

Subprime Fallout: The Changing California Real Estate Market and Economy

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Subprime Fallout: The Changing California Real Estate Market and Economy

- Brief intro to the subprime mess
- Major components in California
 - Vulnerability
 - Housing Market Effects
 - Other consequences—employment, public sector
- Can it be fixed? Should it be fixed?

Why Housing Prices Kept Going Up—and why the market turned

- Fed low interest rate policy
- Investors seeking higher returns—by accepting higher risk
- Liberalized credit policies created new loan products and brought in new borrowers/homebuyers
- Creative securitization products kept \$\$\$ available
- “Hot” homebuying market kept prices rising; borrowers saw little risk in taking on more debt; speculation increased
- Rate adjustments on loans began to challenge buyers; higher rates reduced the number of potential buyers; prices began to level off; reduced ability of borrowers to sell their way out of the problem; defaults and foreclosures began to rise; market for securities backed by loans dried up.

The Subprime Crisis at the National Level

- Subprime exposure
 - 12% of all loans outstanding subprime
 - 25% of subprime loans in default (60+ days), 11% in foreclosure
- Mortgage market feedback
 - Narrower band of eligible borrowers
 - Higher spreads for alternatives (eg. Jumbo loans)
- Housing market impacts
 - Home Sales ↓ Existing: -31%, New: -49% from 2005 peak
 - Median existing home price ↓ 8% from 1 year ago
 - Indexed home price—Case-Shiller Q108 ↓ 15% from peak; OFHEO Q407 ↓ 8% from peak.
 - Housing starts ↓ 57% from peak.

The Subprime Crisis at the National Level

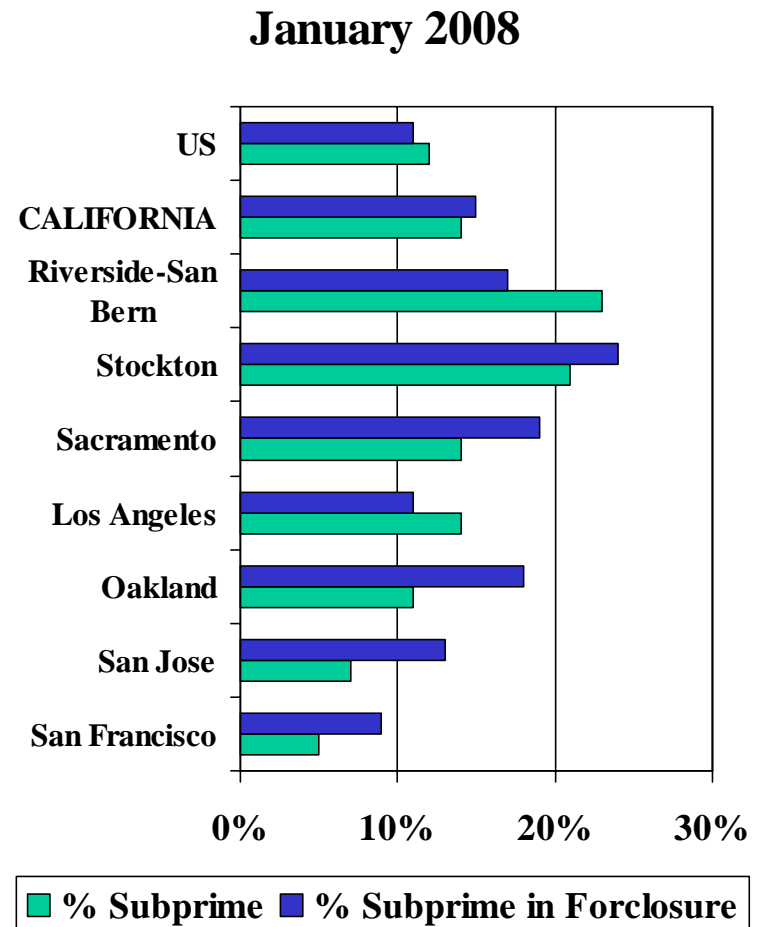
- Credit market spillover
 - Direct losses in mortgage related securities top \$200B, may reach \$400B
 - Contagion
 - Other RE related
 - Corporate
 - Public sector
- Output and employment
 - Finance and real estate related sectors
 - Other parts of the economy? Recession?

Factors and Concerns for California

- Mortgage related problems—
Vulnerability—who and where?
- Housing market effects—construction,
sales, and price effects
- Economic spillover—employment,
unemployment, investment, income
- Public sector finance—property revenues,
income and sales tax revenues, service
demand

Where has the subprime problem hit hardest?

- Varies widely among metro areas and within metro areas
- Lower cost markets
- Newer markets
- Suburban communities
- Minority, immigrant communities

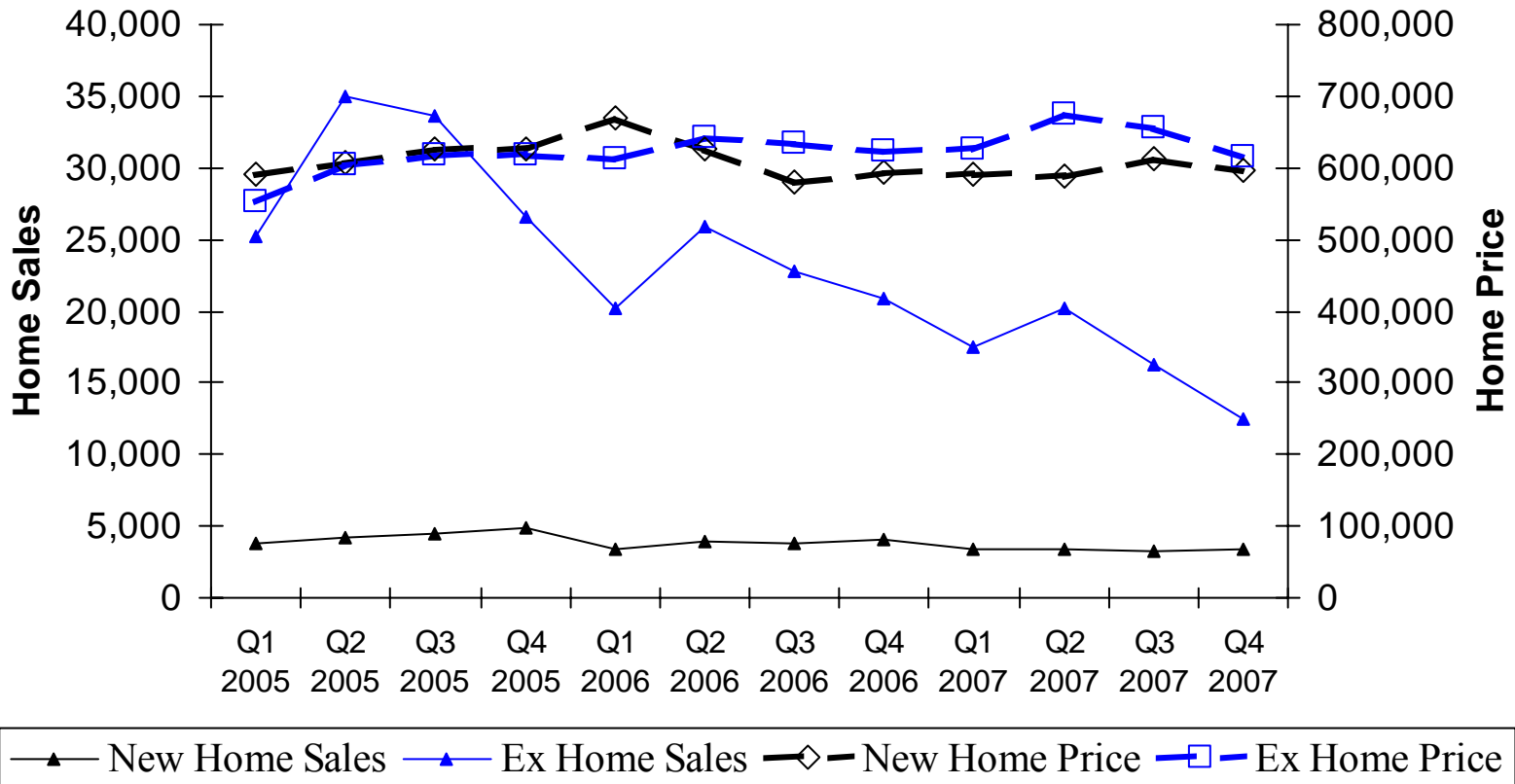


Source: First American CoreLogic, LoanPerformance data.

Housing Market Effects

- Sales activity—California home resales down 25% in past year; 50% since 2005
- Home prices—
 - Median (resale) down 29% from March 2007
 - OFHEO same home index value down 7%, Q407
 - Started at the low end, spreading to the high end
- Rents—Pressure to *increase* in short term
- Building permits down 31% in 2007 and by 47% since peak in 2004.

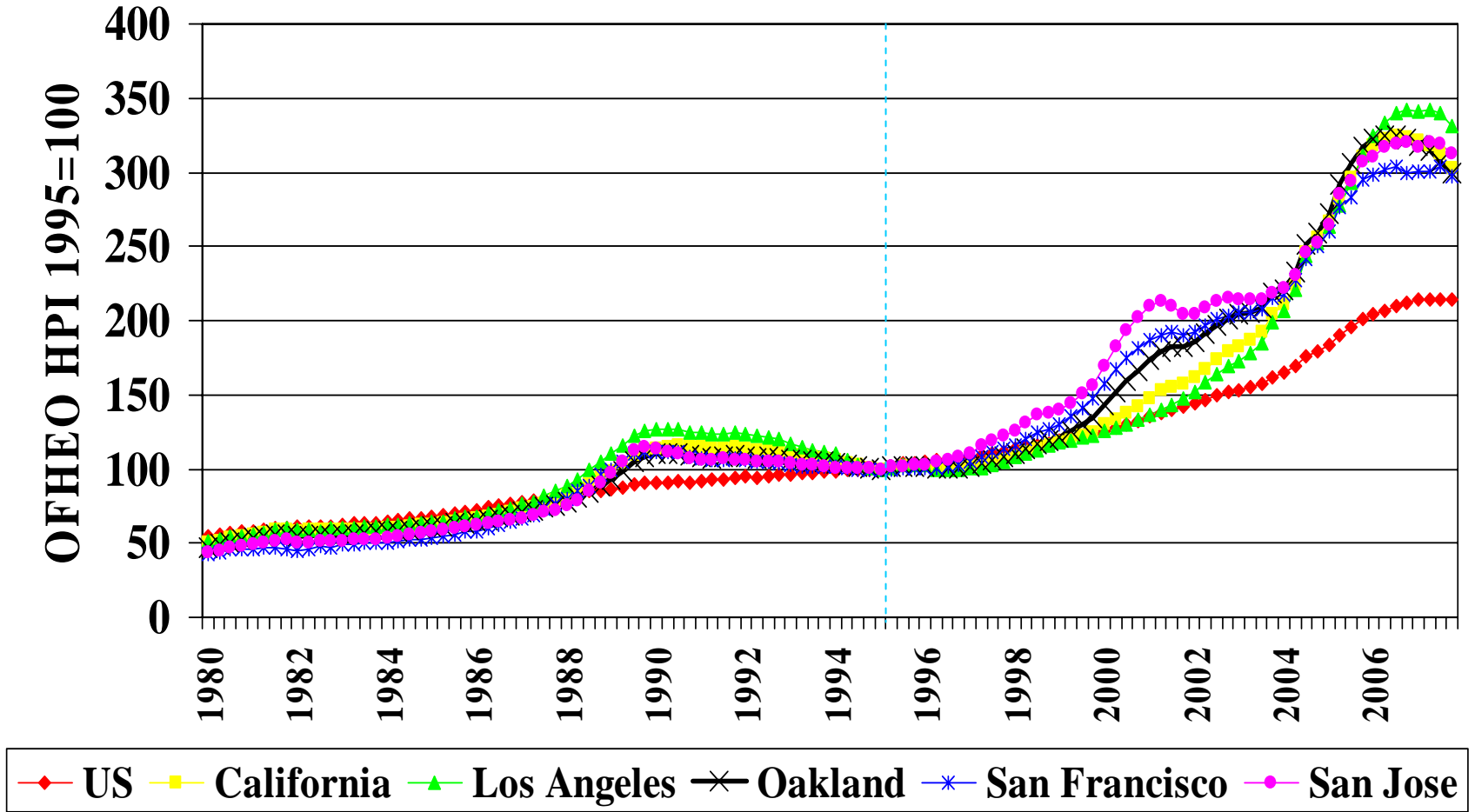
Home Sales and Price Trends, New Homes and Resale Homes, Northern California Q1 2005 – Q4 2007



Source: FCREUE from Real Estate Research Council summaries of Dataquick data.

California Historic Home Price Trends

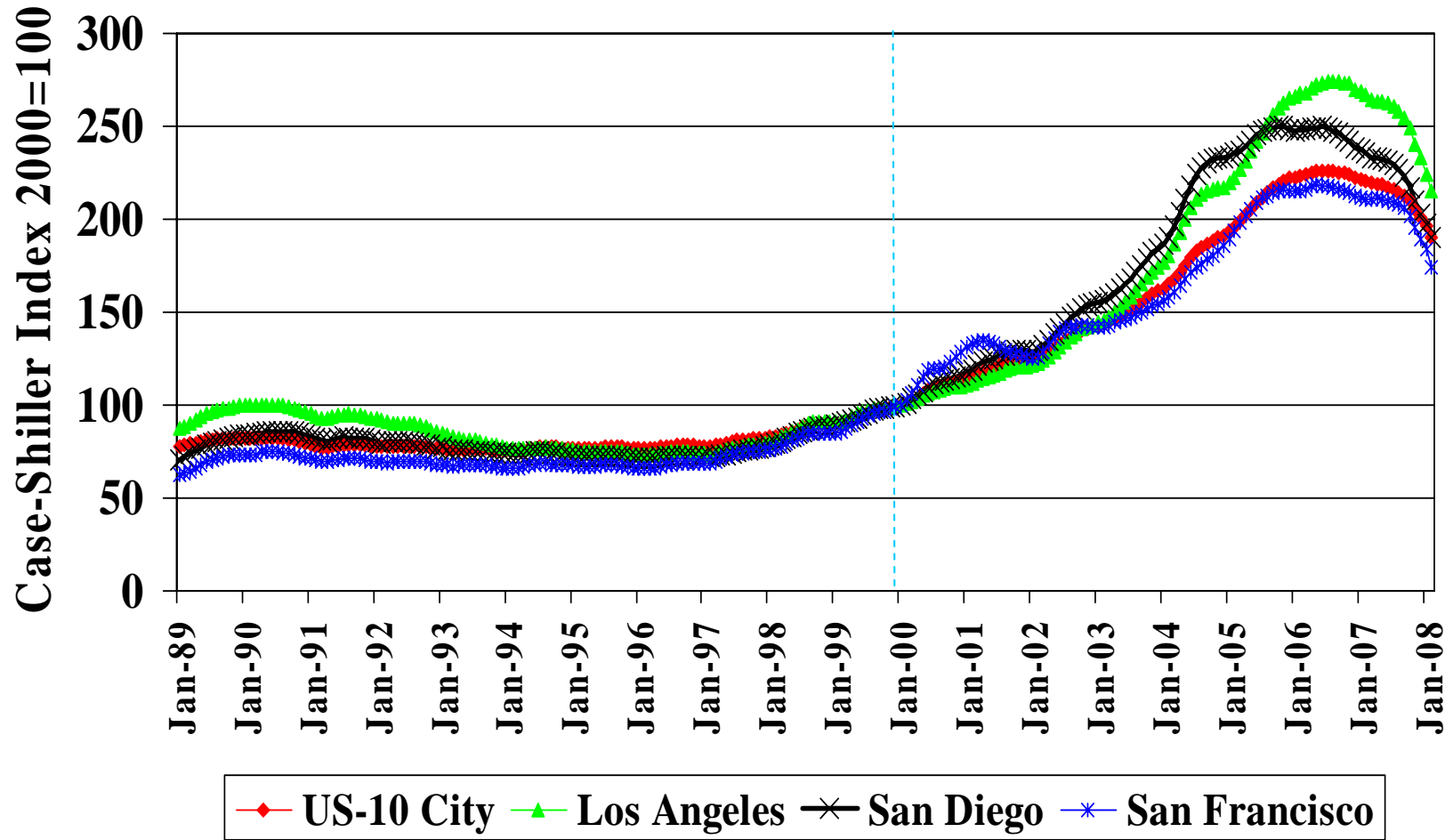
Q1-1980 to Q4- 2007



Source: FCREUE from OFHEO data.

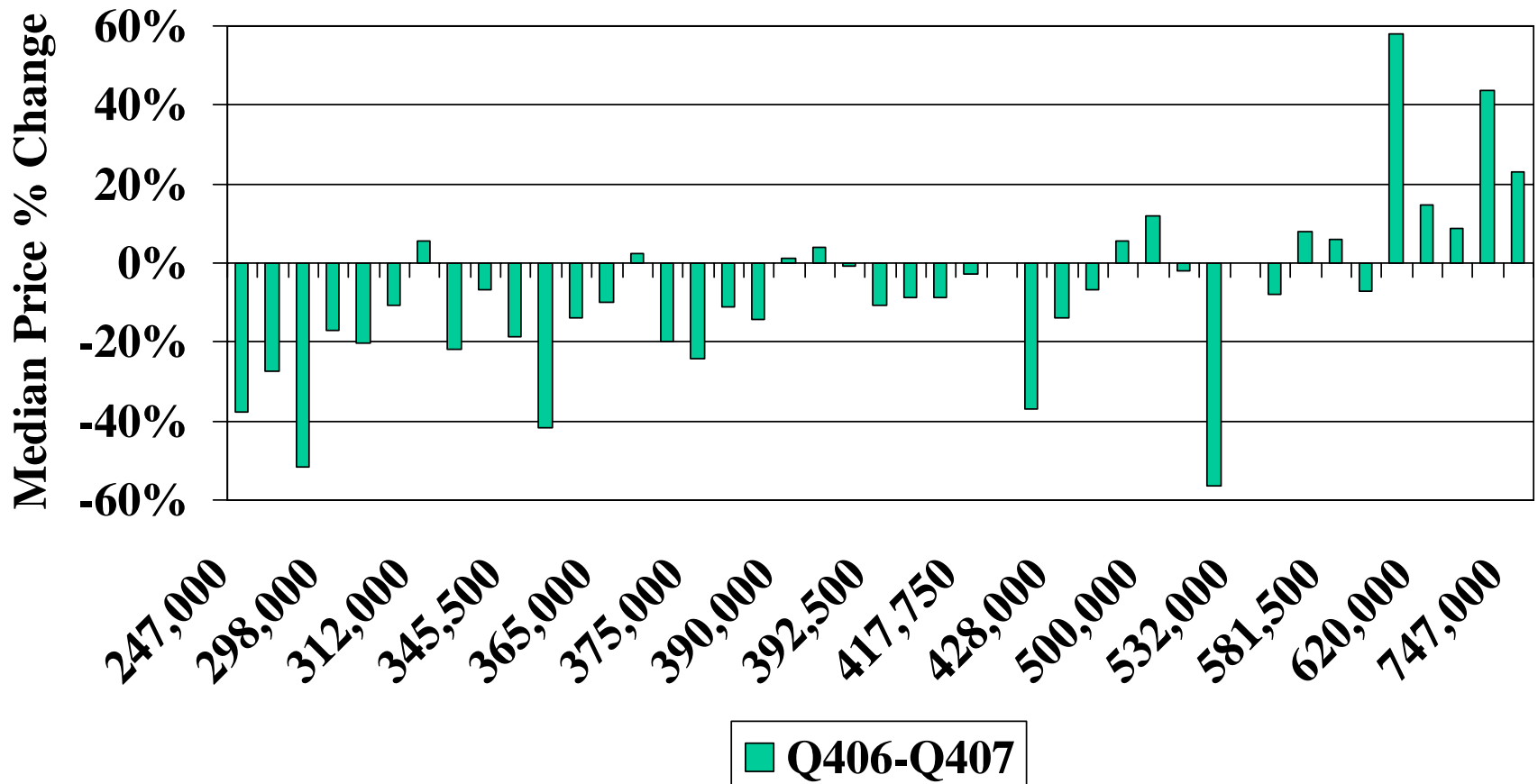
California Historic Home Price Trends

Q1-1980 to Q4- 2007



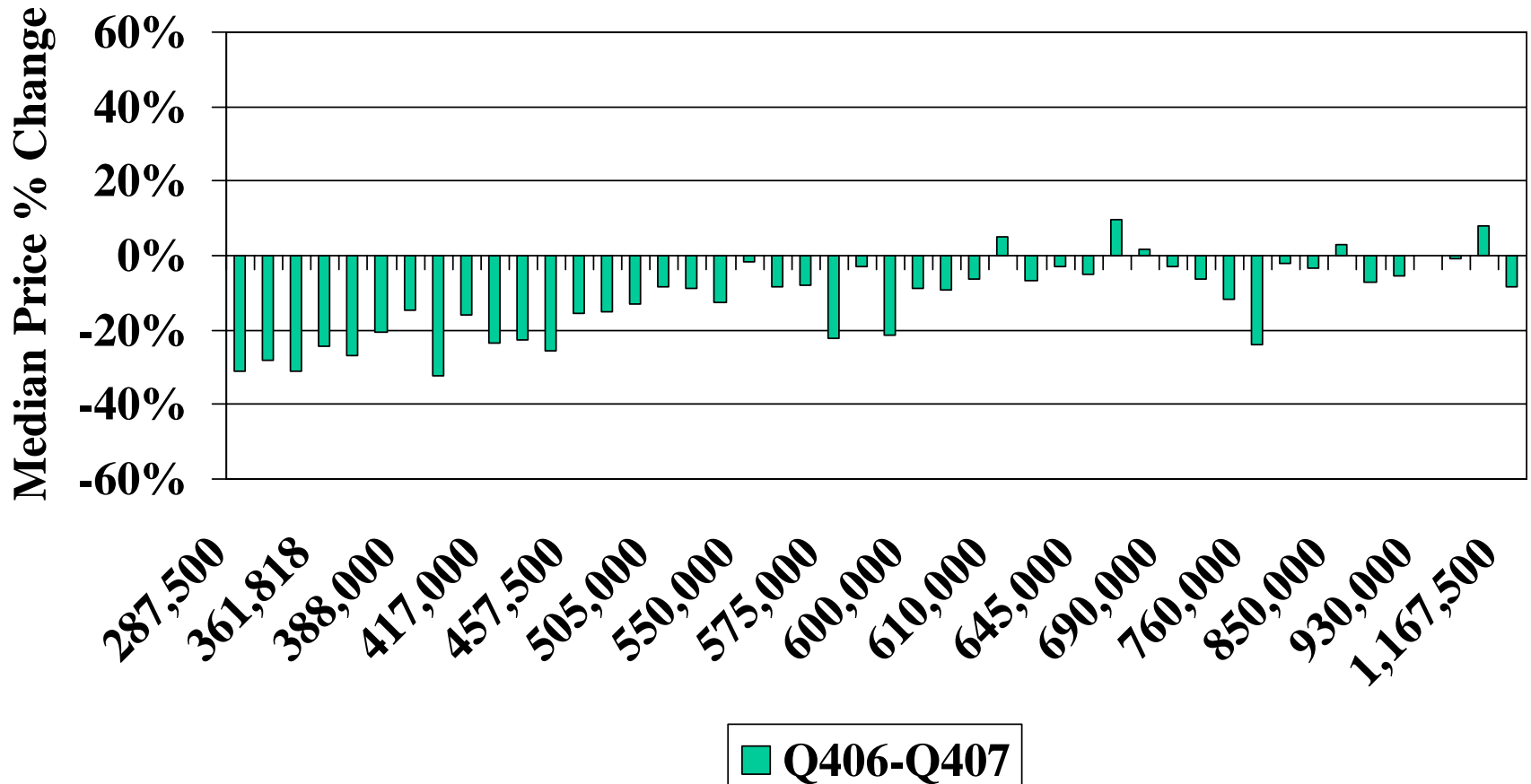
Source: FCREUE from OFHEO data.

Home Price Change by Median Price of Neighborhood, Alameda County Attached



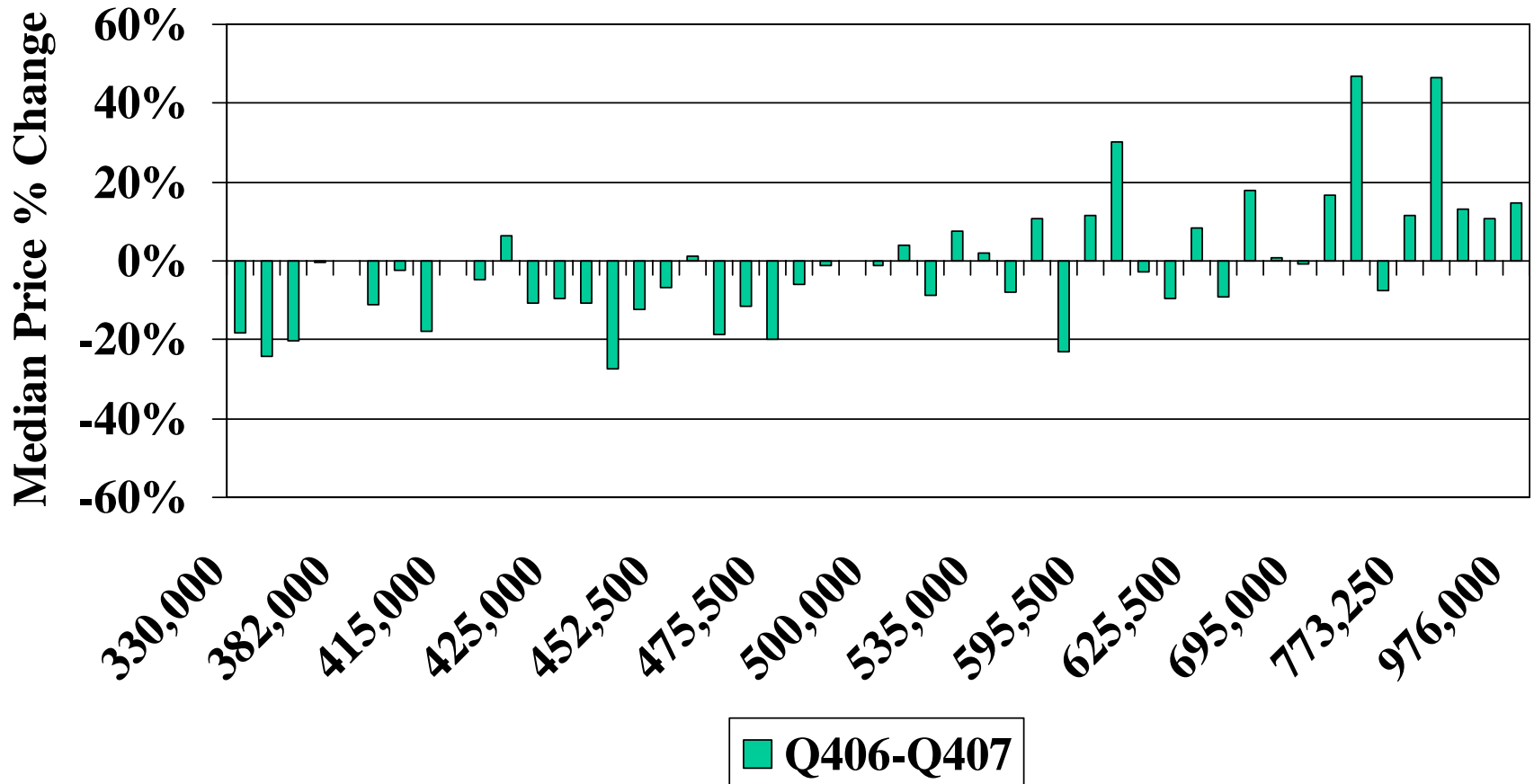
Source: FCREUE from zip code summaries provided by IHP Capital.

Home Price Change by Median Price of Neighborhood, Alameda County Detached



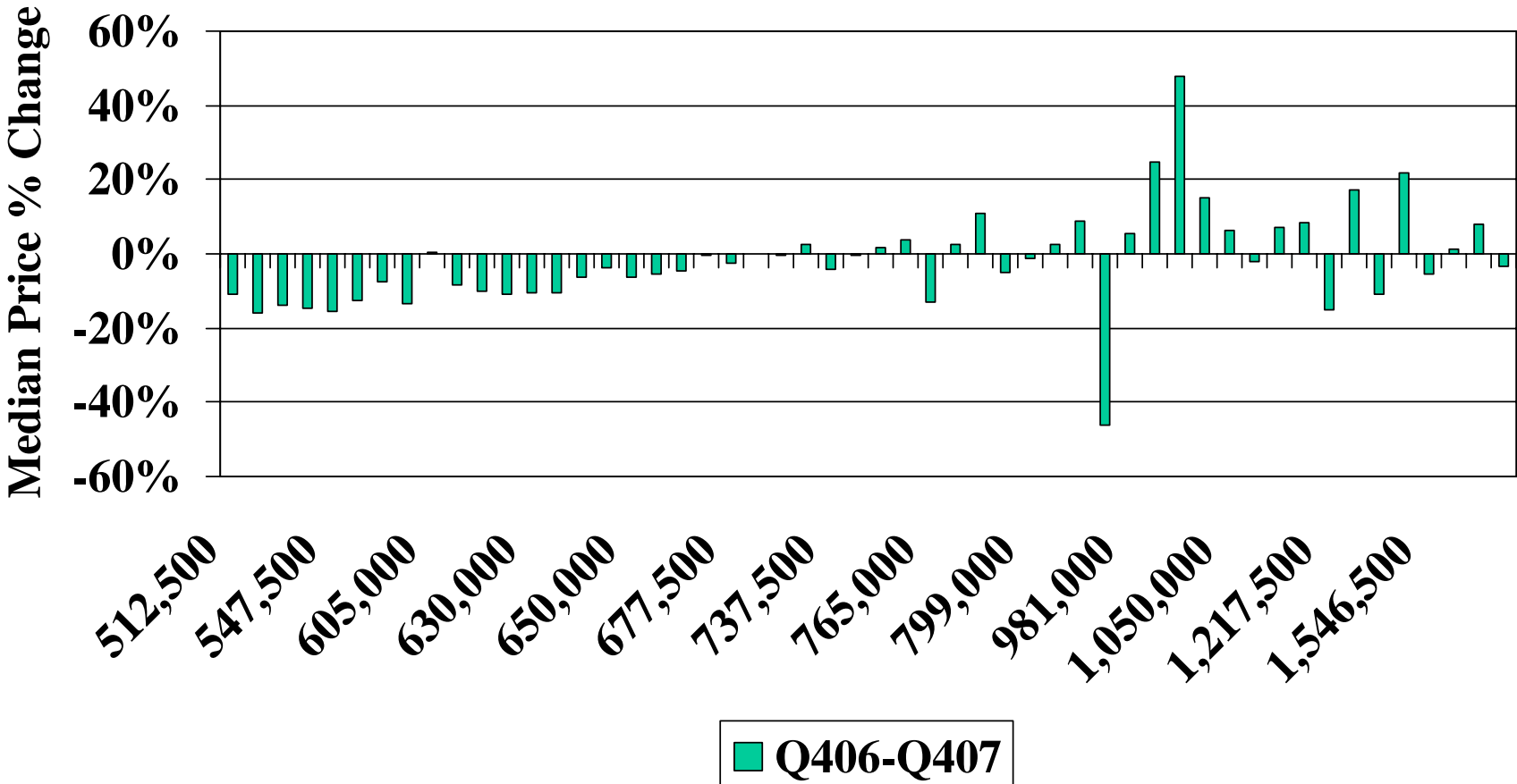
Source: FCREUE from zip code summaries provided by IHP Capital.

Home Price Change by Median Price of Neighborhood, Santa Clara County Attached



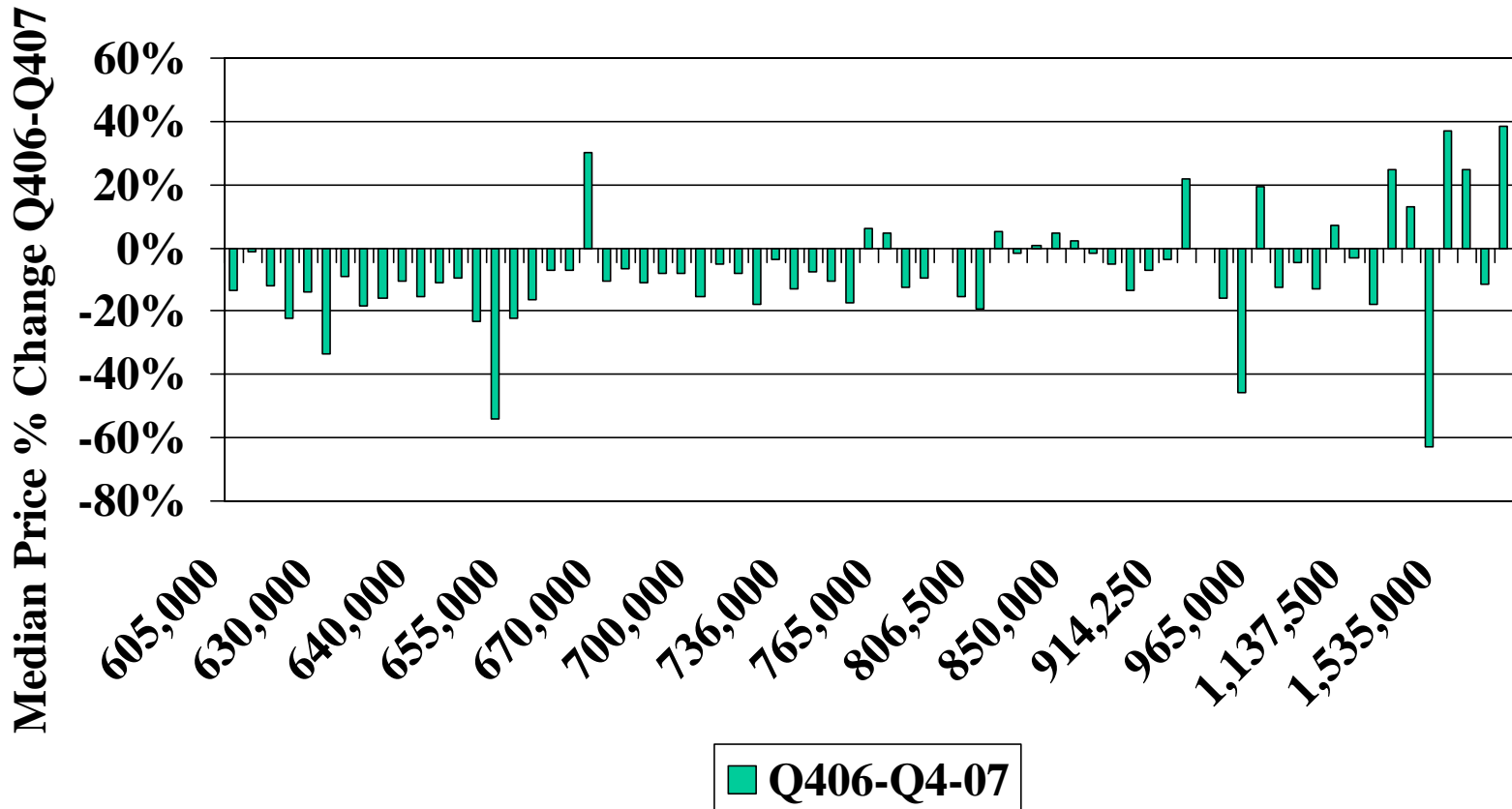
Source: FCREUE from zip code summaries provided by IHP Capital.

Home Price Change by Median Price of Neighborhood, Santa Clara County Detached



Source: FCREUE from zip code summaries provided by IHP Capital.

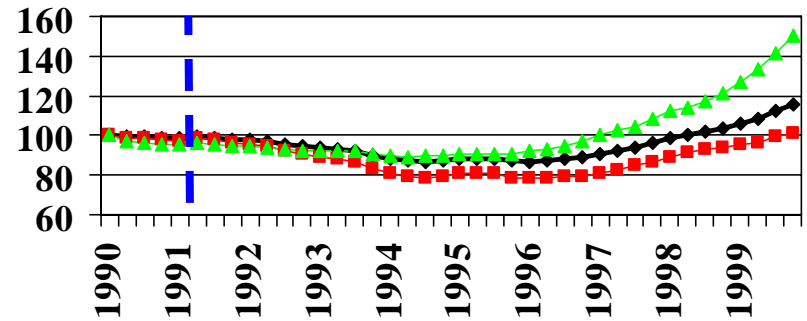
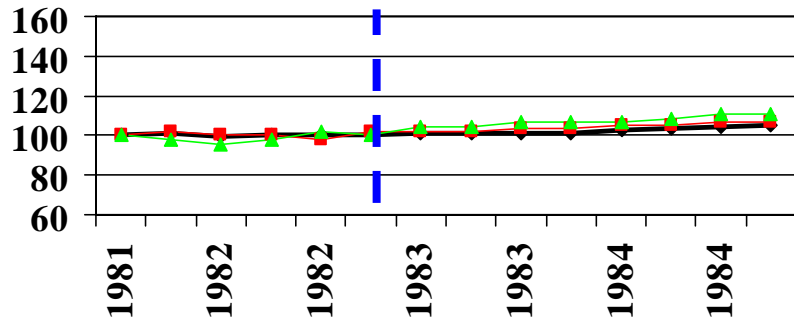
Home Price Change by Median Price of Neighborhood, Orange Co Detached



Source: FCREUE from zip code summaries provided by IHP Capital.

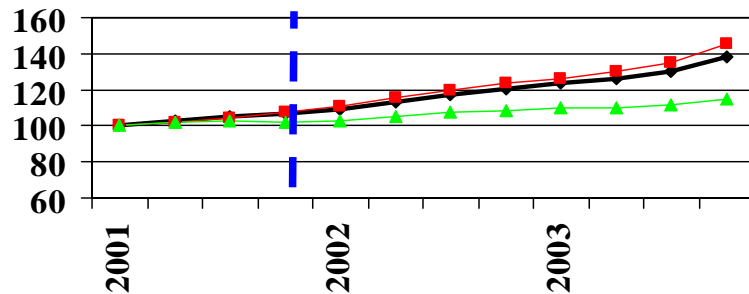
California Housing Cycle Price Histories

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



California Los Angeles San Francisco

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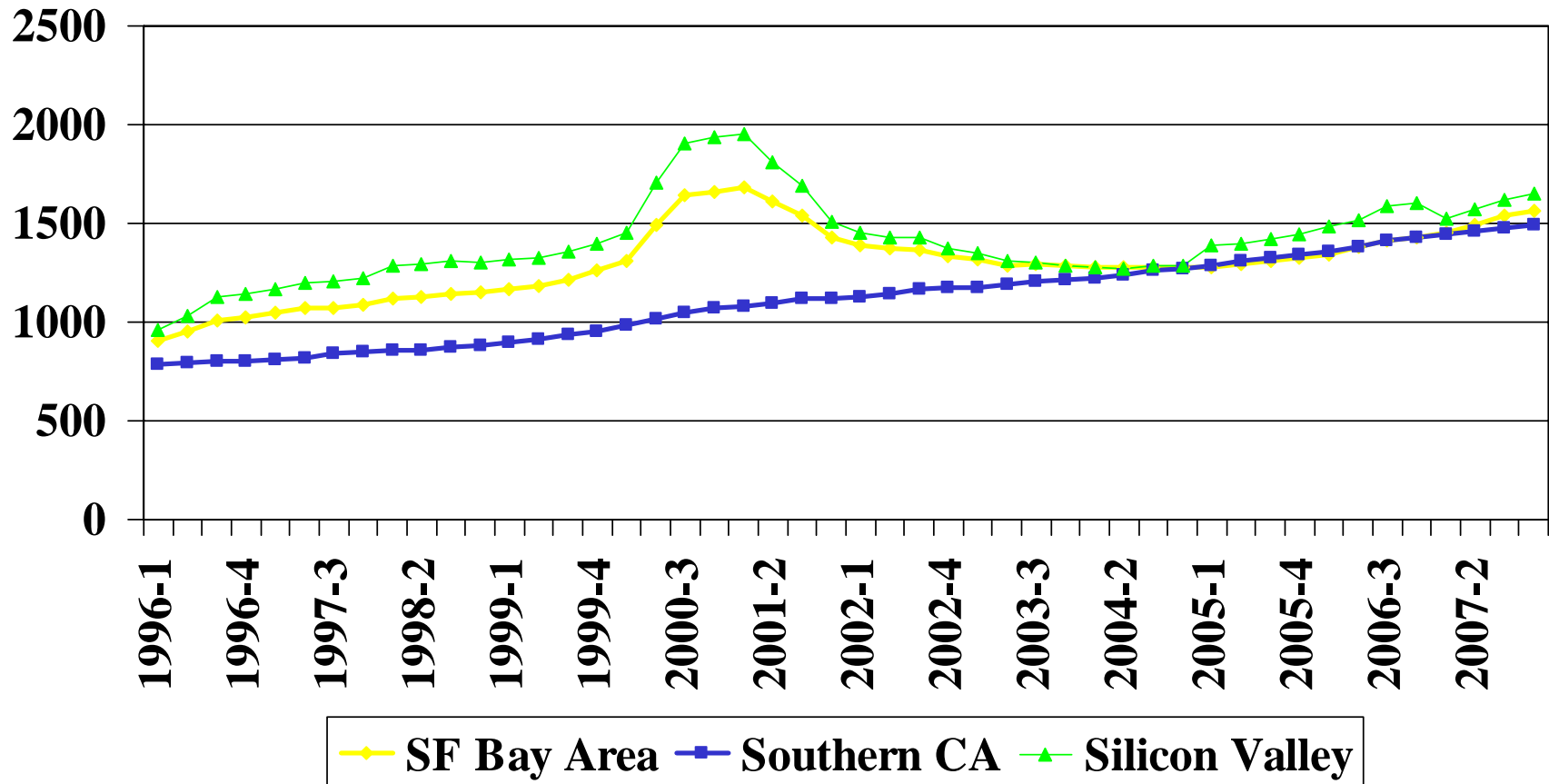
HOW LONG TO RECOVERY?

- 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.

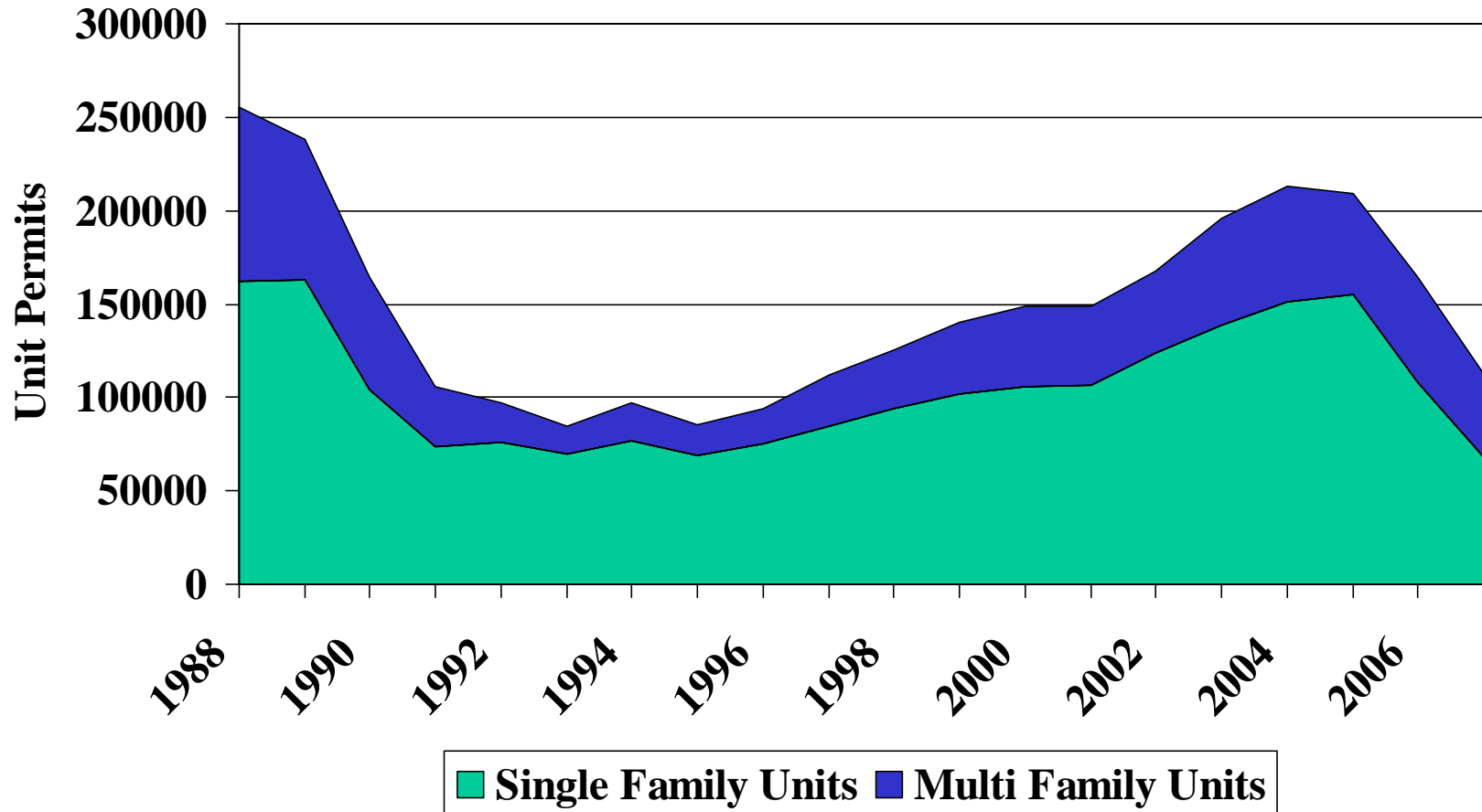
Rent Levels, SF Bay Area, Silicon Valley and Southern California

Quarterly, 1996- 2007 Q4



Source: Real Estate Research Council from RealFacts.

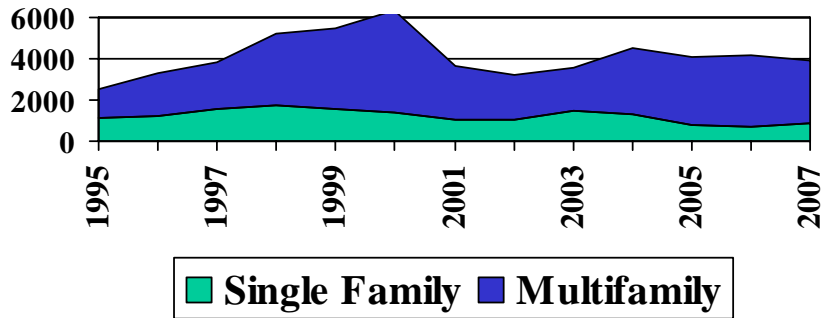
California Residential Building Activity 1988-2007



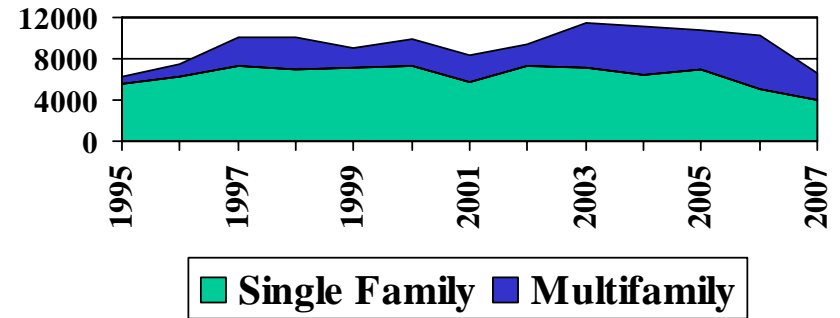
Source: FCREUE from Construction Industry Research Board data.

Residential Permit Trends, California MSAs

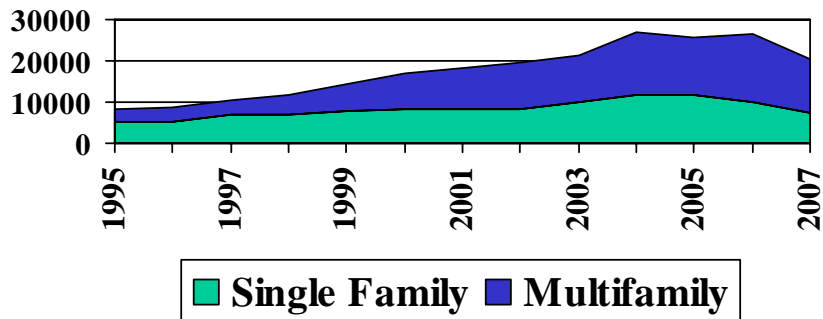
San Francisco MSA



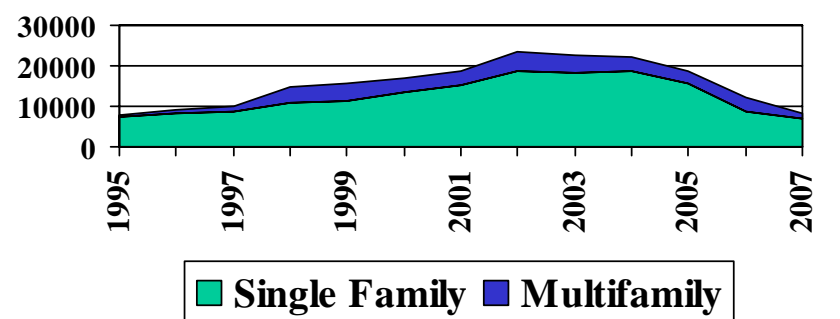
Oakland MSA



Los Angeles



Sacramento

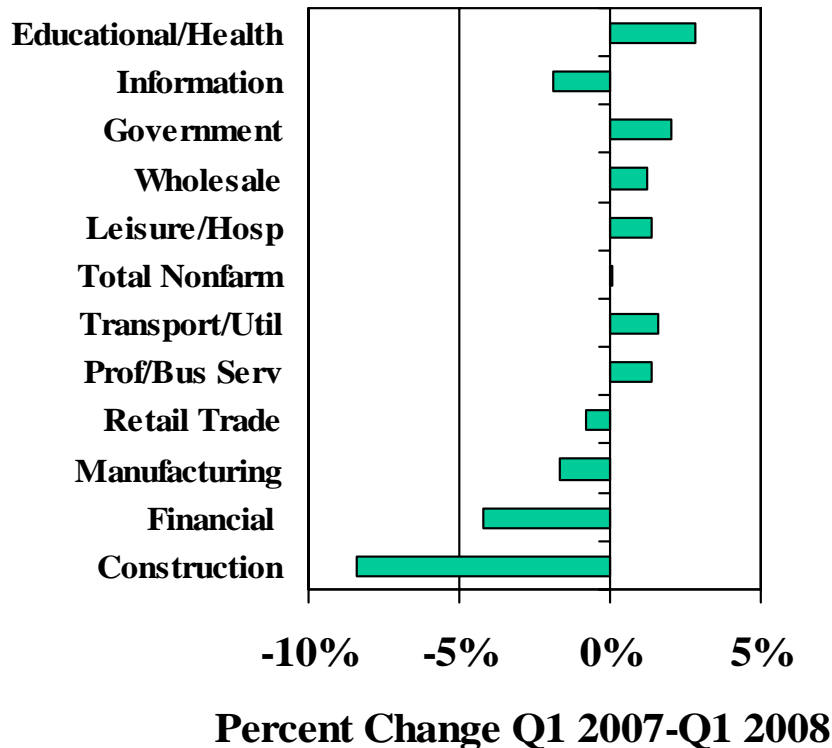


Consequences for Employment

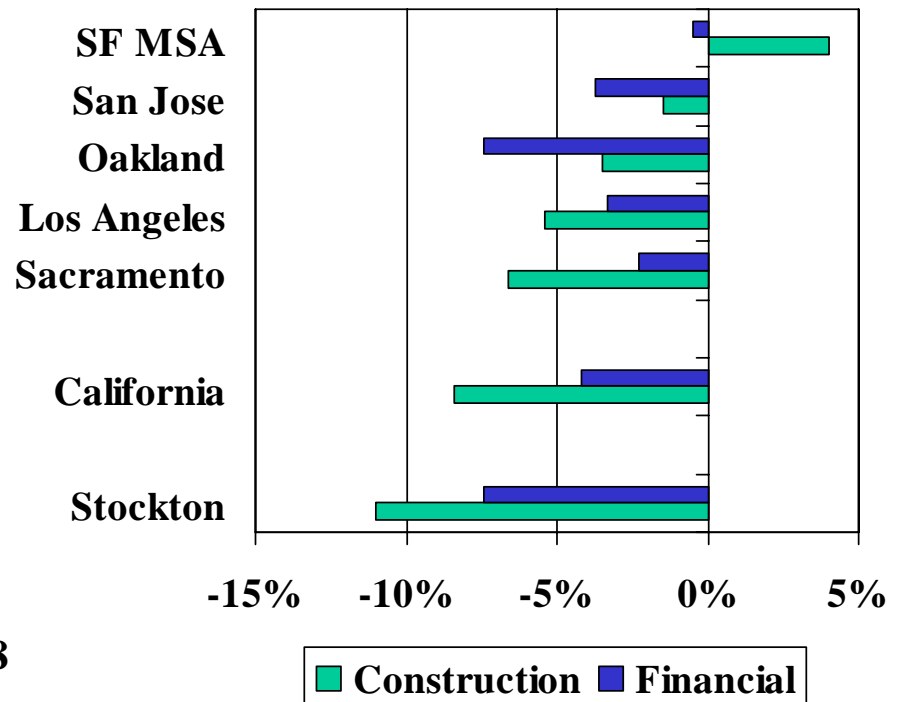
- Direct effects
 - Employment in construction and finance
 - Access to and cost of credit
- Cumulative effects—
 - Consumer confidence
 - Spending and investment
 - Employment and income in other sectors
 - Unemployment

1st Quarter 2008 Employment Effects Still Heavily Housing-Market Weighted

California Employment Change



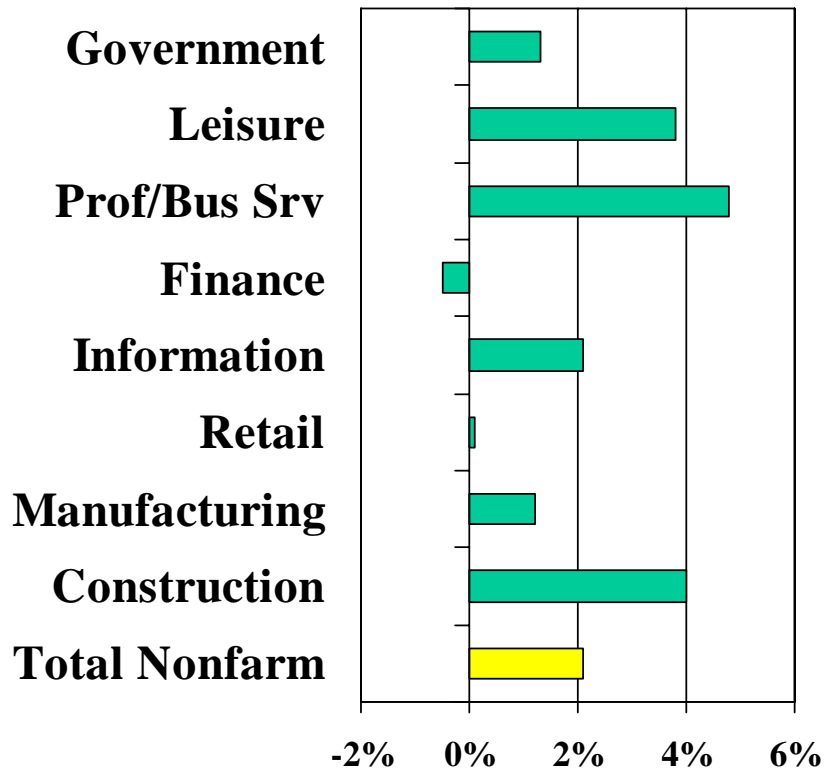
Housing-Related Employment Change by MSA



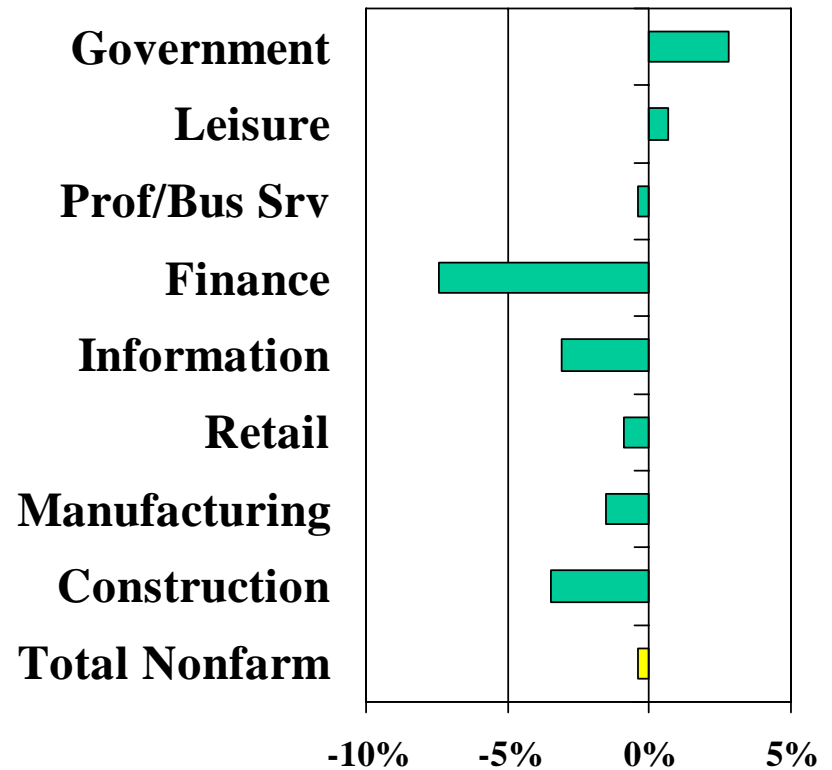
Source: FCREUE from California Employment Development Department data.

Employment Change by Major Sector Q1-07 to Q1-08

San Francisco MSA



Oakland MSA



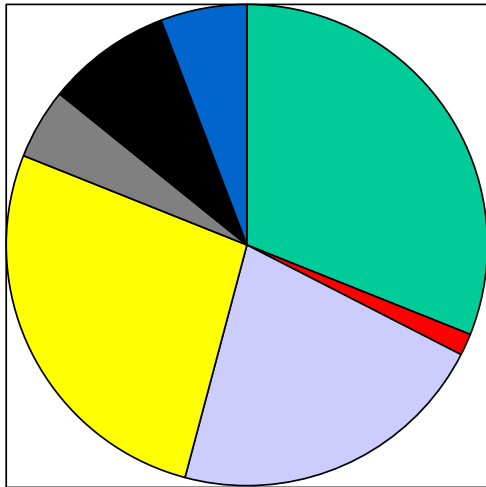
Source: FCREUE from California Employment Development Department data.

Public Sector Vulnerabilities

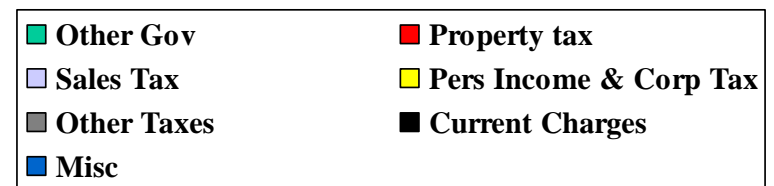
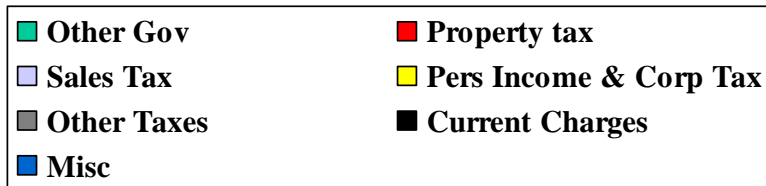
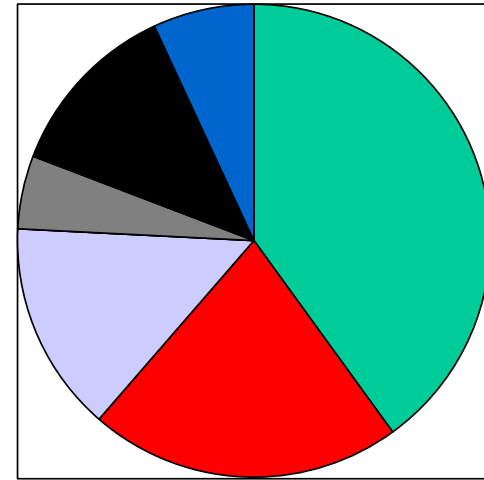
- Local government general funds rely on property and sales tax revenues
- Property transaction revenues and development fees change more rapidly than property tax revenues
- New communities with many recent sales faces greater risk of property tax revenue drops
- State affected by related income and corporate tax revenue declines

General Revenue Sources California State and Local Governments

California State Government



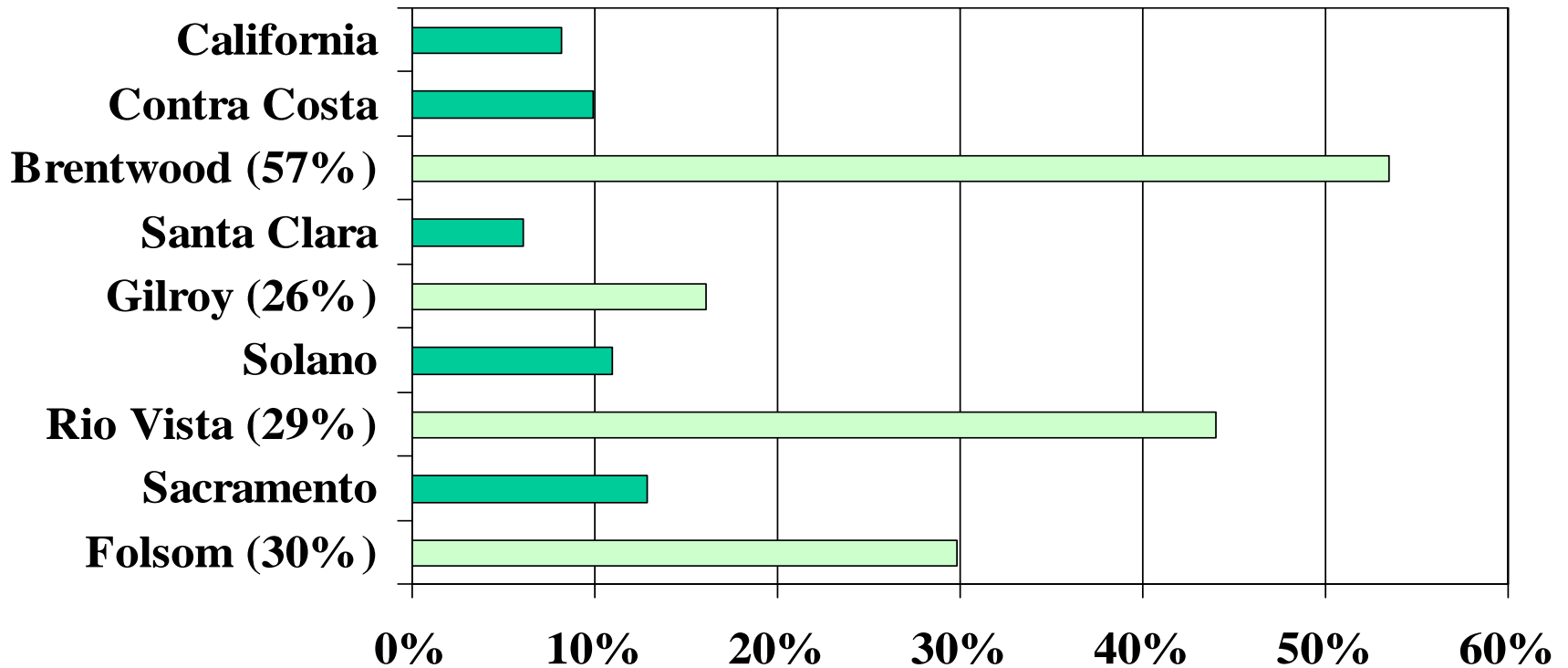
Local Government



Source: US Bureau of the Census, Census of Governments 2002.

Percent of Homes Added within Jurisdiction Since 2000

(*Share of 2004/05 General Fund from Real Estate Income)



Source: FCREUE from California Dept of Finance and Construction Industry Research Board data.

Summary: Effects of the Subprime Crisis/ Mortgage Meltdown on California's Economy

- Declines in home sales, prices, and building permits
- Employment effects in construction, real estate and finance have halted employment growth
- Local governments revenue impacts from slower property tax growth, decreasing transfer tax revenues, fewer permit and development fees, and related sales tax revenue declines
- Public sector effects, as well as other economic issues, could bring about wider spread employment impacts

What Can/What Should Be Done?

Proposals for Immediate Action

- Lenders—Vehicles for mortgage workouts (FHA insurance), short term loans
- Borrowers—Interest rate and long term equity adjustments
- Securitization/Investment Banks—Workouts, mergers, loan guarantees
- Tax relief for targeted groups
- Public sector—???

What Can/What Should Be Done? Proposals

- Mortgage reform—change incentive structure, responsibility/recourse
- Securitization—reallocate risk, capitalization requirements
- Borrower—reinstate income requirements, counseling
- Public sector—access to capital, funding process

What Can/Should Be Done?

Local Implications

- Existing Borrowers
 - Assistance/counseling on loan restructuring
 - Assistance/counseling on housing decision
- Potential Buyers
 - Lower prices, low interest rates
 - Tax benefits
- Builders
- Public Sector