

A real estate trip in California

Residents of the Golden State can learn from Texans about falling home values.

Sunday, December 03, 2006

SANTA ROSA, Calif. — In a laid-back kind of way, the Flamingo Resort Hotel and Spa, where I am staying, is centrally located. Drive in one direction and you're less than a mile from downtown. Drive in another and you're at a casual shopping center. Drive in still another and you're on your way to Glen Ellen and wine country.

My son Ollie, who lives in Santa Rosa, told me that real estate values are down.

A day later, the Santa Rosa Press Democrat had an article observing that the median price is down 4.2 percent — to \$565,000. This means the median home price here is now only 10 times the \$55,000 median household income in the area.

Worse, prices have fallen for four consecutive months. This means that many of those who bought at the top — which the Press Democrat identifies as August 2005, when the median home price in the area peaked at \$619,000 — are now upside down. With virtually no down payment and creative financing, recent buyers now owe more than their house or condo is worth.

This may be a good time for Californians to talk to Texans who went through the Texas real estate crash in the late 1980s and early 1990s.

Back then I wrote about Dallas "condo slaves." These were people who had bought overpriced condos in a rising market. They bought them with buy-down mortgages that would reset to a higher interest rate in a year or two. They bought them with very low down payments, often less than 5 percent.

Then the market turned.

Prices slipped. Inventory ballooned. Thousands of homeowners and condo owners put their keys in the mailbox and walked away from their mortgages. When that happened, prices plummeted. Then the condo lenders disappeared. Condo prices fell some more.

Those who tried to tough it out found themselves in an odd position. They could rent identical units around them for less than they were paying on their mortgages because the other units had been sold to speculators who paid cash. But they could not refinance to a lower interest rate because their condo was now worth less than their mortgage balance.

They were "condo slaves." They were indentured to their depreciated property.

Well, it's starting to happen in Northern California. Listen to this story.

Over lunch at Monti's Rotisserie, a friend tells me her Tale of Two Transactions.

Now a renter, she sold her townhouse in the mid-\$400,000s, nearly three times what she had paid for it. Today she rents a smaller townhouse for less than \$1,000 a month.

Her shelter expenses are way down. The equity from the townhouse, after paying off her credit cards, has been invested. To celebrate, she replaced her decrepit early 1990s Honda with a mature but beautifully maintained Lexus.

She is a happy camper. She believes the sale of her unit last August was the last sale in her entire complex.

But the next-to-last sale was to a speculator.

The speculator, a woman my friend knows, made a \$50,000 down payment (which may have been taken from a home equity credit line on her personal residence) on another mid-\$400,000s unit.

The speculator immediately found a tenant at about \$1,400 a month. That's nice, but it doesn't cover expenses. Figure a \$400,000 mortgage at 6 percent, interest only, and you've got a \$2,000 monthly payment. Add taxes, insurance and homeowner association dues, and you've got another \$700 a month, at least. So of that \$2,700, the speculator is paying about \$1,300 a month and the tenant is paying \$1,400. The place will have to appreciate at nearly 4 percent a year just to cover the monthly losses.

Worse, if the unit was sold at a loss of 6 percent plus a 6 percent real estate agent's commission, the speculator would be looking at losing her \$50,000 down payment and, maybe, bringing a check to the closing to cover the remaining loss. The site www.trulia.com, which tracks real estate prices, shows average and median sales price declines of 7 percent and 6 percent, respectively.

The speculator is between a rock and a hard place. She may need to hold the property for years before she can sell it and break even. If she does hold it, she'll have to have enough income from other sources to cover the monthly loss.

As thousands who survived the Texas crash will be happy to affirm, monthly losses get old really fast.

Does this mean a great real estate crash is coming?

One is coming for speculators who don't have deep pockets. That's certain. Without staying power, they will be wiped out.

For others it's a question of how great the collateral damage will be.

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