Loudoun County Real Estate Bubble Is Ready to Implode

by L. Wolfe

Loudoun County, Virginia, one of the nation's fastest-growing counties, and the "poster child" for the so-called national real estate boom, is in trouble. Economist Lyndon LaRouche had warned last year that this "white hot" real estate market was "Ground Zero" for the coming collapse of the Alan Greenspan real estate bubble. Where the equivalent of tar-paper shacks with gold faucets were selling for astronomical prices even one year ago, Loudoun is now experiencing what real estate veterans have identified as the classic early signs of a coming blowout—the buildup of unsold inventory; the panic-driven dumping of properties onto the market by worried homeowners seeking to cash out before prices fall; and the collision of the former with the seemingly insane rush to build new homes and townhomes and get them on the market before the whole thing comes crashing down.

When LaRouche put out his renewed warning of an impending Loudoun bust in the Spring of 2005, his remarks were greeted with skepticism and disdain from members of the real estate community and from Loudoun residents caught up in the cycle of greed and denial that marks a "bubble" mentality. They acknowledged that there had been a stupendous appreciation of property, especially in the last three years—a rise *averaging* more than 150%, and in some cases more than 300%—but rather than attributing this to pure speculation, they came up with "reasons" why such gains were justified—the growth of the "Internet economy," for which Loudoun is supposedly the "Crossroads of the Information Highway"; the large number of defense-related high tech contracting jobs, spurred by the Cheney-Bush war in Iraq; a similar government-driven spending spree for homeland security; and, Loudoun's role as a bedroom community for the Washington area's super-elite. Since, the delusional people claimed, Loudoun would continue to benefit from its relationship to Washington and the Federal government, there was no reason to doubt its continued prosperity as a real estate "boom town." There was no danger of a collapse—those powerful people who lived here and who had fueled the "boom" would never let it happen.

Today, less than a year later, those same people are worried. While many local residents continue to live within their delusions, and live a lifestyle supported by their real estate-based "wealth," a growing number of residents as well as real estate professionals are already preparing for a crash. No serious members of the real estate community, despite what they might say in public earshot, denies the basic truth in LaRouche's forecast of a real estate collapse, although they might quibble about how bad it will finally get. "I wish to hell that he [LaRouche] was wrong," said one leading member of the local real estate community. "But, this market is on the edge, and it won't take much to push it over. And when it falls, there's a long way down before it hits bottom."

Such reality has very real implications for the national real estate market and a commercial banking, which, it is conservatively estimated, has nearly 50% of its total asset base tied up in mortgages and mortgage-based financial instruments. While the Loudoun-based mortgage market is estimated at around $40-50 billion, Loudoun mortgages are significantly leveraged in the larger national mortgage market; since they were formerly regarded as "gold-plated" (i.e., rock-solid assets), they have been bundled with weaker mortgages from other areas, for reselling among financial institutions. Should the Loudoun mortgages go bad, it will trigger a chain reaction down the line for the holders of those mortgage bundles and mortgage-backed securities. Even more important than that, the collapse of the Loudoun bubble would have a devastating *psychological* effect on the national bubble, signaling that "all bets are off."

Back in July 2005, this author was commissioned by *EIR* to prepare an analysis of the Loudoun bubble, which showed that it was ripe for the kind of collapse forecast by LaRouche ("The Loudoun County Real Estate Bubble: A Case Study of How the World Went to Hell," *EIR,* July 22, 2005). In this current report, we shall summarize the main points of that article, and then show how subsequent developments, which have caused the dramatic change in the market, have confirmed LaRouche's forecast.

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.

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EIRNS/Stuart Lewis

Going down . . . Loudoun County's speculative frenzy is running out of easy money and lax lending policies.

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 dramatically 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 such as 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 a 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 Expansion of the Bubble

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. 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 reported by local realtors suggest that these are 20-30% above the official county asssesements.)

One year ago, local realtors estimated that the total market value of Loudoun properties was well above $60 billion—an increase in five years of more than 350%. Both the county and realtors agreed that the yearly rate of increase in property value was 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 is 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 built 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, have 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 approximately 70,000 people were 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 to the area. Such figures place Loudoun as the leader in population growth rate for the nation.

From figures prepared by *EIR*'s staff, we can see that over

FIGURE 1
Days on the Market, Loudoun County, VA (2005-06)

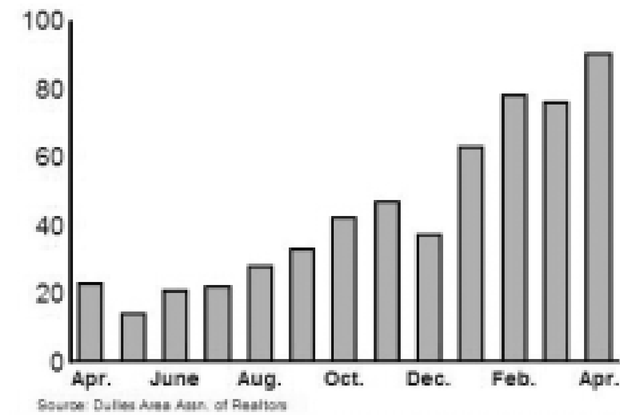
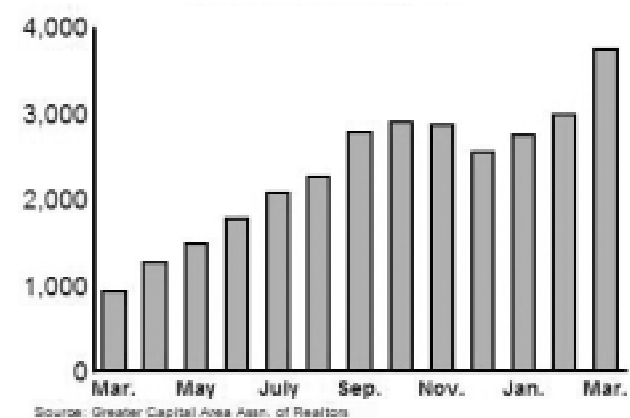


FIGURE 2
Single Family Homes on the Market, Loudoun County, VA (2005-06)



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.)

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 7-10 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.

Thus, the county had two swarms of greedy locusts—ones that are internally migrating, and others that coming into the "promised" land to stake their "claims."

The Bubble Springs a Leak

The trends discussed in the July 2005 article continued, pretty much unabated, through October 2005. At that point, there began a slow reversal in some key indicators of the bubble: unsold housing inventory and length of time a property remains on the market.

In the heyday of the bubble, realtors now fondly remember that if a property—almost any property—were put on the market, almost within hours, the phones would be ringing with potential buyers. It was not unusual for a home, especially in a choice location, to be sold within a few days, often with several buyers bidding up the price. In October, it was still the case that, according to "official" real estate industry figures, the average home (of all types) sold within 15 days. Now, the market has slowed down dramatically. As **Figure 1** indicates, there has been an almost hyperbolic rise in a short span of time—less than six months, where it is estimated that the figures for April will show that a home now takes at least 90 days to sell.

At the same time, despite this obvious slowdown in the market, there has been a sharp jump in inventory, as evidenced by the rise in the number of total real estate listings compared to last year. The latest available month, March, shows a year-on-year rise of more than 275%, placing some 3,800 homes in the unsold inventory as of March. Again, as our chart shows (see **Figure 2**), this rise in inventory has been accelerating over the last three months, at what many realtors say is an alarming rate. And these figures don't include homeowners who place their homes on the market themselves, seeking to avoid real estate commissions; sources say that figures for "sale by the owner" are also way up.

What is driving this apparent panicky dumping of homes onto the market?

First, long-term interest rates are rising, from historically low levels, thanks to the Greenspan-Bernanke policy, backed by their fellow central bankers, to reign in the hyperinflation

FIGURE 3
Sales of Single Family Homes, Loudoun County, VA (2005-06)

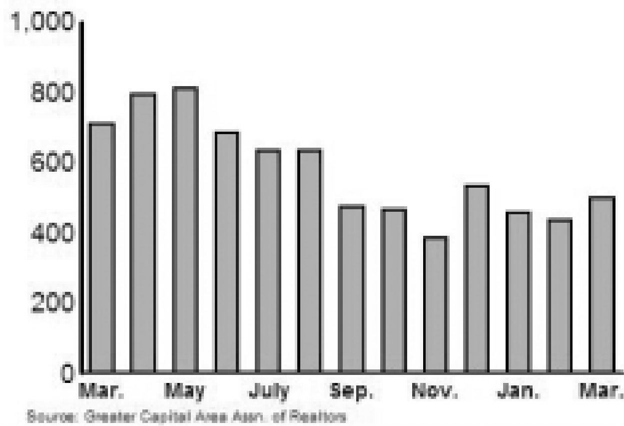
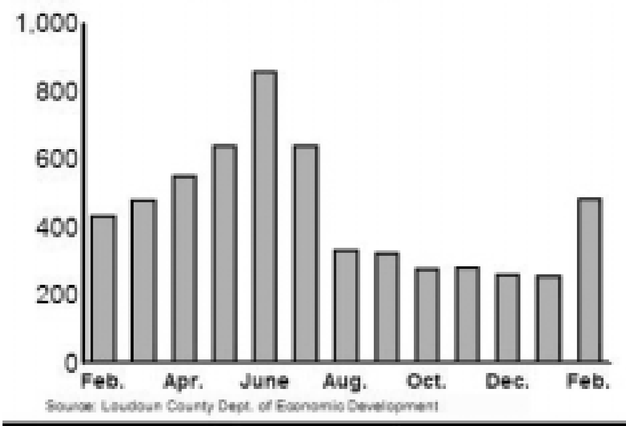


FIGURE 4
Residential Building Permits Issued, Loudoun County, VA (2005-06)



in commodity and other speculative items by tightening credit. The Loudoun market, as with the national market, has been fuelled by easy money and lax lending policies; take those away, and there are problems.

As we indicated above, many homeowners have been caught up in the speculative frenzy, believing that they can "make" money merely by buying a home and then letting it appreciate a bit, then selling it for a non-taxed gain. In addition, homeowners, especially in Loudoun, with its recent history of stupendous price appreciation, sought to cash out their supposed (appreciating) equity, by borrowing against it. This means that an increasing number of homeowners have assumed debt loads that can only be supported *if home prices keep rising* and/or if *interest rates remain low*.

Even though properties in Loudoun have continued to appreciate, with interest rates rising, the sense has been communicated to many people—especially those whose homes are heavily encumbered with first and second mortgages and equity lines and so forth—that they had better get out while the getting is good.

This problem in Loudoun has been compounded by the large number of new home buyers who have fallen prey to various delusional financing scams such as "equity plus" borrowing (borrowing above the present assessed value of property on the prospect of its continued, significant appreciation), adjustable rate mortgage (ARM), and so-called interest-only loans which have a trigger when much higher rates suddenly kick in. Up until late 2004 and early 2005, most Loudoun mortgages were standard 30- or 15-year fixed rate instruments. However, in 2005, nearly 50% of all homebuyers were either using ARMs or interest-only loans.

It is now estimated that a growing portion of the mortgage market has been refinanced into these dubious loan instruments, compounding the problem. Since these scams are mostly used in the middle and low end of the market, they have a tendency to make that component highly volatile. Real estate industry statistics now place the average Loudoun home at between $400,000 and $500,000. It is precisely this segment of the market that is dumping homes into a problematic and dangerous environment. Real estate listing figures for this segment (also including homes $300,000 to $499,000) have shown an astronomical 400% jump over last year!

Nationally, there is a growing and alarming trend for homeowners to find themselves "upside down"—owing more on their home than its current market value. It is estimated that nationally, at least one mortgage in ten is "upside down," with more than one in twenty, "under water," so to speak, by more than 10%. So far, since property values have continued to appreciate, the figures for such "negative equity" for Loudoun, according to banking sources, are not as high as the national average. But as one local mortgage lender told me, should property value appreciation slow down significantly, many homeowners will suddenly find themselves drowning in unpayable debt—and will dump their homes on the market to try to bail out.

One would think, given the current market conditions, with large numbers of existing homes suddenly coming onto the market, that developers, in order to protect their own investments, would slow down the pace of new construction. Last year, once again, was a near record for home sales, with more than 8,000 new units of all types sold, bringing the total housing stock to more than 94,000. According to the latest figures from the county's Office of Economic Development, this torrid pace of homebuilding has only slightly slowed—by less than 9%. New homes are continuing to come on the market at near record pace, colliding with a rising inventory of unsold homes, as overall settlement

of contracts is declining by nearly 20% against a year ago. (See **Figure 3.**)

This collision will soon lead to a "train wreck" in the market, which will sharply drop prices in almost all categories. Already there have been sharp drops in advertised sale prices on homes that have languished on the market for weeks.

Builders and developers still have more than 30,000 potential homes, townhouses, etc. in the pipeline—in one or another stage of zoning approval or construction—which indicates the enormous level of additional pressure on what is becoming a fragile market.

Meanwhile, the county government, instead of trying to rein in this dangerous speculation, is apparently trying to fuel more of it. Last month, the local Board of Supervisors suddenly declared a moratorium on restrictive zoning policies that had limited growth in the more rural areas of western Loudoun (**Figure 4**). This year-long moratorium has prompted developers, property owners, and speculators to rush in for building permits, for especially the "McMansions"—million-dollar-plus homes on small rural lots. Local government, which depends on property tax for its revenue, has no interest in believing that their money machine is coming down; the same Board actually lowered the tax rate this year, stupidly claiming that they were giving the taxpayers a break because of increases in the property assessments. (An official in the county Assesors office once said, "They don't pay us to lower assessments.")

Living in a Delusion

What is happening in Loudoun has not escaped the national media. Since LaRouche's "early warning" of a renewed threat of a blowout appeared last year, national media outlets have all picked up on the story that the "bloom is coming off the rose," with potentially dangerous consequence. For example, a Dec. 19, 2005 story in *Business Week* reported on a reversal of fortunes in the market, with a deep "chill" setting in. It quoted local insurance agent Joe Kelley as offering his own explanation for the turnaround in the market: "They ran out of stupid people."

But while there may not be so many stupid buyers, there are plenty of still-deluded sellers. A local realtor reported to me that he is running into great difficulty in convincing clients what is happening: "They come to me with these preconceived notions about what their home is worth, baesd on what was happening two years ago. I try to convince them to lower prices, but they won't—or can't—listen. I tell them that I'll do what they say, but I'll come back to them in three months, and we'll have this same conversation."

In the end, it will probably take the collapse itself to convince people that the game is finally over. By that time, the many people in Loudoun who should have listened to LaRouche when he warned them about the bubble, will have paid a very dear price for their foolishness.

A Surprise Flank Against Delphi-Led Auto Collapse

by Paul Gallagher

Two weeks remain before the potentially industry-destroying bankruptcy plan of Delphi Corporation goes to trial before a New York bankruptcy judge on May 9. But flanks are developing against the attempt of Delphi's pirate CEO Steve Miller, to use bankruptcy to drive outsourcing and globalization to their extreme, and wipe out the irreplaceable U.S. auto/machine tool sector.

Some of the attacks are legal ones in the bankruptcy court itself, including challenges to Miller's phony "tactical bankruptcy" strategy from the entire court-appointed creditors' committee, and from the Federal Pension Benefit Guarantee Corporation.

More important are the first serious moves in Congress since the U.S. auto collapse crisis began 14 months ago. These moves, though still defensive in nature, begin to challenge the shutdown of auto and its vital machine-tool capabilities, rather than just discussing ameliorating the effects for hundreds of thousands of laid-off workers and shut-down businesses—something Congress has not come up with any way to do.

Most notable is the surprising move originated by some Flint, Michigan auto union organizers, taking shape in an April 29 mass march and rally in Michigan. Their strategy is to raise the level of the battle: from a fight—possibly a national strike—against Delphi, to a mobilization for action by Congress to reverse globalization and "save the American dream," of a good productive job, a good education, and a secure retirement. Their march and rally under that theme, to the Michigan capitol building in Lansing on April 29, may begin a mass mobilization into the U.S. capital in Washington. If so, it may intersect continuing mass demonstrations of immigrants, in which the fundamental *underlying* issue is the same—how globalization destroys advanced productive capabilities, infrastructures, and wages.

"Citizens Marching for the American Dream" aims high, at "the current direction our elected officials are taking our Country. We are angry that our government gives incentives to corporations who move our jobs outside the borders of the United States." Its mission statement says, "The time has come to tell our lawmakers . . . what we expect from them. We, the people, have certain inalienable rights. Among them are life, liberty, and the pursuit of happiness." The Lansing mobilization calls on elected officials—primarily aimed at the Federal level, say the organizers—to provide "certain pro-