Report From Ground Zero

# Smoke Rising From Loudoun Housing Bubble

by L. Wolfe

As we head into a fateful period of weeks at the end of the world financial system, there are some ominous sounds coming from Loudoun County, Virginia, the northern suburb of Washington, D.C. that Lyndon LaRouche has termed the "Ground Zero" of the multitrillion-dollar U.S. residential real estate and mortgage bubble.

For the first time, the median selling price of a home is beginning to drop, while at the same time, a glut of overbuilt inventory is choking the market. Those familiar with the workings of a real estate bubble understand that its continued existence is based on the perception that prices will continue to rise *faster* than expectations. Instead, in Loudoun, which has seen multiple 100% speculative appreciations of values over the last ten years for most properties and homes, local realtors report that the general perception is that prices will fall, perhaps precipitously, in the next few months. This has triggered a rush to the exits by many homeowners, who have suddenly dumped properties on the market, hoping to cash out before the bottom falls out.

Those dumped properties are colliding with new townhouses, condos, and single-family homes produced by developers who once viewed Loudoun as the "golden cash cow"—a sure bet for huge profits. Last year at this time, there were a little over 1,000 homes for sale; today there are more than 5,000. And, there are more than 50,000 new homes in the Loudoun housing pipeline, waiting to be built or in some stage of completion.

The result is that both the new properties and the older ones being dumped are staying on the market for extended periods. The average time that a property stays on the market has risen steadily, to where it now approaches three months: a year ago, when properties were moving like hotcakes in what was still a white-hot speculative market, that figure was less than a month.

Nationally, the trends reflect the alarming pattern in Loudoun. Homes are now appreciating at much slower rates than last year, while the inventory of single family homes has risen to a 6.8 month supply—the largest amount of overbuilding since the pre-bubble, depressed market days of 1993. Meanwhile, the nearly 9% decline in sales prices from June to June represents the greatest such drop since 1995. The largest U.S. builder of luxury homes, Toll Brothers, reported that new orders plunged 47% in the quarter that ended July 31, compared to a year ago, "the worst slump it has seen in 40 years," said Toll.

A local realtor, who is growing increasingly worried about the future of the market in Loudoun, reported that for a time, prices are still "holding their own." He attributed this to the fact that most Loudoun mortgages are Federally insured at their inflated values, and thus, despite pressure from rising mortgage interest rates, the banks and other mortgage lenders see no point in "pressuring" the market to force price-busting liquidations, by calling in late loans. (This is contrary to national trends, where foreclosures have shown a steep rise in the last year.)

"The problem," said the realtor, "is that the sellers themselves are getting nervous about the economy. They are mostly in over their heads, borrowing money on super-inflated equity values and they are worried about whether they can get out in time, if things turn downward. So far, they are waiting it out. But if there is a local shock, layoffs and the like, or some national or international event, then the brakes come off, and this thing goes down the tubes fast."

As *EIR* has reported, the Loudoun market is not a local phenomenon, but is symptomatic of the national and international real estate bubble, created by former U.S. Federal Reserve chairman Alan Greenspan to replace the collapsing IT (information technology) bubble. Literally hundreds of billions of speculative dollars were poured into the housing bubble in the form of easy-money, mortgage credit. Those mortgages have been leveraged many times over, then bundled and leveraged again through hedge fund and other operations; and at the same time, the lenders induced homeowners to refinance with low-equity, low-payout mortgages (adjustable-rate mortgages, and so on.) Thus, for every dollar of speculative value in these mortgages, there are scores of "markers" all over the international financial system, in hedges and derivatives, that would be threatened if the Loudoun bubble pops. The force of a blowout here in Loudoun could amount to a financial Krakatoa for the already weakened and collapsing financial system, finally pushing the whole mess over the edge, as LaRouche has warned.

## No One Can Live in the County

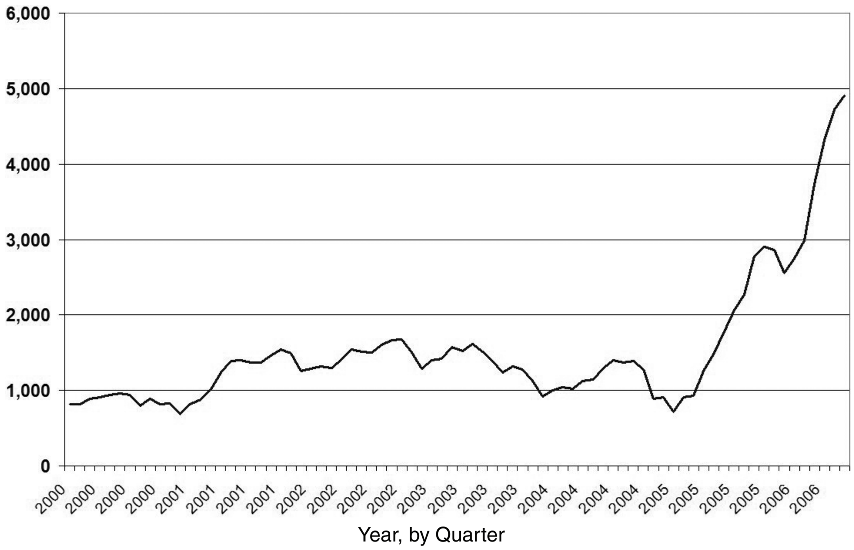
Just how unsupportable the situation is in Loudoun, was demonstrated by a recent study by county authorities of the affordability of housing in the county, which has had the largest growth rates of any county in the country over the last five years. The study, prepared by the Loudoun County Housing Advisory Board, shows that 44% of the county's workforce have to commute to their jobs in the County from other places because they cannot afford to live in Loudoun.

Meanwhile, those who live in the county, disproportionately commute out of the county to jobs in the metropolitan Washington area, mostly in the Federal government or in government-related (e.g., defense) jobs. Even these people, who are in the highest 20% percentile of incomes, cannot really afford to live in Loudoun—or at least they are spending

FIGURE 1

**Monthly Listings of Homes for Sale, Loudoun County, Va., From 2000 to June 2006**

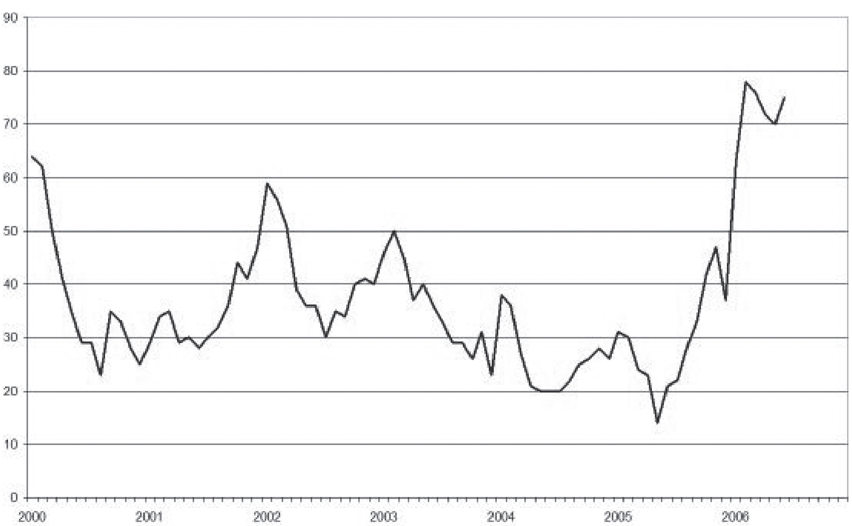
(Number of Houses)




Source: Loudoun County Government.

FIGURE 2

**Average Number of Days Home Is on Market, Loudoun County, Va.**




Source: Loudoun County Government.

too much money on their housing.

The study also showed that "about 25% of Loudoun County households have housing costs exceeding the 30% monthly housing cost standard," while the county has a "surplus of both rental and for-sale housing at the most expensive end of the scale indicating that a significant number of households are house-poor."

The executive summary of the study bluntly refers to the households forced to commute *into* the county for work and *out of* the county to live, as "displaced," and says that continued emphasis on construction of "market rate housing" (that is, high priced) will aggravate the situation by both increasing the out-of-range housing for these sectors, and requiring "additional workers in *precisely* those . . . industries . . . which are already experiencing disproportionate in-commuting" (emphasis in original).

Left unsaid in this rather formalist study is that such a workforce is extremely vulnerable to potential income shocks—equity market collapses, layoffs in the Federal sector, or even reductions in defense and related spending. What the study describes, is a population living beyond its means, a fact supported by other studies that show the county population to be one of the most heavily indebted in the country.

"People have taken huge amounts of equity out of their homes to support a lifestyle which they otherwise could not afford," said one realtor. "They believed that they had found the endless font of money in their Loudoun homes, that when times got rough, they'd simply sell them off and come out all right. It looks like that belief may be a delusion."

This and other local real estate sources report that although sellers are still getting about 90% of their asking price, and still making well over their original purchase prices, there are indications that this may not continue to be the case in the near future. The glut of new housing, colliding with existing homeowners trying to cash out, puts pressure on to reduce prices for quicker sales; but the sellers have borrowed so much, that there really isn't much margin for reductions. However, at some point, as market conditions tighten, "the sellers will want to limit potential losses," said another local realtor. "That's when the real panic starts." The first section of the market to give way will be the huge, overpriced homes in developments—the "McMansions"; and from there it will spread to overpriced townhouses and condos.