Domestic Credit by Steve Parsons

Real estate could go the way of junk

Parts of the U.S. real estate liabilities are becoming just as unpayable as Third World debt.

The failure of Canadian financier Robert Campeau to meet debt payment deadlines on Sept. 15 heralded the derailing of the junk bond/leveraged buy-out roller-coaster. Now, with the almost simultaneous default of the Dallas-based Lomas Financial Corp., an even more terrifying specter looms before the fast-buck speculators and big banks: the detonation of the huge real estate bubble.

On Sept. 1, Lomas defaulted on $145 million in notes, immediately triggering a cross-default on $1.45 billion of senior debt. Lomas finally filed for bankruptcy on Sept. 25, suspending indefinitely payments on $2.1 billion in debt held by 47 unsecured lenders, led by Chase Manhattan and the Bank of New York. Lomas, which until this spring had been the largest mortgage banker in the United States, has stopped dividend payments, and reported a loss of $282.4 million for its just-ended fiscal year.

The Lomas debacle coincides with three major New York banks writing off $4 billion in bad Third World debt. Among them was Lomas' chief creditor, Chase Manhattan. Unlike with the other banks, a chunk of Chase's write-offs was for non-performing Arizona real estate investments. Now Chase is getting hit by Texas real estate.

It is no secret that Texas and other Sunbelt real estate has been sour for several years. But so far, banks have written off only a relative smattering of bad real estate debt. Furthermore, real estate markets in almost every part of the nation are softening.

On Sept. 19, Federal Deposit Insurance Corporation chairman William Seidman indirectly warned that the combination of rising non-performing loans—which banks admit to only well after the loans stop producing income—and the sudden softening of real estate markets could spell a disaster for commercial banks and the grossly underfunded bank insurance fund. This is particularly true for the Northeast, where the market is on the verge of falling apart and where the bulk of FDIC-insured savings banks are located.

Average and median prices of homes and commercial property throughout the nation have generally been falling for more than a year. Most realtors blame overbuilding and a speculative demand-push that has doubled and tripled prices in the last ten years. Half-heartedly, they maintain that things will eventually turn around as they always have.

But there is a huge difference. Real estate and construction downturns in the recent past have primarily been caused by credit crunches. The current downturn is due to prices and rents outstripping the ability of debt-ridden consumers and businesses to pay.

One of the most ominous signs for commercial real estate is that leveraged purchases of New York City office buildings are blowing out. One firm, Broadway Management Co., has lost control of about a dozen properties because it is unable to meet debt payments, because vacancies are rising and property values falling. Broadway is one of a number of highly leveraged companies that bought everything in sight at a time when prices were soaring, and are now getting hit with huge debt payments amid falling cash flow.

The bellwether home real estate market in metropolitan New York is also falling apart. From 1982-88, the market went through a stupendous speculative price surge. The median sales price increased 160%, from $70,500 to $183,500. A two-bedroom Manhattan condominium has gone from $220,200 to $476,000. Now, this housing is beyond the reach of even yuppies, let alone most families.

On Long Island, homes listed for sale are up 30% over last year, while actual sales are down 15%. Sellers throughout the region are already taking 10-20% cuts in their prices. "The New York area is simply tapped out in terms of income and buying power," said one regional economist.

A recent study by Lomas and Nettleton showed that homebuilding in each of the past 11 quarters has been lower than in the same quarter of the preceding year. The fall in the second quarter of this year occurred despite lower mortgage rates. New home sales were down 8% in the second quarter, and down 5% in the first half of the year. In the first half of 1989, residential building permits were down 6.3%. In Hampton Roads, Virginia, building permits plunged 20.7%.

All of this sets the stage for what City of London economist Stephen Lewis recently forecast. "I think that mortgage-backed securities will be the next shock," said Lewis. "This is a $400-500 billion market where Citicorp and Salomon Brothers play a leading role."

Lewis is right on the mark. On Sept. 27, the General Accounting Office told Congress that the Federal Housing Association insurance fund, which guarantees mortgages, lost a record $4.2 billion in 1988.

© 1989 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.