

After the Boom

Housing Slump Proves Painful For Some Owners and Builders

'Hard Landing' on the Coasts

Jolts Those Who Must Sell;

Ms. Guth Tries an Auction

'We're Preparing for the Worst'

By JAMES R. HAGERTY and MICHAEL CORKERY

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HERNDON, Va. -- For years, real-estate brokers and home builders promised that the soaring property market eventually would glide to a soft landing. These optimists predicted that home prices, which had more than doubled in parts of the country between 2000 and 2005, would continue to rise, but at a more normal pace of 5% or 6% a year.

It isn't working out that way. The rapid deterioration of the market over the past 12 months has caught many homeowners and builders off guard. Some are being forced to cut prices far below what their homes could have fetched a year ago. It's too early to say how hard the landing will be, but at a minimum it will be bumpy for many people who need to sell homes. And the economy as a whole, buoyed in recent years by the housing frenzy, could suffer.

WALL STREET JOURNAL VIDEO

[David Seiders, chief economist for National Association of Home Builders, forecasts](#) a cooling housing market.

The pain that homeowners and home builders are now feeling follows a raging national house party. As Americans soured on the stock market after the tech bubble burst in 2000, they poured money into real estate, spurred on by the lowest interest rates in four decades and looser lending standards. Surging demand created home shortages in California, Florida and the Northeast. Over the five years ending Dec. 31, average U.S. home prices jumped by 58%, according to a federal housing index.

But mortgage rates began rising and surging inventories of homes for sale finally caught up with demand. Though economists had been predicting a slowdown in housing for years, many homeowners and builders were surprised by how fast the market changed. "It's just like somebody flipped a switch," says Lynn Gardner, a real-estate auctioneer who works in Northern Virginia.

"It would be difficult to characterize the position of home builders as other than in a hard landing," says

Robert Toll, chief executive of luxury home builder [Toll Brothers Inc.](#), which reported yesterday that net income fell 19% in the third quarter ended July 31. ([See related article.](#))

In his 40 years as a home builder, Mr. Toll says, he has never seen a slump unfold like the current one. "I've never seen a downturn in housing without a downturn in employment or... some macroeconomic nasty condition that took housing down along with other elements of the economy," he says. "This time, you've got low unemployment, you've got job creation, you've got a stable stock market and relatively low interest rates."

Joan Guth is one homeowner who was taken by surprise. Last September, she put her stately five-bedroom home in Herndon, Va., on the market for about \$1.1 million. She was confident she would get something near that price, and planned to use the proceeds to buy a retirement home in Florida. But her home in the Washington suburbs attracted few serious lookers, and in March, she cut her asking price to \$899,900. Still there were no takers. Finally, on the advice of her broker, she called in an auction firm, beginning a process that would eventually reveal to her just how weak the Northern Virginia market had become.

In much of the country, property markets began cooling rapidly in the second half of last year. Home builders were still turning out houses at a rapid clip, and the surge of new and previously occupied homes on the market convinced buyers there was no need to hurry. Over the past year, the number of previously occupied homes listed for sale nationwide has risen nearly 40%. In some metropolitan areas, including Orlando and Phoenix, the supply has quadrupled.

Investors who during the boom had been snapping up properties from the outskirts of Phoenix to the slums of Baltimore began dumping them on the market, hoping to get out with a profit before it was too late.

The resulting slump, thus far, is being felt mainly on the East and West coasts and in Florida, where home prices had soared beyond the average working family's ability to pay. In California's San Diego County, the median home-sale price was \$487,000 in July, down 1.8% from a year earlier, according to DataQuick Information Systems, a research firm in San Diego. Prices in the Northern Virginia counties of Fairfax and Arlington and in nearby towns, near Washington, averaged \$537,731 in July, down 3.9% from a year earlier, according to the Northern Virginia Association of Realtors.

In some other parts of the country, notably Texas and the Seattle area, local housing markets remain robust. Texas' low housing costs are attracting new residents and investors, while Seattle's strong job market and shortage of homes have kept prices rising.

Joan Guth, outside the Herndon, Va., home she agreed to sell earlier this month.

Nationwide, the median sale price of previously occupied homes in June was 0.9% higher than it was a year earlier, the smallest year-to-year increase since May 1995, according to the National Association of Realtors, a trade group.

Over the next few months, the median price may decline from year-earlier periods, a spokesman for the association says, something that hasn't happened since February 1993.

The market may be weaker than the Realtors' widely followed monthly reports suggest. The group's data don't reflect the latest transactions. Its report on July home sales, for instance, due today, will mainly reflect sales that were agreed upon in May or June and closed in July. Moreover, when the market turns down, many home sellers initially let their homes sit instead of cutting prices enough to entice buyers.

Allen Sinai, chief economist at Decision Economics Inc., a New York research firm, contends that housing is poised for something "harder than a soft landing but softer than a hard landing." The weaker market will hurt the economy by eliminating jobs in construction and other housing-related fields and by reducing the ability of consumers to finance spending by borrowing against their home equity. Mr. Sinai predicts these factors could shave as much as a percentage point off economic growth over the next year or so. Taking that into account, he expects the economy to grow at a relatively sluggish annual rate of 2.5% to 2.75% in 2007, compared with 2.5% in this year's second quarter and 5.6% in the first quarter.

In a speech yesterday, Michael Moskow, president of the Federal Reserve Bank of Chicago, noted: "While we factor a housing slowdown into our outlook, there is some evidence -- such as higher rates of cancellation in home-building contracts -- that the slowdown could be more extensive."

With fewer consumers applying for home loans, some big mortgage lenders are already retrenching. [Countrywide Financial](#) Corp. last month announced plans to reduce costs by \$500 million. Earlier this year, [Washington Mutual](#) Inc. eliminated 2,500 jobs at loan-processing centers.

Builders, who were optimistic about prospects until a few months ago, are cutting back too. [KB Home](#), a big home builder based in Los Angeles, has eliminated 7% of its work force, or 440 jobs. In July, U.S. home builders started construction at an annual rate of 1.45 million single-family homes, down 20% from the January peak.

Last August, when Horsham, Pa.-based Toll Brothers reported that its quarterly profit had doubled, Mr. Toll boasted: "We've got the supply, and the market has got the demand. So it's a match made in heaven." Since then, Toll has cut its guidance four times on the number of homes it expects to close on, and its share price has fallen by more than 45%. Yesterday, the company said orders for new homes in the third quarter were down 48% from a year earlier.

Mr. Toll blames a "drop in confidence" among prospective home buyers, who he says are worried about "the direction of America" and the situation in Iraq. The retreat of speculators who were buying and "flipping" homes also hurt the market, he says. Such speculative buyers, who Mr. Toll estimates accounted for about 10% of demand one year ago, are now sellers.

Even so, Mr. Toll contends that new household formation, immigration, job creation and rising affluence are currently producing a pent-up demand for housing. Once Americans believe that home prices have bottomed, he argues, they will rush back into the market, although he is unwilling to predict when that will happen.

At [D.R. Horton](#) Inc., the nation's largest home builder by units built per year, executives said late last year they were confident that quarterly earnings would continue to increase even during a housing-market slump. In July, Horton reported a 21% decline in net income for the third quarter ended June 30, the first quarter in 28 years in which it didn't report year-over-year profit growth. Horton's chief executive, Donald Tomnitz, said the surge in home prices had priced many people out of the market.

"Every time we've gone into a downturn in the home-building industry, they've always been longer and deeper than we've all imagined," Mr. Tomnitz told analysts in a July 20 conference call. "So we're preparing for the worst, and we think this one will be longer and deeper than just the last six months."

For some homeowners who bought as the market was peaking last year, the downturn is already creating a financial pinch.

In April 2005, Jennifer Bloom paid about \$229,000 for a condominium in Yarmouth Port on Massachusetts's Cape Cod, where her son planned to live. After his plans changed, Ms. Bloom, a software specialist for a computer company, decided early this year to sell the condo. She initially listed it at \$229,000, and then gradually shaved the price to \$199,000 as the market weakened. Earlier this month, she gave up on finding a buyer at a price she could bear to accept. Instead, she is renting out the condo for \$1,000 a month, which she says is more than \$200 below her monthly costs for mortgage payments, insurance, taxes and other items. She says she intends to hold off on selling it until the market improves.

The slump has been particularly harsh in Northern Virginia, where in recent years, large home builders have turned open fields and wooded lots into new subdivisions.

Inventories of unsold homes here have risen 147% over the past year, compared to a 40% increase nationally.

Would-be sellers such as Tahir Javed, a 36-year-old management consultant, are growing frustrated. One year ago, Mr. Javed decided to move up from his town house in Ashburn, Va. He signed a contract to buy for \$983,000 a four-bedroom brick colonial that a developer planned to build in nearby Leesburg. He put down a \$60,000 deposit and planned to move into the new house in October 2006.

In May, Mr. Javed put his town house on the market for \$499,900, which he says is far above the \$212,000 he paid in 1999, but in line with asking prices for similar homes in the neighborhood. He hasn't been able to find a buyer, and the balance he owes on his new house -- about \$920,000 -- is due in about six weeks.

Mr. Javed says he asked the builder for a price break, but the answer was no. He's considering cutting the asking price for his town house to slightly under \$470,000, and if that doesn't work, he may try to find a renter. He had planned to use the money from selling the town house as a 20% down payment on what he owes on his new home, and to borrow the other 80%. Now he may need a bigger loan, which could carry a higher interest rate, he says. "That is the painful part," he says.

Ms. Guth, whose home in Herndon, Va., had failed to attract a buyer after months on the market, eventually turned to Tranzon Fox, an auction firm based in Burke, Va. Ms. Guth had based her initial \$1.1 million asking price on a 2005 appraisal of her home, which now appeared far off the mark. She and her family decided they would accept the highest bid of at least \$675,000.

Kristin Eddy, a 35-year-old pediatric occupational therapist living in a town home in Reston, Va., had noticed Ms. Guth's dark-green turreted home with its wraparound verandas while riding her bike along a nearby trail. "I've had my eye on that house for a long time - - as a dream," Ms. Eddy says. When it first went on the market, it was far beyond her price range. Then she noticed the sign announcing the auction.

On the morning of Aug. 5, the auctioneer, Stephen Karbelk, set up loudspeakers on Ms. Guth's side lawn. Ms. Guth handed bottles of chilled water to the several dozen bidders and curious neighbors who showed up. "I have a whole stomach full of butterflies," Ms. Guth said.

Ms. Eddy figured her chances of winning were near zero. When the auction began, it became clear that there were only two serious bidders. Although Mr. Karbelk tried to stir excitement, the bidding petered out within minutes. Ms. Eddy was the high bidder, at \$475,000.

Looking stricken, Ms. Guth and one of her sons huddled with their broker for a few minutes. Then they told the auctioneer they wouldn't accept the bid, which fell below the stipulated minimum that hadn't been revealed to bidders. The auction was over.

Ms. Guth said she would move and leave the house empty until she could sell it at a reasonable price. Late that afternoon, Ms. Eddy raised her offer to \$525,000. The Guths wavered for two days before agreeing to accept about \$530,000. Ms. Eddy is getting a home with five bedrooms, four full bathrooms, a half-acre lot and a three-car garage for about what some people had been paying until recently for town houses in the area.

Ms. Guth has revised her retirement plan. The disappointing auction result made it difficult for her to afford the kind of home she wanted in Florida. She has decided to buy a home in South Hill, a rural area of south-central Virginia where home prices are cheaper than they are in either Florida or the Washington suburbs. She thinks she can find a home there for \$175,000 or less.

Write to James R. Hagerty at bob.hagerty@wsj.com and Michael Corkery at michael.corkery@wsj.com