have seen, these properties on average sell at a record 28% discount to the market—although prices vary tremendously by region. The strategy is to buy entry-level REO properties, fix them up, bundle and lease them, and ultimately sell them in five to seven years. Properties priced at $200,000 or less can generate hefty rental yields and have limited price downside due to investor demand. Prime rental target groups are families with children, making for limited overlap with prospective renters of apartments such as singles.

A big hurdle to this strategy is the operational nature of real estate rentals. Who will fix the light bulb in the middle of the night in that far-flung suburb? It needs a hands-on property management company. The other problem is the difficulty to scale this business. It is likely limited to areas with high foreclosure rates and rental demand in "sand states" Arizona, California, Nevada and Texas, as well as in Florida and Atlanta.

Opportunities for new home sites abound—in the right locations. The strategy is to buy land, ready lots and sell them to one or several homebuilders. Prime or "A" locations are close to jobs, transport, quality schools and amenities. Foreclosures should be minimal. Consumers are looking for value, and are happy with smaller lot sizes and houses (after the average home's floor space expanded for decades). Again, expert knowledge and operational acumen is needed to make this strategy work.

Examples of markets combining these features are the San Francisco Bay area, coastal southern California, southeast Florida, the Washington, D.C. metro area and suburban Philadelphia.

BlackRock Investment Institute

The **BlackRock Investment Institute** leverages the firm's expertise across asset classes, client groups and regions. The Institute's goal is to produce information that makes BlackRock's portfolio managers better investors and helps deliver positive investment results for clients.

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