

How Tainted the Golden State?  
Assessing the Fallout of California's  
Economic Crisis

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Fisher Center for Real Estate and Urban Economics  
Haas School of Business, University of California Berkeley  
Changing Face of Orange County Lecture Series  
University of California Irvine, May 7, 2009

# Fisher Center for Real Estate and Urban Economics

- Organized research unit, housed at the Haas School of Business
- Current research
  - Housing policy—affordability and location
  - Inclusionary housing (is this even an issue any more?)
  - Consequences of the credit crisis and housing market meltdown
- Other research topics—globalization, services foreign trade, high-tech sectors, “green” and innovation



# Issues of the Evening

- Why “California’s” crisis
- The real estate role
- The economic consequences—how far will it spread?
- The public policy impacts—state and local struggle for resources
- How do we get out of this? Some critical factors

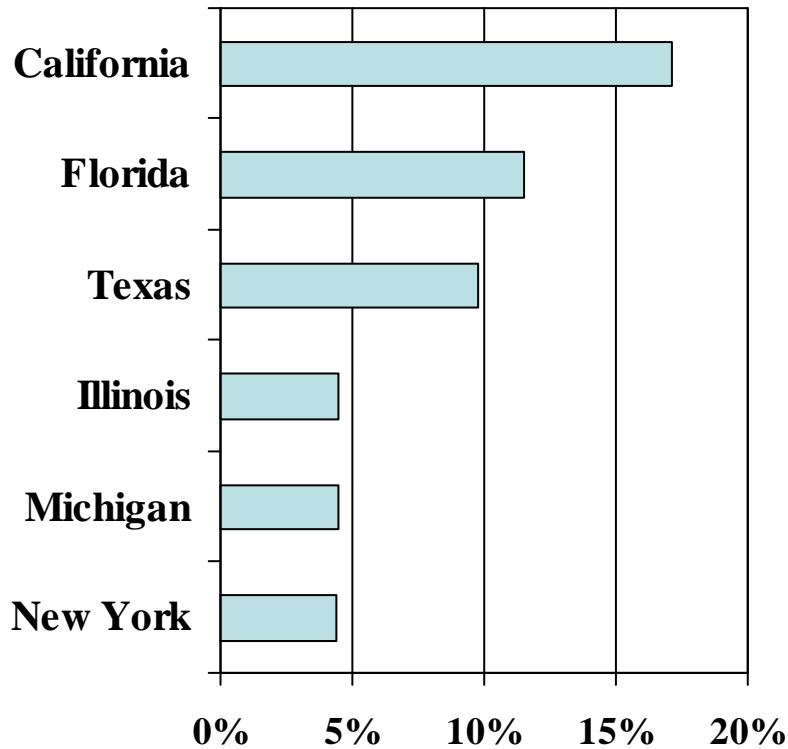
# Why “California’s” Crisis?

- Leader in subprime activity
- Residential construction and finance led the 2001 recovery for California
- Public sector consequences of a weak real estate market are far reaching

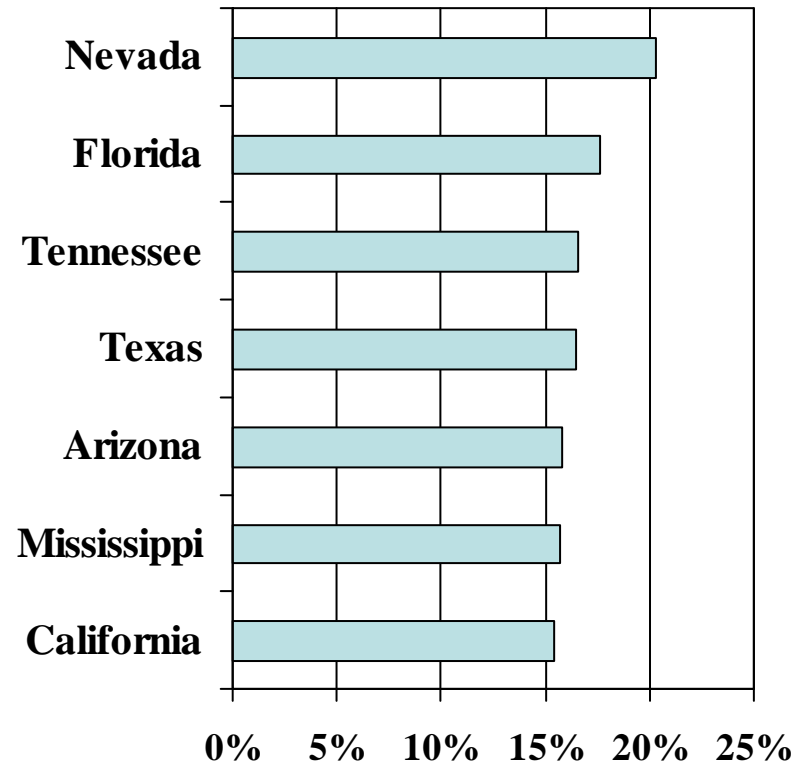
# Subprime Exposure

## 4<sup>th</sup> Quarter 2008

### Share of US Subprime



### Subprime Share of All Loans



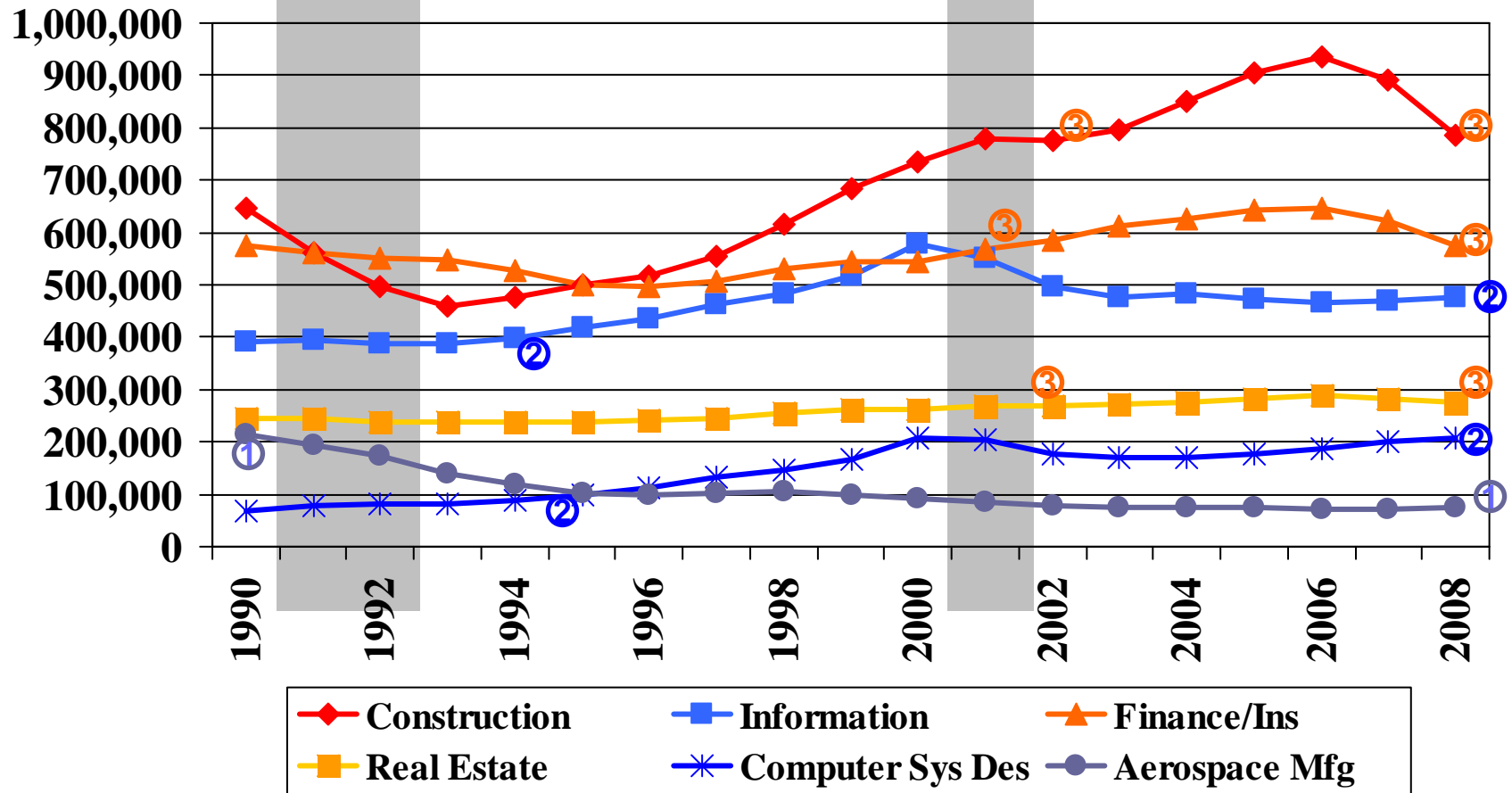
Source: First American Core Logic LoanPerformance data.

# US Lenders with Largest Subprime Volume 1996, 2002, 2005

1996	2002	2005
Associates First Cap. TX	Household Financial, IL	Ameriquist Mortgage, CA
The Money Store, CA	CitiFinancial, NY	New Century, CA
ContiMortgage Corp, PA	Washington Mutual, WA	Countrywide Financial, CA
Beneficial Mortgage, NJ	New Century, CA	Wells Fargo Home Mtg, IA
Household Financial, IL	Option One Mortgage, CA	Option One, CA
United Companies, LA	Ameriquist Mortgage, DE	Fremont Investment, CA
Long Beach Mtg, CA	GMAC-RFC, MN	Washington Mutual, WA
Equicredit, FL	Countrywide Financial, CA	First Franklin, CA
Aames Capital Corp, CA	First Franklin Financial, CA	GMAC-RFC, MN
AMRESO Residential, NJ	Wells Fargo Home Mtg., IA	HSBC Mortgage, IL

Source: Mortgage Bankers Association, Inside Mortgage Finance.

# California Employment In Successive Boom and Bust Sectors



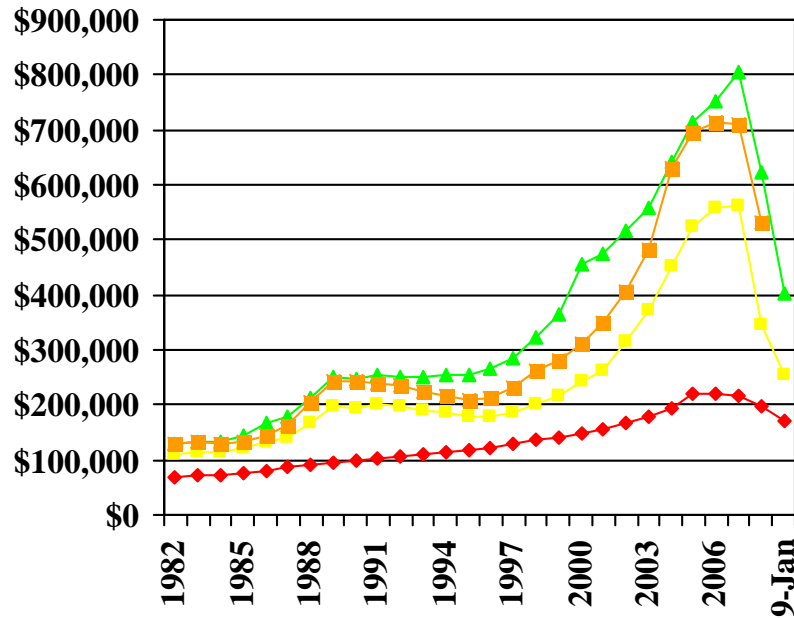
Source: California Employment Development Department

# Real Estate—Where and How?

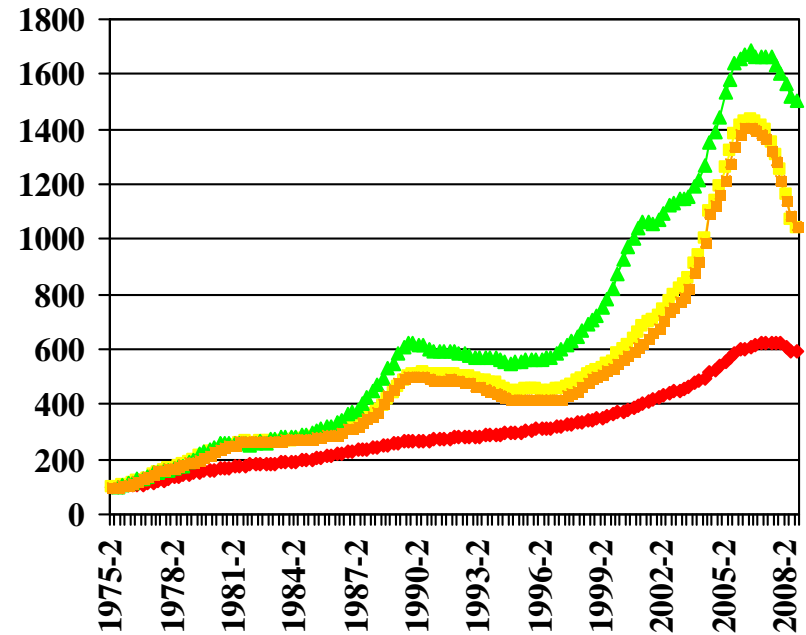
- Unprecedented post-war drop in values
- Geographic and product type variability in
  - Vulnerability
  - Outcome
- How long will it last?
- Contagion beyond the residential sector?

# Will California Maintain its Price Premium?

Median Price



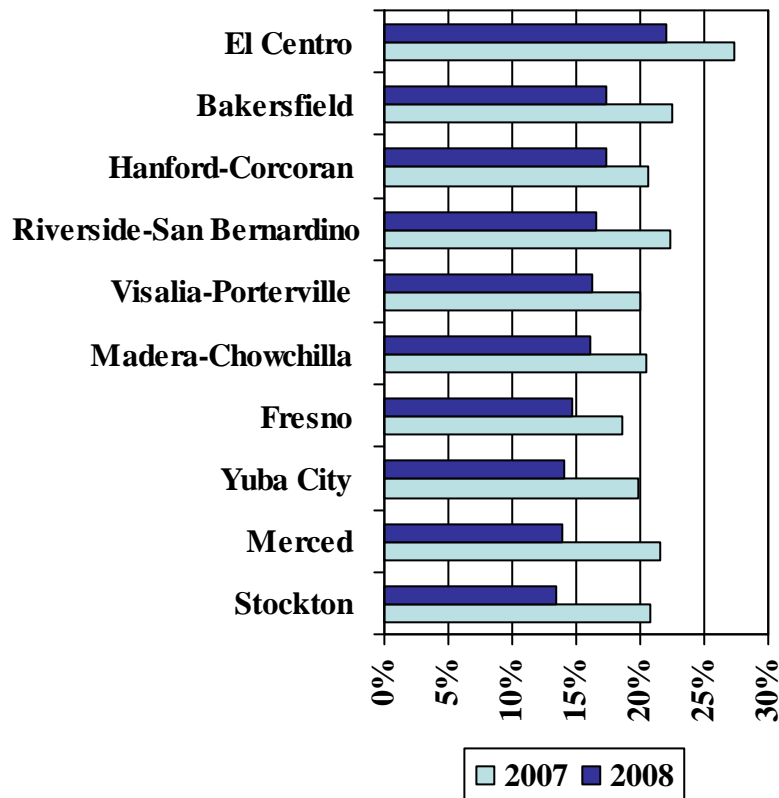
Adj. OFHEO Index (1975Q3=100)



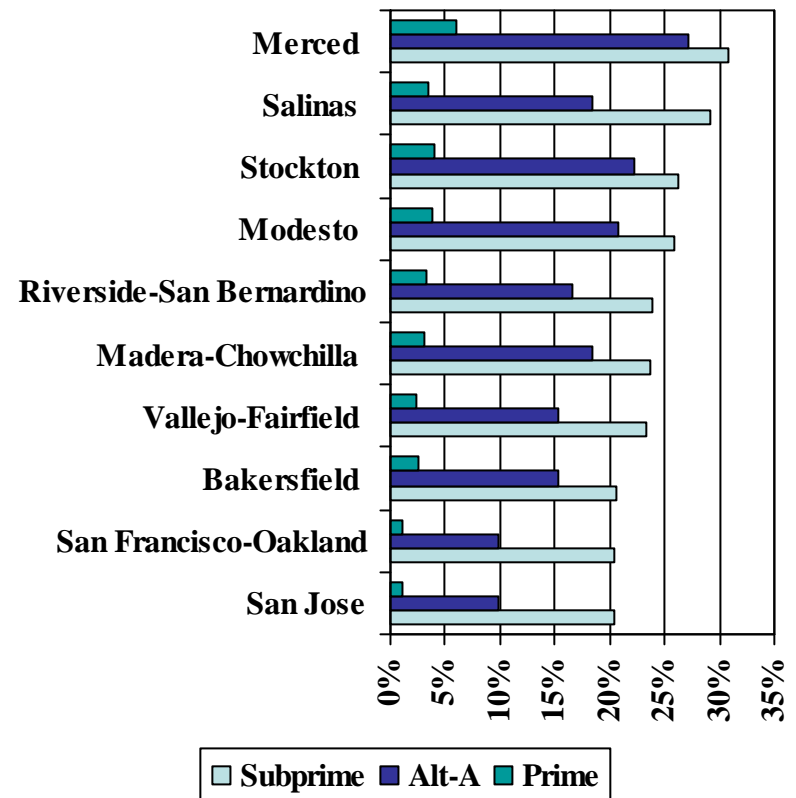
Source: California Association of Realtors and Office of Federal Housing Enterprise Oversight.

# California Regions—Top Counties by Subprime Vulnerability and Foreclosures

**Percent Subprime**

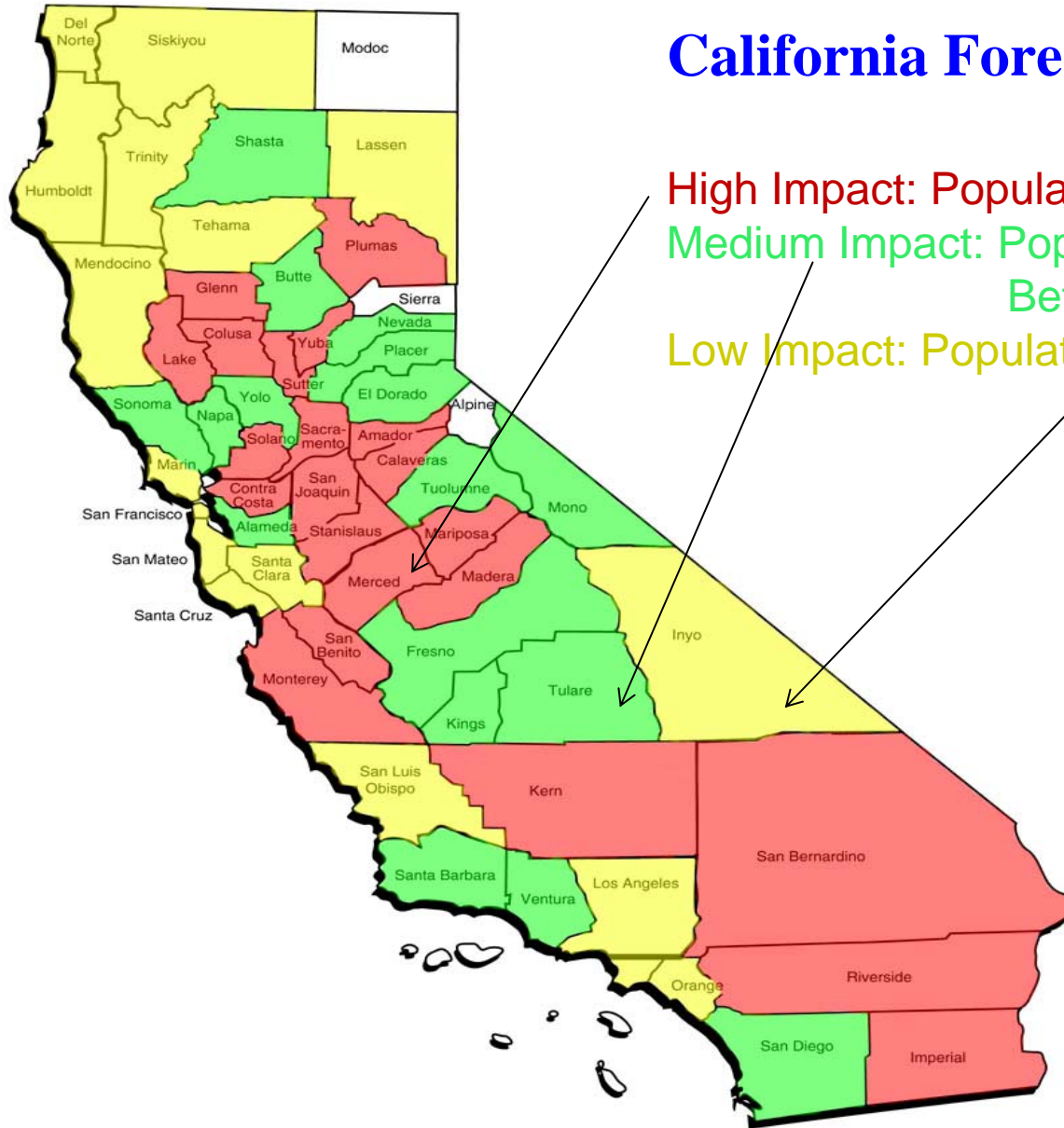


**Percent in Foreclosure Q408**



Source: First American Core Logic LoanPerformance data.

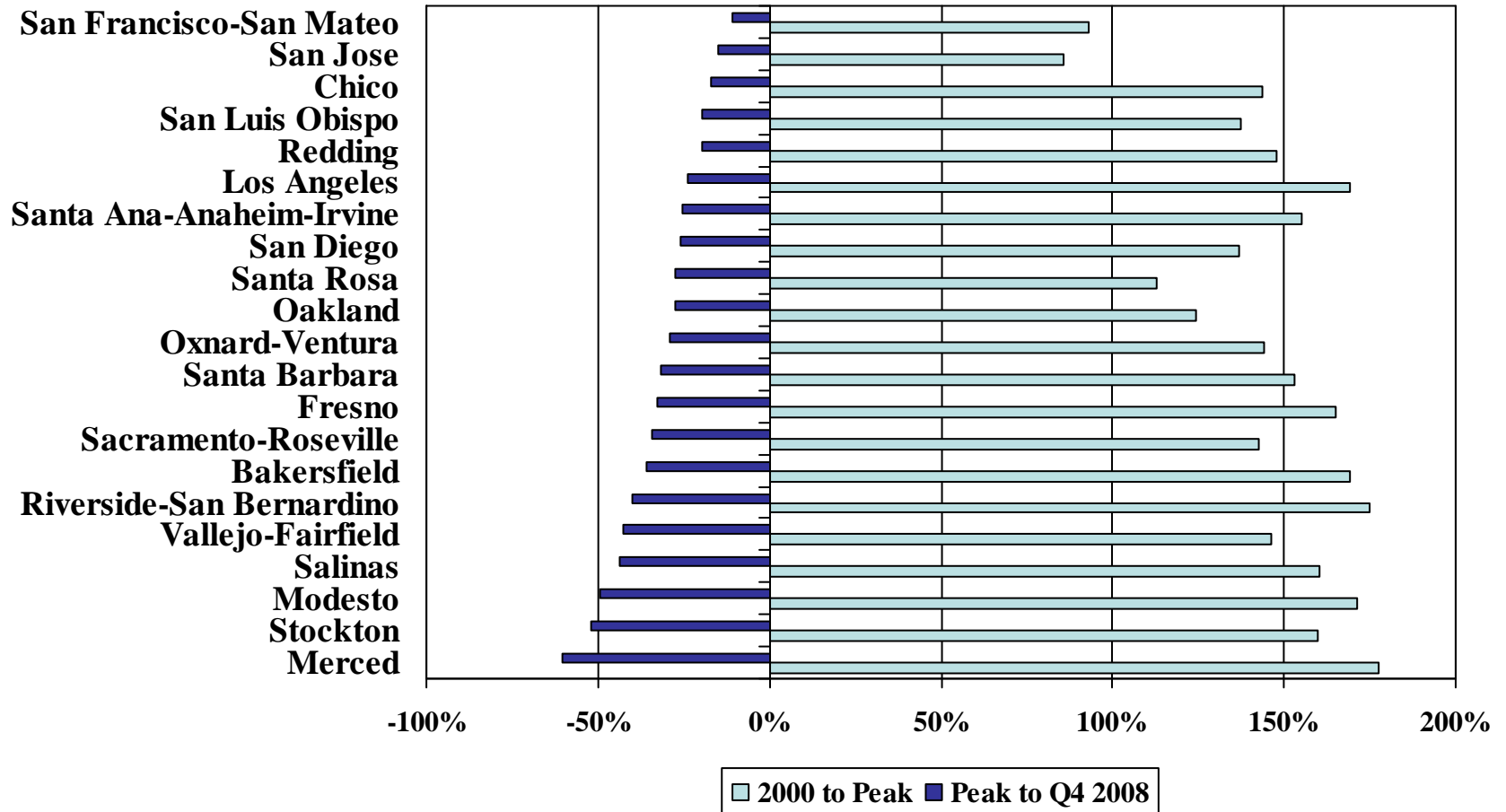
# California Foreclosure Sales Map



High Impact: Population per Sale < 3000  
Medium Impact: Population per Sale  
Between 3000 and 6000  
Low Impact: Population per Sale > 6000

# Same Home Price Index Change

## California MSAs, 2000 to Peak to Q4 2008



Source: FCREUE from Office of Federal Housing Enterprise Oversight, 4<sup>th</sup> quarter 2008 data download.

# Strongest and Weakest SF Bay Area For-Sale Markets

City	Zipcode	Median \$, 2007	% Change 07-08
Atherton	94027	\$2,649,229	49.1%
Palo Alto	94301	\$1,786,000	42.9%
Menlo Park	94025	\$1,239,000	39.5%
San Francisco	94123	\$1,525,000	31.4%
San Francisco	94105	\$839,000	29.1%
Richmond	94801	\$450,000	-70.0%
Byron	94514	\$559,211	-69.6%
Oakland	94621	\$365,169	-64.4%
Oakland	94603	\$403,101	-61.3%
Oakland	94601	\$459,586	-52.6%

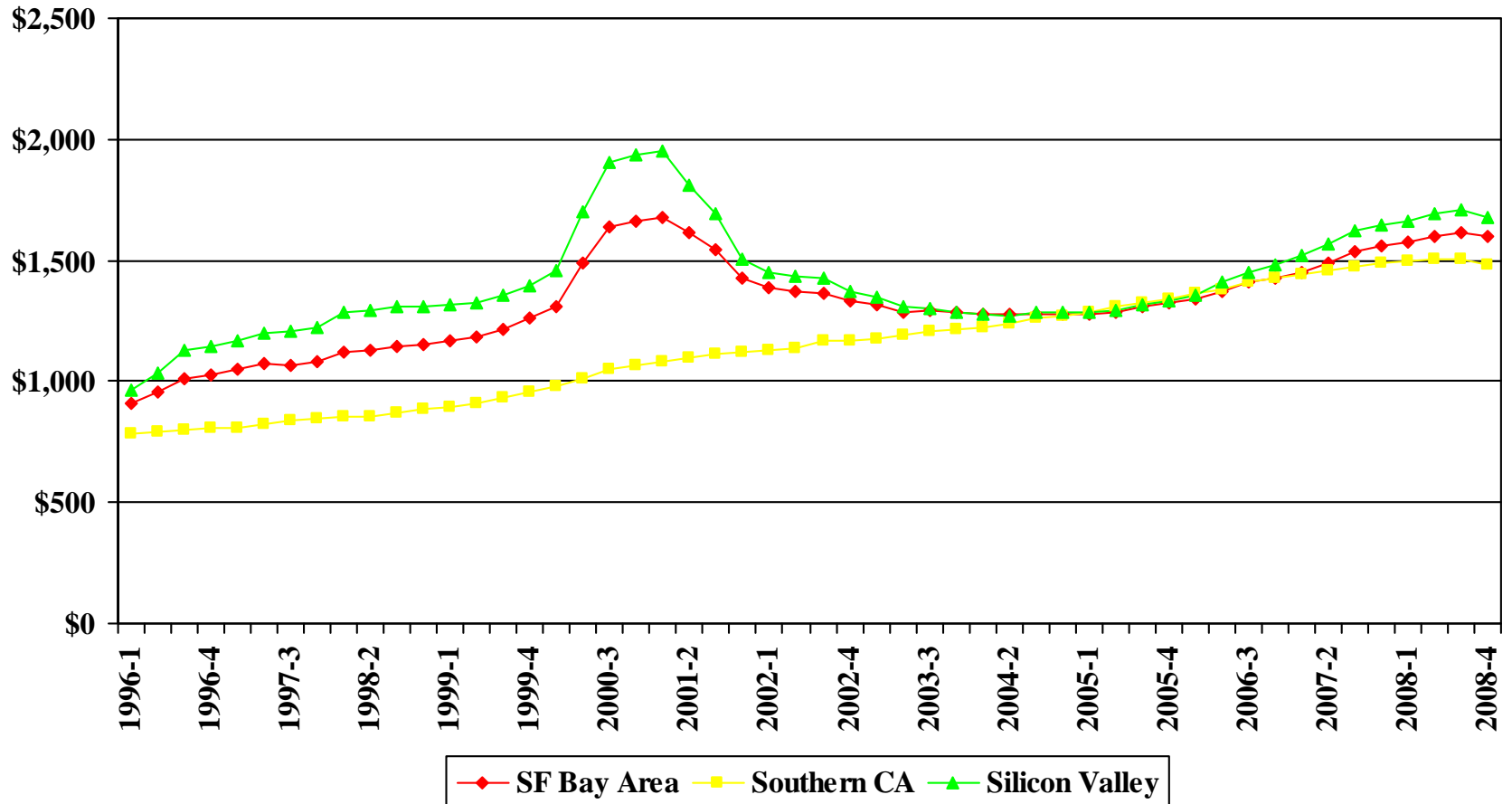
Source: FCREUE from Dataquick data.

# Strongest and Weakest Orange County For-Sale Markets

City	Zipcode	Median \$, 2007	% Change 07-08
Newport Beach	92662	\$1,849,490	17.6%
Corona del Mar	92625	\$1,674,641	4.5%
Laguna Beach	92651	\$1,529,703	1.0%
Tustin	92782	\$656,568	-1.8%
Irvine	92603	\$894,794	-7.8%
San Juan Capistrano	92675	\$774,540	-51.1%
Santa Ana	92707	\$495,238	-47.5%
Santa Ana	92701	\$359,779	-45.8%
Santa Ana	92704	\$549,651	-45.3%
Santa Ana	92703	\$502,688	-44.2%

Source: FCREUE from Dataquick data.

# Rent Levels Show Less Decline (this round)

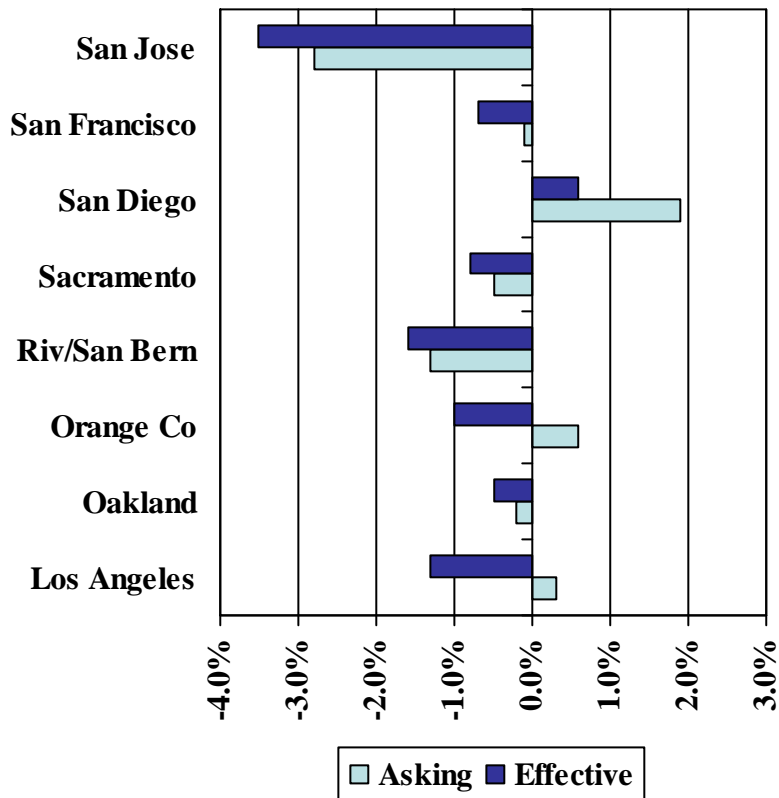


Source: RealFacts from Real Estate Research Councils of Northern and Southern California.

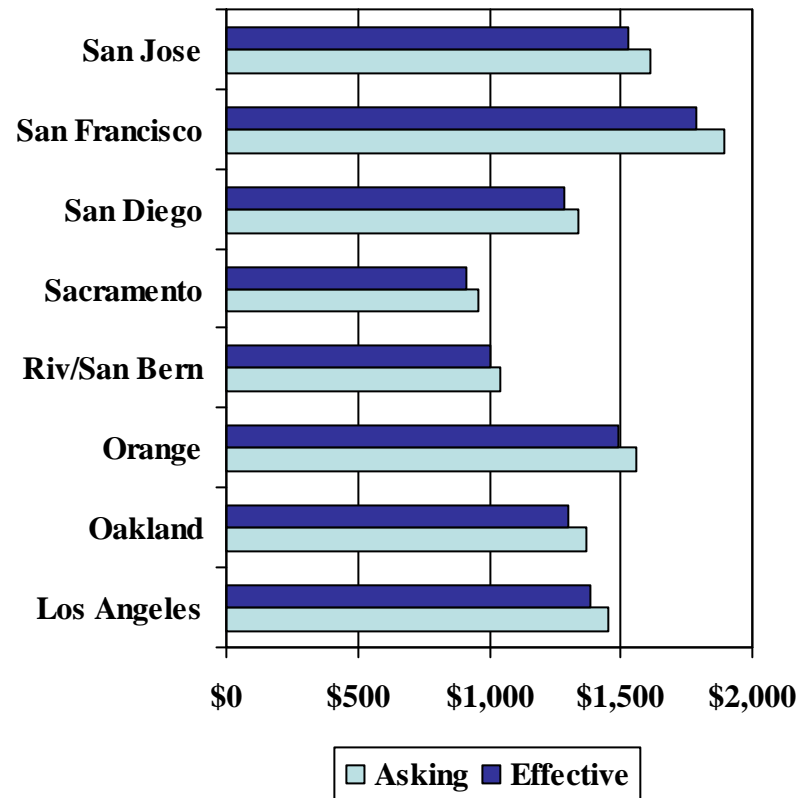
# Apartment Rents Levels and Changes

## Major California Markets, Q1 2009

**Rent 1-Year Percent Change**



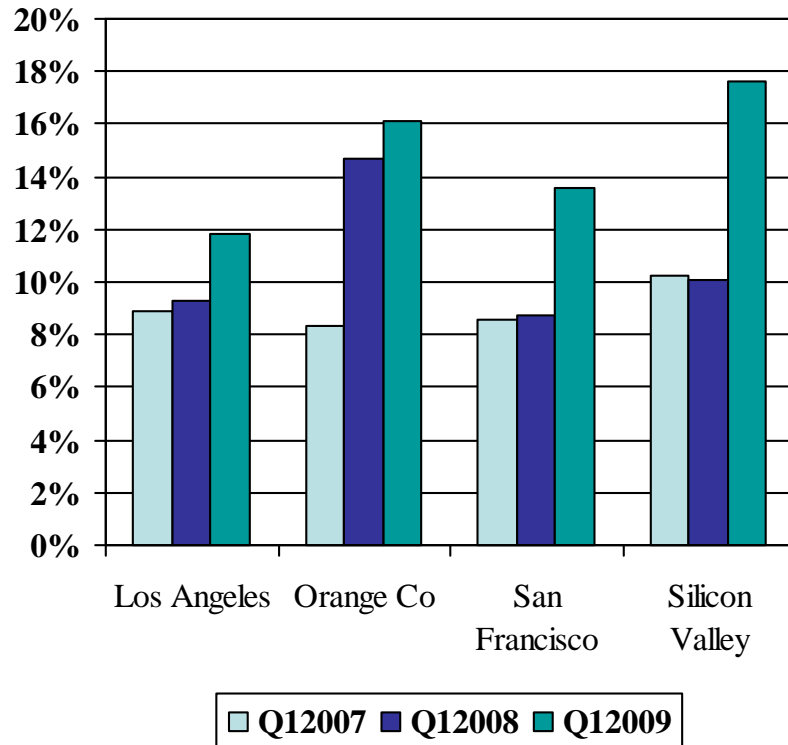
**Rent Levels**



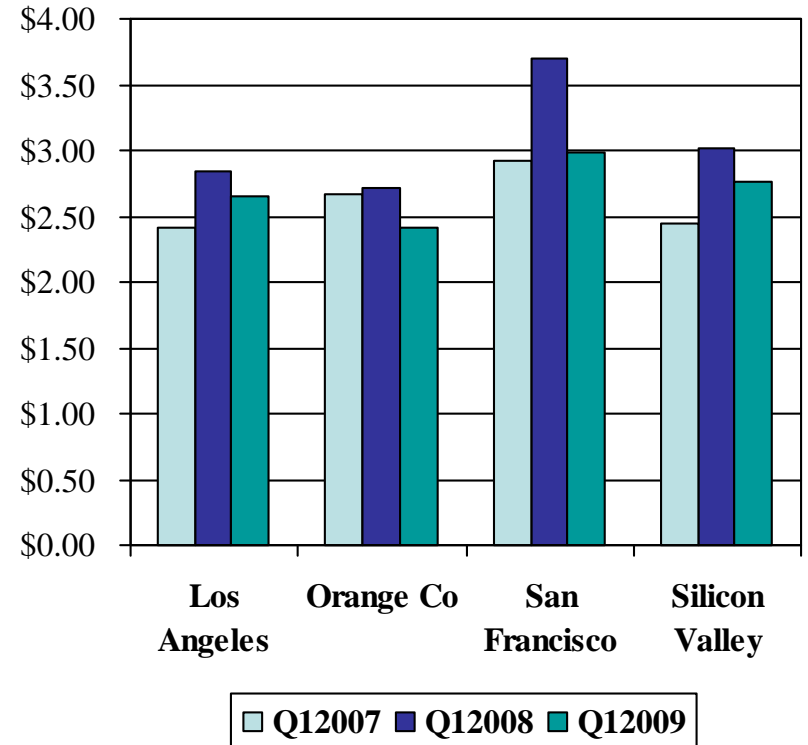
Source: Marcus & Millichap, Apartment Research Reports, Second Quarter 2009.

# Office Markets Trend Downwards

## Vacancy Rates



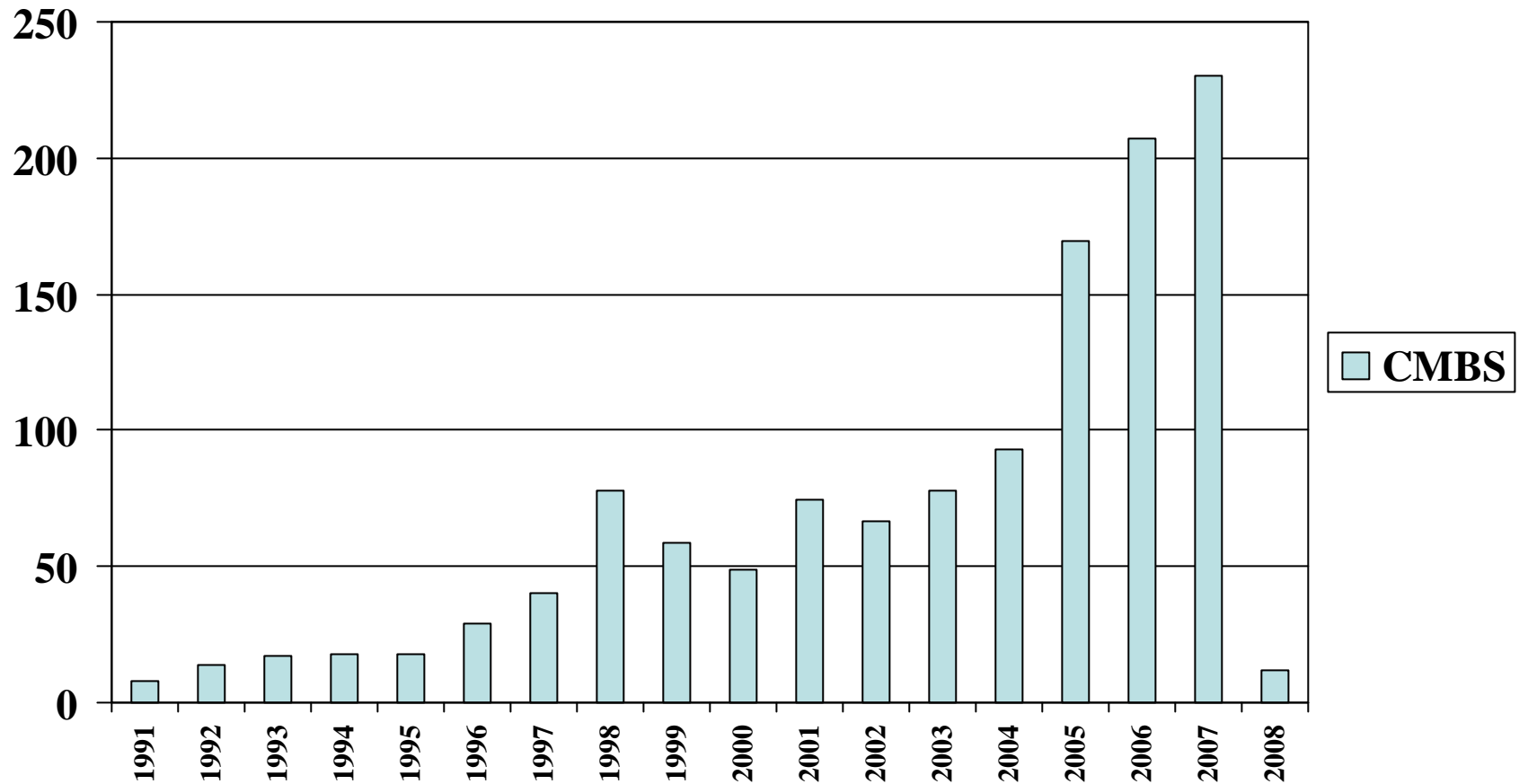
## Weighted Average Rents



Source: CB Richard Ellis Market View reports.

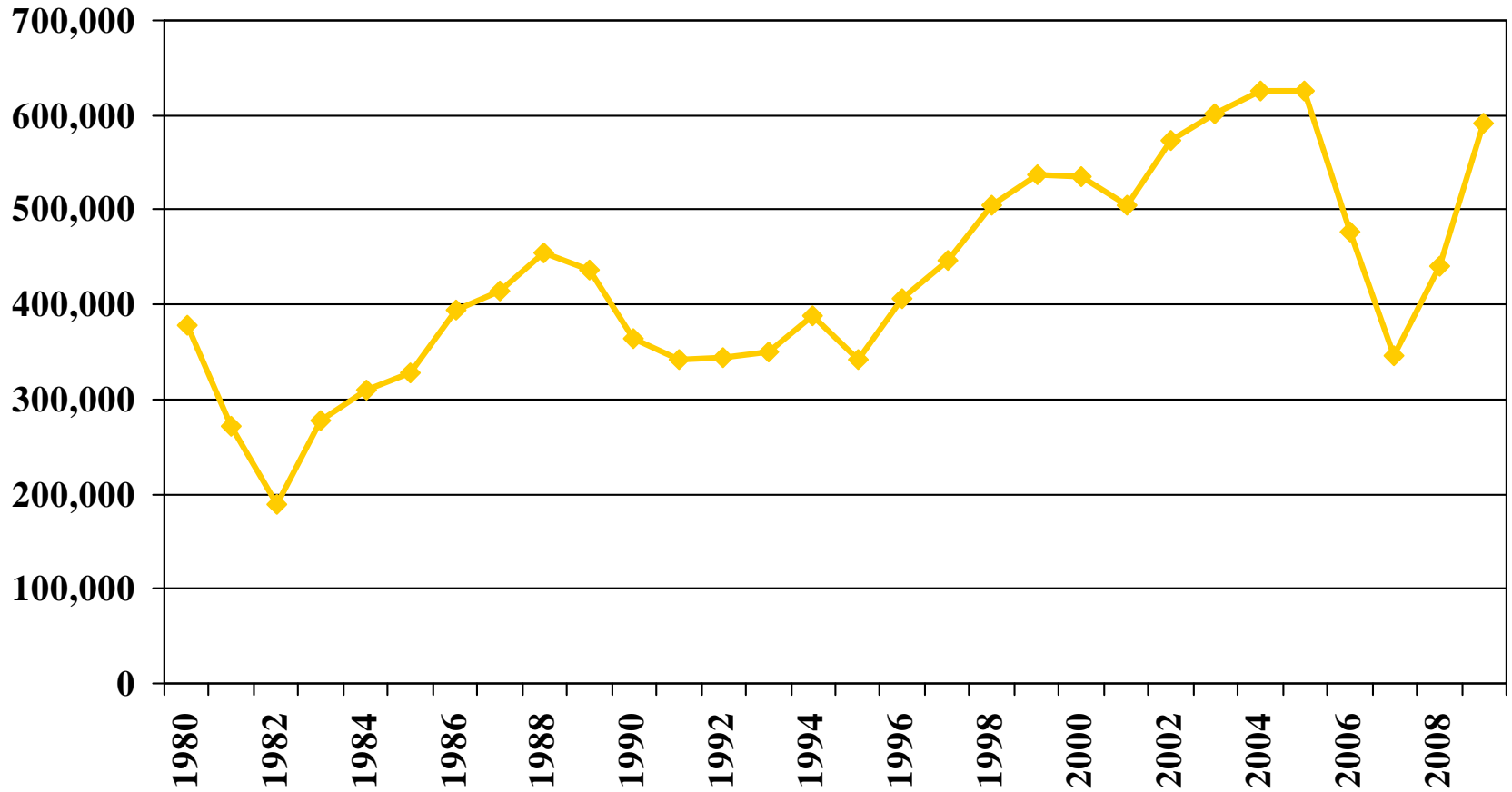
# Domestic Commercial MBS Issuance

(Gross amount, billions)



Source: Commercial Mortgage Alert

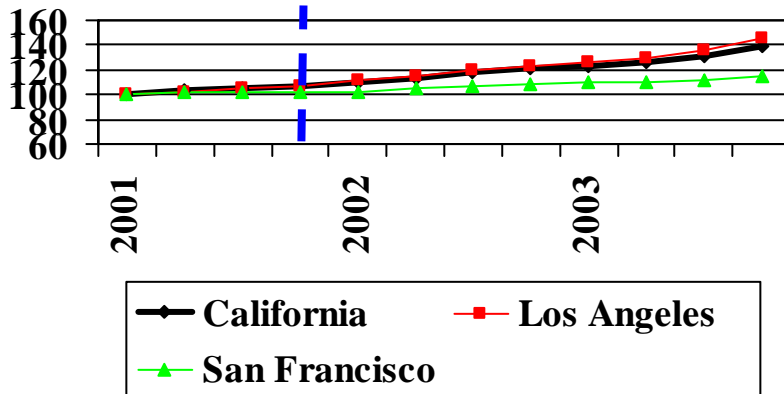
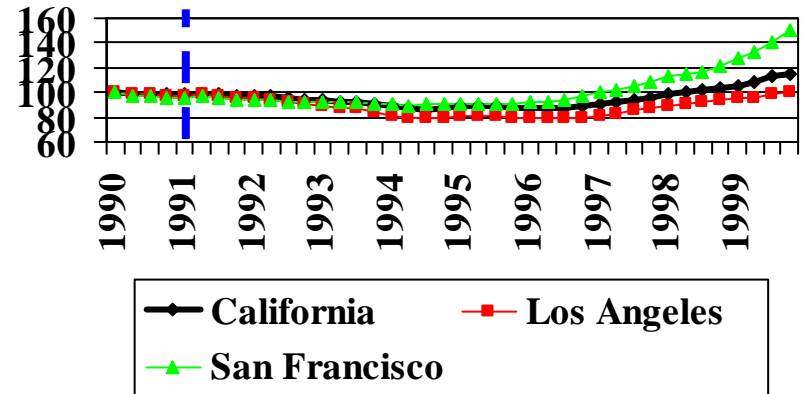
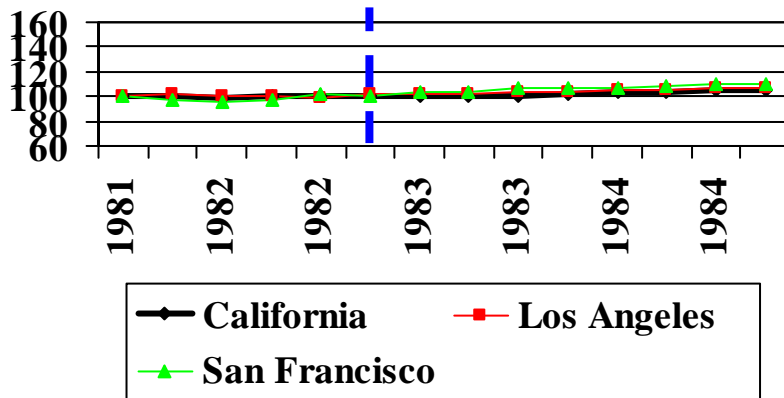
# California Home Sales



Source: FCREUE from California Association of Realtors

# California Housing Cycle Price Histories

Index: 100=Price index at peak prior to downturn  
(Q3 1981, Q3 1990, Q12001)



## HOW LONG TO RECOVERY?

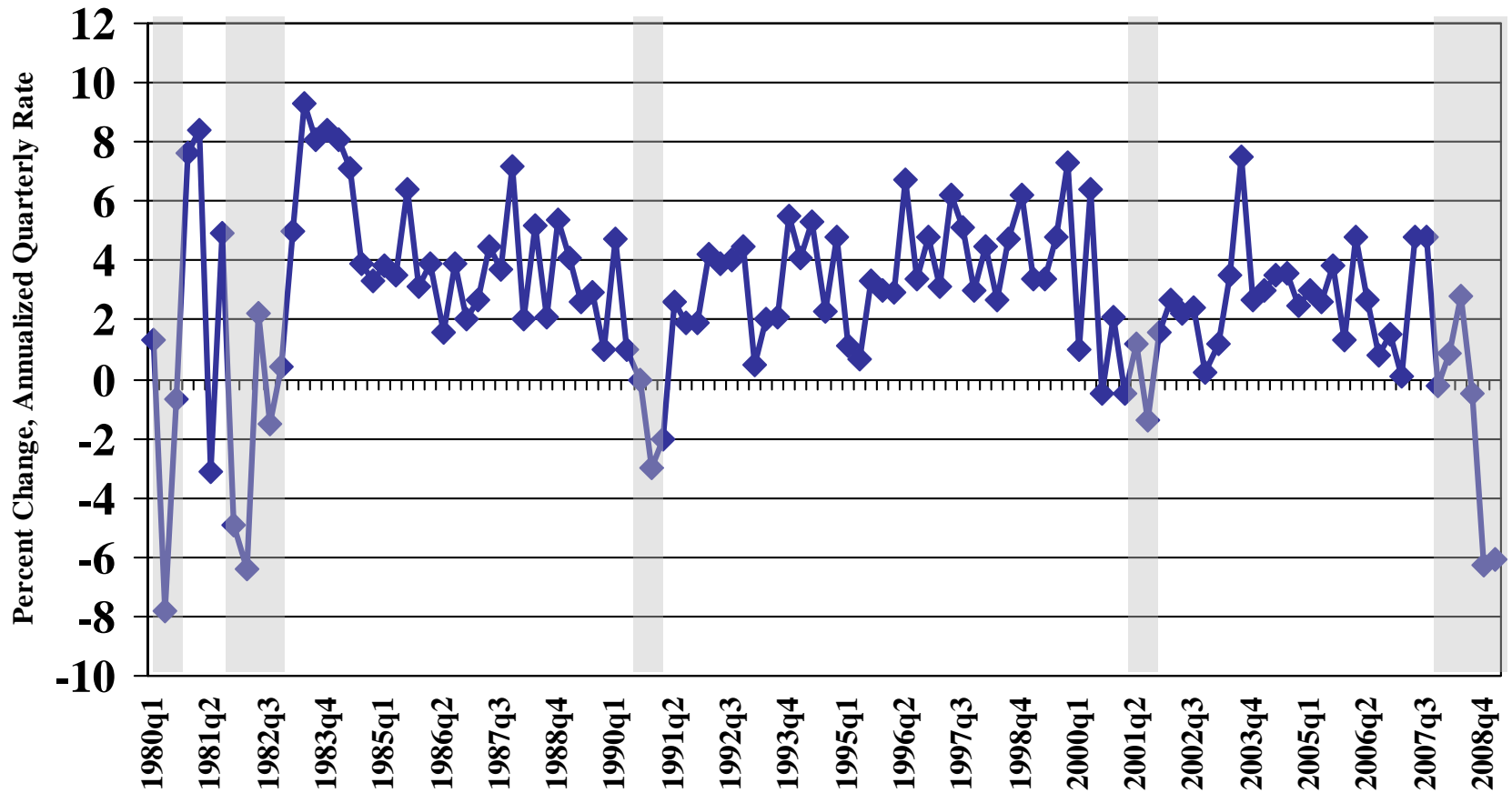
- Prices don't always decline (California, LA, 2001-2002)
- Shortest recovery after decline—2 quarters (San Francisco 2001-2002)
- Longest recovery after decline—10 years (Los Angeles, 1990-2000)

Source: FCREUE from OFHEO data.

# Economic Consequences

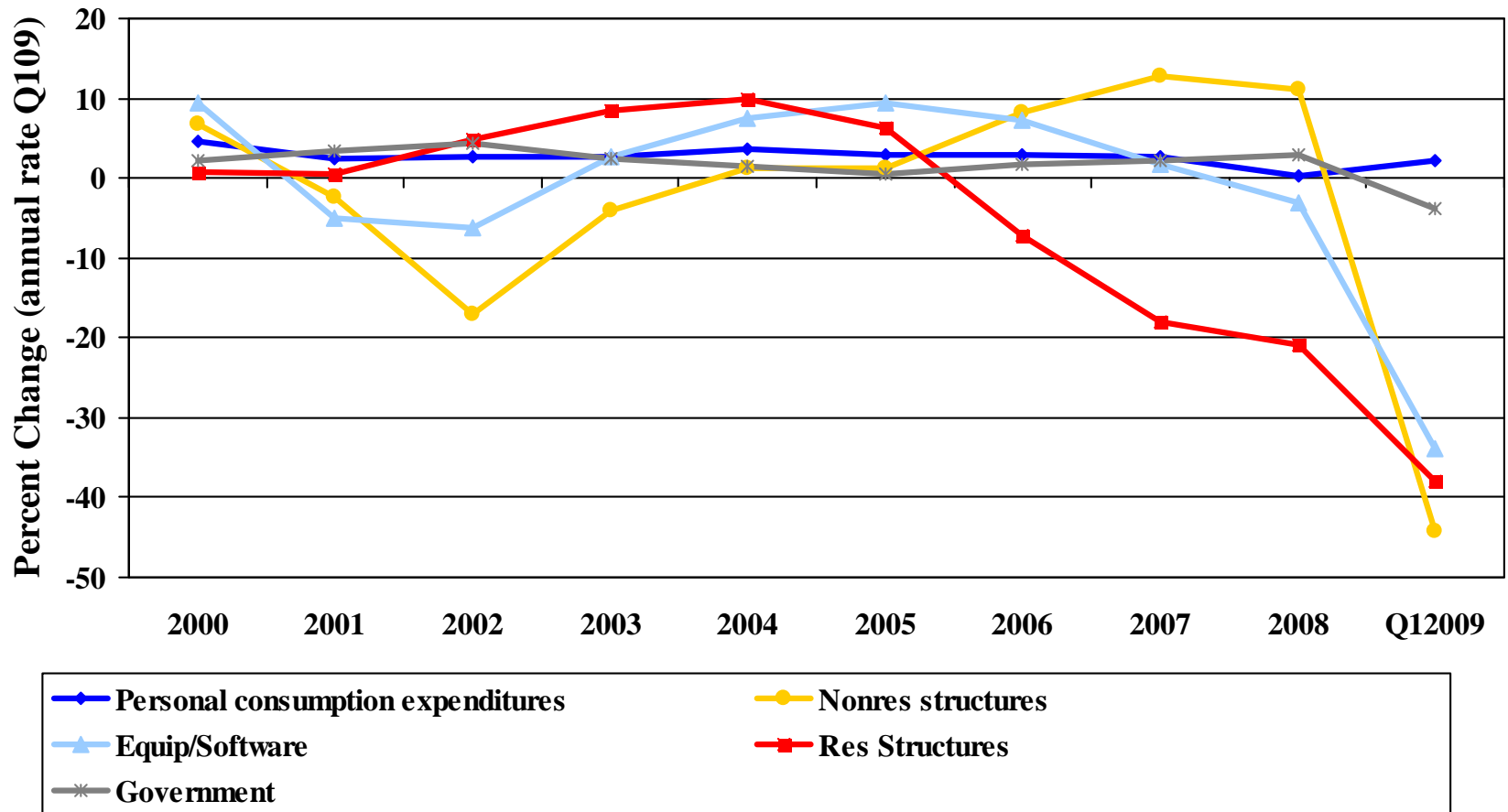
- National output and employment decline
- Broad impacts across California's economy
- Uneven impacts geographically
- Interrelationships between building activity and recovery

# US GDP Growth, 1980-2008 Quarterly % Change – Chained 2000 Dollars



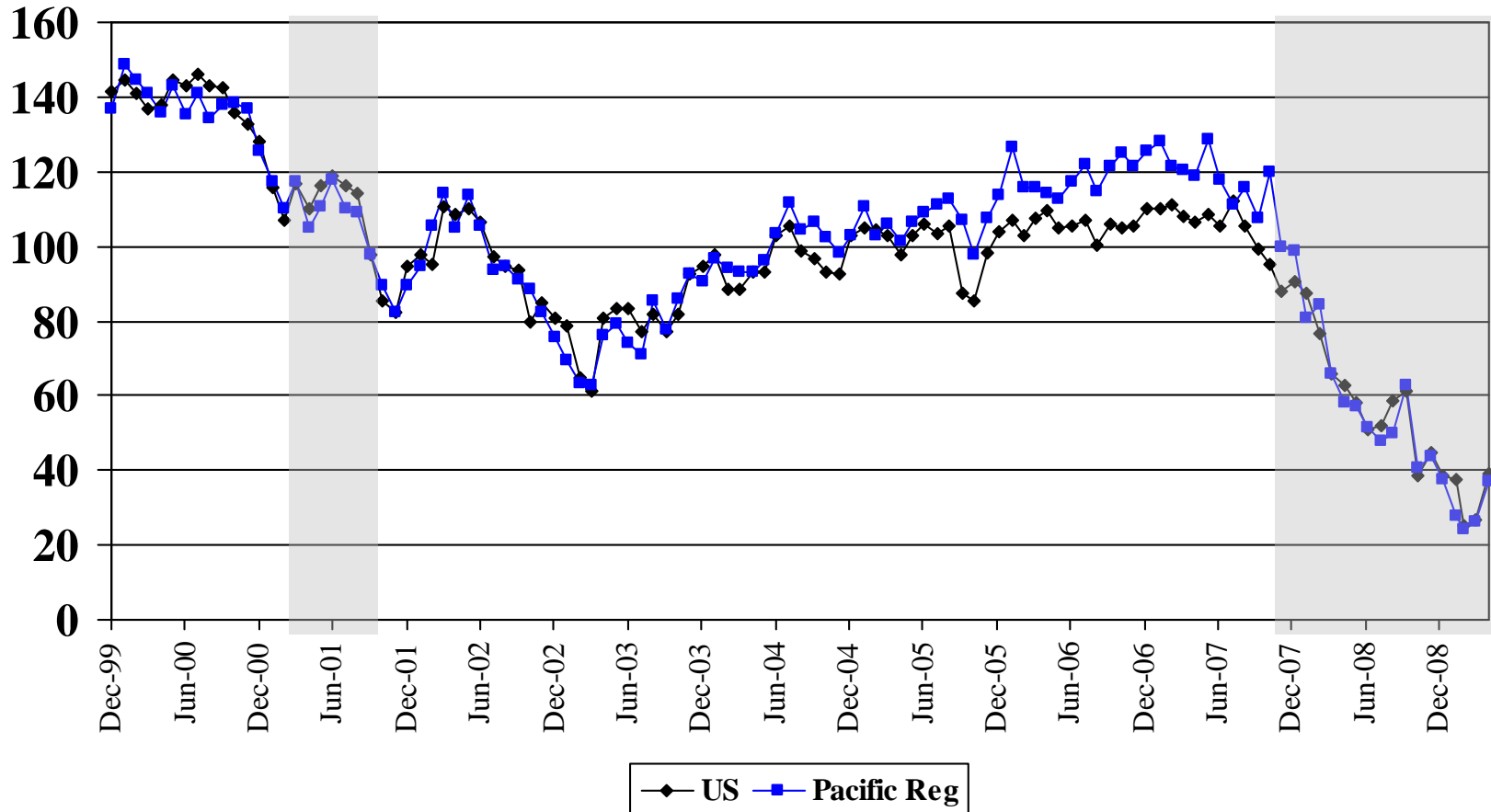
Source: US Bureau of Economic Analysis, April 2009.

# GDP Change by Category



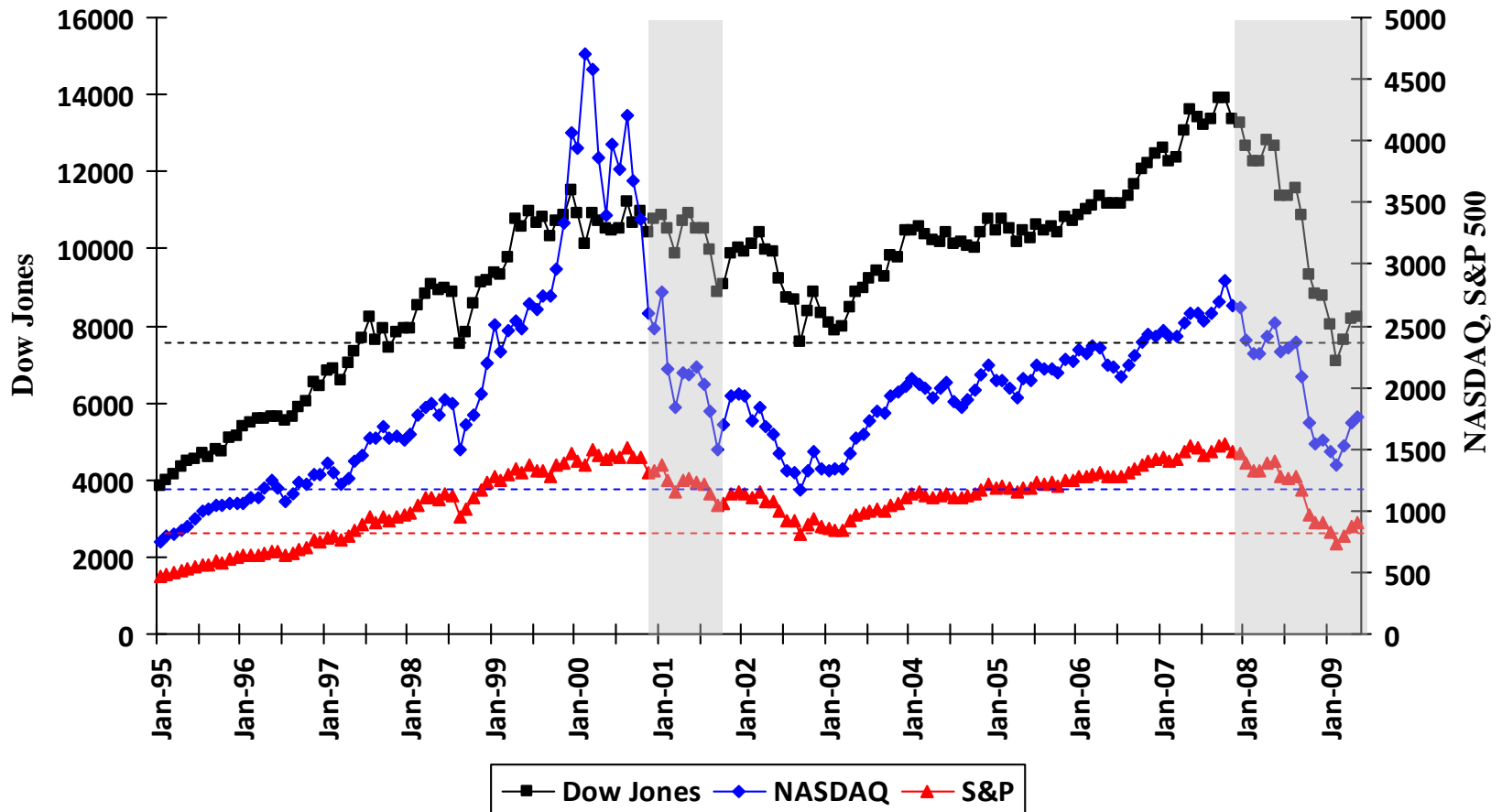
Source: FCREUE from US Bureau of Economic Analysis data.

# Weak Consumer Confidence



Source: Conference Board Consumer Confidence Survey.

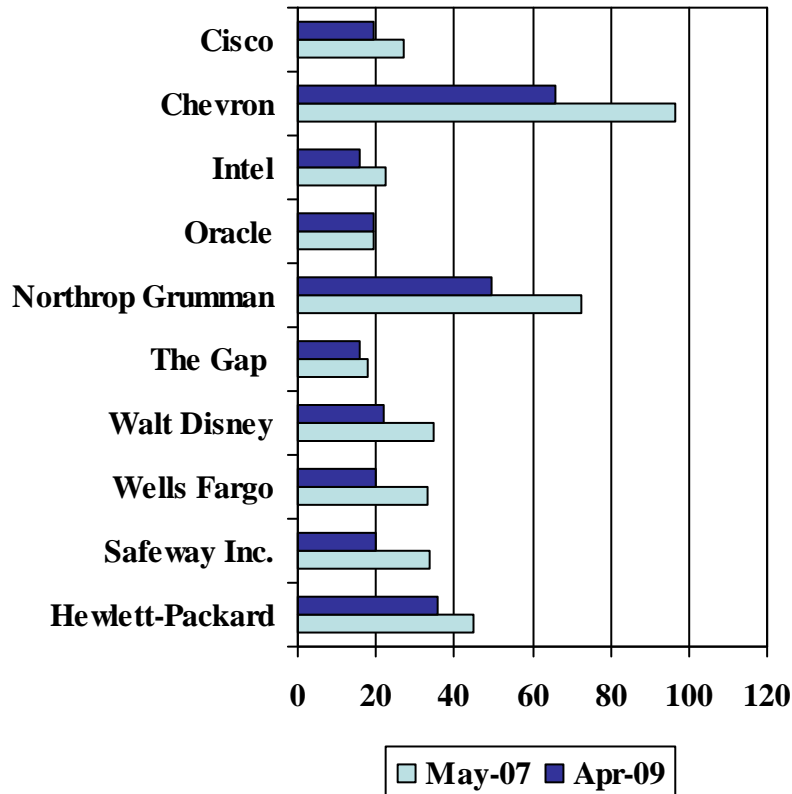
# Slide in Stock Values



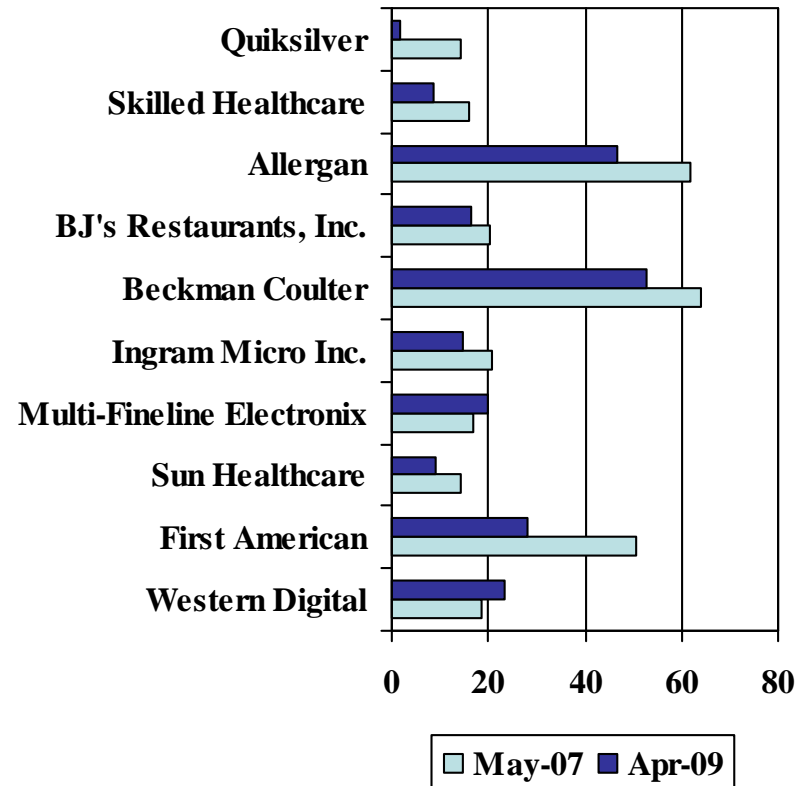
Source: finance.yahoo.com

# Stock Values, Largest California and Orange County Public Companies (by Employees)

**California**



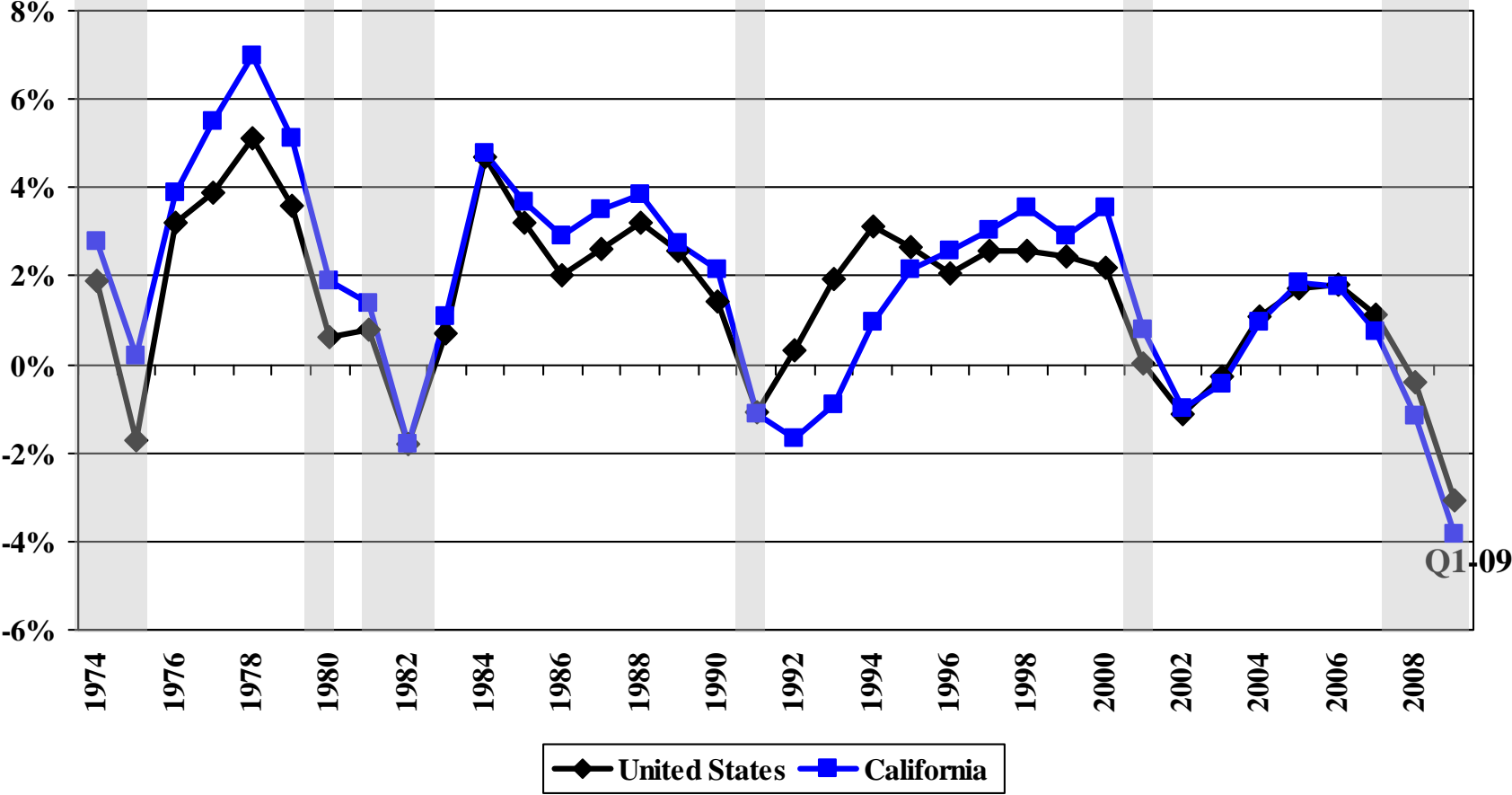
**Orange County**



Source: Onesource database; finance.yahoo.com

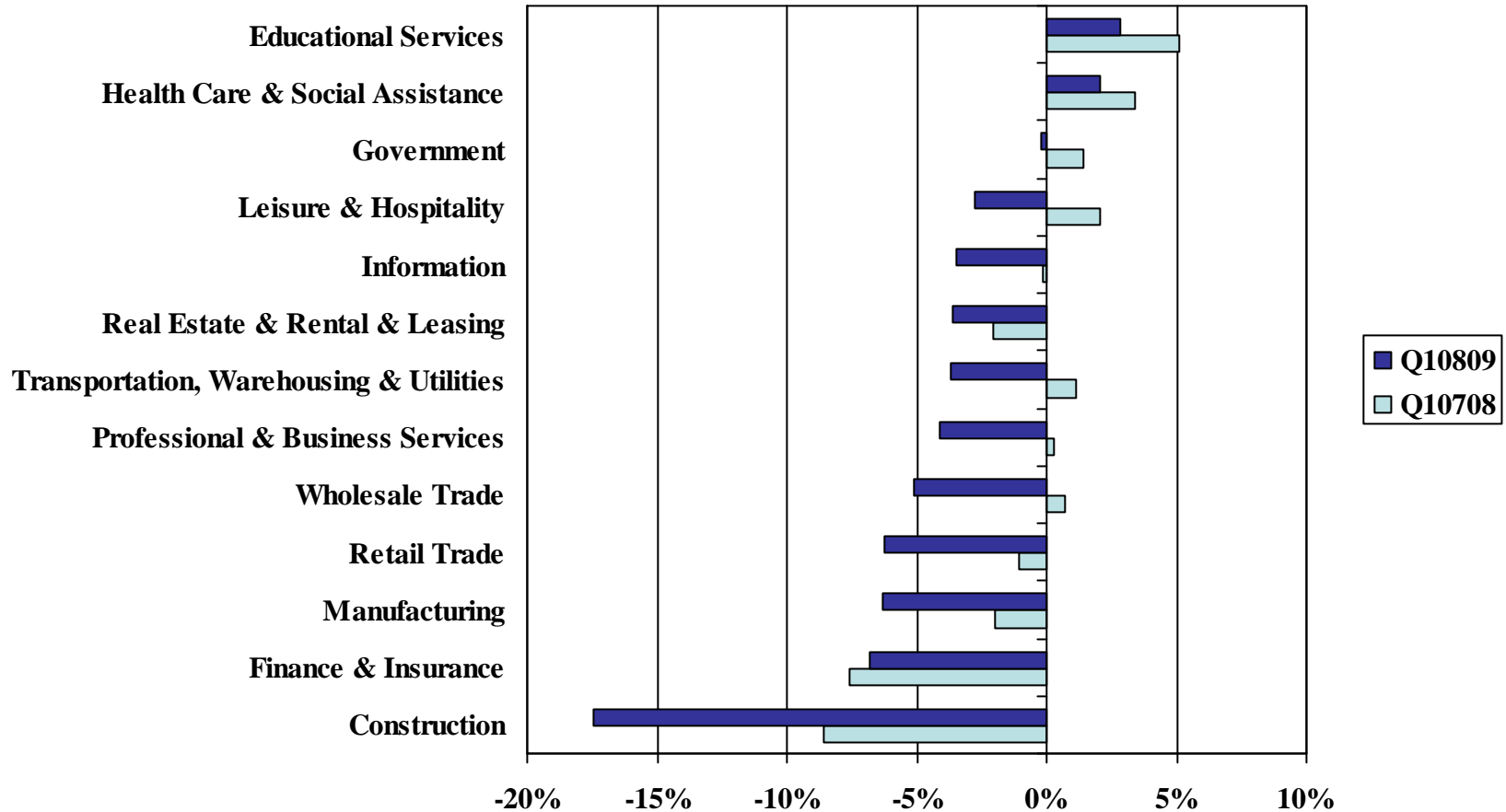
# California and US Employment Rate of Change

## 1974-2008, and Q1-2009



Source: FCREUE from California Employment Development Department and US BLS data.

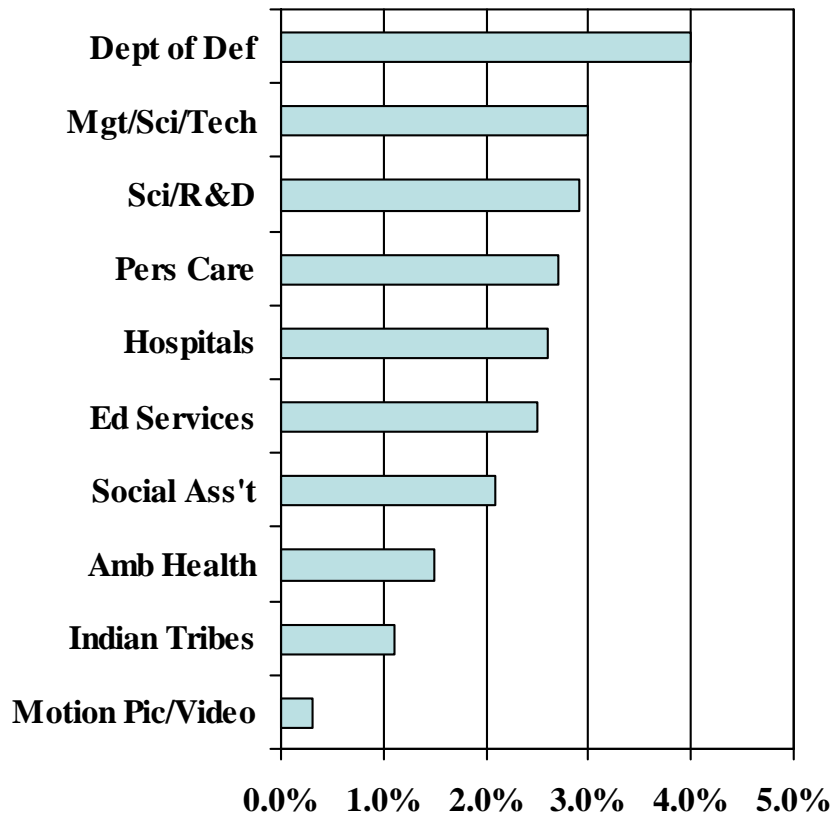
# Employment Change by Major Sector Annual Rate, Q107-Q108, Q108-Q109



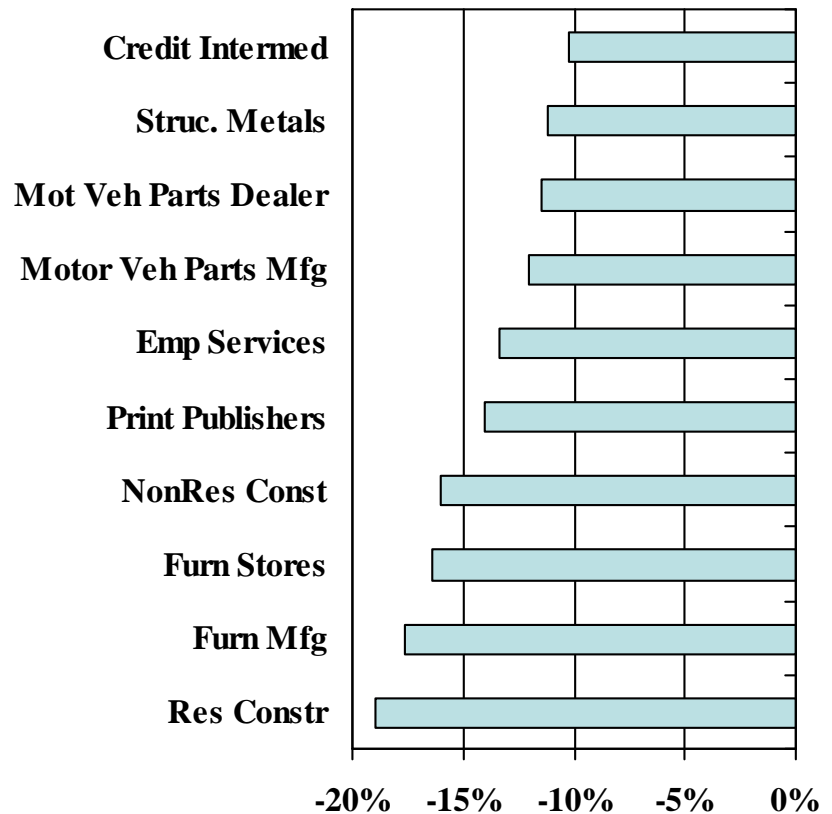
Source: FCREUE from California Employment Development Department.

# Strongest and Weakest California Sectors Change in Employment Q107 to Q108

**Strongest**

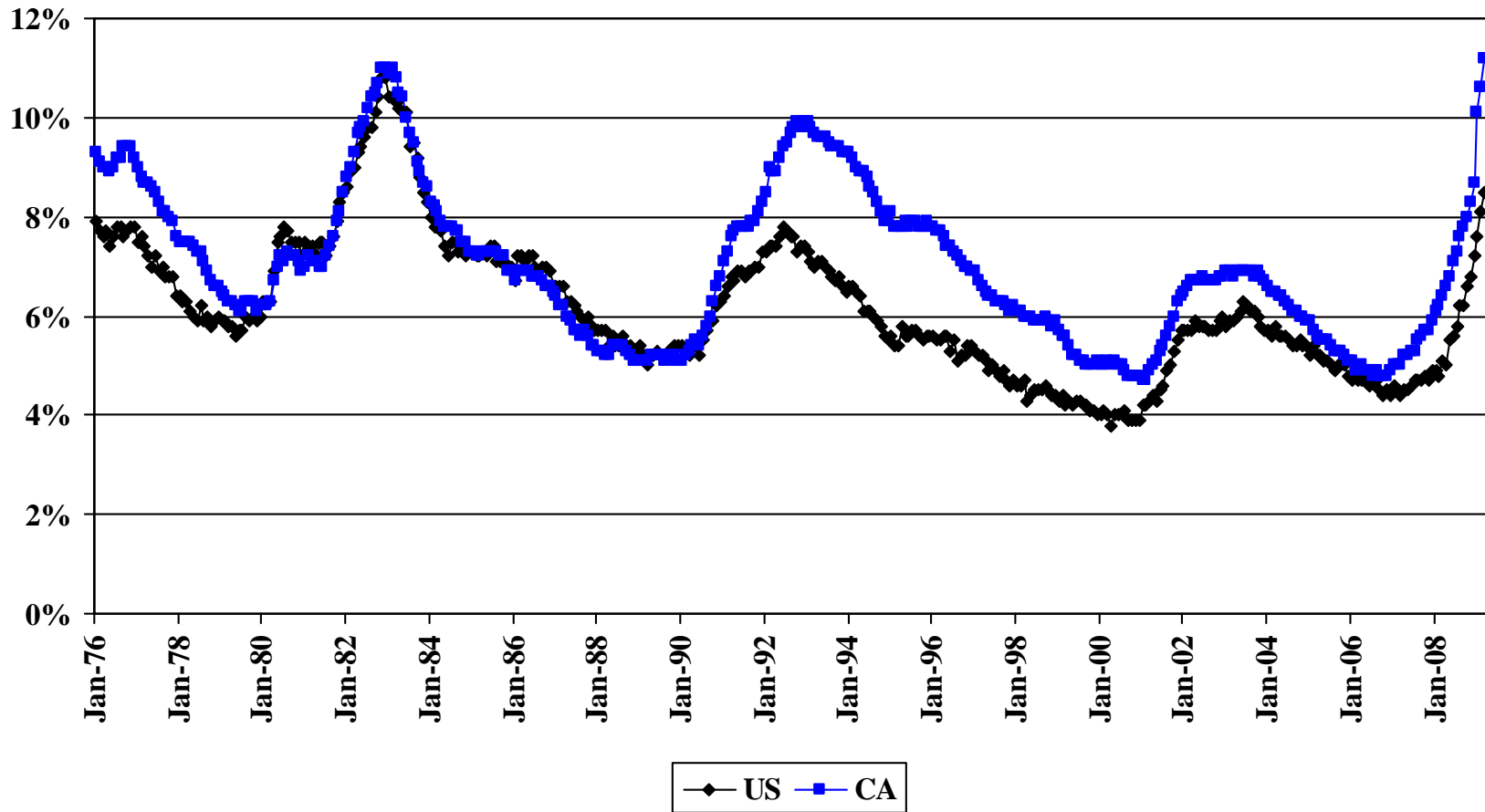


**Weakest**



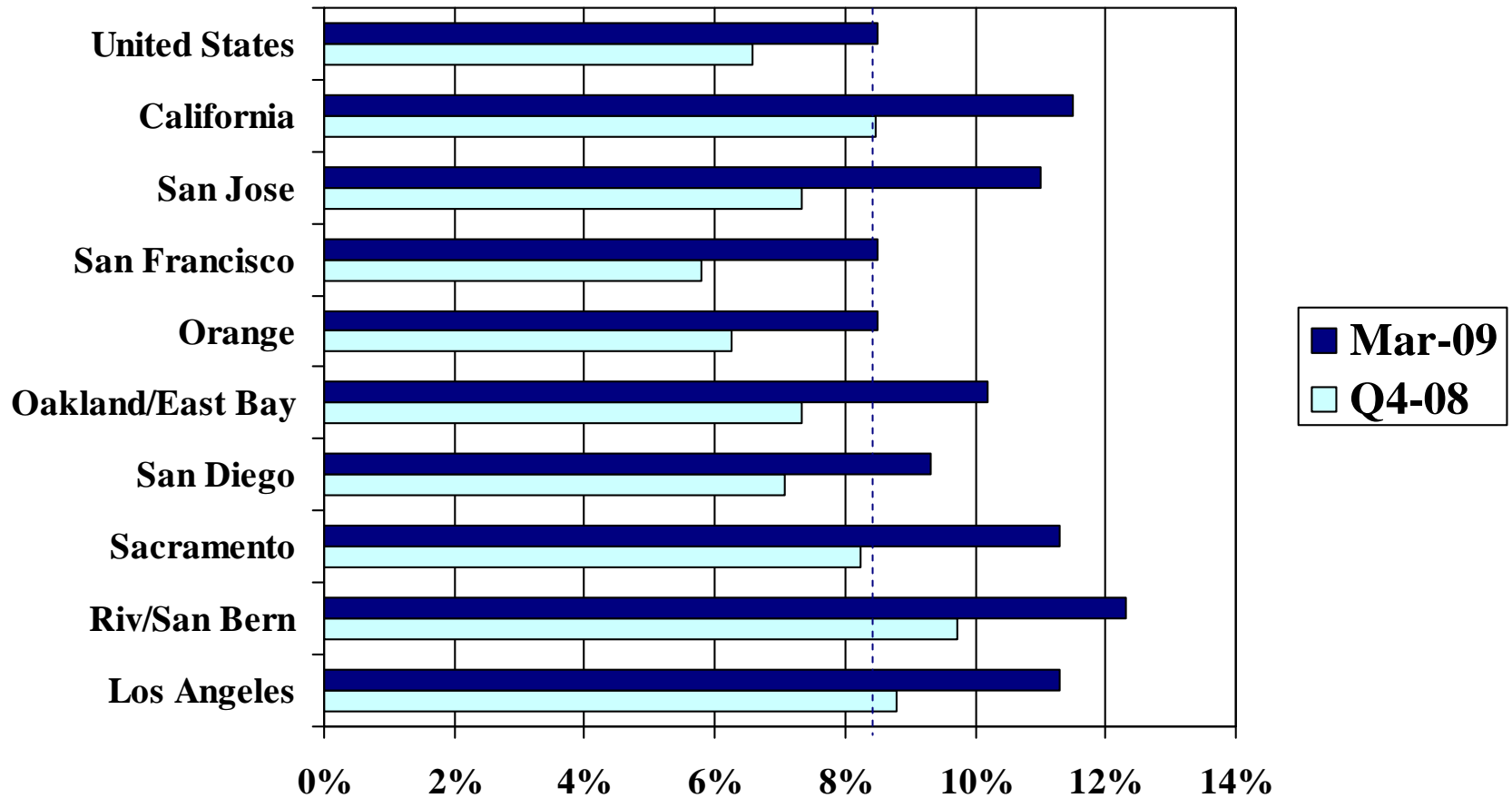
Source: FCREUE from California Employment Development Department.

# California and US Unemployment Rates



Source: FCREUE from California Employment Development Department and US BLS data.

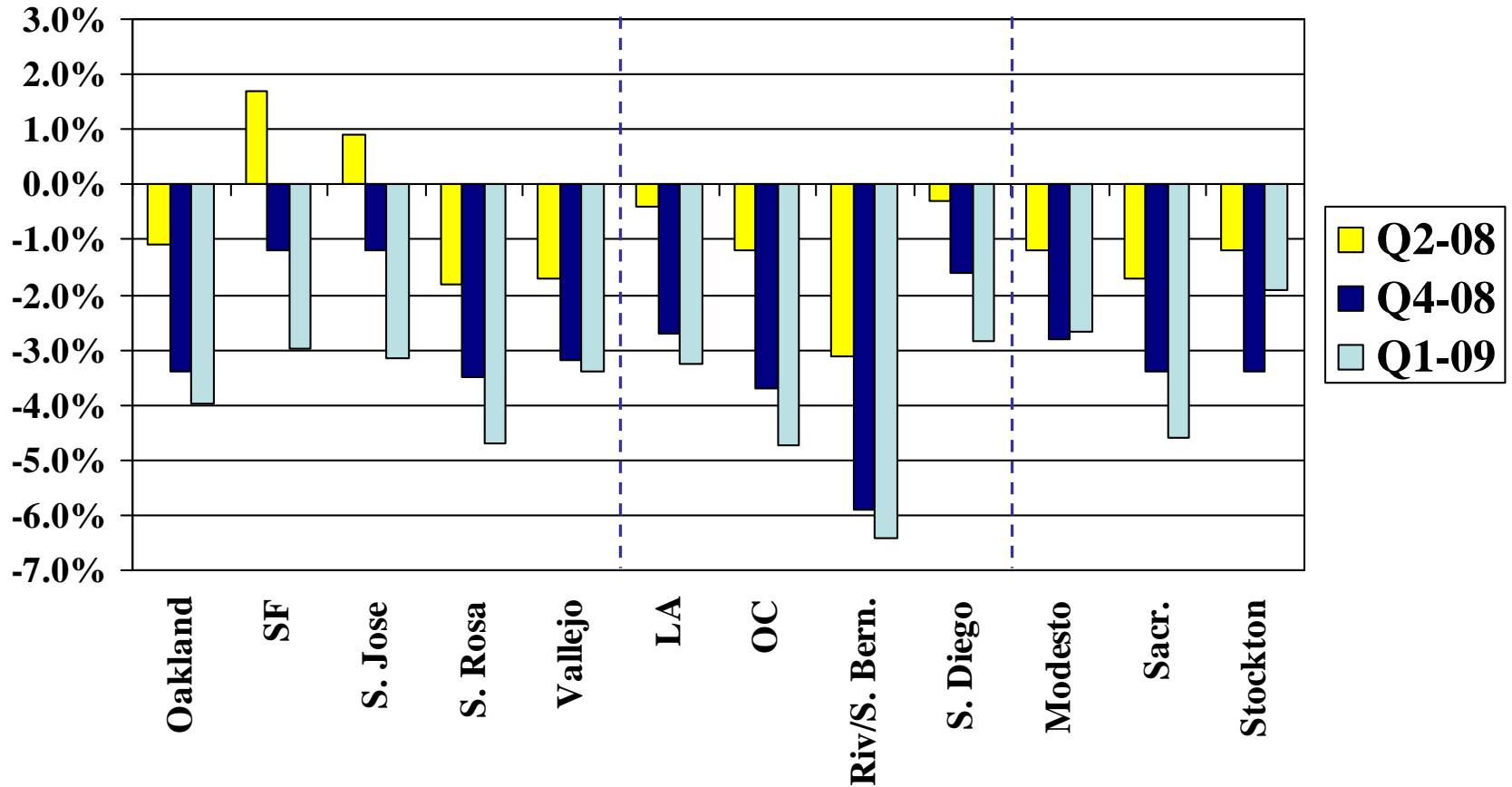
# Unemployment by California MSA



Source: FCREUE from California Employment Development Department data.

# Employment Change, California Metro Areas

-3.6%/-550,000 Jobs Statewide  
Q2 and Q4 2008, Q1 2009 (Annual ROC)



Source: FCREUE from California Employment Development Department data.

# Fastest Growing Employment Sectors

San Francisco		
Sector	Q1 2009 Employment	Q108- Q109 Ch
Computer Syst Design	32,400	6.2%
Social Assistance	18,833	2.5%
Ambulatory Health Care	26,200	2.5%
Arts, Enter., Recreation	18,000	1.5%
Educational Services	26,000	1.4%

Orange County		
Sector	Q1 2009 Employment	Q108- Q109 Ch
Nursing/ Resid. Care	20,867	8.3%
State Gov. Education	19,033	4.4%
Social Assistance	14,667	3.5%
Hospitals	32,567	3.3%
Wholesale Electronics	14,767	2.8%

Source: FCREUE from California Employment Development Department data.

# Prospects for Job Recovery

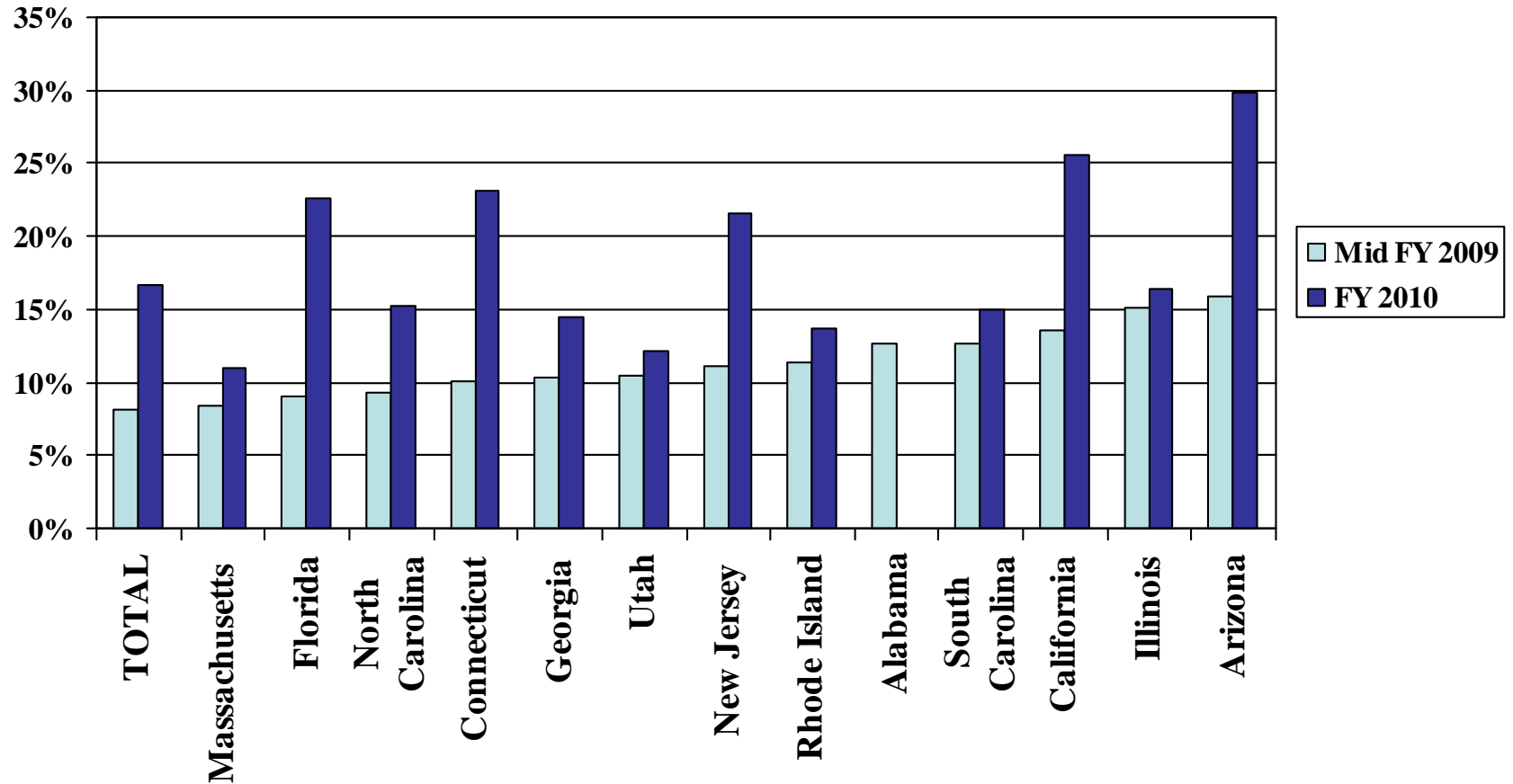
- Will lag turnaround in output
- Building activity will need credit access, reduced inventory, sustained *owner-occupant* interest to revive
- High-cost state issues remain (labor costs, housing costs influence types of jobs that expand) => 2 tiered growth.
- Potential remains from areas of innovation

# Public Sector

- California is not alone—many states and local governments face deficits
- State revenues declining or growing more slowly than expected
- State expenditures lack flexibility
- Local government sources heavily affected
- Local government long term salary commitments
- Impacts, responses vary widely among places

# States with High 2008-09/2009-10 Deficits

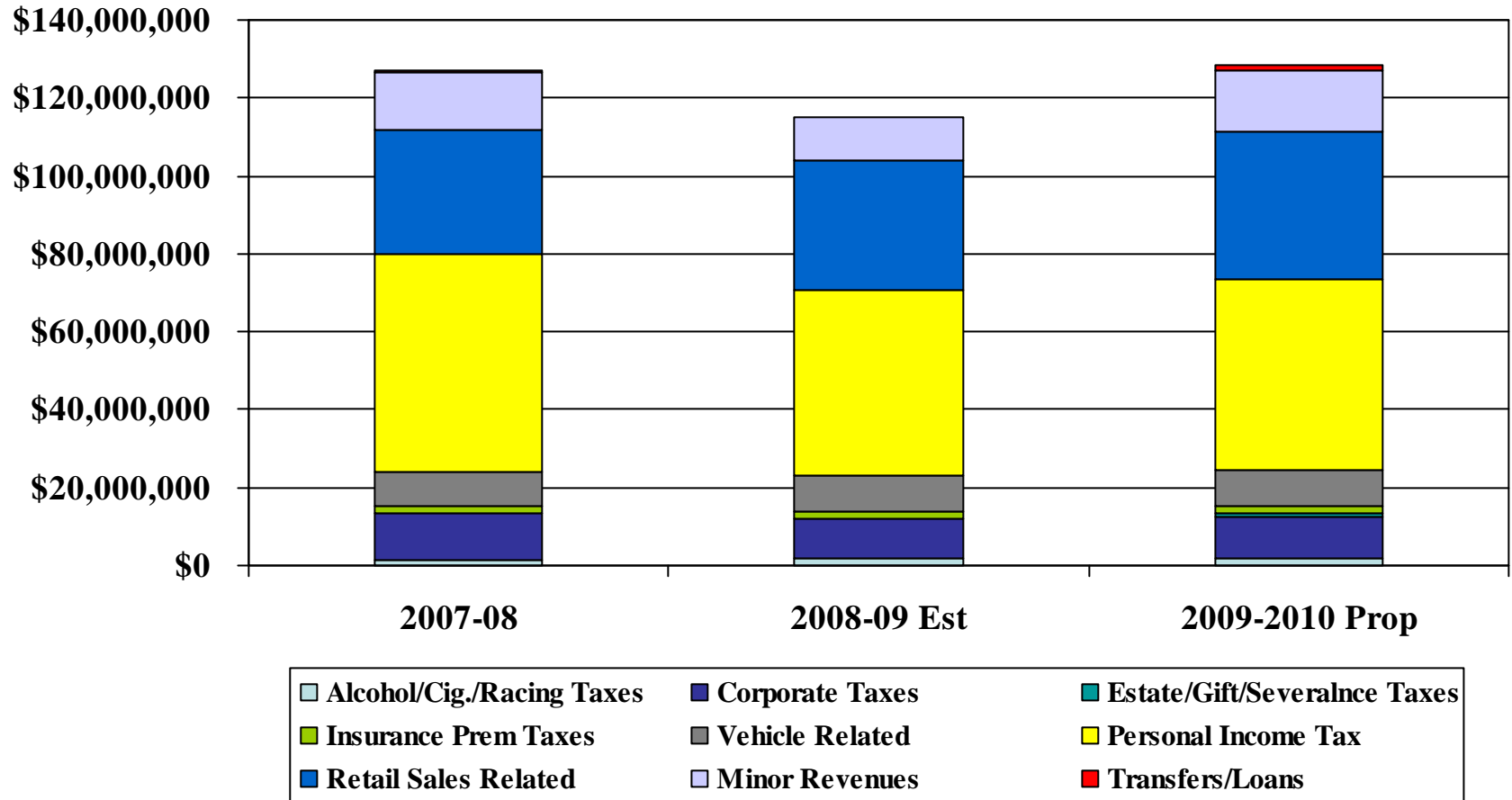
## Shortfall as Percent of 2009FY General Fund



Source: Center on Budget and Policy Priorities; <http://www.cbpp.org/cms/index.cfm?fa=view&id=711>

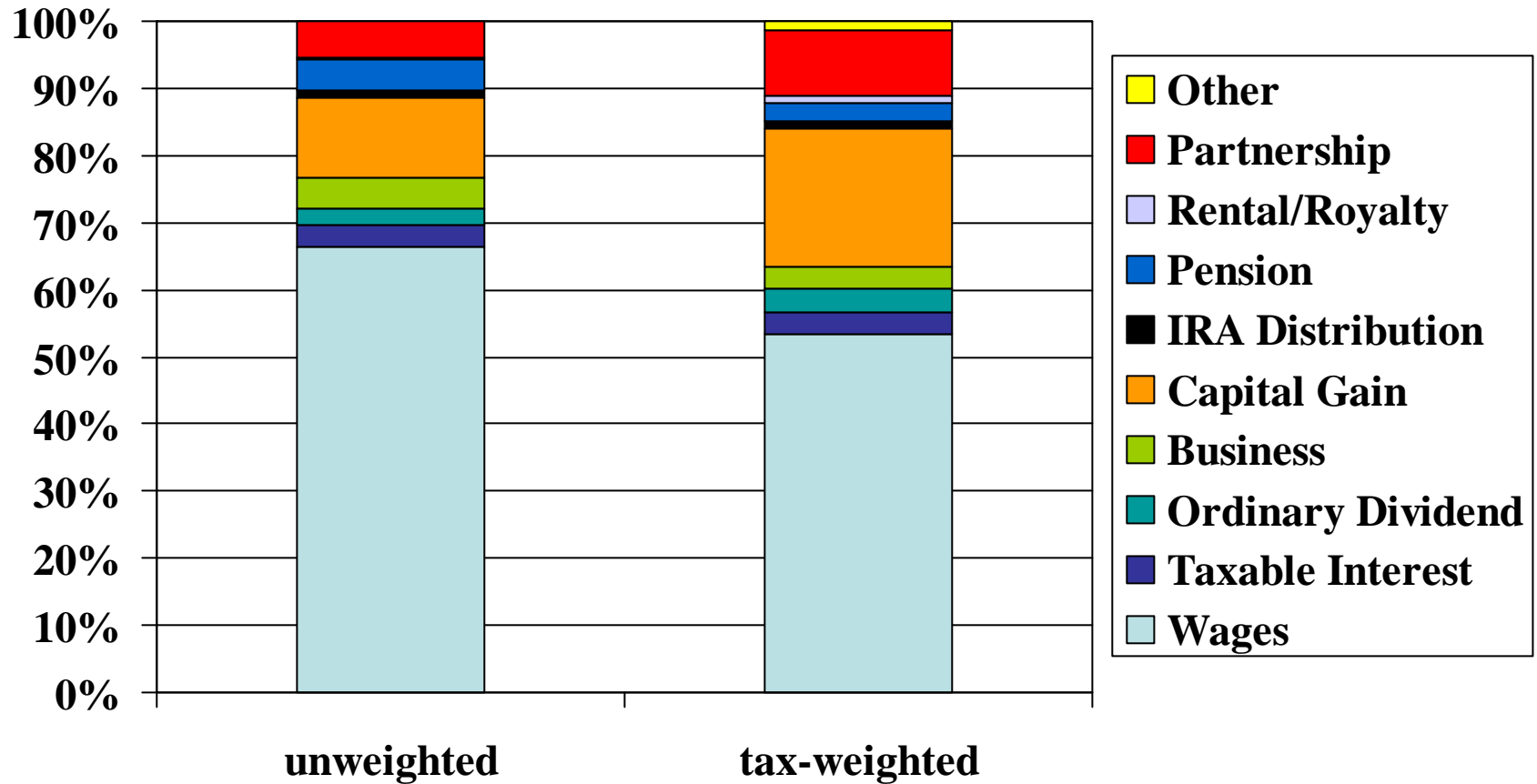
# California Revenue Sources, 2007-08, 2008-09 Estimated, and 2009-2010 Proposed

(Thousands)



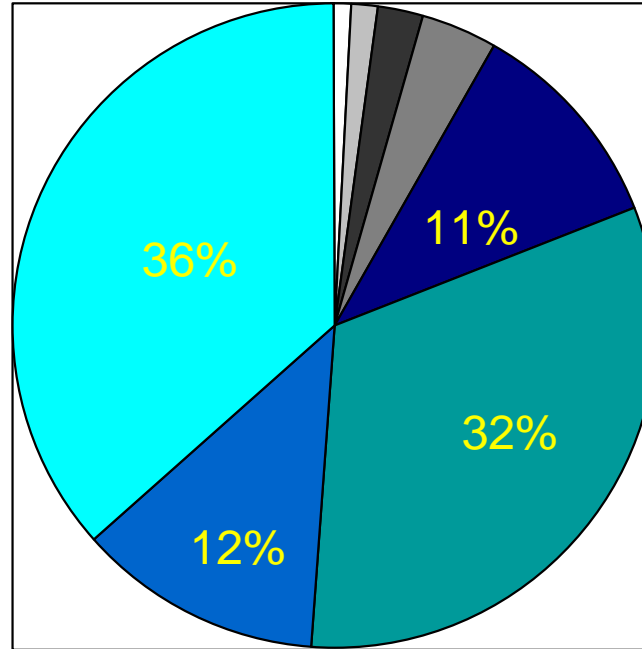
Source: FCREUE from California Department of Finance schedule 8 comparative statement of revenues.

# Personal Income by Source, 2006



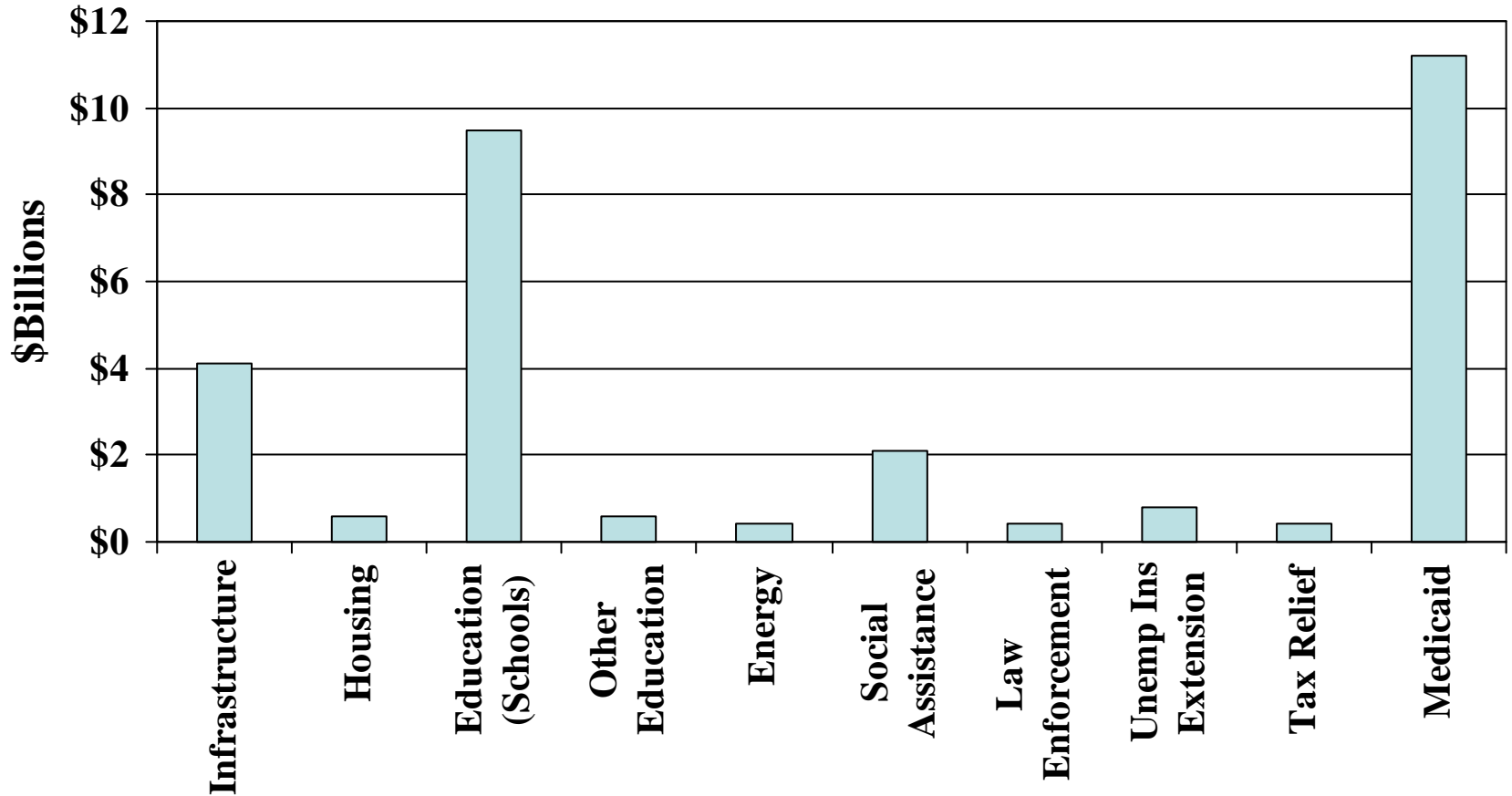
Source: Franchise Tax Board

# Distribution of General Fund Expenditures 2008-2009 Revised Budget



- |   |   |
|---|---|
| <input type="checkbox"/> Other                          | <input type="checkbox"/> Business, Transportation & Housing |
| <input type="checkbox"/> Resources & Environment        | <input type="checkbox"/> Legislative, Judicial, Executive   |
| <input type="checkbox"/> Corrections and Rehabilitation | <input type="checkbox"/> Health and Human Services          |
| <input type="checkbox"/> Higher Education               | <input type="checkbox"/> K-12 Education                     |

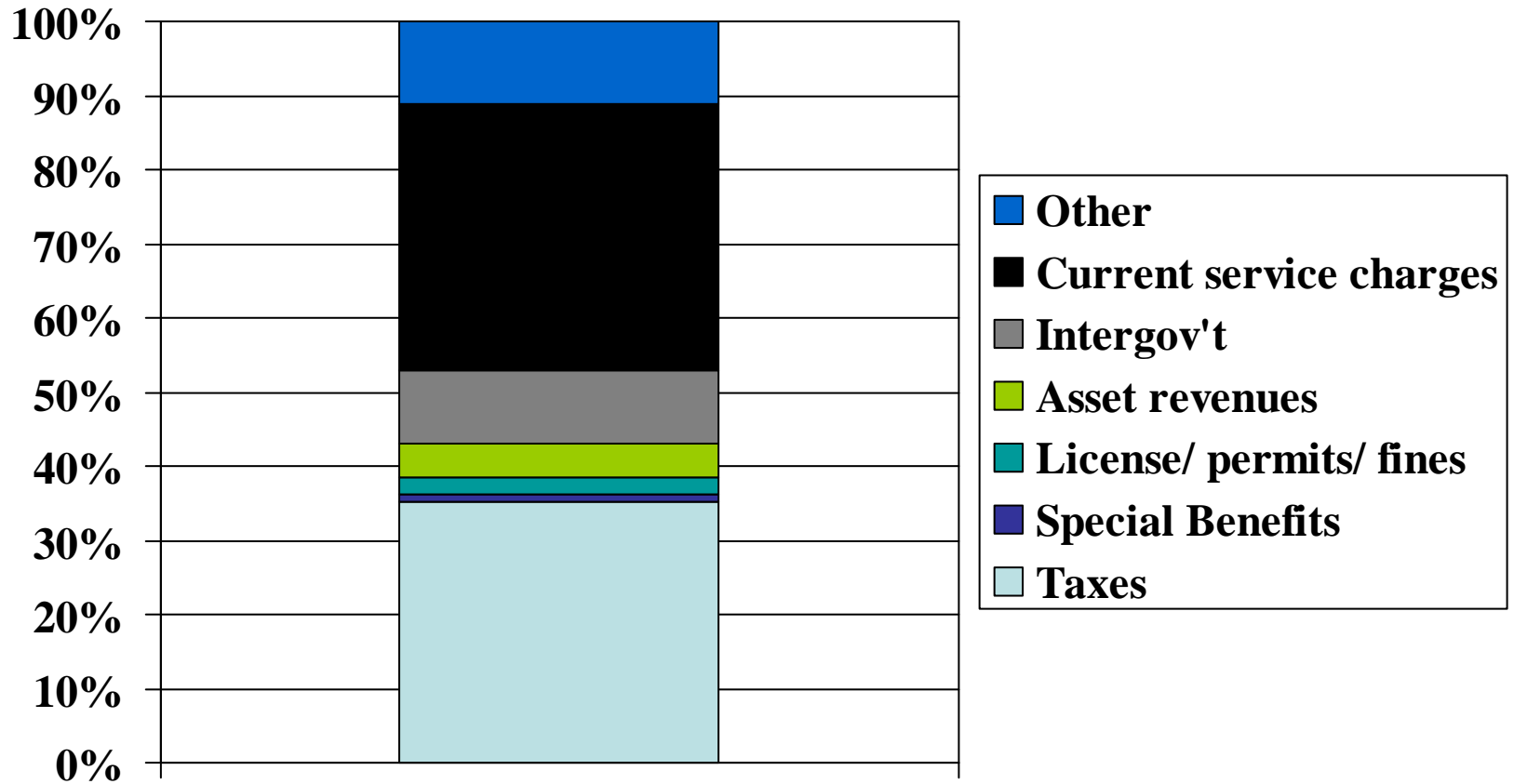
# California's ARRA Stimulus Estimates (February 2009)



Source: FCREUE from California Green Collar Jobs Council summary.

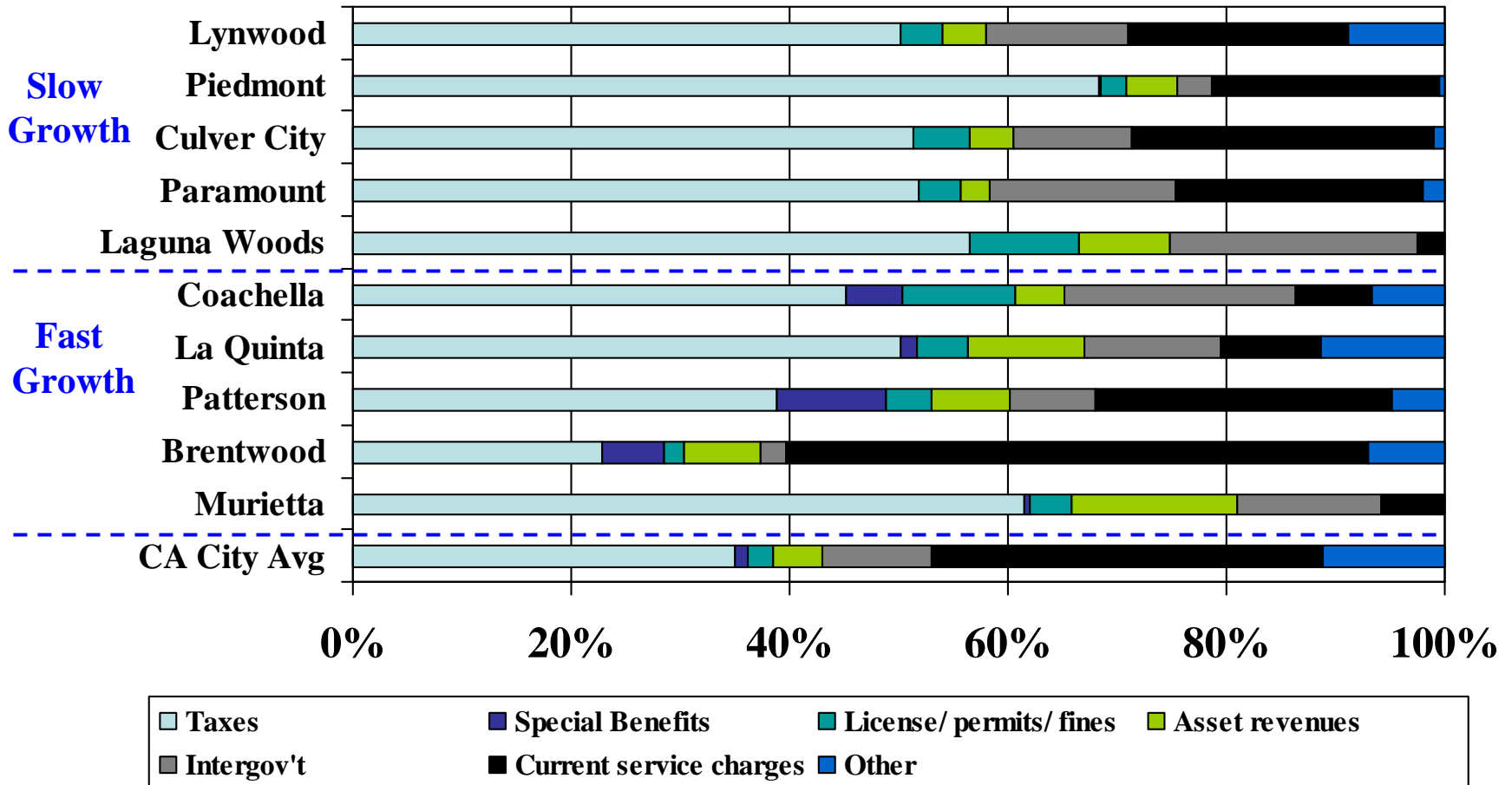
# Major Sources of California City Revenues

## FY 2006-07



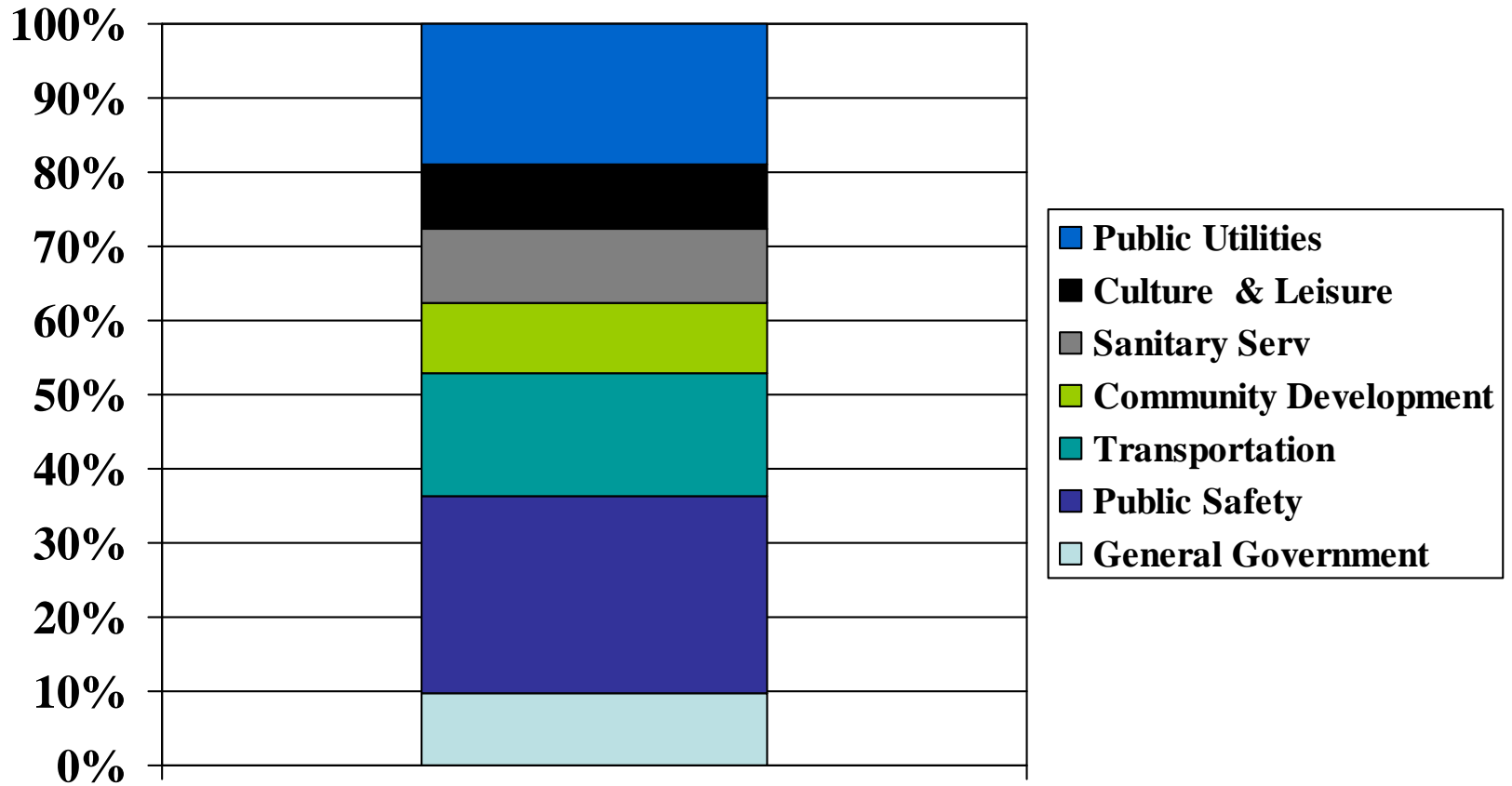
Source: FCREUE from California State Controller, Cities Annual Report FY 2006-07.

# City Revenue Dependence on Taxes and Service Fees



Source: FCREUE from California State Controller, Cities Annual Report FY 2006-07.

# Major City Expenditure Categories



Source: FCREUE from California State Controller, Cities Annual Report FY 2006-07.

# Where Will the Pain Be Felt?

- Growing demand for unemployment-related social services
- Belt-tightening in schools
- Cut-backs in basic city services
- Degree of local shortfall determined by:
  - How earlier surplus was budgeted
  - Long term commitments/entitlements to increases
  - Alternative income sources

# Where Will the Help Come From? Is it Enough?

- Federal responses
  - Stabilizing financial system
  - Stabilizing the housing market
  - State and local government stimulus
- State and local responses
  - California disfunctional budgeting process
  - Budget cuts?
    - State: Furloughs, overtime status
    - Local: layoffs, privatization, service cuts
  - Revenue increases?
    - Sales Tax
    - License fees
    - Borrowing
    - Stimulus
  - Government reform

# The Future—Key Directions and Concerns

- Real Estate
  - Will the home price gap narrow?
  - Where will building revive?
  - Impacts of SB375 on future growth?
- Economy
  - Recovery job growth trajectory?
  - Increasing bifurcation of jobs?
  - Riding a new wave of innovation?
- Public Sector
  - Solution to budgeting issues—constitutional reform?
  - Maintenance/improvement of knowledge infrastructure
  - Physical infrastructure investment