2008 Midyear Housing Forecast

June 25, 2008

By Alan N. Nevin
Chief Economist
California Building Industry Association

Executive Summary: Housing Production Falling Short of Earlier Forecasts

Due to the greater-than-expected volume of foreclosures and short sales, the forecast for single-family new-home production has been substantially modified from CBIA's January forecast. The forecast now calls for just 38,250 single-family permits to be issued this year, with the four areas of Sacramento, San Joaquin Valley, Riverside and San Bernardino County continuing to experience the heaviest rates of decline. Single-family housing production in 2008 will be a 75% decline from the peak year of 2005.

The multi-family sector will produce 10,000 units less than had been forecast at the beginning of the year, but it is now apparent that condominium production throughout the state has come to a standstill, both in the urban cores and in the suburbs. For all of 2008, the projected total output of the California multi-family industry will be 34,000 units. Total production for the year is now forecast at 72,350 units, which would be a decline of 66% from the peak year of 2004.

Production this year is expected to be at the lowest level since records began being kept in 1954 and in all probability will be at the lowest level since World War II.

The downturn has caused a sharp decline in construction-related employment. During the past two years, the state reported a loss of 181,300 construction, finance and insurance jobs. But in fact, the job losses related to construction have been much more severe as the multiplier effect of the construction industry is higher than any other industry in the U.S. Thus, the multiplier effect of a sagging construction industry affects all industries, including retailing and services and government. Local governments have been particularly affected by the construction downturn because of their heavy reliance on development fees and rising retail and property taxes.

The number of foreclosures on the market should decline substantially by the end of 2008, but prices will remain depressed until the market reaches equilibrium again sometime in 2009. Next year should see gradually rising resales (albeit mostly distressed housing), but that is an indication that the buyers are gradually regaining faith in the housing market and households that could previously not afford to buy a home can now once again qualify for a loan. But until the resale market recovers and prices stabilize, it will be difficult to entice developers back into the homebuilding business. Experience has shown that it is far more financially sound to sit with vacant lots than with completed homes that have no buyers in sight.

Despite downturn, underlying demographics for housing remain strong

Demographics is one of the blessings of California because of its long-term implications for housing demand and labor supply. This month, the California Department of Finance released its 2008 population statistics. During the past year, the state gained almost a half-million persons, a pace ahead of each of the prior three years. Based on this progression, California will reach a population of 40 million by 2012, only four years from now.

POPULATION CHANGE CALIFORNIA 2004-2008		
YEAR	POPULATION	CHANGE FROM PREVIOUS YEAR
2004-2005	36,675,346.00	476,004.00
2005-2006	37,114,598.00	439,252.00
2006-2007	37,559,440.00	444,842.00
2007-2008	38,049,462.00	490,022.00
CALIFORNIA DEPARTMENT OF FINANCE 6.08		

Until the massive decline of the construction and real estate finance industries, the state of California was routinely gaining more than 250,000 jobs annually. From May 2006 to May 2007, the state gained 192,100 jobs and maintained an unemployment rate of 5.2%.

2006-2007 marked the beginning of the residential construction downturn. From May 2006 to May 2007, the state lost 61,000 jobs in construction and real estate finance. Absent these constructionï related losses, the state gained more than 250,000 jobs.

The past year, the construction-related losses were so significant that it had the effect of dragging down the entire California economy. In the past year, the state lost 120,300 construction-related jobs, a loss that caused total employment to dip by 17,100 jobs, the first California downturn in seven years.

Further, Californiaŝ unemployment rate reached 6.8% in May of this year, significantly higher than in the past five years.

EMPLOYMENT CHANGE CALIFORNIA MAY 2005 THRU MAY 2008							
TITLE	May-05	May-06	May-07	May-08	2005-2006	2006-2007	2007-2008
Civilian Labor Force	17,671,700	17,892,100	18,159,300	18,442,900	220,400	267,200	283,600
Civilian Employment	16,698,900	17,011,500	17,203,600	17,186,500	312,600	192,100	(17,100)
Civilian Unemployment Rate	5.50%	4.92%	5.26%	6.80%			
Construction	895,900	941,500	903,700	815,300	**45,600**	**(37,800)**	**(88,400)**
Finance & Insurance	639,400	652,800	629,500	597,600	**13,400**	**(23,300)**	**(31,900)**
TOTAL CONSTRUCTION & FINANCE	1,535,300	1,594,300	1,533,200	1,412,900	**59,000**	**(61,100)**	**(120,300)**
SOURCE: CALIFORNIA EDD 6.08							

The job declines related to construction have far more depth than the basic numbers shown here as the multiplier effect of the construction industry is higher than any other industry in the U.S. Thus, the multiplier effect of a sagging construction industry affects all industries, including retailing and services and government. Local governments are particularly affected by a construction downturn because of their heavy reliance on development fees and rising retail and property taxes.

We want to note that most of Californiaôs other basic industries continue to evidence strength, including tourism, manufacturing, import/export and the bio-com/telecom sectors.

Construction Output in California 2003-2007

From its peak in 2005, residential construction has declined by 50% in California. Single-family housing ï the traditional backbone of the industry ï has seen a decline from 155,322 units in 2005 to 68,409 in 2007. Multi-family permits have not been as severely affected because that category includes both condominiums and rental apartments. Rental apartments have increased their percentage of multi-family new construction in the past three years, while condominium construction has ebbed.

RESIDENTIAL UNITS PERMITTED CALIFORNIA 2003-2007					
TYPE	**2003**	**2004**	**2005**	**2006**	**2007**
TOTAL SINGLE FAMILY	**138,762**	**151,417**	**155,322**	**108,021**	**68,409**
MULTI-FAMILY TOTAL	**56,920**	**61,543**	**53,650**	**56,259**	**44,625**
TOTAL UNITS PERMITTED	**195,682**	**212,960**	**208,972**	**164,280**	**113,034**
SOURCE: CONSTRUCTION INDUSTRY RESEARCH BOARD 6.08					

Similarly, the dollar value of permits for residential housing has declined $45.0 to $22.0 billion from 2005 through 2007.

Most areas in California suffered major declines in single-family construction, but two-thirds of all permit declines were in four areas: Sacramento, the San Joaquin Valley, Riverside and San Bernardino counties. Those four areas produced almost 60,000 fewer homes in 2007 than in 2005.

SINGLE FAMILY UNITS PERMITTED CALIFORNIA BY REGION 2005-2007					
				CHANGE 2005-2007	
REGION	**County**	**2005**	**2007**	**NO.**	**%**
CENTRAL COAST		4,248	2,037	2,211	52.0%
NON METRO		14,318	5,739	8,579	59.9%
SACRAMENTO VALLEY		15,629	6,999	8,630	55.2%
SAN FRANCISCO BAY AREA		14,686	8,953	5,733	39.0%
SAN JOAQUIN VALLEY		34,676	14,749	19,927	57.5%
SOUTHERN CALIFORNIA	LOS ANGELES	11,911	7,509	4,402	37.0%
	ORANGE	4,058	2,182	1,876	46.2%
	RIVERSIDE	29,994	9,763	20,231	67.5%
	SAN BERNARDINO	15,305	6,239	9,066	59.2%
	SAN DIEGO	7,904	3,503	4,401	55.7%
	VENTURA	2,593	736	1,857	71.6%
	TOTAL SOCAL	**71,765**	**29,932**	**41,833**	**58.3%**
TOTAL SINGLE FAMILY		**155,322**	**68,409**	**86,913**	**56.0%**
MARKETPOINTE REALTY ADVISORS & CBIA 6.08					

Multi-family permits fell by only 16.8% in the 2005-2007 period, with most areas experiencing comparable downturns. The apartment construction business has increased substantially in the past 24 months as apartment developers acquired lands once destined for condominium development, often at much-reduced prices. Often, apartment developers have acquired partially completed condominium projects and completed them as apartments.

MULTI-FAMILY UNITS PERMITTED CALIFORNIA BY REGION 2005-2007					
				CHANGE 2005-2007	
REGION	**County**	**2005**	**2007**	**NO.**	**%**
CENTRAL COAST		1,012	1,437	425	42.0%
NON METRO		1,565	1,355	-210	-13.4%
SACRAMENTO VALLEY		2,863	1,455	-1,408	-49.2%
SAN FRANCISCO BAY AREA		12,215	9,335	-2,880	-23.6%
SAN JOAQUIN VALLEY		4,315	3,791	-524	-12.1%
SOUTHERN CALIFORNIA					
	LOS ANGELES	13,736	12,854	-882	-6.4%
	ORANGE	3,148	4,890	1,742	55.3%
	RIVERSIDE	4,140	2,690	-1,450	-35.0%
	SAN BERNARDINO	1,379	1,765	386	28.0%
	SAN DIEGO	7,354	3,942	-3,412	-46.4%
	VENTURA	1,923	1,111	-812	-42.2%
	TOTAL SOCAL	**31,680**	**27,252**	**-4,428**	**-14.0%**
MULTI-FAMILY TOTAL		**53,650**	**44,625**	**-9,025**	**-16.8%**
MARKETPOINTE REALTY ADVISORS & CBIA 6.08					

The Residential Housing Business – 2008

The residential housing business has suffered throughout the United States, but nowhere more than in California. The combination of the subprime financial disaster and, related to it, the massive increase in foreclosures and short sales, has created a situation where the housing market ï new and resale ï has not been able to operate in a normal manner.

The effect of the financial mishaps and foreclosures has caused home prices to decline throughout California, but mostly in those four areas that have now experienced massive declines in new construction. It is apparent that the residential construction industry cannot compete with the foreclosure/short sale market, particularly in an environment where homebuyers have not yet been convinced that the bottom of the market is at hand.

It is likely that most of the foreclosure activity will ebb by the end of 2008 as owners of those homes have long ago recognized that the imputed equity in their homes has been lost. In most cases, these buyers had little if any down payments on their homes and therefore their actual losses are minimal, but no less painful. Further, it is now known that a major segment of the buyers were investors, often masquerading as owner-occupants for purposes of acquiring favorable financing.

We are of the opinion that the foreclosure market will decline substantially by the end of 2008, but prices will remain depressed until the market reaches equilibrium again sometime in 2009. In many markets today, and particularly those four markets with the most devastating decline in construction, as many as two-thirds of the resales are foreclosures or short sales.

We do want to make the point that in most of the coastal communities in California, home sales have declined, but prices have remained relatively stable or have had modest reductions in value. As those communities house the vast majority of Californians, the widely publicized statistics showing massive declines in home prices are somewhat distorted. In other words, those homes in the inland communities that were hardest hit constitute most of the foreclosures and short sales. It is important to note that the statistics showing the massive declines are based only on homes that have sold. Most homeowners in the state live in communities where there are relatively few foreclosures and therefore few sales.

Despite this positive note, the new-home construction market in California in 2008 has faltered far more than we had previously envisioned. Since producing the 2008 forecast in late 2007, the housing world has been greatly wounded.

We have substantially modified our single-family projections for 2008 for California. We now anticipate that single-family permits will total just 38,250 units, with the four areas of Sacramento, San Joaquin Valley, Riverside and San Bernardino County continuing to experience the heaviest rates of decline. Thus, single-family housing production in 2008 will be 25% of what it was in 2005.

SINGLE-FAMILY PERMIT FORECAST 2008 CALIFORNIA, BY REGION				
REGION	**2005**	**2006**	**2007**	**2008F**
CENTRAL COAST				
NON METRO	4,248	3,132	2,037	1,200
SACRAMENTO VALLEY	14,318	9,022	5,739	3,500
SAN FRANCISCO BAY AREA	15,629	8,797	6,999	4,000
SAN JOAQUIN VALLEY	14,686	10,528	8,953	5,000
	34,676	23,106	14,749	9,000
SOUTHERN CALIFORNIA				
LOS ANGELES	11,911	10,097	7,509	4,500
ORANGE	4,058	3,735	2,182	1,600
RIVERSIDE	29,994	20,692	9,763	4,000
SAN BERNARDINO	15,305	12,599	6,239	2,500
SAN DIEGO	7,904	4,753	3,503	2,500
VENTURA	2,593	1,560	736	450
	71,765	**53,436**	**29,932**	**15,550**
TOTAL	**155,322**	**108,021**	**68,409**	**38,250**
MARKETPOINTE REALTY ADVISORS & CBIA 6.08				

The multi-family sector will produce 10,000 units less than we had forecast at the beginning of the year, but it is now apparent that condominium production throughout the state has come to a standstill, both in the urban cores and in the suburbs. In 2008, we project that the total output of the California multi-family industry will be 34,000 units.

MULTI-FAMILY PERMIT FORECAST 2008 CALIFORNIA, BY REGION				
REGION	**2005**	**2006**	**2007**	**2008F**
CENTRAL COAST	1,012	727	1,437	600
NON METRO	1,565	1,336	1,355	1,100
SACRAMENTO VALLEY	2,863	3,530	1,455	1,200
SAN FRANCISCO BAY AREA	12,215	13,780	9,335	10,000
SAN JOAQUIN VALLEY	4,315	3,282	3,791	3,000
SOUTHERN CALIFORNIA				
LOS ANGELES	13,736	16,251	12,854	9,000
ORANGE	3,148	4,636	4,890	3,500
RIVERSIDE	4,140	4,519	2,690	1,500
SAN BERNARDINO	1,379	1,273	1,765	1,500
SAN DIEGO	7,354	6,024	3,942	1,800
VENTURA	1,923	901	1,111	900
	31,680	**33,604**	**27,252**	**18,200**
TOTAL	**53,650**	**56,259**	**44,625**	**34,100**
MARKETPOINTE REALTY ADVISORS & CBIA 6.08				

As we move toward 2009, we see gradually rising resales (albeit mostly distressed housing), but that is an indication that the buyers are gradually regaining faith in the housing market and households that could previously not afford to buy a home can now once again qualify for a loan.

As an industry, we know that until the resale market recovers and prices stabilize, it will be difficult to entice developers back into the homebuilding business. Experience has shown that it is far more financially sound to sit with vacant lots than with completed homes that have no buyers in sight.