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Opinion

California housing may have a new foundation

Despite the shaky economy, resales have been booming. That may be a sign that basic economics is working to stabilize the market.
By Douglas C. Neff and Gerd-Ulf Krueger

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Other than perhaps McDonald's hamburgers, what is selling better today than it did a year ago? Resale homes in California.

Sales in the last six months have gone up 89% compared with sales for the same period a year ago, according to the California Assn. of Realtors. Despite a worsening economy and a media and government afflicted with a bad-news disorder, something strange is happening in the California housing market. There is strong evidence that basic economics is addressing the housing meltdown in a direct manner, which might set the stage for stability and give a hint as to what policies work best.

Resales have been booming in the worst foreclosure markets in the state. Declining prices, severe job losses and pervasive foreclosures are supposed to stifle the market, yet we see record sales and significantly reduced listings in the foreclosure areas. For example, in Stockton, seasonally adjusted resales in December 2008 were up more than 440% from September 2007, according to MDA DataQuick, the definitive source for tracking California home sales. That December sales rate was a record for this market. By March, stories continued to abound of strong sales and multiple offers.

Similarly in Moreno Valley/Perris, the heart of the foreclosure badlands in Southern California, resales rose 720% to a record high. After steep home-resale declines in 2006 and 2007, the snapback in volume can be observed in the California interior from Chula Vista near the Mexican border to Sacramento.

Although this may all still abate, this is a cyclical novelty in California, where in the past it could take three, four or even five years after a housing recession before a vigorous resale volume recovery occurred.

Despite waves of foreclosures, resale listings have actually declined. The months it takes to burn off the inventory on local multiple listings in the last year have fallen from about 30 to 40 months down to three or four months in Stockton and the Moreno Valley/Perris area. Brokers now complain about the lack of foreclosure listings. In Stockton, 71% of foreclosures in the last 18 months have already been sold; in Riverside County, it was 67%; and in California overall, it was 66%, according to MDA DataQuick.

Although no one likes foreclosures, they are serving a number of valuable purposes, which are barely cited by the media or politicians. They are establishing a sustainable and affordable pricing floor, albeit low, in many markets. And before we label the prices as unduly low, we should note that they are returning pricing to the 2000-2002 pre-bubble levels. Foreclosures are also letting some borrowers out of very bad contracts, which often committed them to crushing monthly payments on loans unsupportable in the post-bubble pricing market.

Fortunately, government policy has already done the most important thing to maximize sales of foreclosure properties. It has made FHA and GSE (Fannie Mae and Freddie Mac) loans readily available to those who qualify under new and more sustainable standards. And gathering from the amount of demand we're seeing in the California interior, lending doesn't seem to be a problem.

Given the speed and volume of the resale sector's comeback -- aided by market forces -- getting the government more involved in housing could actually slow things down. And there can be no housing recovery -- and maybe no general economic recovery -- until the resale market stabilizes.

So what does the government need to fix at this point, when the market has almost completed its pricing adjustment work? Sometimes, simple solutions can have a big impact, more so than big government foreclosure bailouts or having bankruptcy judges reduce -- "cram down" -- the principal on mortgages. More elegant would be if mortgage servicers and consumers facing foreclosure could freely negotiate loan modifications. They are often hampered because mortgage servicers do not have a liability shield against investors.

We have a simple suggestion: Congress or the states could pass laws that protect mortgage security servicers from lawsuits, giving them the freedom to negotiate new terms with the borrowers if that's what both parties want. That way we leave the question of "to foreclose or not to foreclose" to the wisdom of thousands of voluntary micro-decisions rather than the forms of coercion that have become de rigueur lately.

Economists, politicians and pundits, left, right and center, all want something "done" about the mortgage meltdown. The fact is that some very important things tend to get done by tens of thousands of individuals who are already dealing with a huge range of individual situations: repricing housing, investing in the future and clearing the decks for an eventual recovery. It's called Economics 101 at work, and it's setting the stage for stabilization of housing in California.

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