

## Credit crunch hits Bay Area housing market hard

Marni Leff Kottle, Special to The Chronicle

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San Francisco may be 3,000 miles from Wall Street, but the crisis that has engulfed the country's biggest financial institutions is putting even more pressure on the Bay Area's real estate market, making it increasingly difficult for home buyers to get credit.

Cheap credit played a dramatic role in fueling the housing boom of the late 1990s and early 2000s, particularly in places like the Bay Area, where buyers relied heavily on unconventional loans to purchase homes that would have otherwise been unaffordable, economists said. That cheap credit also played a dramatic role in toppling financial institutions like Lehman Bros., Washington Mutual and Wachovia Corp., which were saddled with growing piles of toxic loans as borrowers who took advantage of lax lending criteria have proved unable to pay back those loans.

Now, as the federal government has agreed to spend \$700 billion to shore up the country's ailing financial institutions, economists and real estate professionals say that the aid may help stabilize Wall Street. The housing markets here and in other parts of the country, on the other hand, still have a long road to recovery.

"The first step toward recovery is stabilization - prices have to stop declining," said Mark Zandi, chief economist and co-founder of Moody's Economy.com. "That probably won't be until next summer. In terms of actual recovery and price growth, I don't think that will be until the fall or end of 2010."

The bank failures and declining stock market are hurting the region's housing market in two ways, economists said. First, the turmoil has deepened the country's economic woes, and second, it has dried up the credit market and made it even more difficult for potential home buyers to get loans.

The Bay Area up until now had skirted a recession, said Ken Rosen, chairman of the Fisher Center for Real Estate and Urban Economics at UC Berkeley. But as Wall Street's troubles have made the national recession worse, it's likely that the Bay Area's economy also has slipped into a recession, bad news for the already troubled housing market, Rosen said.

"It means there is less security of employment and when that happens, fewer people are willing to go out and buy things," he said. "People are going to be more cautious about buying a house if they're afraid of losing their jobs."

Zandi agreed. "The panic of the last several weeks is going to hit the housing market hard because it's going to hit jobs hard," he said. "We're going to lose a lot of jobs, and that's just one more weight on the already-crashing housing market."


The uncertainty about the depth of the recession and when the economy will improve is also spooking potential home buyers, according to real estate industry executives.

"Buying a house is a long-term investment," said Avram Goldman, chief executive officer of Pacific Union GMAC Real Estate in San Francisco. "When there is uncertainty out there, people go on pause." As home buyers have tried to digest the news over the past two weeks, buyers and sellers have become even more cautious, said Ed Krafchow, chief executive officer and co-owner of Prudential California Realty.

"There has been some fear," Krafchow, who manages agencies in California, Nevada and Texas, said of the reaction in his Bay Area offices. "We've had some buyers slow down or stop a transaction, though that has actually been very rare."

The wait-and-see will continue as buyers watch what happens with the bailout package, said Ed Craine, vice president of the California Association of Mortgage Brokers. "We have some people who are progressing along with their transactions," said Craine, who is also president of the San Francisco lender Smith-Craine Finance. "But a number of people are saying that they want to see how the dust settles before they proceed. We have partial answers now that the bailout's been passed. But people are wanting to see

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what impact it might have on interest rates before they go ahead with their purchase."

Beyond the psychological impact of the declining stock market, the losses have a very real effect on some Bay Area buyers, Pacific Union's Goldman said. Many home buyers sell stock in order to put together a down payment. At a time when lenders are requiring high down payments - in some cases more than 20 percent - shrinking stock portfolios mean that potential home buyers are having a hard time scraping together enough cash.

"If the purchase is going to be based on cashing in stock and if the value of that stock goes down, a buyer might not be able to make that purchase," Goldman said. Home buyers seeking to take out jumbo loans - loans of more than \$729,750 - are being asked to put down as much as 30 percent in some cases, according to real estate and mortgage industry experts.

That's because the investment banks and hedge funds that gobbled up those loans on the secondary market during the housing boom have slammed the door shut, limiting the capacity of banks to make loans.

"Lenders have a limited amount of money to use, and they are being much more careful about the loans they are making," said Craine, the California Association of Mortgage Brokers executive. "Down payments are creeping up, interest rates are significantly higher than they have been historically and in general it is harder to qualify."

For Bay Area home buyers, who seek out some of the largest mortgages in the state, the problem is especially pronounced, said Leslie Appleton-Young, chief economist for the California Association of Realtors.

"The Bay Area tends to have the highest median home prices in the state," she said. "The availability of loans is really the critical issue looking at 2009."

Even as home prices have declined, the median price for a house or condo in San Francisco was still \$725,000 in August, according to MDA DataQuick. The tighter lending standards for jumbo loans are taking a toll on the middle to high end of San Francisco's housing market, Goldman said.

"The market that is being most affected by all of this is not the lower end, it's the \$1 million to \$3 million range," he said. "There just aren't that many buyers out there willing to make the plunge."

Goldman expressed optimism that over the next six months or so, as the government begins implementing the bailout package, things will improve.

Economy.com's Zandi said he expects the credit situation to begin to ease up a little bit in the coming months.

"The availability of mortgage credit nationwide and in the Bay Area is at its low point right now," he said. "It will get better."

But even if the bailout package helps restore balance in the credit markets, it's not going to be a return to business as usual, real estate experts said.

"Investors have finally come out of their shell past the point of denial to a stage of panic," said Christopher Thornberg, an economist with the consulting firm Beacon Economics. "This is not a temporary lull in demand for these bonds, it's a permanent devaluation."

Economists and real estate professionals alike said that even with the bailout package, it will take the housing market some time to recover.

"I would guess we're into this for two to three years," said Charles Moore, president of McGuire Real Estate in San Francisco. "I hope not, but that's what I would guess."

After 15 years of a market that heavily favored sellers, Moore said he expects that even after the housing market recovers, real estate deals will be much more balanced between buyers and sellers.

In the end, though, real estate experts said that if the bailout plan does what it was intended to do and helps keep the credit market flowing, that will be good for both Bay Area buyers and sellers.

"I think most people agree that the bailout plan was a necessary chance to really stabilize the financial system," Goldman said. "Although some parts of the plan were probably onerous to some, I think it will have a positive effect."

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