Aguero Letter to Commissioners Heather Murren and Bryon Georgiou re: FCIC commision hearing/ written testimony

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August 31, 2010

Commissioner Heather Murren
and
Commissioner Byron Georgiou
Financial Crisis Inquiry Commission
1717 Pennsylvania Avenue, NW, Suite 800
Washington, DC 20006-4614

Sent via email (hmurren@fcic.gov and bgeorgiou@fcic.gov)

RE: Financial Crisis Inquiry Commission Hearing | Written Testimony

Dear Commissioners:

In response to your letter dated August 18, 2010, requesting written testimony for the upcoming September 8, 2010 meeting of the Financial Crisis Inquiry Commission (the “FCIC”), please accept this letter as written testimony, including the attached exhibits. Specifically, you requested information on (1) the causes of the financial and economic crisis; (2) the length and depth of the economic downturn in the state of Nevada; and (3) the impact of the financial crisis on the State of Nevada. Each of these topics is addressed in turn below.

WRITTEN TESTIMONY

As a principal and analyst with Applied Analysis, I routinely analyze and produce reports relating to trends in Nevada’s economy. I have been with the firm in my current capacity since 1997. I am also a fourth-generation Nevadan. I attended the University of Nevada, Las Vegas, where I undertook a special course of undergraduate study under the direction of the late Dr. Shannon Bybee and graduated Cum Laude from the William S. Boyd School of Law. My education, experience and assignments conducted provide a reasonable basis for my testimony that follows.

Causes of the Financial and Economic Crisis

The initial request regarding the causes of the financial and economic crisis is not easily addressed, with much of the available information coming from the FCIC’s own hearings. What is clear is that there were a number of factors contributing to the national crisis rather than a single cause. Primary among them was an environment driven by unprecedented liquidity, an aggressive lending climate and decision-making processes that seemed to disregard or discount risk, historical performance, and other market-based dynamics. Unsustainable levels of investment, development, and consumer spending followed. The ensuing fall-out from these decisions has been significant and well documented, resulting in economic challenges and fiscal shortfalls. Nowhere is this more apparent than in Nevada.
Length and Depth of the Economic Downturn in Nevada

The best available data would tend to suggest that the length of the current downturn is three years and running. The magnitude of the decline is without a modern comparison.

The statewide unemployment rate currently stands at 14.3 percent (seasonally-adjusted), which reflects an all-time high during the modern era. Additionally, establishment-based industrial employment totals 1,108,300, the lowest level since September 2003 and well below the peak of 1,303,800 reported in May 2007. While seasonality may play a role, there is no question that a 15.0-percent reduction in employment is not only challenging for those looking for work, but creates new challenges for those that continue to be employed. It is also worth noting that in September 2007, the state reported its first annual decline in employment since August 2002. Assuming the September 2007 timeframe established the start of the downturn (three months in advance of the national recession (December 2007)), the contraction in the job base has persisted for nearly three years.

While different sectors of the economy have responded differently, the state’s core tourism industry and construction industry were some of the hardest hit. Employment in the leisure and hospitality sector, which currently accounts for 27.5 percent of total employment, stands at 304,600 and is 11.4 percent lower than the peak reported in June 2007 (39,000 jobs lost). The construction industry peaked earlier with a high of 148,800 workers in June 2006 (11.5 percent of the workforce). Today, the construction industry employs 61,200 workers (5.5 percent of jobs), a decline of 87,600 jobs (58.9 percent) from the peak. Combined, leisure and hospitality and construction account for approximately two-thirds of the 195,500 jobs lost during the past several years. Other sectors have been, and will continue to be, impacted but not to the extent of these two sectors.

The Impact of the Financial Crisis on the State of Nevada

The financial crisis can be viewed in two parts: the run-up in the economy occurring between 2002 and 2007, and the sharp decline that followed and continues still today. Nevada was uniquely positioned to benefit from the period of rapid economic growth that began in 2002. Home equity extractions bolstering consumer spending and low-cost capital fueling new construction could not have aligned more perfectly with the state’s dependence on tourism and growth.

Growth is nothing new for Nevada. The state led the nation in nearly every measure of economic expansion during the preceding twenty years, with population, employment, and income; commercial and residential construction; new business creation and business investment all expanding at or near the nation’s highest rates. However, from 2002 to 2007 that growth started to take a notably different form. It was more aggressive, more speculative. This is true in the housing market, where non-occupant buyers increased from a fraction of home sales to the majority of home sales. It was true in the commercial markets, where office, industrial and retail projects began being developed at an unprecedented pace, and it was true in the tourism sector where several private equity transactions and large-scale developments increased the industry’s combined long-term debt from $10.5 billion to $17.1 billion.

In mid-2008, the financial crisis was in full swing and reality began to set in. The degree to which households and businesses were leveraged was a mounting concern. Access
to capital was gone. The state was overbuilt and some 100,000 jobs were predicated on a level of growth and consumer spending that seemed to evaporate almost overnight.

In much the same way as Nevada’s consumer spending and construction-dependent economy was uniquely positioned to take advantage of the economic run up, it was equally well positioned to bear the full force of its decline. The state went from national-leading rates of population growth, to net population outmigration. It now leads all other states in unemployment, job losses, reductions in employees’ hours and wages, housing price declines, foreclosure, delinquency and bankruptcy. Nevada is behind only California and Florida, respectively, in the number of outstanding subprime and adjustable rate mortgages, suggesting that the 50,000 foreclosures recorded during the past two years are far from the end of the cycle. Those who have chosen to stay in their homes have collectively lost billions of dollars in home equity and household wealth.

The downward cycle also has a more human element. At present, some 290,000 Nevada residents are participating in the Supplemental Nutrition Assistance Program. This figure, which translates into more than one in ten Nevada residents, is up more nearly 33 percent from where it was just one year ago and is currently the highest figure on record. Similar trends are apparent in the number of residents that are Medicaid eligible. At present, nearly 50 percent of students in the Clark County School District qualify for the free and reduced lunch program, and more than 7,500 children are currently homeless. The impacts of the crisis are apparent in neighborhoods and business parks, schools and churches. Government service providers are seeing caseloads grow, even as the nation’s largest general fund budget shortfall looms.

EXHIBITS

The exhibits included on the following pages provide graphical depictions of key economic trends in Nevada.

SOURCES AND LIMITATIONS

As part of this testimony, a number of data sources and providers were utilized. As it relates to employment-specific information, the Nevada Department of Employment, Training and Rehabilitation was utilized while population statistics were derived from the Nevada Demographer. Housing-related data is generally sourced to Home Builders Research, SalesTraq, Foreclosure.com, RealtyTrac and Applied Analysis. The commercial market information and vacant land sales data is sourced to Applied Analysis’ proprietary research and databases.

Market and economic information furnished to us and contained in this submission or utilized in the formation of the findings were obtained from sources considered reliable and believed to be true and correct. However, we did not perform any audit or other assurance procedures on the data; and as such, no representation, liability or warranty for the accuracy of such items is assumed by or imposed on AA, and all submissions are subject to corrections, errors, omissions, and withdrawal without notice.

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Thank you for the opportunity to participate in this important process. If you have any questions or comments, I can be reached directly at (702) 967-3333 or via email at jaguero@appliedanalysis.com.

Sincerely,

Jeremy A. Aguero
Principal Analyst
EXHIBITS

[INCLUDED ON FOLLOWING PAGES]