

A REPUBLIC SPECIAL REPORT

Can we learn from '80s crash?

Reviving Valley market demands new approach this time

By Catherine Reagor

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Before the bottom fell out of the housing market last year, the most recent real-estate plunge in Phoenix was 20 years earlier, during the savings-and-loan collapse.

Back then, in the late 1980s, property values fell, sales stalled, and it took several years before the real-estate market recovered.

A year into the latest downturn, comparing what happened then to what is happening now reveals sharp contrasts, differences that could determine how long a recovery may take this time.

So far in 2009, the Valley's real-estate market and economy have yet to hit bottom. Homeowners, potential buyers, builders, con-

tractors, real-estate agents and thousands of other people connected to the area's vast real-estate industry are eager for signs of recovery or at least a stabilized market. Most key measures of distress or recovery are the same as last time around: foreclosures, property sales, prices, jobless

rates and population growth. Right now all those indicators are still going in the wrong direction.

"For Arizona, this recession appears to be far worse than that of the late 1980s, largely due to our persistent dependence on growth to drive our economy," said Ioanna Morfessis, the founding chief executive of the Greater Phoenix Economic Council and current president of the consulting firm IO Inc.

Differences between the collapse of the late 1980s and now include what pushed the market over the edge, the scale of the market, tactics for a recovery, and the larger economic context in which both real-estate markets struggled to recover.

Two crashes

When the bubble burst in 1988, real-estate values plummeted and foreclosures and bankruptcies soared. Lenders — the savings and loans — failed. Developers were indicted for illegal deals.

Federal regulators cleaned up the mess by liquidating property seized from the savings and loans. The Valley's rapid growth slowed, and it took several years before the real-estate market rebounded.

When the bubble burst in 2008, real-estate values plummeted and foreclosures and bankruptcies soared. Banks and investment firms failed. Hedge-fund managers, real-estate agents and mortgage brokers were indicted for fraud. Indictments will likely continue this year.

Federal bailout programs are now doling out billions to banks and insurers to prop them up. Regulators have taken over mortgage giants Fannie Mae and Freddie Mac.

"What Arizona went through in 1989 involved a lot of failed commercial properties. But now it's the residential market, which affects a lot more people," said Jay Butler, director of realty studies at Arizona State University. He has been tracking the real-estate market for ASU since the early 1970s. "Back then the economy slowed, but it didn't slam into the wall like it seems to be doing now."

The hot real-estate market 20 years ago was based in commercial and land projects. A federal tax incentive to spur real-estate investment allowed people to write off huge losses on those types of developments. At the same time, loose regulation of savings and loans allowed them to compete with banks. The result was a development spree across

the Valley, funded largely by savings and loans. Dozens of shopping centers, office buildings, warehouses and apartments were built by developers who counted on the safety net of writing off losses. Many failed to find tenants.

When Congress removed the tax incentive at the end of 1986, the value of commercial properties dropped as much as 50 percent. The commercial real-estate market imploded and pulled the residential market down with it.

In contrast, the latest real-estate bubble started in the residential market. In 2004-06, speculators and loose lending guidelines set off a home-buying spree. Wall Street snapped up the home loans, bundled them together and sold them to investors around the world. Home prices shot up a record 50 percent in metro Phoenix.

In response to the earlier collapse, the federal government created the Resolution Trust Corp. in 1989 to liquidate all assets of the failed savings and loans. It wasn't until 1996 that commercial real-estate vacancy rates for office, industrial and retail centers fell below double-digit levels and prices rebounded.

So far during this collapse, as foreclosures have soared, the federal government has spent billions of dollars to bail out lenders and insurers. Millions of dollars have gone to states, including Arizona, to try to help homeowners facing foreclosure. It hasn't been enough.

President Obama's \$800 billion-plus economic stimulus plan could mean more aid for municipalities, neighborhoods and struggling homeowners.

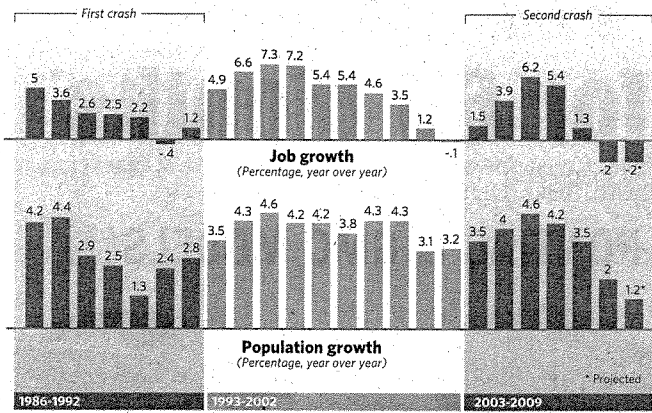
Basic questions remain: Will this be enough to stop the slide, and when might a recovery begin?

Two crashes, two stories

When the Valley's real-estate bubble burst in 1988, values plummeted. Foreclosures and bankruptcies soared. Is today's crash the same? Can the Valley recover from this crash the same way?

1 How things started

The crashes had similar beginnings. Job growth peaked, then plummeted. Jobs had driven surging population growth, which then came to a halt.



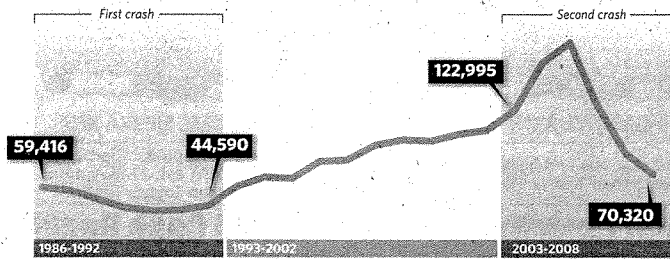
Sources: Arizona Department of Economic Security, Arizona State University, U.S. Census Bureau, University of Arizona, economist Marshall Vest, Department of Commerce, Elliott D. Pollack & Co.

2 Key difference

The crash of the 1980s centered on upheaval in the commercial real-estate market. Today's crash hit more people because it centered on the housing market. The numbers show what came next.

Number of home sales

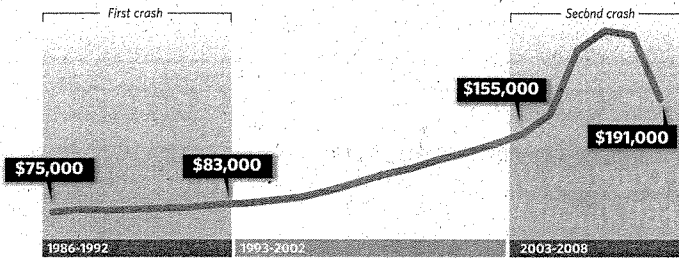
While home sales declined in the '80s crash, the drop was moderate — most trouble was in the commercial sector. The current collapse followed a bubble in the housing market, as shown by the run-up and sudden decline in sales rates.



Source: Arizona State University Realty Studies

Median home price

What happens when houses won't sell? Prices fall. This time around, prices have already dropped 40 percent.

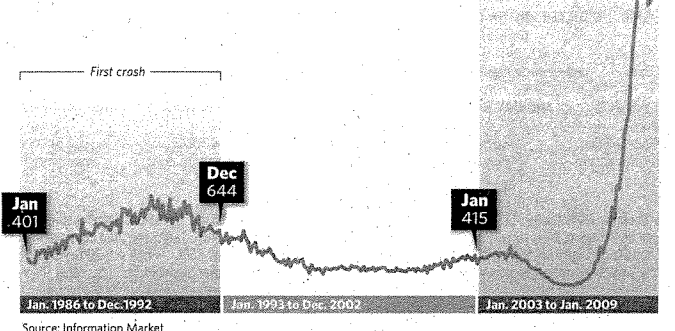


Source: Arizona State University Realty Studies

NOTE: Median price includes new and existing home sales.

3 Foreclosures (By month)

Today, struggling homeowners can't sell or refinance. Unemployment is up, so fewer people can afford their homes, and population growth is down, so fewer people are buying. The result is foreclosures, which are now soaring far above foreclosures during the '80s.



Source: Information Market

Different times

This real-estate collapse is being felt more deeply because it's affecting almost every homeowner. As the housing market continues to contract, the high rate of foreclosures is dragging overall home values down even further.

Housing has been the Valley's biggest industry for years, accounting for one out of every three dollars spent. Home building has now dropped to a fraction of what it was a few years ago.

Housing analyst RL Brown recently flew over the Valley looking for developments where new homes were being built.

"I went from Pinal to Peoria and found only a few homes under construction," said Brown, who has been tracking the Valley's housing market for more than 30 years. "It reminded me of 1990, except then there was one spot where homes were being built and sold. That was Ahwatukee. We don't even have an Ahwatukee for home builders now."

During the last real-estate collapse, housing prices dipped less than 5 percent. So far Valley home prices have fallen almost 40 percent from the high reached in mid-2006.

Residential foreclosures continue to climb to new monthly records. Resale of foreclosure homes taken back by lenders now accounts for half of all home sales.

The larger state and national economy also is suffering, which only makes matters worse for housing and growth. Unemployment in Arizona is at a 15-year high. The state is now ranked 48th in job growth after being in the top five among states for the past decade.

Arizona's population growth is slowing because there are fewer jobs and because people can't sell homes in other parts of the country to move here. The state is expected to grow by only 1.2 percent this year, the slowest rate since the early 1970s. Most of the growth is coming from births outpacing deaths in the state, instead of from people moving here.

"We are in uncharted economic territory now," said Marshall Vest, chief economist with the University of Arizona. "The last real-estate recession wasn't nearly as deep."

Different responses

Federal response to the two real-estate collapses differed.

The Resolution Trust Corp., created in August 1989 to sell properties financed by failed savings and loans and banks, became one of Arizona's biggest land and commercial-property owners. The federal agency took about five years to liquidate its assets in the state. Most of those properties were empty buildings or parcels of land. In the end, the RTC program cost U.S. taxpayers about \$150 billion.

The same kind of property liquidation strategy won't work now in a battered residential market. There are just too many homes. More than 40,000 Valley homes went into foreclosure last year. At least that many people are in danger of losing their homes in 2009.

In September, Congress passed the \$300 billion Housing Act to tackle the foreclosure crisis. So far Arizona has received several million dollars to train housing counselors to help home buyers facing foreclosure.

In the next month, the state should receive \$121 million more to help neighborhoods hardest hit by foreclosures. Most are in the Valley. The money is mainly to help buyers and municipalities purchase run-down foreclosure homes and fix them up.

Housing advocates say lenders, many of which are getting federal aid, need to modify loans to keep more homeowners in their homes.

In the early 1990s, the RTC was criticized for driving down property values by selling prime property for below-market prices.

So far lenders, which have taken houses back through foreclosure, have resold the homes for far below what other houses are reselling for in the same area. Bargain foreclosure sales are now being blamed for contributing to the steep drop in housing values.

To assess the current crash, *The Republic* talked to four leaders in the Arizona real-estate industry. They compared the crash of the late 1980s with the current crash and discussed what signs will signal the start of a recovery. Read a full interview with each at housing.azcentral.com.



“For Arizona, this recession appears to be far worse than that of the late 1980s, largely due to our persistent dependence on growth to drive our economy. ... Virtually every sector of the state and national economy is affected by the near-total collapse of business and consumer spending in the U.S., which was not the case in the late 1980s.”

— **Ioanna Morfessis**, president of consulting firm **IO Inc.** and founding chief executive of the **Greater Phoenix Economic Council**



“In my opinion, we have not seen the worst yet. The rental and commercial markets have yet to weigh in on their losses, which I expect to be record-breaking numbers.”

— **Marge O'Campo de Castillo**, owner of **Arizona Dream Realty**, past president of the **Hispanic Association of Real Estate Professionals**

PHOTOS BY NICK OZA/THE ARIZONA REPUBLIC



“The recession of 20 years ago occurred as an interruption to a long-term bull-market cycle. The current recession may mark the beginning of a new cycle where a recovering economy may grow more slowly.”

— **Drew Brown**, managing director and chief executive of **Scottsdale-based developer DMB Inc.**



“Credit to a market economy is like oil to a machine. The flow of credit in the system is critical. As a sign of recovery, a basic indicator would be banks begin lending again.”

— **Francis Najafi**, chief executive of **Phoenix-based real-estate developer and investor Pivotal Group**

Signs of recovery

The first step toward recovery this time will be a slowdown in foreclosures, but job losses must slow, too.

Foreclosures in metro Phoenix dipped slightly in November and December because the big lenders temporarily suspended foreclosure actions over the holidays. But foreclosures climbed again in January and are expected to keep climbing until lenders do more to work with struggling homeowners.

Housing advocates say lenders are still not doing enough to shore up troubled loans. Of the hundreds of thousands of troubled U.S. mortgages that lenders worked with to forestall foreclosure in 2008, about 58 percent are back in foreclosure.

The current economic stimulus plan doesn't specifically address loans facing foreclosure. Instead, it's set up to boost spending on public-works projects, which could provide more jobs, and tax benefits, which should help struggling families save money.

Whether it's through government aid or intervention, keeping more people in houses and paying mortgages they can afford will help stabilize the markets, particularly in the Valley, where housing and growth are the leading indicators.

The Valley's dependence on the three industries that led the nation into recession — construction, housing and financial services — will make any recovery more difficult. But federal funding for infrastructure projects in Arizona will help the job market, which will help the housing market.

Real-estate analysts and economists predict that the Valley's real-estate market will continue to slow through 2010, with no significant increase in home prices or sales until 2012.