

California's once 'impregnable' real estate market goes bust

by Steve Parsons

Over the last two decades, California has come to symbolize the so-called surge in America's prosperity. In particular, the California real estate market has been the hallmark of not just the great "Reagan recovery" of the 1980s, but of the tremendous rise in real estate "value" since 1970.

California is the largest real estate market in the United States, having been buoyed by an enormous influx of people drawn to plentiful, high-paying jobs in what seemed to be the Golden West. Land and building prices have skyrocketed, from a median sales price of \$24,500 for a single-family home in 1970, to a high of more than \$200,000 at one point last year.

But now this vaunted market—supposedly immune from the depression that has collapsed the housing markets in Texas and the Northeast—is nosediving. And the huge increase in property "value" is being shown for exactly what it has been all along: the biggest and most hyperinflated speculative real estate bubble in this country.

Recent figures on home sales, prices, and market turnover show a dramatic collapse in process.

From boom to bust

The median price of existing, single-family home sales has been sliding downward since February, from a level of \$197,184 to \$190,350 in September (Figure 1). Except for a two-month rebound last January and February, the median price has tumbled nearly 6%, down almost continuously since the July 1989 peak of \$202,650.

This contrasts with the almost uninterrupted burst in prices from 1984 to mid-1989, when the median sales figure nearly doubled from about \$114,510 to the \$202,650 peak in July 1989. From May 1988 to July 1989, the median price rocketed upward from \$163,639—nearly \$40,000 in one year.

Sales of existing, single-family homes have plummeted since March, from an annualized rate of 560,663, to only 381,080 in September—a drop of 32% (Figure 2). Sales have fallen nearly 40% since the peak of the recent period, March 1989, when sales hit 624,168.

Sales in September 1990 were down 26.5% from the

level of September 1989, and down 10.7% from a month earlier, August 1990. This was the biggest month-to-month drop since a 22.4% decline back in January 1987, which was triggered by changes in the tax law. The sales plunge was led by the Los Angeles regional market, which dropped 41.3% in September from August levels.

Also shown in Figure 2 is the so-called unsold inventory index—the number of months it would take to deplete the supply of resale homes on the market at the current sales pace—which skyrocketed to 13.4 in September. The index has been zigging and zagging upward for two years, from a low of 3.8 in August 1988. Put another way, in September 1990 it took 3.5 times longer to sell 35% fewer homes in California than it did two years ago. Furthermore, the turnover period increased, *despite a decrease* in listings.

The collapse in home sales has ricocheted back into construction. In 1988 and 1989, the number of residential permits issued for building single-family homes averaged around 13,500. From January through June of this year, that average had slipped to under 11,000. Since then, the decline has been precipitous—9,346 in July; 8,145 in August; and then only 6,167 in September, a drop of more than 50%. The valuations of this construction have concomitantly fallen, from a level approaching \$2 billion per month, to only \$784,573 in September.

Similar figures pertain to commercial construction. Hardest hit has been industrial construction. Through the first six months of this year, the valuation of industrial building construction was approximately \$150 million per month. By September, that had dwindled to \$87 million.

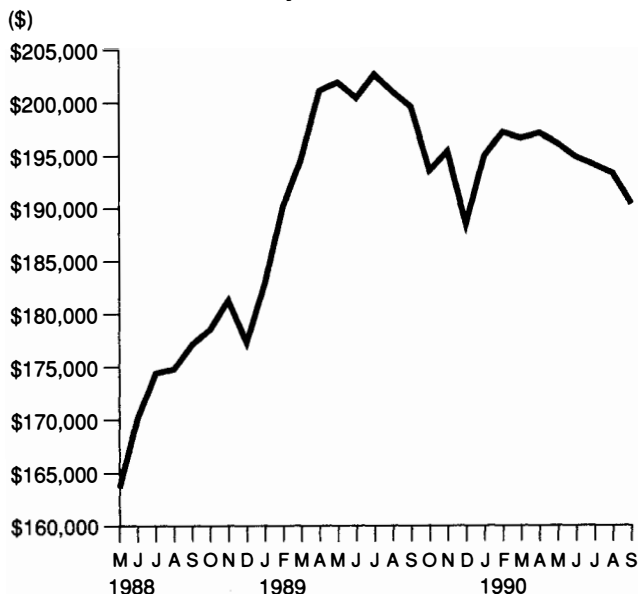
Blame Iraq?

California bankers and real estate speculators are shells-hocked in the face of reality's sledgehammer. On Oct. 28, the *San Francisco Examiner's* business section ran a feature entitled "Golden age over?" mooting what these august "entrepreneurs" haven't dared to think about the "once unassailable California market" and "invincible growth machine."

"The state's bankers and economists bristle at the idea that things may have changed," says the *Examiner*. "They

FIGURE 1

Median sale price of existing single-family homes in California peaked in mid-1989



Source: California Association of Realtors

have seen California and its banks weather far worse economic storms. . . . ‘Historically, home prices have risen even during housing downturns, including the 1982 period,’ wrote Wells Fargo Bank chief economist Joseph Wahed. . . . ‘This time around, prices have dropped more precipitously and over a shorter period.’ ”

James Antt, Jr., president of the California Association of Realtors (CAR), put forth the laughable thesis that the September “intensification” of the housing slowdown was due to “consumer uncertainty resulting from the Persian Gulf crisis.” Of course, for professional perception-mongers like Antt, this has to be merely temporary. We are assured by his vice president of research and economics, Leslie Appleton-Young, that “the Persian Gulf crisis has caused a one-time jolt to the entire U. S. economy, but the ripple effect of that shock likely will dissipate during the next few months.”

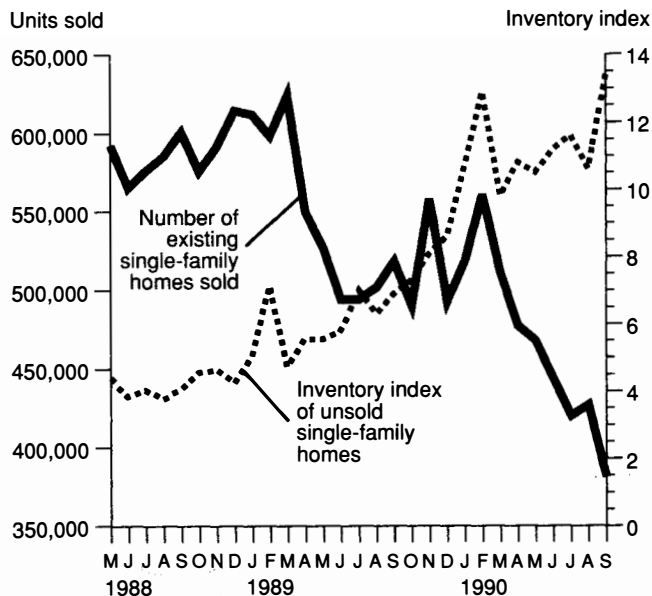
What’s really behind the bust?

Although the *Examiner* doesn’t quite go along with blaming California’s real estate bust on Saddam Hussein, the paper nevertheless admits that it can’t fathom the reason for it. “What is incredible about this housing slump is that there is seemingly no outside cause. Interest rates haven’t jolted the economy, there’s no serious economic downturn, the work force is growing—albeit at a slower rate—and housing inventories are not excessive.”

But in the very next sentence, the *Examiner* puts its finger on it: “This time California’s housing prices simply rose

FIGURE 2

Sales of existing California single-family homes plummet, as inventory climbs



Source: California Association of Realtors

higher than most people can pay. Only 18% of California’s households could afford the state’s median-priced home in June,” versus 46% for the nationwide average. “In the last two decades, median home prices in California have increased 700%, almost twice the national rate. But California incomes—constrained by a change in the composition of the work force from high-paying manufacturing to low-paying services—have risen on average only 230%.

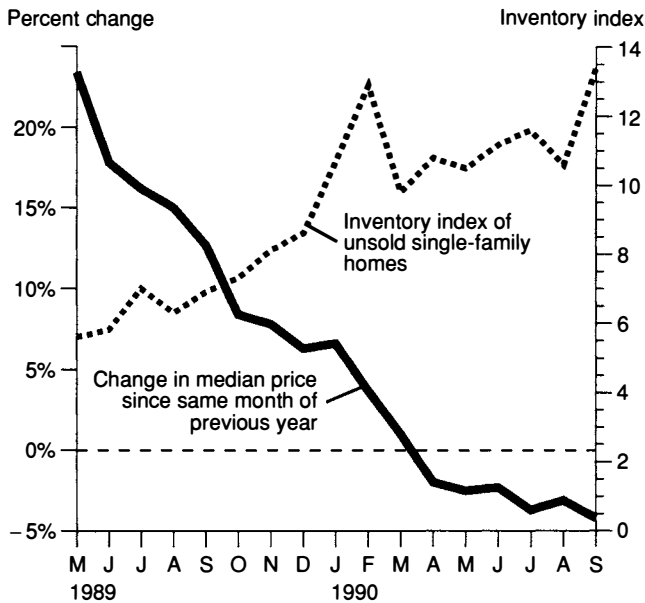
“To cope, more Californians entered the labor force: Some 56% were working in 1989 compared with only 44% in 1970,” in addition to the big population influx from the east into California’s rising job market.

That’s all over now, precisely because the “outside cause” that the *Examiner* can’t see, is the same as the “inside” cause: the deflation of the speculative balloon, both nationally and in California. The overblown real estate market, and related debt bubbles from junk bonds to public budget deficits, are crashing the economy, with a concomitant surge in real unemployment.

The business moguls in California should have seen it coming. When one looks at the *rate of change* of prices and sales of homes, as well as the inventory index of unsold homes, the negative trend shows the inevitability of today’s disaster. Even while the median price was zooming in 1988 and the first half of 1989, and “recovering” in the beginning of this year, if monthly prices since May 1989 are compared with prices for the same month in the previous year, the *rate of increase has been steadily falling* (see **Figure 3**).

FIGURE 3

Price increases of California homes slow and become negative



Source: California Association of Realtors

In May 1989, the median price was 23.4% higher than in May 1988—\$201,930 versus \$163,639. By December 1989, it was only 6.3% higher—\$188,477 versus \$177,307. By April 1990, the change in the median price had become *negative*; the price actually fell below last year's level for the first time in many years. The negative pace has *accelerated* nearly every month since then; September's price was 4.2% below that of September 1989.

Even more indicative are comparisons of the year-to-year changes in monthly single-family home sales (Figure 4). For every month from May 1989 through September 1990, sales have been *lower* than for the same month in the previous year. Since June, the negative rate has accelerated, with September sales plunging 26.5% from the level of September 1989. This, of course, dovetails with the steady increase in the inventory of unsold homes, from 5.6 in May 1989 to 13.4 last September.

It won't be long before the downturn in home prices—not to mention those for commercial buildings—approaches the rate of collapse of sales.

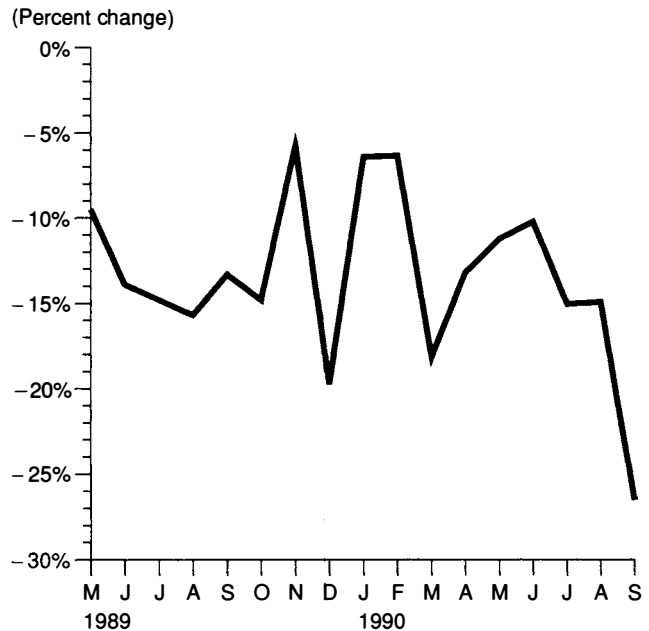
Rose-colored glasses . . . and knocking knees

None of the players in the huge California real estate market want to see this reality. While everyone now is forecasting a "downturn" into next year, they are all saying the slide will moderate from the sharp drop this year.

Even more deluded are the bankers, insurance compa-

FIGURE 4

Change from previous year's single-family homes sold shows accelerating decline



Source: California Association of Realtors

nies, and financiers holding the mortgages and building loans—the enormous debt paper that is now bleeding red ink. Even if prices continue to plummet, they insist, and even if homeowners, whose property values fall below the cost of their mortgage, walk away from their homes, the banks will ride out the storm. This is because of their supposedly huge "equity cushions." That is, the sum of the downpayments plus the rise over the years in home values (i.e., prices) far exceed the losses they would take on the unpaid portions of mortgages. Wells Fargo and Bank of America, for example, boast that they can withstand a 45% decrease in prices.

This is sheer bravado. First, as pointed out by bank analyst George Salem of Prudential-Bache, 60%-plus, in dollar terms, of these banks' mortgages and loans were made in the heady speculation of the last two years. Therefore banks simply do not have the equity cushion they are bragging about. But even more to the point, which Salem and other "experts" do not mention, is that such widespread property assumptions and foreclosures will completely destroy the market value of these properties, as banks either dump them willy-nilly on a market already saturated with unsold homes of plummeting worth, or wind up holding them indefinitely—just like the Resolution Trust Corp., which is now stuck with increasingly worthless real estate from the savings and loan debacle. And no bank these days can withstand that.