THE LOUDOUN COUNTY REAL ESTATE BUBBLE

A Case Study in How The World Went to Hell

by L. Wolfe

Loudoun County, Virginia, was once a quiet agricultural area, dotted with family farms and expensive estates, nestled some 50 miles from Washington, D.C., and known primarily as the center of Northern Virginia's "Hunt Country." Today, most of estates and the oligarchs who inhabit them are still there, but many of the farms have given way for some of the wildest real estate speculation in the nation.

In this brief report, we shall describe this bubble, and show how the bubble and the bubble "mentality" has grabbed hold of an area, driving it insane.

The creation of this speculative bubble was deliberate, part of an effort to keep a dying and dysfunctional monetary system afloat. In the process, in this former backwater of the nation's capital, it sucked thousands of people into a speculative vortex, from which they will not emerge whole. Thus, what has happened and will happen here provides a lesson for a nation consumed by similar delusions of "easy wealth" to be made from real estate speculation.

The Shape of the Bubble

In the space of five years, since 1999, real estate valuations, as reported in official County statistics, have risen nearly threefold, from approximately $13.3 billion to more than $35.7 billion, and are rising by even faster rates as you read this (**Figures 1-2**). Most single family homes, both old and newly built, are rising, at a rate of *at least $400 a day,* with some rising as much as $500 or more. (These latter figures are based on "market values"—what property will fetch if sold, and figures from local realtors suggest, that these are 20% to 30% above the official County asssesements. As an official in the County Assessor's office told this author, it is impossible for the County to accurately estimate the inflating values of homes; they are rising too fast, with rates that are rising faster than any models the assessors have to work from!)

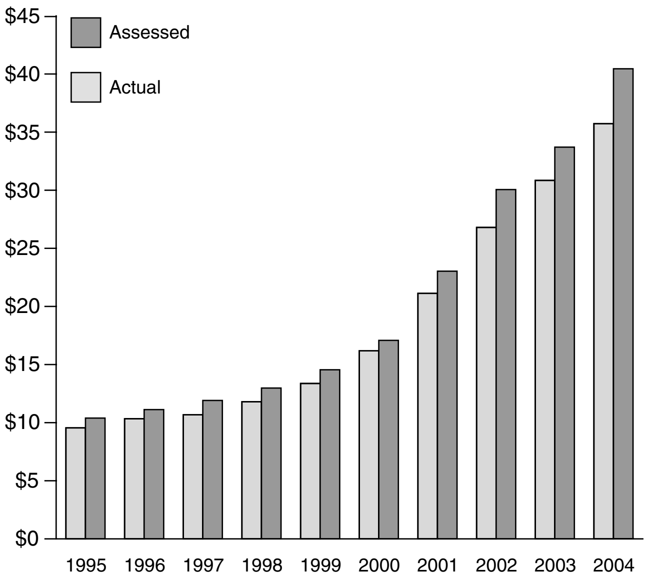
Local realtors estimate that the total market value of Loudoun properties is well above $60 billion—an increase in five years of more than 350%. Both the County and realtors agree that the yearly rate of increase in property value is in the 25-35% for most properties.

This coheres with a staggering price inflation, especially in residential properties over this same period, 1999-2004. Since 1999, the average sale price of a home has risen from well under $300,000, to $379,000 in 2004. As typical of a speculative bubble, the rate of the rate of increase has accelerated in each succeeding year. By May 2005, the average sale price had risen to more than $470,000, according to figures published by the Loudoun Board of Realtors. According to County figures, in 1999, the average price of a single-family detached home was about $291,000; by 2004, this figure had jumped to more than $566,000. In 1999, the price for a single-family attached home (for example, a townhouse) was $165,000; by 2004, it was $362,000! For a condominium unit, the average sale price in 1999 was about $118,000; by 2004, it was $252,000.

During this same period, developers have built some 23,479 units—increasing the County's housing stock from a little more than 62,000 in 2000 to more than 85,600 in 2004. While the majority of new homes are still single-family detached, the sharp rise in the prices of townhouses and condos, along with the desire of developers to maximize use and density in residential development, has led to a significant increase in the number of townhouses, relative to single-family detached.

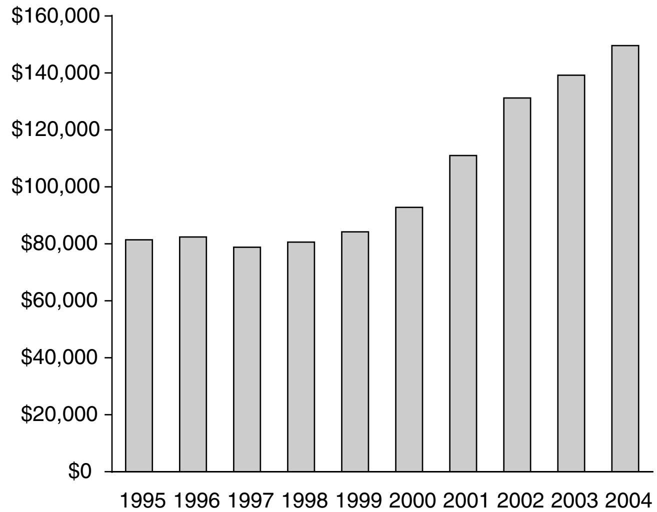
From 2000-04, the U.S. Census Bureau estimates that

FIGURE 1
Loudoun County, Virginia, Taxable Real Estate: Assessed Value and Estimated Actual Value
($ Billions)



Source: Loudoun County, Virginia

FIGURE 2
Real Estate Assessed Value Per Capita, Loudoun County, Virginia
(Dollars)



Sources: U.S. Census, Loudoun County.

approximately 70,000 people have been added to the County's population, an increase of 41%, to about 239,000. (The County's own estimates, which are based on what it considers more reliable data, are for an increase of about 60,000 people for the same period, and we have used the latter figures in our calculations.) The vast majority of this increase are new families moving here. Such figures place Loudoun as the leader in population growth rate for the nation.

Most Loudouners now find themselves trapped inside this great real estate bubble. If you look at the County statistics, you will see that the average family (household) annual income has been rising from around $60,000 in 1992, to more than $80,000 in 2002, and an estimated more than $90,000 today. But such figures are very misleading; Loudoun is home to some of the wealthiest families in the nation, whose fortunes skew such income figures. (See "The Lords of Loudoun" *EIR,* Dec. 15, 1995.) In addition, Loudoun has the highest percentage of multiple-income families (those with more than one significant wage earner) in Northern Virginia. Thus, most families make far less than the reported County average household income.

It used to be a rule of thumb that a household should spend no more than a quarter of its annual income on housing (that is, mortgage or rent, taxes, repair, utilities, and so on). Assuming the higher annual income figure, that would mean that a family should spend no more than $20,000-22,000 on its home. According to figures from the Board of Realtors, more than three-quarters of all Loudoun properties are encumbered by mortgages of greater than 80% of their value. This means for a $500,000 home, with a standard mortgage, at current market rates, a family would be spending between $35,000 and $40,000 a year on its mortgage alone! And, realtors estimate that upwards of 20% of all properties are encumbered up to 100% of their market value.

In figures prepared by *EIR*'s staff for this report, we can see that over the course of the last five years, mortgage debt per capita (as derived from County assessment figures) has been rising astronomically, from a little more than $80,000 in 1999 to around $150,000 in 2004, and an estimated $170,000 in 2005. And, the rate of increase, is increasing. (Although these figures are themselves derived from estimates of mortgage debt and should not be taken literally, the trends reflected are accurate—and appalling.)

In a deregulated financial universe, there are no available figures for the total size of Loudoun's mortgage bubble. However, both local bankers and realtors say that it is conservative to estimate that for both residential and commercial property, the mortgage bubble is at least around the $40-45 billion mark, and probably much higher.

How the Bubble Was Created

According to real estate and banking sources, the take-off point for the Loudoun real estate bubble occurred in 1999. Several factors played a role in igniting it.

1. Some time in the Fall of 1998, just after the near-blowout of the world monetary system around the collapse of the Long Term Capital Management hedge fund, a decision was made to create a national real estate bubble by dramati-

cally lowering long-term interest rates and changing the tax codes to encourage high turnover in real estate transactions. This decision was made at the "top," by central bankers like Federal Reserve chairman Alan Greenspan, and forced down the throat of the weakened Clinton Administration.

2. The U.S. Treasury Department put through two key tax code changes: first, the limit on "gains" that were exempted from taxation in the sale of a primary or secondary residence was raised to $500,000; second, a home could be sold as frequently as every two years (or less, under certain loopholes), without a tax impact.

3. In the case of Loudoun County, first the Clinton Administration, and then the Bush Administration funnelled contracts to IT and other firms, to create the impression of an employment boom—and to counter the effects of the collapse of the IT bubble in 2000-01.

4. Loudoun already had a large number of developable tracts in the pipeline, as result of rezonings that took place from 1996-99, in both the county at large, and in its largest town, Leesburg. When interest rates dropped, and the first new waves of buyers hit the County, these projects took off, while still more properties were opened for development. By 2001, County officials estimated that there were potentially more than 200,000 new homes in the Loudoun pipeline over the next 30 years!

5. As news spread of the great acceleration in home prices, Loudoun property began to be marketed by realtors and others as "golden"—that is, at whatever price you bought, it would experience phenomenal price appreciation. This brought in, from the region and the nation, buyers and investors, who gobbled up property almost as soon as it was put on the market.

The Home As a 'Cash Machine'

Given the significant numbers of government workers who lived in Loudoun, the County always had a relatively high turnover rate, with people moving in and out on average every 7 to 10 years, and many moving more frequently. However, with the changes in the tax code, the turnover rate has accelerated; the average homeowner now stays in his home around two or fewer years. This change is not, in general caused by changes in employment or other economic circumstances (although this has taken place with layoffs at three of the County's largest employers, America Online, Worldcom/MCI, and United Airlines). Instead, it is caused by the greedy desire of homeowners to "cash in" on their equity appreciation.

While a home was once properly viewed as a long-term investment, it has now become a speculative "cash machine"—the equivalent of an ATM, which through sale, owners "withdraw" huge sums.

Most homes are now purchased as short-term speculative investments, not by investors, but by the homeowners. They attempt to fully encumber the property, putting in as little cash as possible, and with little concern for equity positions. As the home value appreciates, they add an equity line of credit, and then cash the whole thing out in two years, and move up to a larger home, where they intend to repeat the operation. It is not unusual for a homeowner, despite lack of equity, to make as much as $200,000 above his or her original purchase price in two years or so.

Thus, the County has two swarms of greedy locusts—ones that are internally migrating, and others that coming into the "promised" land to stake their "claims." No wonder that some realtors have taken to calling this Loudoun bubble "The Great Gold Rush."

The majority of Loudoun mortgages are still the conventional type—fixed-rate, 30-year. But with homeowners less and less interested in the long haul and in securing equity positions, there has been a huge increase in adjustable rate mortgages (ARMs) and in the new "interest only" loans, where no equity is secured. Many realtors, bankers, and mortgage brokers see this trend as dangerous and increasing. Should interest rates spike, or should there be a sharp break in the economy, then such homeowners with their ARMs and interest-only loans could find themselves in greeat difficulty.

It's All Coming Down

Lyndon LaRouche, who lives in the County, once estimated that if a crash occurs, real estate values would fall by more than 50%—and rapidly. He has pointed out that, in real terms, most of the housing is the equivalent of tarpaper shacks, held together with shrink-wrap, with a few gold-plated faucets. In other words, this housing has little intrinsic or real value, outside the insanity of the bubble. And as our figures cited above show, there is no real floor under it.

While people in the so-called real estate industry once scoffed at such arguments, now they are rightfully scared that this analysis is on the mark. All bubbles eventually collapse, and even the optimists in this crowd say that all that it would take to bring things crashing to earth would be a spike in interest rates, to around 8%, or some major economic disaster. However, they, like the homeowners in the vortex of the bubble, prefer not to dwell on such "negatives."

How does this market implode? Well, if something stops the flood of entry-level buyers, and the pace of new sales slows down, the existing homeowners would suddenly find it difficult to sell at prices that liquidate their debt. As market values drop, they would find themselves sinking deeper into negative equity, and then panic *selling* would set in. Once that happens, the market would collapse onto itself, and soon, with people bailing out and buyers looking only for real bargain-basement prices, the whole thing would go "poof."

Because Loudoun's bubble is interlinked, through various mortgage and credit derivatives, to the national and international financial bubbles, a collapse in this relatively small county, with its hefty mortgage base, could have the effect of a detonating trigger on a larger, thermonuclear explosion of the whole shebang. No wonder that LaRouche has dubbed Loudoun "Ground Zero" for the entire real estate bubble!