

The Housing Market Outlook for 2009 and 2010

**Prepared by
Joseph Carreras
Housing Program Manager
January 16, 2009**

One of the biggest problems facing cities and counties today is that revenue from sales and property taxes are declining together for the first time in decades. There is a "perfect Storm" of financial woe facing local governments as housing prices decline, sales and property taxes decline and consumer confidence declines in the face of rising foreclosures and rising unemployment. This is why stabilizing communities by rescuing Real Estate Owned properties and "upside down" home owners is such an important issue as dilapidated properties harm surrounding property values as they are almost never well maintained, invite squatters and other problems needing both police response and code enforcement. The strain on local governments is compounded by the impact on the State budget as the State attempts to balance its budget by using funds needed by local governments for redevelopment, education and public works...

Anticipated Strain on Local Budgets due to the Housing Market Downturn

Examples of local governments facing cutbacks include the City of Riverside because of construction related fiscal impacts (less building, less revenue from impact fees and permits combined with falling property values and retail sales tax) and Long Beach where fiscal impacts are raising the question of whether the Long Beach Airport should be sold off to help balance the budget. LA City is also facing a large budget deficit.

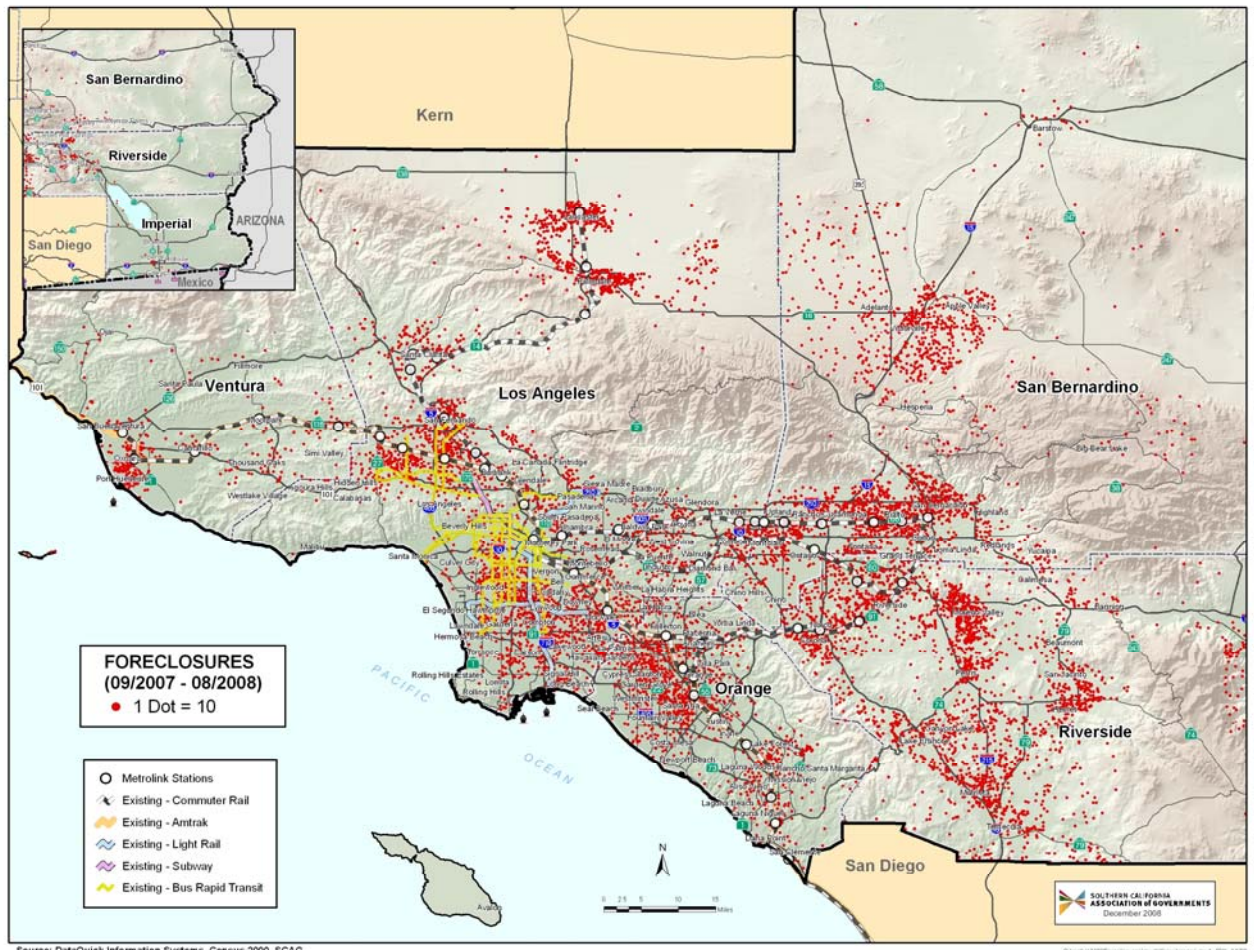
The LA Times reports that about 2/3 rds of southern California Cities had less sales tax revenue in the last 6 months of 2008 than in the same period of 2007. An on-line interactive map is available to show the change in sales tax revenue by local jurisdiction: <http://www.latimes.com/news/local/la-me-recession-proof16-2009feb16-fl0,3451653.flash>

The situation should stabilize when home prices, rents and incomes are in a more reasonable relationship with each other as evidenced by: home price decline ceases, distress sales stop, and foreclosures return to low historical levels. An improvement in economic conditions spurred by lower unemployment is also needed to ensure stability.

As consumer confidence falls in the face of declining home values, people are less likely to make big-ticket purchases. In Riverside, Calif., in the region's hard hit Inland Empire, the city budget was cut by \$10 million from 2007 to 2008 and numerous departments saw reductions. Riverside saw 2,500 foreclosures and could have another 7,500 homes at risk as home values continue to fall.

Across the region the foreclosure picture is serious with a heavy cluster of foreclosure along our transit and transportation network. A key problem is that despite the sharp

decline in home values, prices remain historically high when compared with people's incomes. So even though home prices have come down, people can't afford to buy them. And the exotic mortgage products that made it possible to buy expensive houses in the past are no longer available. Low interest rates can make pricey properties more affordable, but that's meaningless if you can't get a loan, and most lenders have tightened their requirements so much that even people with good credit often don't qualify.



The main cause of all these foreclosure related problems is the decline in house prices, which has led to a collapse in the value of mortgage securities. House prices almost certainly have further to fall. Supply is another key factor affecting home values. When there are too many homes on the market, there is downward pressure on prices, and this is the case in our region.

All homes	Sales Volume			Median Price		
	Nov-07	Nov-08	%Chng	Nov-07	Nov-08	%Chng
Los Angeles	4,468	5,037	12.70%	\$499,000	\$340,000	-31.90%
Orange	1,567	2,177	38.90%	\$582,750	\$400,000	-31.40%
Riverside	2,503	3,719	48.60%	\$356,500	\$220,000	-38.30%
San Bernardino	1,719	2,385	38.70%	\$330,000	\$185,250	-43.90%
San Diego	2,400	2,673	11.40%	\$440,000	\$305,000	-30.70%
Ventura	516	729	41.30%	\$521,250	\$355,000	-31.90%
SoCal	13,173	16,720	26.90%	\$435,000	\$285,000	-34.50%

Source: DQNews.com

Neighborhood Stabilization Funds

The Neighborhood Stabilization Program (NSP) program sponsored by the U.S. Department of Housing and Urban Development (HUD) allows localities to renovate and rehabilitate foreclosed and vacant homes, eliminating blight and reinvigorating and stabilizing the affected neighborhoods. This program was part of HR 3221, the American Housing Rescue and Foreclosure Prevention Act of 2008. Among the Act's numerous provisions is the Neighborhood Stabilization Program (NSP), which provided \$3.9 billion nation-wide in funds to state and local governments to purchase abandoned and foreclosed homes and residential property. About a half billion dollars was allocated to California. Funding may be provided directly to a locality by HUD or through the State Housing and Community Development Department (HCD) to a locality or to communities working together to establish a program. The funds can be used to:

1. Purchase and rehabilitate homes to sell, rent or redevelop
2. Create land banks for homes that have been foreclosed upon
3. Demolish blighted structures
4. Redevelop demolished or vacant properties
5. Establish financing mechanisms for purchase and redevelopment of foreclosed upon homes and residential properties

For instance, the City of Los Angeles was allocated \$32.8 million dollars by HUD. The Los Angeles Housing Department (LAHD) has been monitoring the impact of foreclosures in the City of Los Angeles and working with other agencies for several months to develop a neighborhood-based post-foreclosure stabilization strategy that will focus on the City's most affected neighborhoods. This plan notes that "a key goal of the program is to prevent the downward spiral of property abandonment and crime in neighborhoods that can result when vacant, boarded up properties sit without attention for weeks or months at a time. Such conditions can have a chilling effect on public safety and property values; therefore, it is urgent to address this crisis before City neighborhoods deteriorate further."

The clusters of foreclosures in the City are in Central, East and South Los Angeles and in the North and South Valley areas and total nearly 13,000 units. Although \$32.8 million is a large sum, given the cost of housing and property rehabilitation in Southern California, the City estimates that it will only enable it to address approximately 300 units of housing, according to its proposed HUD Action Plan, “nowhere near the total number of foreclosed properties, present or future.”

Riverside County's economy is struggling largely as a result of the difficulties being experienced by the housing market. In August 2008, a time-sensitive "Red Team" comprised of representatives from the private and public sectors to identify and, if feasible, work to implement stimulus measures to address the housing issues existing in the subregion. At the January 5 meeting, the Executive Committee of the Western Riverside Council of Governments (WRCOG) endorsed a series of recommendations developed through the "Riverside Red Team" effort aimed at addressing the region's economic crisis.

WRCOG, in conjunction with the County of Riverside, City of Riverside, Riverside County Chapter of the Building Industry Association and the Riverside Chamber of Commerce, contracted with Dr. John Husing to perform a survey of key leaders in western Riverside County and develop this list of strategies that could be pursued among the subregion's public and private sector entities to help invigorate the local economy. The report and recommendations focused on the following:

Gaining an understanding of the magnitude of the problems in the Inland Empire and western Riverside County that are related to the downturn in the region's economy and associated impacts on the housing market;

- Developing tools that local jurisdictions can consider for responding to the surge in foreclosed and abandoned properties in their communities. This includes reducing the flow of foreclosures;
- Examining opportunities for participating in the process regarding how, when, and to whom foreclosed units will be sold; and
- Examining opportunities that local jurisdictions can consider related to high costs associated with new housing construction.

The following eight recommendations were endorsed:

1. Development of a uniform database to identify and track foreclosures, notices of default and "properties at risk."
2. Survey jurisdictions and identify "best practices" for maintaining abandoned properties.
3. Survey jurisdictions to compare code enforcement efforts and develop list of approaches for review by WRCOG members.
4. Coordinate activities between jurisdictions and other agencies to work with lenders, area realtors and others to steer foreclosure home turnover from investors to owner-occupants.

5. Continue to examine efforts to acquire foreclosed homes in bulk, refurbish and resell.
6. Encourage development of federal legislation that would require local input to efforts related to reducing the flow of foreclosures and restructuring existing loans.
7. Support efforts to increase outreach and counseling to homeowners at risk of foreclosure.
8. Support legal examination regarding the extent to which significant temporary fee reductions could be implemented without jeopardizing project mitigation ("nexus") requirements.

Meanwhile, San Bernardino County will use the largest share of its \$22.8 million in NSP funds to provide subsidized second mortgages to low- and moderate-income residents buying foreclosed homes. Other communities including Huntington Beach, Fountain Valley in Orange County and Lancaster in Los Angeles County are considering plan to buy foreclosed homes and sell them for affordable housing.

Impact of Subprime Foreclosures on Neighboring Homes and Local Tax Bases

The Center for Responsible Lending has estimated how many homes—including families who are paying their mortgage on time—will suffer a decline in property values because of foreclosures in their neighborhoods. They also estimate the monetary value of these losses in terms of lower property value and a reduced tax base for communities. The projected decrease in the SCAG region’s six county tax base from Subprime Foreclosures from 2005/2006 equals \$39,587,387,638.

Impact of Subprime Foreclosures on Neighboring Homes and Local Tax Bases

County	Projected Homes Lost through Subprime Loans from 2005/2006	Number of Homes Losing Value	Average Decrease in House Value	Projected Decrease in County's House Values & Tax Base from Foreclosures
Imperial	669	19,712	\$801	\$55,220,070
Los Angeles	38,843	2,545,978	\$10,706	\$27,257,444,619
Orange	8,661	670	\$8,576	\$5,750,060,854
Riverside	18,436	398,158	\$7,044	\$2,804,543,196
San Bernardino	18,337	423,605	\$7,058	\$2,989,697,004
Ventura	1,980	114,188	\$6,397	\$730,421,895
Total	86,926	3,502,311	\$40,582	\$39,587,387,638

Source: Center for Responsible Lending

Anticipated Strain on State Budgets due to the Mortgage and Lending Crisis

At least 37 states and the District of Columbia have faced or are facing budget gaps totaling \$66 billion in the 2009 fiscal year, according to a New York Times study. Most states, which rely on sales, income and property taxes, are seeing a significant drop in such revenues or increase that, are below the inflation rate, compared to the same period last year. Click on California, using the link below, and see the per capita budget gap in California and on Revenues to see the gap in tax revenue collection between 2007 and 2008. Unlike the federal government, states are generally required to balance their budgets each year. This is why the Governor has called for the special legislative session in California to balance the budget.

http://www.nytimes.com/interactive/2008/11/17/us/20081117_budget

National foreclosure activity in November hit the lowest level since June 2008, a decline attributed to new foreclosure notification requirements and more aggressive loan modification programs and holiday foreclosure moratoriums adopted by private lenders and government lenders Fannie Mae and Freddie Mac. It won't help that, according to the U.S. Office of Thrift Supervision, more than half of homeowners who received loan modifications to reduce their mortgage payments in the first half of 2008 are already delinquent on their loans again. Bailouts for auto makers, financial institutions and builders, yes even they are lining up for assistance in these difficult times, may not work as planned as we stumble into 2009.

In 2009, the housing market in the nation and the region will continue its sharp decline and not hit a bottom. Foreclosures will spike this year after a short reprieve granted by moratoriums that have delayed the inevitable and as a second wave of Alt A loan foreclosures sweeps over the nation. This will happen throughout the country, but especially impact the Inland Empire and LA County, where median home price declines are projected to be the steepest in the Country (-25%), according to the Case-Shiller Home Price Index. But this projected decline will be only slightly exceed the fall in prices forecasted in the Inland Empire (-23%) and Orange County (-22%).

But not only are homeowners having problems coping with unaffordable mortgages, but rising unemployment will add to foreclosures as people who lose jobs fail to keep up payments and local and state governments run big deficits as sales and property taxes as well as municipal revenues decline sharply in response to housing and economic distress. The Inland Empire metro area has, for instance, one of the highest unemployment rates in the nation and is one of the hardest hit metro areas for declining home prices and foreclosures.

The SCAG region is at the epicenter of the national housing crisis and the economic distress it will wreck on communities. The hardest hit households are typically minority households and immigrants seeking home loans. For instance, The Center for Responsible Lending has reported that nationally that about half of all 2006 home loans to African American families were subprime and two fifths of all home loans to Hispanic and Latino families were subprime; while only one fifth of all home loans to white non-

Hispanic families were subprime. Much of the future growth in the region will be fueled by immigrants and minority households who will struggle to recover from the recession and related housing and economic challenges.

Regional Well Being in 2009

Several Regional Council planning priorities are emerging in the coming year and include: 1) synchronize the 2012 Regional Transportation Plan (RTP) and Regional Housing Needs Allocation Plan (RHNA) planning process; 2) finalize a 2009 task force report on RHNA reforms, and: 3) conceptualize a SB 375 sustainability strategy that will set land use efficiency goals for reducing vehicle miles traveled (VMT) targets for autos and light trucks and 2010 Green House Gas (GHG) emissions targets.

Clearly there is a strong relationship between the 2009 State of the Region, State of the Economy, State of the Housing Market, State of the Environmental Sustainability (Air Quality), and the future fiscal well being of local government. Housing market stability and economic recovery will be closely tied together in 2009 and will carry over into 2010.

Housing Forecast for 2009 and 2010

Both Coastal and Inland areas in the region are expected to see a further decline of between 20 and 25% below the existing median home values. The LA Metro Area is projected as the #1 Worst Housing Market for 2009 by Fortune Magazine, as housing market distress moves and intensifies from east to west.

The good news is that housing affordability, as measured by the relationship of median income to median home asking price, will markedly improve, but coming with this improvement will be a rise in unemployment and an increase in local, state and federal government fiscal distress caused by a loss in municipal revenues from reduced property taxes, redevelopment tax increments, retail sales taxes and other business related revenues. Much more stringent lending standards and frozen capital markets will also tend to keep potential buyers on the sidelines as the recession moves into 2009 and re-enforces deflationary pressures in the economy and housing market.

A second wave of foreclosures (Alt A and Option ARM loans) will sweep over the nation and will be fueled by declining median home values, especially in the SCAG region. This in turn will spur more foreclosures as more and more households fall "under water" and mortgage loans reset to higher levels. Dynamic and printable maps and data on subprime and Alt A lending and foreclosures by zip code are available on-line from the Federal Reserve Bank of New York - click on California; your County and your zip code.

Foreclosure related sales already account for half of all sales in LA and Orange County and 70% of sales in the Inland Empire. Foreclosures and vacant homes in older, existing neighborhoods and an excess of supply in newer inland subdivisions will hamper an economic comeback and new residential construction in 2009 may be no better than in 2008, which is one of the lowest production years on record.

With home prices declining and lenders discounting foreclosed and distressed properties, bargain hunters do not want to pay “retail” prices for new homes, so builders are holding back inventory and shelving new development projects. This reduces construction activity and slows down any market recovery. A downturn in retail and commercial construction may also follow as the recession deepens. The California Building Industry Association notes that, “2008 will finish with a total of 66,000 newly constructed units – 25% of normal and the lowest level in recorded history.”

Within this market context, local governments will be challenged to facilitate and sustain mixed use, transit oriented development, housing affordability, and home ownership achievement as capitol markets try to revive and the existing inventory glut is sold off. More than ever, the linkage between local and regional transportation, housing and environmental planning will increase as the "nuts and bolts" of metropolitan area planning are tightened through the implementation of SB 375 requirements.

The Nation’s 10 worst real-estate markets for 2009 and their Outlook for 2010 (SCAG Region Markets are in Bold)¹

The housing market hasn't bottomed out yet. For the third quarter of 2008, the closely-watched S&P Case-Shiller national home-price index fell 16.6%, and experts are predicting further declines. Of the top 100 markets, here are 10 with the worst forecasts. Only two of the ten most distressed housing markets in the Nation are outside of California, with three of the hardest hit metro areas in the SCAG region - Los Angeles County, Inland Empire and Orange County. Within the region, the down turn in 2009 will see a continued sharp decline in home prices. Prices will also decline in 2010, and may not flatten out or see an increase until 2011. In the long run, this will be good for the region as the relationship between prices, rents; incomes and affordability achieve a much more sustainable relationship with each other.

1. Los Angeles

2008 median house price: \$375,340

2009 projected change: -24.9%

2010 projected change: -5.1%

The median home price in the L.A.-Long Beach-Glendale metro area is projected to fall nearly 25% in 2009 - the biggest drop in the country.

2. Stockton

3. Riverside, Calif.

2008 median house price: \$256,540

2009 projected change: -23.3%

2010 projected change: -4.8%

4. Miami

¹ Source: CNN Money and Fortune Magazine

5. Sacramento

6. Santa Ana-Anaheim

2008 median house price: \$532,810

2009 projected change: -22.0%

2010 projected change: -3.5%

7. Fresno

8. San Diego

9. Bakersfield

10. Washington DC