

The Land of the Open House

Merced, once the state's hottest housing market, is headed back to being, well, Merced again.

By David Streitfeld, Times Staff Writer
March 25, 2006

MERCED, Calif. — Where did everyone go? Real estate agent Mark Gregory is holding an open house to sell a nearly new three-bedroom on a corner lot, and it's as if the Earth had been emptied.

Last year, this Central Valley city enjoyed the state's hottest real estate market. Sure, things have slowed since then, but Gregory possesses a salesman's indestructible optimism.

He put a sign on the lawn, a note on the Internet, an ad in the paper. He's hoping for investors from the coast marveling at how much house you can buy here for \$359,000. Or local couples looking to move up into something nicer. Or Bay Area workers willing to make the long commute.

Three hours quietly pass. At 4PM, the agent pulls up the sign and locks the door. Total visitors: 0. "It's like everyone got together and said, 'Let's not buy for a while,' " Gregory says.

After five increasingly wild years, the great real estate boom appears to be coming to a close. The Commerce Department reported Friday that sales of new homes nationwide plunged 10.5% in February, about five times the drop analysts predicted.

In places such as Los Angeles, which have diverse economies, the consequences could be mild. In other communities, where prices became untethered from reality long ago and real estate not only drove the economy but virtually became the economy, the fallout could be much more turbulent.

Merced — a farming town once known, if known at all, as a place campers turned off California 99 on their way to Yosemite National Park — is falling into the latter category.

The good times have already ended here in the same way slamming into a wall reduces your speed. A house will fetch 20% less today than it did last summer, brokers say, assuming it finds a buyer at all.

Just a little while ago, Merced was an investor's dream. The Office of Federal Housing Enterprise Oversight reported this month that prices in the city and surrounding area increased 31% in 2005. The housing agency ranked Merced first in price appreciation in California and ninth in the nation.

That already feels like ancient history, an era when agents would list a property and within hours people would be madly bidding against one another. In five years, Gregory never had a listing that lasted longer than four days.

The number of agents registered to sell in Merced went from 200 to 1,200 as property prospered. Mortgage brokers, title companies and other processing firms flocked to town. One new complex, the Plaza at El Portal, accommodates Chicago Title, Wells Fargo Mortgage, New Freedom Mortgage, First American Title, Building Showcase Interiors, Moonlight Development and Sunlight Development. There's almost nothing that isn't connected to housing.

The phenomenon occurred throughout the Central Valley. According to the Housing Enterprise Oversight numbers, the leading edge of the nation's real estate mania was not San Francisco or Manhattan or Miami, no matter how giddy those markets seemed to their residents, but in some little-known agricultural communities.

The housing agency's No. 1 US city for price appreciation over the last five years was Madera, an old logging town northwest of Fresno that rose 144%. Yuba City, north of Sacramento, was 2nd. Third place went to a Florida city, Port St. Lucie. Fresno and Merced, both at 142%, rounded out the top five. (Los Angeles prices increased 131%, still above the state average of 117%.)

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Andrew Leventis, a Housing Enterprise Oversight economist, contemplated this ascending arc in a region that is not a tourist destination or retirement haven, where incomes are not growing and unemployment is perpetually high. He then used an un-economist word: "Shocking."

"It's difficult to know what was driving these high rates of appreciation," Leventis said.

To people in Merced, however, there's little mystery. This was a classic bubble, where people paid increasingly higher prices because they were sure that someone would come along and pay even more. Economists call this the "greater fool" theory.

In 2003 and 2004, carloads of investors would come down from the Bay Area and up from Los Angeles. They would see a \$200,000 house and say, "Wow, if this were on the Westside or in Berkeley, it would be worth \$750,000, easy. Let's offer \$225,000 to make sure we get it."

Then the seller across the street would say, "If that place was worth \$225K, I'm asking \$250K."

It helps that Merced is a pleasant place, with an appealing main street and lovely spring evenings. The first new UC campus in 40 years is being built in stages on the outskirts. Twenty-five thousand students will eventually study there, greatly benefiting the local economy.

But at the moment, the city and county are relatively poor. More than 1 in 5 Merced County residents had incomes below poverty level in 2000. The per-capita income of \$14,257 was about two-thirds of the state average.

"The demographics never changed here, but people bought as if they did," said Ray Rodriguez, president of the Merced County Assn. of Realtors. "It got real wild."

Then last September came, when the first portion of the university opened. "The market shifted in two weeks," said Gregory, the agent. "All of a sudden, nothing."

Two doors down from Gregory's open house, which he has been trying to unload since September, a second home is on the market. Three more doors and across the street is another. Around the corner is a fourth. A fifth home directly across the street from Gregory's just sold — after the owners slashed the price.

Officially, this city of 77,000 has 640 homes for sale, about 10 times as many as last summer. But agents say that if you add homes for sale by their owners, new homes being sold by builders and the dwellings that would-be sellers have pulled off the market in despair — none of which are in the agents' centralized database — the real number is at least twice that. The Merced Sun-Star's Sunday real estate supplement has 40 pages of ads.

Many of those ads are for new developments. The city lists 47 active subdivisions where 7,173 homes are going up. For builders with excess inventory, it's let's-make-a-deal time.

At the sales office of Shadow Creek, whose prices range up to \$523,000, signs on the front door and walls proclaimed: "Ask us how to save \$40,000 off a new home!!!"

"If you want to ask for more, just do it," the saleswoman advised. She said a \$60,000 break would probably be fine.

Over at Summer Creek, the saleswoman offered a \$75,000 discount, subject to a few restrictions, like using a preferred lender. There was also a \$3,000 referral fee available — talk a friend into buying there, and the money's yours.

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Ryan Burchard, a San Luis Obispo radio host, examined one of Summer Creek's model homes with his two daughters. "Some of these salespeople seem a little jumpy, a little desperate," he said. "It's like walking onto a used-car lot." Burchard might be moving here this summer, but he felt no urgency to buy. "Every other house here is for rent," he said.

This is a very good time to be a renter in Merced. A new \$450,000 house, owned by an investor waiting to flip it — or sell for a quick profit — can be had for less than \$1,000 a month. That's a silver lining for locals who missed out on the boom.

But prices will have to drop quite a bit more before many of them can imagine becoming owners themselves.

Brenda Rodriguez looked for a house in Merced for a decade. "Houses are being built faster than you can blink your eyes, but prices are outrageous," she said. "I don't know how most people are doing it."

Most people aren't. Fewer than 3% of Merced families can afford a house, according to the National Assn. of Home Builders' latest survey.

Rodriguez, 49, takes care of her disabled daughter. Her husband, Richard, is a maintenance worker. They finally were able to buy a place in November through a county program for low-income families. The house has its problems, but she's glad to leave renting behind.

"A house is something you invest in, it belongs to you," she said. "You hand it down to your family. Renting is just throwing your money away."

Merced is going to grow, Rodriguez said, which means house prices will keep going up.

And if they don't? "Then I'm screwed."

When houses rise in value, households are, at least on paper, worth more, giving them a cushion in bad times. But many homeowners have been treating that equity as if it were income and spending it. In Merced, they would go down to the car dealers even before their refinancing cash-out check came through.

Before the escalation began, 8 out of 10 home buyers in Merced County got a safe, fixed-rate loan, according to research firm DataQuick Information Systems. As the boom proceeded, interest rates fell, which should have increased the appeal of fixed-rate loans.

Instead, buyers switched to adjustables, which saved them money in the short term at the cost of a riskier future. By last summer, 80% of buyers in Merced got adjustable-rate loans.

This presents an opportunity for mortgage broker David Alan Love. He bought a list of 2,000 people who are late on their mortgage payments by at least 30 days, and he is sending them all a letter. "Home values are coming down," it says. "Call me NOW!!"

And they do. A widow whose house is worth \$225K called. She owes \$98,000 on it, is two months behind and has no income other than Social Security. That makes a standard refinance impossible.

Love's advice was to sell the house, but she didn't want to do that. He got her a cash loan of \$25,000, a direct investment from a private lender. For a while, she has money to pay the mortgage, but of course she's more in debt than ever. "You're putting a Band-Aid on a bullet

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wound," Love said he told her.

If the overextended are vulnerable, the investors are at least disappointed. Liubo Hong, a Silicon Valley engineer, bought a four-bedroom on University Drive in February 2005 for \$312,000. He's been trying to sell it since October for \$389,500.

In the late '90s, Hong said, "I got caught up in the stock market. I got in near the peak. I wish I had gotten in earlier." He's trying to rectify that mistake with real estate. "The market may get better in the spring," the engineer said with hope in his voice. "Or next year. Or in 3 to 5 years."

The leaflet for Hong's home calls it "ideal for investors." But he's receiving only \$925 a month in rent, less than his mortgage, and Merced is running low on fools.

Michael Bustamante grew up in town, and its turn as a real estate hot spot still puzzles him. "I thought this place was doomed when the air base shut down a decade ago," the 33-year-old antiques show promoter said. "The economy never got above a mediocre level."

His pregnant wife, Rashell, concurred. She is employed by a medical testing firm up in Sonora, closer to Yosemite. "If I had to work down here," she said, "no way we could have afforded our house when we bought it two years ago."

Now it would be twice as impossible. It's on the market for \$389K, about double what they paid.

The Bustamantes have already reduced their price. "I think the market here is crashing," Rashell said. Down the street are three empty new homes with large signs marked "Red Tag Special."

The only thing worse than the real estate market here is the market for real estate agents. They've been coming down to the Auto Toyz and Auto Store used-car lots looking for work.

"Everyone who applied recently, about eight people, they all were Realtors," said Nico Pineda, who until recently was hiring manager for both lots. "But things were slow for us, so we had to turn them down."

U.S. metropolitan areas with the highest home price rises in 2005:

1. Phoenix-Mesa- Scottsdale, Ariz.: 39.67%
2. Naples-Marco Island, Fla.: 38.89%
3. Cape Coral-Fort Myers, Fla.: 36.19%
4. St. George, Utah: 35.27%.
5. Prescott, Ariz.: 31.89%
6. Lakeland, Fla.: 31.86%
7. Orlando-Kissimmee, Fla.: 31.84%
8. Coeur d'Alene, Idaho: 31.77%
9. Merced: 31.38%
10. Deltona-Daytona Beach-Ormond Beach, Fla.: 30.99%

Source: Office of Federal Housing Enterprise Oversight

Hot markets

Merced ranked ninth in the nation and first in California last year in home price appreciation, part of a surge in Central Valley real estate that is starting to moderate. Also in the U.S. top 20 were Visalia-Porterville and Bakersfield.