

A Brief History of San Diego County Foreclosures: 1990 to Present

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Introduction

There have been two distinct housing recessions in San Diego County since 1990: the 1990-96 Savings and Loan (S&L) Crisis and the 2006-present sub-prime fallout. This overview parallels the two recessions to compare and contrast key indicators in efforts of facing current and future foreclosure crises at the local San Diego County level.

National: U.S.

Same Cause... Different Story

Both San Diego housing recessions were caused by national level banking deregulation followed by risky loans. Although there are distinct differences between the S&L crisis and the complexity of the sub-prime fallout, the underlying fundamentals, lending based on borrowers' ability of repayment and lending regulations to protect banks solvency, were mutually diminished.

The 1990-96 S&L recession was centered on the capital investment divisions of S&Ls funding homebuilders and commercial developers. The S&Ls fell below their reserve limits as a result of federal deregulation of depository institutions through the elimination of the Federal Reserve's Regulation Q, withdrawal in 1986 of federal tax laws, and aggressive lending. With abundant inventory of real estate still in development, the American Bankers Association lobbied Congress for the creation of the Resolution Trust Corporation (RTC) to take over the S&Ls, thereby leaving a clean field for the banks. S&Ls, once the primary capital sources for non-public homebuilders, were put out of business, and the builders had no access to capital. It took until 1996-97 to develop new capital sources like Lehman Brothers, Capstone, and others to provide the necessary capital to fund the homebuilders.¹ The S&L cleanup was Congress' response to the greatest collapse of U.S. financial institutions since the 1930s, until the current sub-prime fallout.

On the surface, the cause of the existing sub-prime fallout has been identified simply as "liar loans" supported by borrowers, appraisers, mortgage brokers, rating agencies, Fannie Mae underwriting, and the lack of government oversight. Borrowers utilized and lenders pushed stated income loans, coupled by temporary interest-only and teaser start rates to finance up to and in some cases above 100% of the

¹ Alan Nevin, Director of Economic Research-Market Pointe Realty Advisors, Personal Interview, (October 13, 2008)

home's appraised value. The "liar loans" and Residential Mortgage Backed Securities (RMBS) structure that have proven troublesome to the sub-prime fallout developed during the S&L Crisis.

Various limited-doc loans with LTVs of 80% or more came onto the scene and were widely available in the late 1980s and early 1990s. "They were offered for the best of intentions, to provide mortgages to people who had trouble meeting the criteria of the conventional conforming market," says David Greco, Mortgage Guaranty Insurance Corp. vice president of credit policy. "Alt-A loans with 80 percent and higher LTV ratios were widely available in the late 1980s and early 1990s, but those loans performed poorly in the early, and mid-1990s. As a result, underwriting standards were tightened, product offerings were withdrawn, and the market mostly evaporated," says Kurt Smith, United Guaranty Residential Insurance Co. vice president of risk management.² Mortgage fraud also found its roots in the S&L Crisis. In 1990-92 the U.S. Department of Justice formed task forces to pursue investigations of bank and mortgage fraud in New England, Texas and San Diego.

Bail-Outs

The S&L bailout came in the form of the RTC, formed in 1989. Total government costs have been estimated at \$374.1 billion, including estimated direct and indirect costs and interest expense. From 1986 through 1995, the number of federally insured S&L institutions in the U.S. fell by nearly 1,600, roughly 50%. The RTC from 1989 through 1995 took over 747 S&Ls with total assets of \$402 billion.

As a result of the sub-prime fallout the current U.S. Emergency Economic Stabilization Act of 2008 has committed a revolving line of \$700 billion, nearly twice the amount of the S&L bailout, intended to take over and relinquish nonperforming loans from failing banks in an effort to prop their balance sheets to encourage lending. The exact allocation of the funds is still unknown at this time. At present, 19 banks with total assets of \$350 billion, have failed, the largest being Washington Mutual.

Interest Rates

The common belief that falling interest rates directly increase the pricing of housing is disproved by the S&L crisis, as housing prices in San Diego declined alongside falling interest rates. The 30-year conventional mortgage rate fell 2.3% from 1990 to 1996. To illustrate the affordability benefit of an interest rate drop, consider that the median home price in San Diego County in 1991 was \$182,000. At a 10.1% interest rate with a 20% down payment, this would result in a principal and interest payment of \$1,290 per month. Adjusting to the 1996 interest rate of 7.8% and holding the monthly payment constant, the borrower would be able to afford a \$224,000 property compared with \$182,000. It is unfortunate that the current sub-prime fallout began at a historic low interest rate of 6.4%. It does not appear that the current housing recession will be softened by falling interest rates, at least not to the same extent as the 1990s. The interest rate influence on the San Diego housing market has worked like an accelerator or brake, slowing down or speeding up the direction of the market cycle.

² Robert Stowe, "Pushing the Edge on Alternative-A," Mortgage Banking (February, 2004)

Exhibit 1: Comparison of S&L Crisis and Current State of the Sub-Prime Fallout

	1990-1996 Savings and Loans Crisis	2006-Present Sub-Prime Fallout
National: U.S.		
Government Bail Out Cost ^{3,4}	\$374.1 B	\$700 B
Bank Failures ^{5,6}	747	19
Bank's Assets Valued at Failure ^{7,8}	402 B	350 B
Interest Rate Trend ⁹	Down 10.1% to 7.8%	Flat 6.4% to 6.1%
Local: San Diego County		
Peak Affordability ¹⁰	12%	15%
Peak Permits ¹¹	2,380	1,526
Median Home Price Decline ¹²	(8%)	(28%)
Peak Unemployment ¹³	7.9%	5.6%
Residential Sales Decline ¹⁴	(53%)	(41%)
Foreclosure Increase ¹⁵	450%	1,600%

³ U.S. GAO, Financial Audit: "Resolution Trust Corporation's 1995 and 1994 Financial Statements," (1996) pp. 13, 19, 20

⁴ U.S. Congress, "Emergency Economic Stabilization Act of 2008," (2008) p. 16

⁵ U.S. GAO, p. 8

⁶ FDIC

⁷ U.S. GAO, p. 8

⁸ FDIC

⁹ Federal Reserve Bank, 30-Year Historic Mortgage Rates

¹⁰ Affordability=Median Home Price, 20% Down Payment, 30 Yr. Amortized Mortgage, and Income Distribution Level

¹¹ DataQuick

¹² CAR

¹³ CA EDD

¹⁴ DataQuick

¹⁵ SD County Records Office

Peak Foreclosures to Total Housing Stock ^{16, 17}	.08%	.22%
Peak Net Domestic Migration Loss ¹⁸	(40,700)	(16,400)

Local: San Diego County

Booms and Busts

San Diego County has seen the following housing cycles since the 1970s:

Exhibit 2: Boom & Bust Cycles of San Diego Median Price Home^{19, 20}

Years	Cycle	Increase/ Decrease
1976-1981	Boom	46%
1980-1984	Flat	10%
1985-1990	Boom	63%
1991-1996	Bust: S&L Crisis	(8%)
1997-2005	Boom	226%
2006-Present	Bust: Sub-Prime Fallout	(28%)

During the boom cycles, newspaper articles from very credible sources have been published, which leave borrowers questioning their rationale that the housing market may be inflated. Susanne Trimboth, a senior research economist at the renowned Milken Institute, stated in “No More Boom-Bust Blues,” which appeared in the *Los Angeles Times* July 20, 2003, that: “We’ve seen the end of the boom-bust cycle in real estate.” Most economists and the public would agree that we just had a “boom cycle”; the San Diego median home value increased from \$172,000 in 1995 to \$422,000 in 2003 (the year of the article), 146% over eight years. San Diego housing indicator charts, in some cases as far back as the 1970s, have been provided below enabling readers to draw their own conclusions on San Diego County housing trends, instead of relying on the most recent news headline.

¹⁶ DataQuick

¹⁷ SANDAG

¹⁸ CA Department of Finance

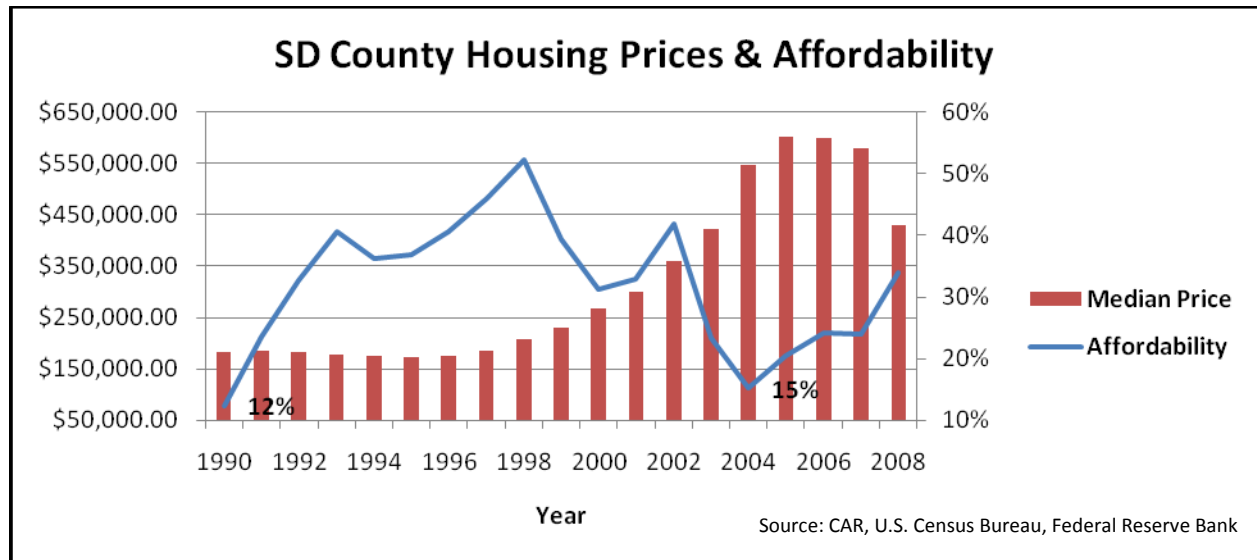
¹⁹ CAR

²⁰ OFHEO

Affordability

Affordability bottoms indicated the turning point of both the S&L crisis at 12% and the sub-prime fallout at 15%. A future affordability of less than 18% may suggest that housing prices cannot be sustained.

Exhibit 3

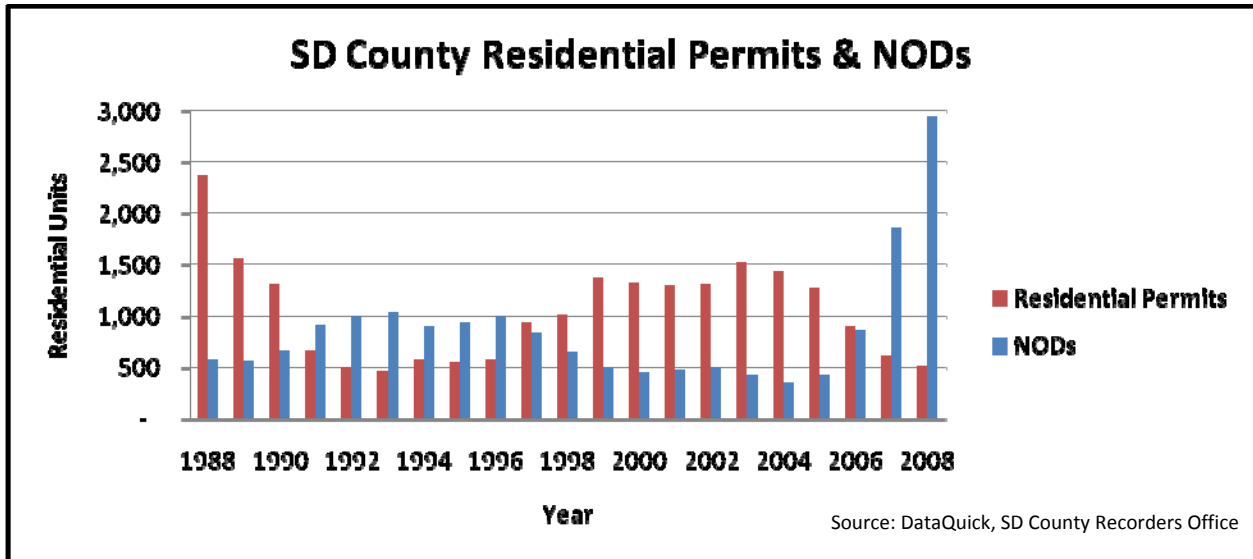


Residential Building Permits

Total residential permits peaked in 1988 totaling 2,380, which is 58% more than the most recent 2003 peak of 1,526. Post-1988 homebuilders had a difficult time financing new projects due to the lack of liquidity in the market caused by the erosion of S&Ls, the developers' primary lending source. Building halted in the early 1990s as a result of softening prices, lack of financing, and a Maryland court case *Casualty Co. vs. Reeder*²¹ which ruled in favor of homebuyers' ability to sue builders for latent non-negligent defects, resulting in higher insurance premiums and in turn higher costs to bring product to an already struggling market. It took until 1996-97 to develop new capital sources like Lehman Brothers to provide the necessary capital to fund the homebuilders. The lack of building between 1990-95 flanked by San Diego coming out of a recession in 1994 (one year after the nation had recovered) caused a run-up in home prices starting in 1996 with increased permits chasing demand. Future permits annually are not expected to reach the 1988 high, due to developable land constraints within the county.

²¹ *Maryland Casualty v. Reeder*, 221 App. 3d 961, 971-74 (1990)

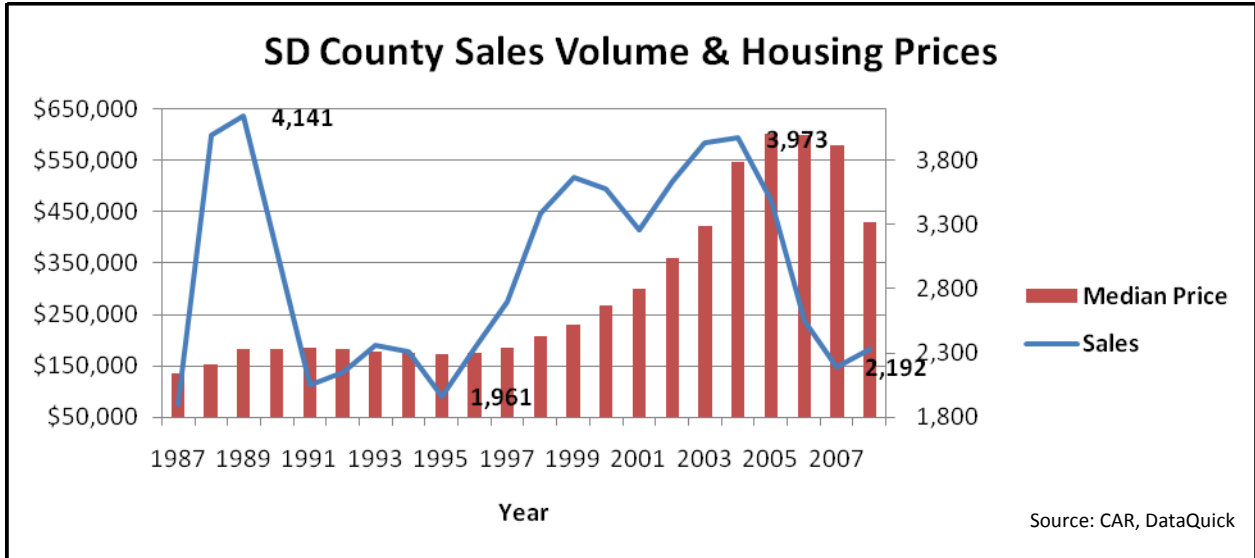
Exhibit 4



Residential Sales

Sales volume is very similar in both the S&L crisis and the sub-prime fallout. The sales volume peak of 4,141 in 1989 was only 4% higher than the 2004 peak of 3,973. Additionally, the bottom of the two market cycles in 1995 and 2007 are only 11% apart; however, that margin may shrink if sales decline further. Both sales volume peaks were a leading indicator one year prior to peak pricing and at least two years ahead of falling prices.

Exhibit 5



Foreclosures

Foreclosures in the S&L crisis climbed 450% from 90 in 1990 up to 500 in 1996. The sub-prime fallout has seen a roughly 1,600% increase from the low point of 46 in 2004 and a projected 1,529 in 2008. A baseline of 90 foreclosures was used to equally compare the foreclosure increases. The 1990-96 period had the benefit of a prior smaller run-up in price of 63% and falling interest rates during the housing recession to increase affordability, softening the fall. The 1997-2005 boom had appreciation of 226%, an increased number of sub-prime loans, and has seen stable interest rates during the current housing recession. Observably, it was probably and is now evident that these factors have led to a higher foreclosure increase than in the S&L crisis. The foreclosure to total housing stock ratio has more than doubled since 1996 and reinforces the severity of the current housing recession.

Exhibit 6

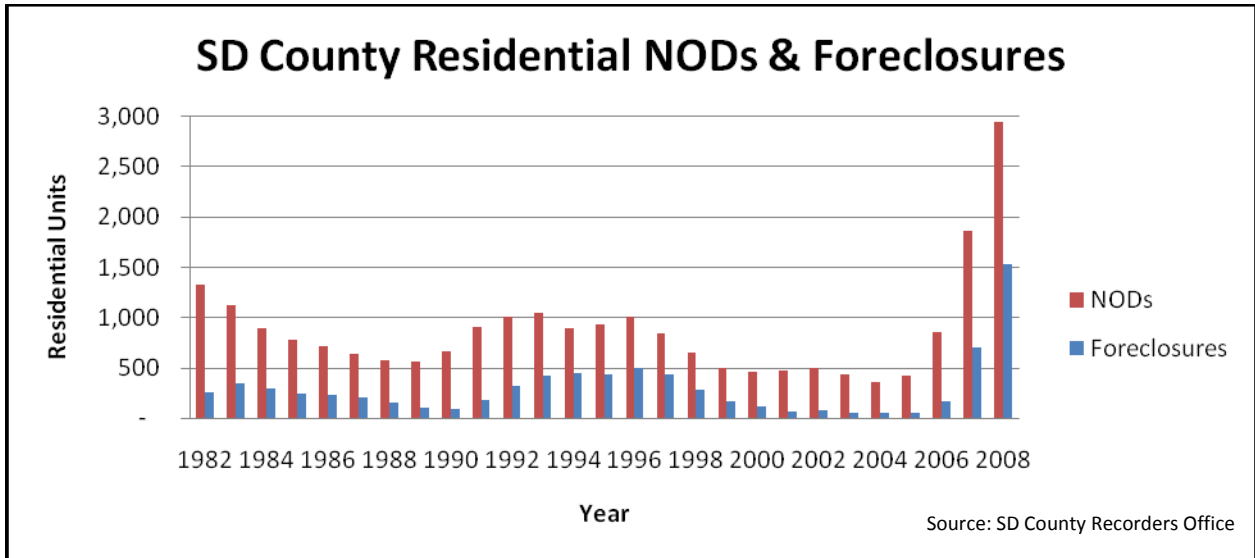


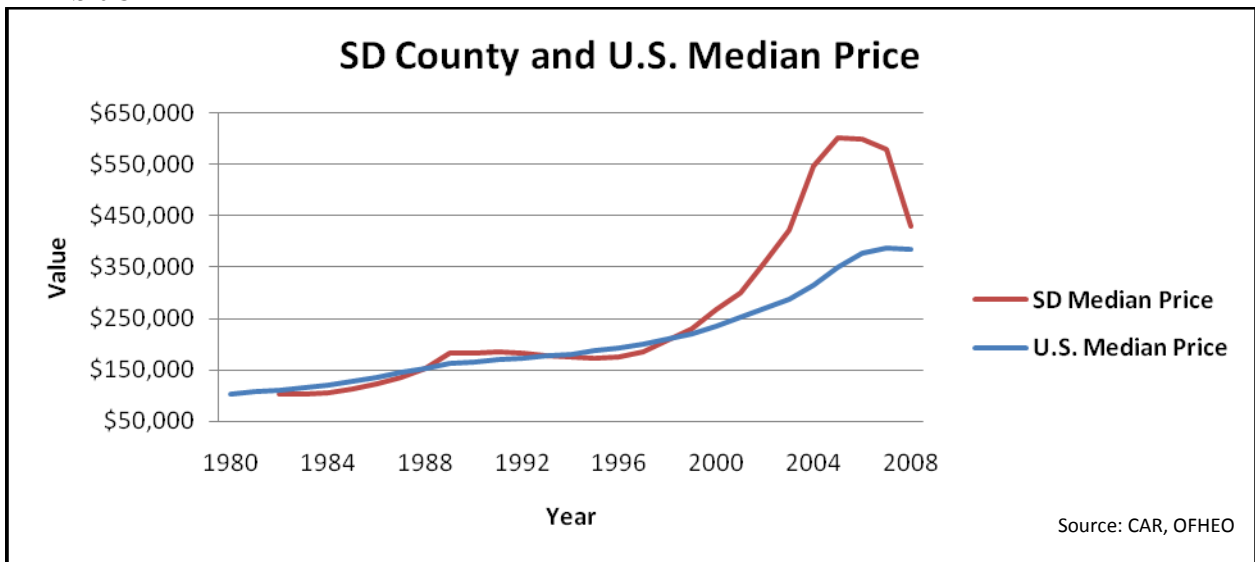
Exhibit 7



Median Home Price

The median home price in San Diego County has proven to be cyclical in nature. Historic figures demonstrate the median home price in San Diego dropping below the U.S. median price in 1982 and again in 1994, prior to climbing above the nation median price in 1991 and 2005. The projection moving forward is that the San Diego County median home price will fall below the U.S. median price before trending in a positive direction.

Exhibit 8

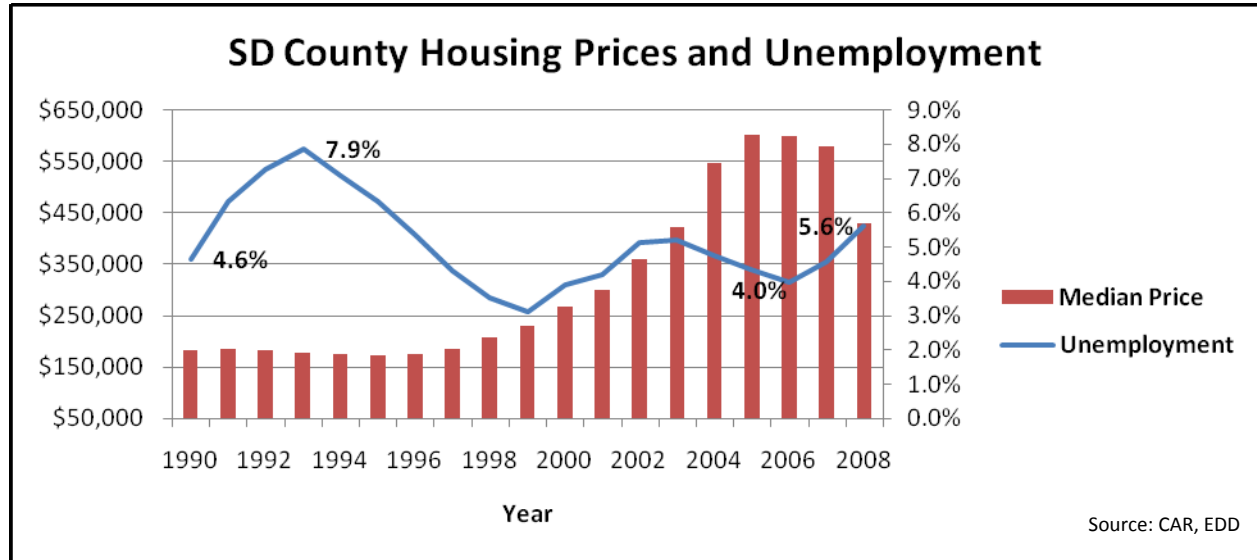


Unemployment

During the S&L crisis, unemployment increased from 4.6% in 1990 to 7.9% in 1993. The industries that contributed the most to unemployment included: 28,000 uniformed military (1989-96), 21,000 construction jobs (1989-93), and 9,000 job losses in finance and real estate (1989-95). The military jobs

have held steady over the eight years, which should reduce the peak unemployment in the current sub-prime crisis. Construction, finance and real estate jobs have been affected in both cycles and will continue to see the highest job loss numbers in the midst of the current housing recession.

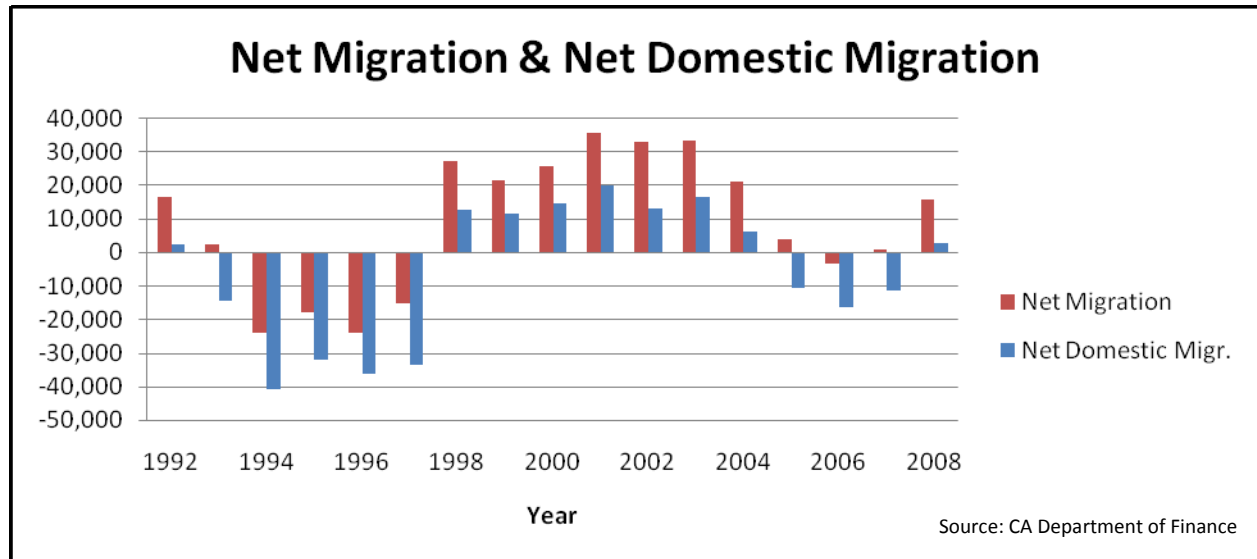
Exhibit 9



Migration Patterns

Both the S&L crisis and the sub-prime fallout periods in San Diego County have experienced negative net migration and net domestic migration. In 1986, the military began cutting jobs, followed by eventual base closures resulting in a loss of 30,000 uniformed military along with their households by 1996. This impact resulted in a greater negative migration pattern than would have normally occurred as a result of a housing and economic recession. Net domestic migration is a better indicator to support housing values than net migration because it does not include immigrants from outside the United States. People within the United States are projected to earn higher wages, have a better education and superior job skills. The negative net domestic migration effect that has taken place in both housing recessions, aside from base closures in the 1990s, is due to the high cost of living (notably housing) and the ability to find construction and real estate service jobs elsewhere.

Exhibit 10



Conclusion

The S&L crisis and sub-prime fallout at the local San Diego County level share many common trends. If the past is any indicator of the future, we should expect long housing cycles of the past 40 years to continue; therefore, the current sub-prime fallout housing recession regrettably will not be the last unless new strategies are implemented to flatten out the cyclical nature of San Diego County home values.

References

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