

Singing the housing blues...



Christopher Thornberg
Principal



BEACON *Economics*

Beacon Economics is an independent consulting firm providing a variety of economic support services to clients across the Western US.

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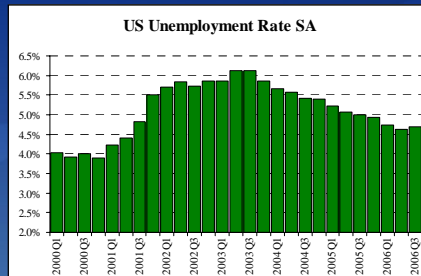
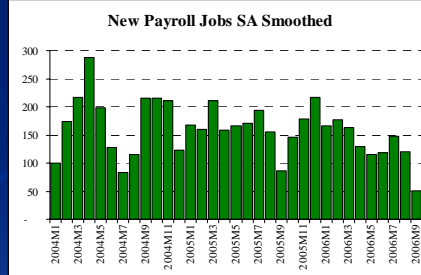
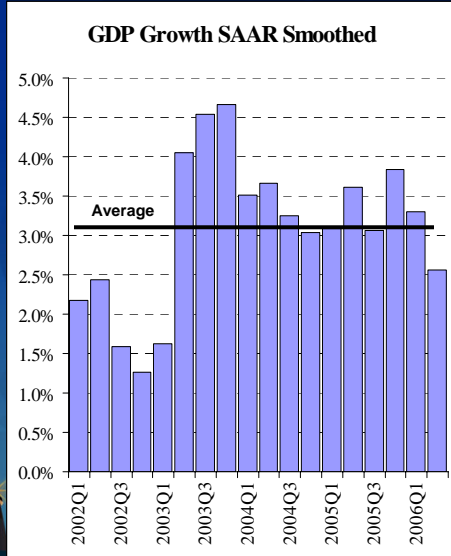
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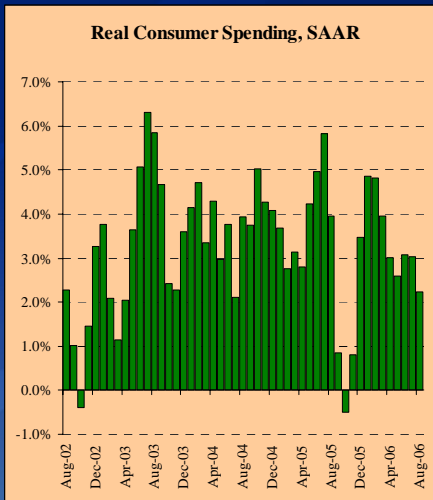
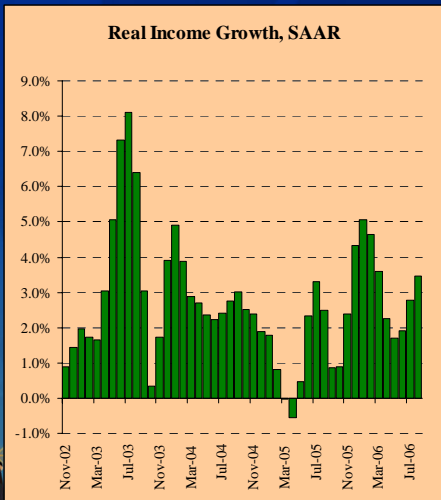
*Jon Haveman and
Chris Thornberg are*

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Growth Decent, Labor Markets Solid

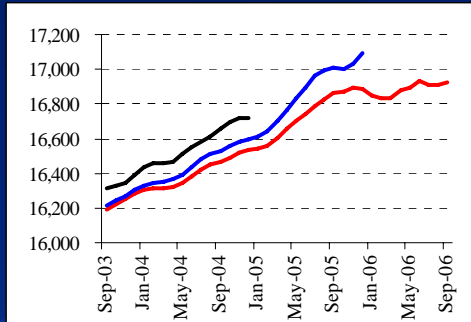


Income / Spending stable

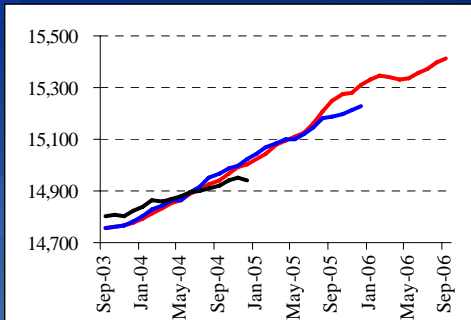


California: Employment up, but slowing

Household



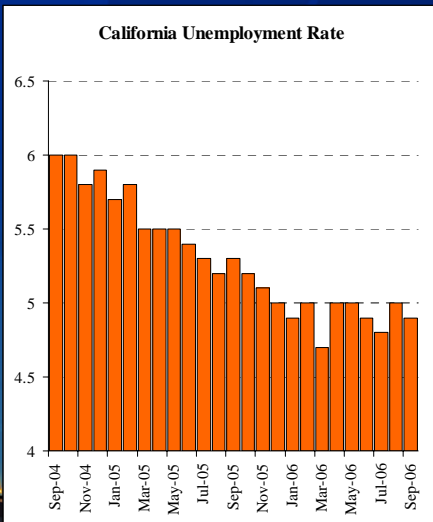
Payroll



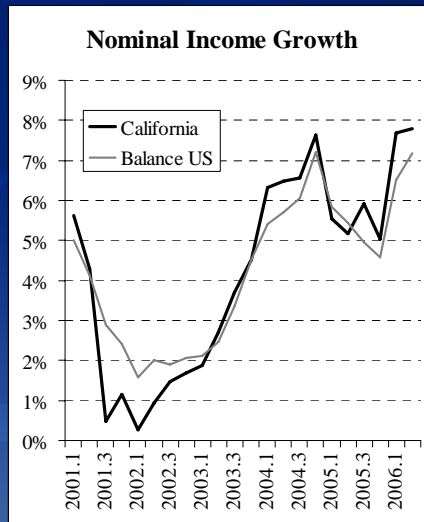
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California: still positive

California Unemployment Rate

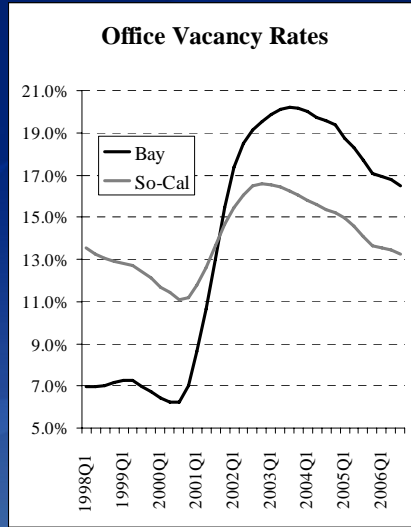
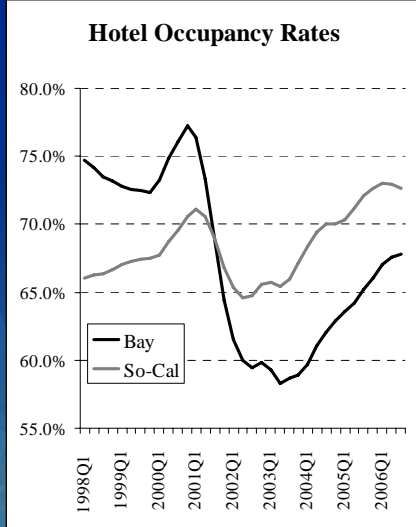


Nominal Income Growth



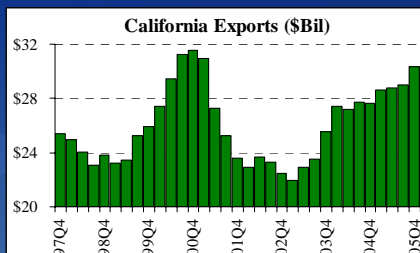
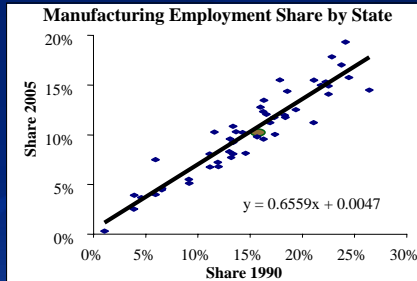
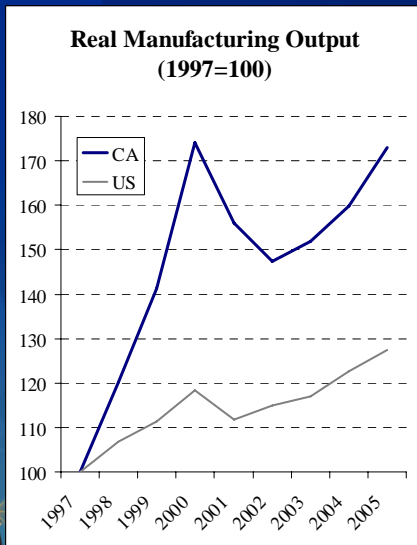
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Other good indicators



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Wither California Manufacturing?



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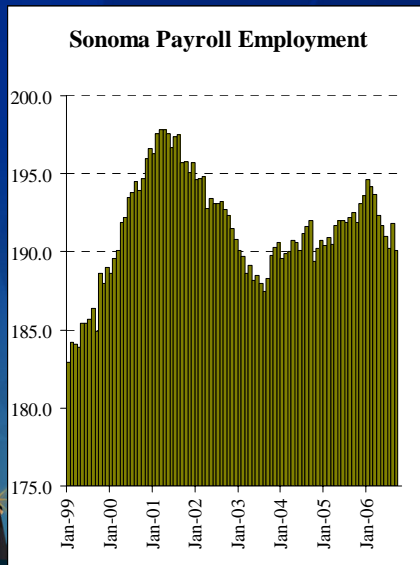
Local Population Growth

Slow, with low natural increases and net migration

	Est July 1 06	Ch 02-06	Ann %			
Sacramento	1,394,074	91,130	1.7%	San Francisco	\$759,000	13.20
San Joaquin	673,954	65,388	2.6%	San Mateo	\$760,000	10.20
Santa Clara	1,784,390	63,624	0.9%	Marin	\$795,000	10.07
Contra Costa	1,033,992	44,652	1.1%	Alameda	\$595,000	9.75
Stanislaus	518,596	39,403	2.0%	Napa	\$615,000	9.42
Alameda	1,515,859	27,338	0.5%	Sonoma	\$535,000	9.17
Solano	423,951	12,130	0.7%	Santa Clara	\$677,000	8.81
Yolo	191,776	11,986	1.6%	Merced	\$350,000	8.69
Sonoma	481,078	11,053	0.6%	San Joaquin	\$429,000	8.69
San Francisco	801,883	11,037	0.3%	Yolo	\$405,000	8.07
San Mateo	726,516	10,844	0.4%	Contra Costa	\$559,000	8.04
Napa	135,241	5,865	1.1%	Stanislaus	\$368,000	7.74
Marin	254,234	3,786	0.4%	Solano	\$458,000	7.36
Mendocino	90,488	2,232	0.6%	Fresno	\$299,000	7.14
				Kern	\$285,000	7.09
				Sacramento	\$359,500	6.94
				Placer	\$430,000	6.93
				Tulare	\$260,000	6.71
				Madera	\$290,000	6.20

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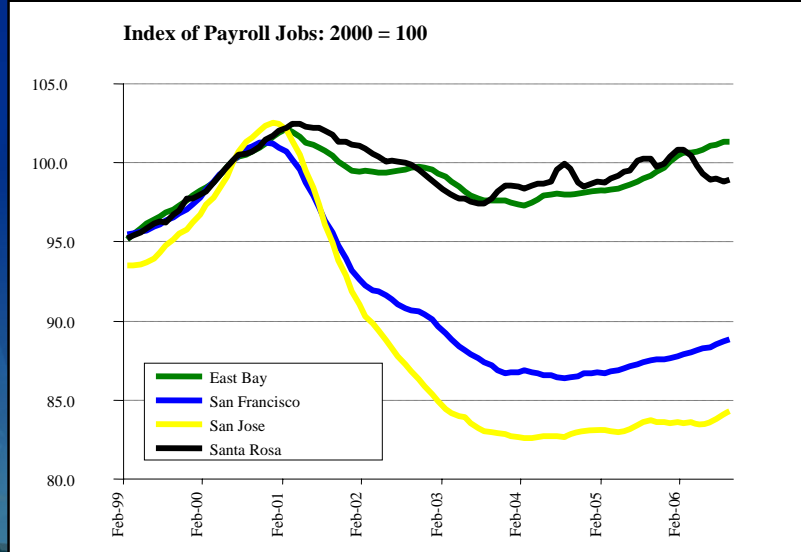
Local Job Growth: Tepid



	Sep-Mar	Mar-Sep	
Total	1,575	-2,975	-4,550
Government	-2,000	1,350	3,350
Agriculture	-450	-350	100
Education Healthcare	-150	-100	50
Durables	-200	-200	0
Financial Activities	-50	-100	-50
Other	100	0	-100
Wholesale	50	-100	-150
Information	50	-100	-150
Transport Utilities	0	-150	-150
Retail	300	-500	-800
Total Manufacturing	450	-500	-950
Non-Durables	650	-350	-1,000
Trade Transport	400	-900	-1,300
Professional Serv	750	-700	-1,450
Leisure	400	-1,300	-1,700
Construction	850	-900	-1,750
Household Employment	-1,900	-3,550	-1,650
Civilian Labor Force	-3,450	-3,050	400

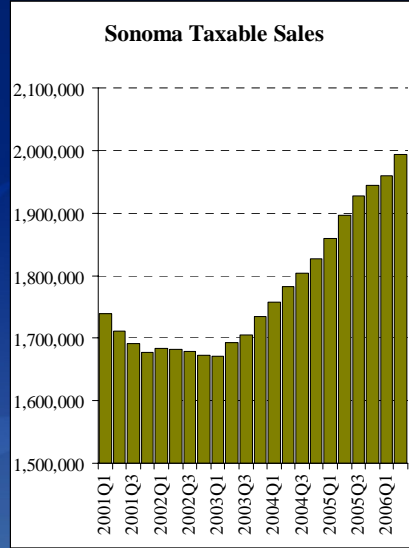
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A bit of perspective



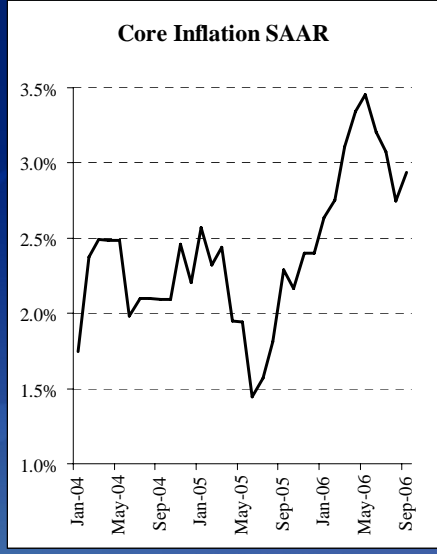
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Other solid signs



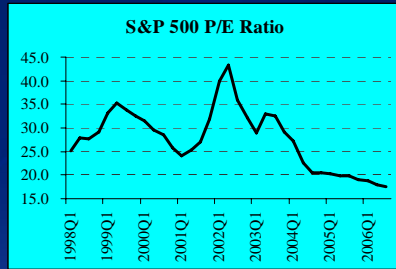
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Good news: Energy and Inflation



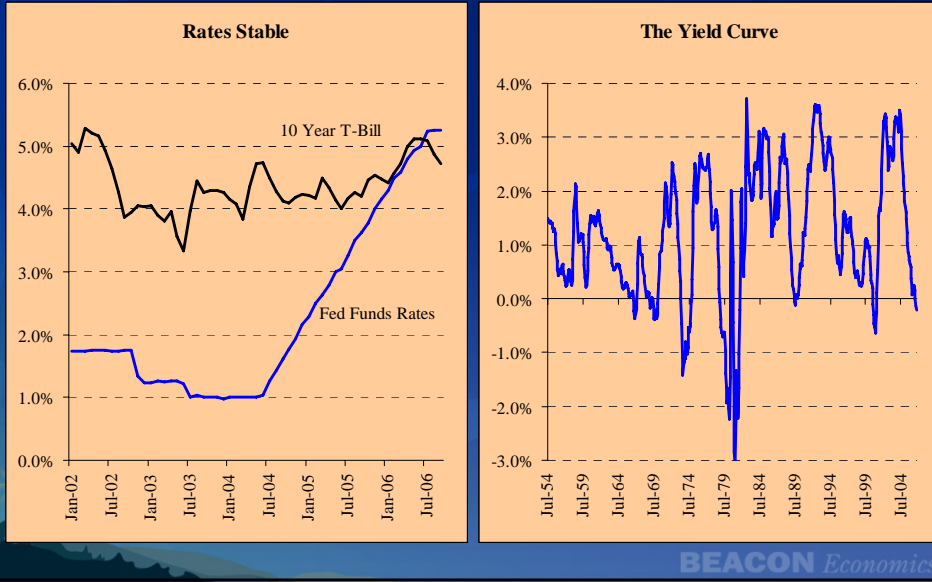
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Equity markets hot

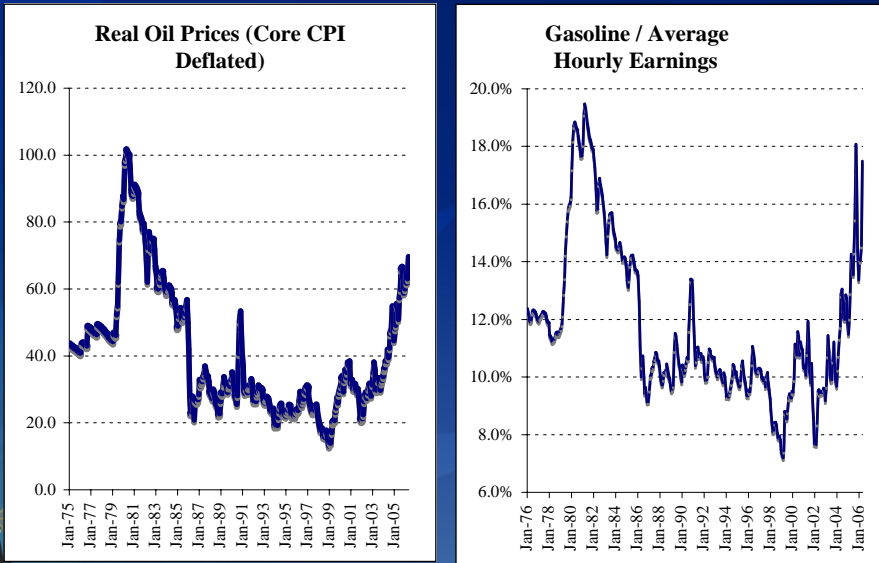


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The bond markets think maybe not

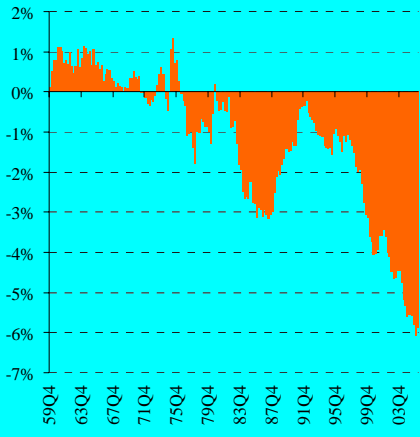


Forget about oil prices...

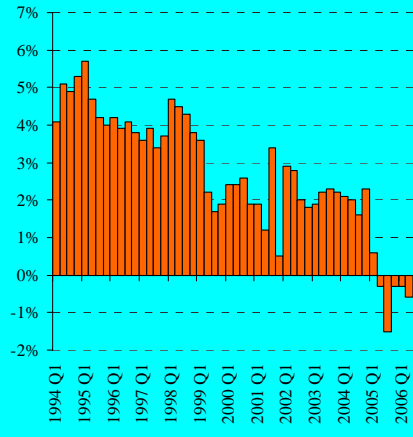


Economic Fundamentals

Trade Balance as % GDP



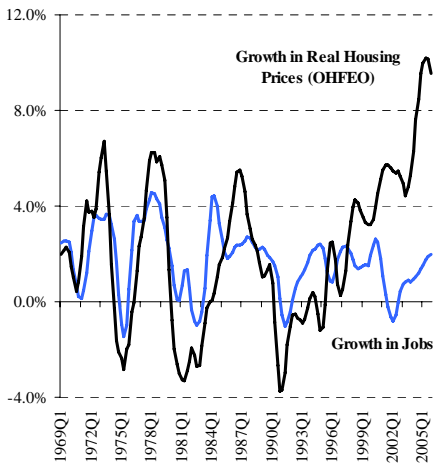
US Private Savings Rates



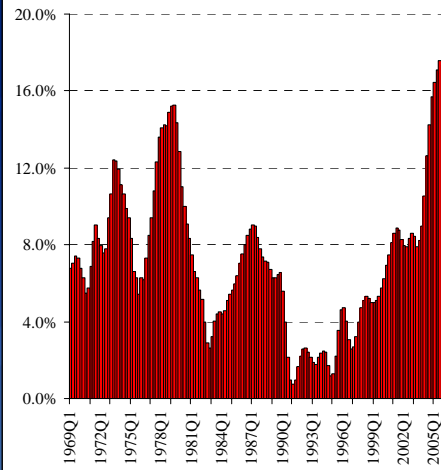
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What has caused the recent surge in spending?

Housing Prices and Jobs



New US Housing Wealth as % of GDP



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Its not just the size...

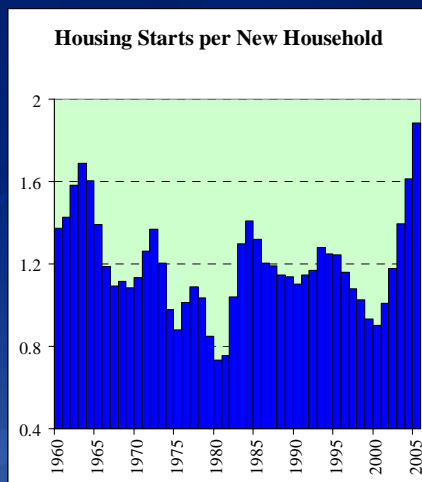
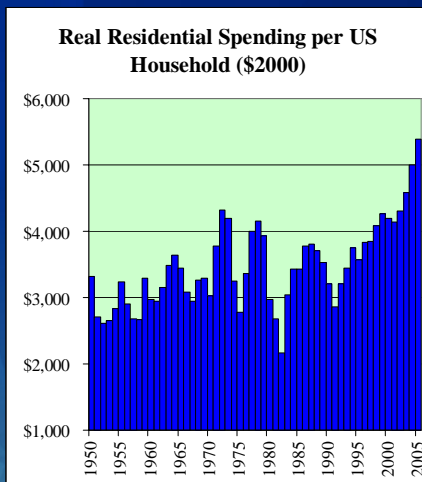
Real Price Appreciation by Region

	70's	80's	Current
Pacific (California)	52.4%	43.0%	64.5%
South Atlantic (Florida)	5.6%	11.0%	43.9%
Middle Atlantic (New York)	3.2%	29.3%	42.9%
New England (Massachusettes)	10.9%	24.4%	35.5%
Mountain (Colorado)	32.0%	-10.2%	34.2%
West North Central (Minnesota)	15.5%	-2.0%	15.8%
East South Central (Tennessee)	6.5%	0.9%	11.0%
East North Central (Illinois)	17.3%	13.7%	10.9%
West South Central (Texas)	25.2%	-20.5%	10.5%
USA	17.2%	12.9%	33.8%



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And we have overbuilt.

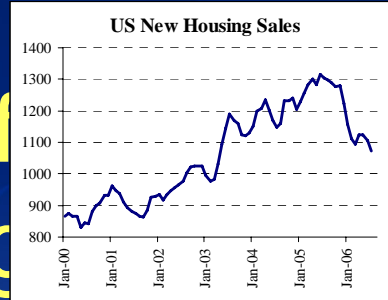
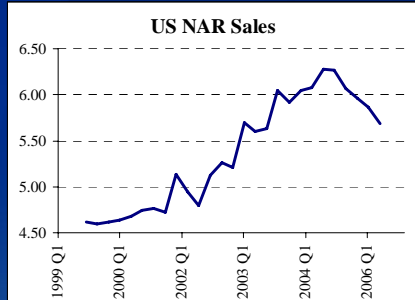


- Residential spending has added .5% growth annually to US GDP 2002-05
- Construction, real estate and mortgage finance contributed 1/3rd of all new US jobs between 2001 and 2005



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The old debate... is it a bubble?



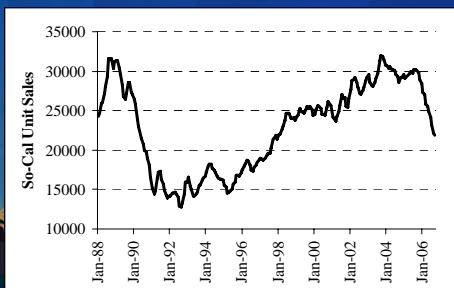
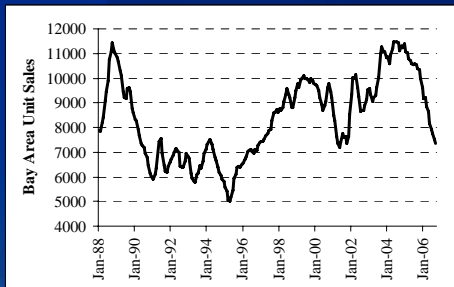
NAR: Home Prices Expected To Fall For Remainder Of 2006

WASHINGTON, September 13, 2006 - Housing prices are expected to continue to have a limited fall throughout 2006, according to testimony submitted by the National Association of Realtors® at today's Senate Banking Committee hearing, titled The Housing Bubble and Its Implications for the Economy. In addition, NAR noted that the sellers' market is transitioning to a buyers' market, which can be healthy for some local economies.

"For the past five years, the housing market has been a steadfast leader in the U.S. economy," Thomas M. Stevens, president of NAR, told the

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California Real Estate



Prices: Existing Single Family Homes

	Price off Peak	Current
Alameda	-\$6,038	\$618,139
Contra Costa	-\$14,693	\$566,574
Marin	-\$46,205	\$896,140
Napa	-\$17,846	\$598,014
San Francisco	-\$1,936	\$802,383
San Mateo	-\$22,263	\$785,581
Sonoma	-\$36,425	\$553,622

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The spin continues...

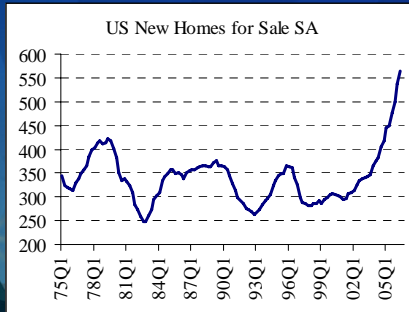
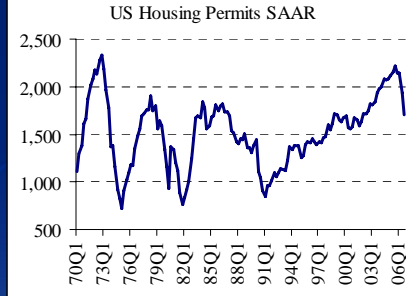
Housing Starts Increase by 5.9 Percent

By Alex Markels
Posted 10/18/06

In a sign that the housing industry may not be quite as bad off as many have suggested, housing starts increased by 5.9 percent in September, the Commerce Department reported today, reversing three months of declines and confounding economists who had predicted a small decrease for the month. Construction in the previous month was also revised upward, although it still represented a 4.9 percent decrease from July.

Related Links

- Median home price dips for first time since '95
- Housing Slump Threatens Jobs
- Do home builders have a hangover?



Pending Home Sales Index Shows Market Stabilizing

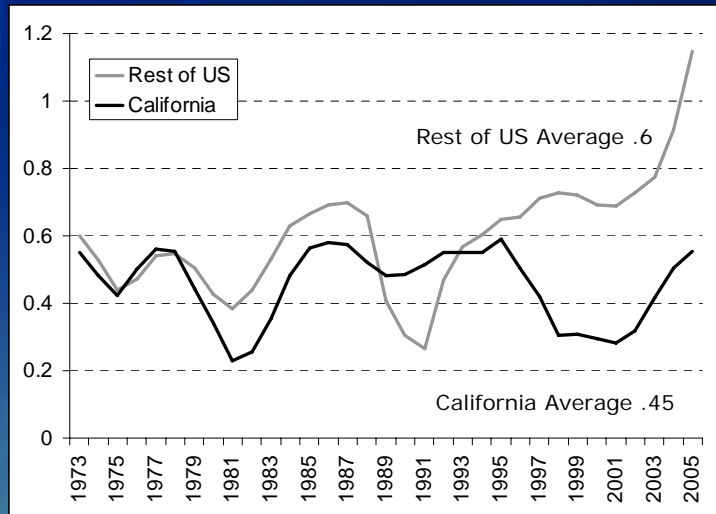
WASHINGTON, October 02, 2006 - Pending home sales are up, indicating a stabilization is taking place in the housing market, according to the National Association of Realtors®.

The Pending Home Sales Index,* based on contracts signed in August, rose 4.3 percent to a level of 110.1 from a reading of 105.6 in July, but is 14.1 percent lower than August 2005.

David Lereah, NAR's chief economist, said the rise in the index is a hopeful sign. "Our sense is that home sales may have reached a low in

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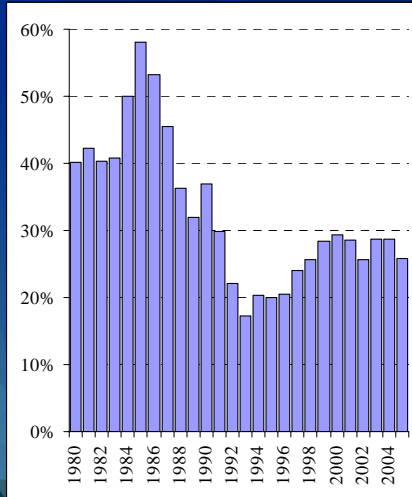
Is California Different? New Housing Starts / New Adults



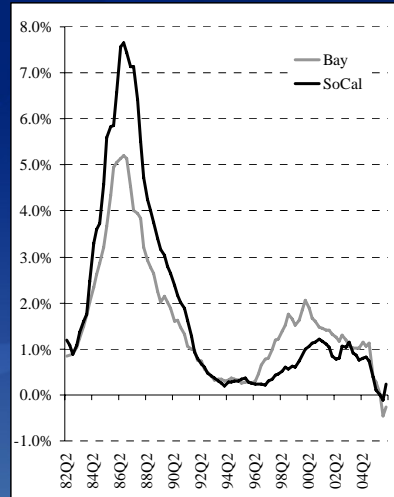
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Apartment Stocks

Multifamily as % of New Residential Units

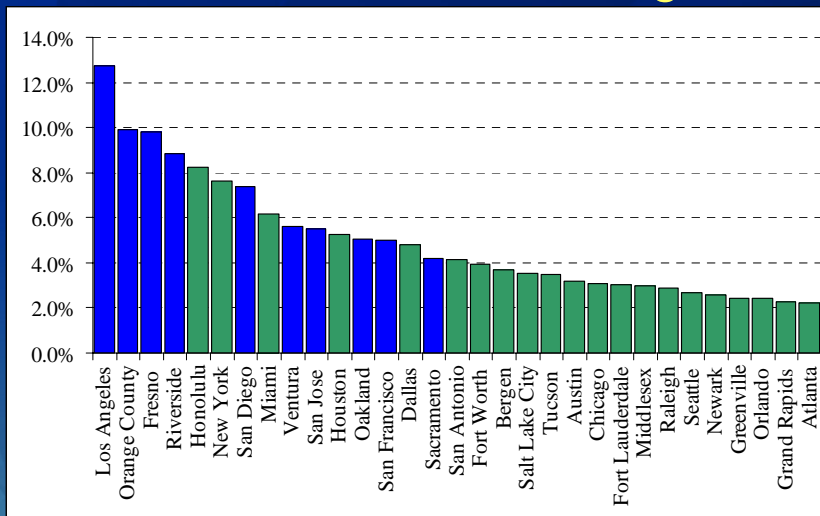


Percent growth in the quantity of rental units (SAAR)



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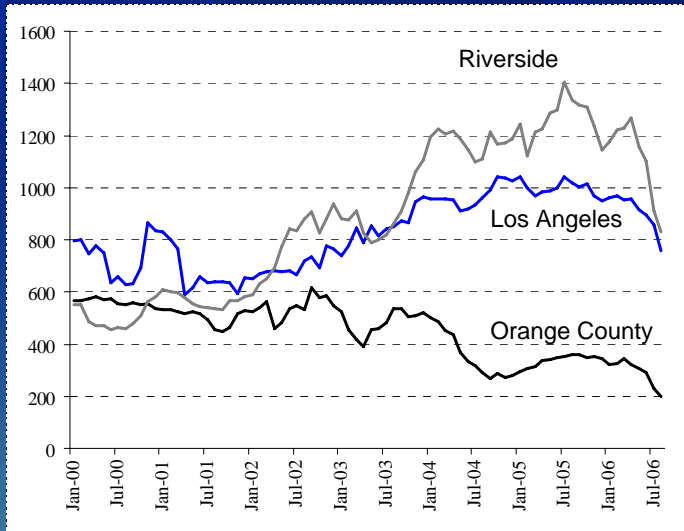
Over-Crowded Housing



Percent of Occupied Housing with > 1 person per room

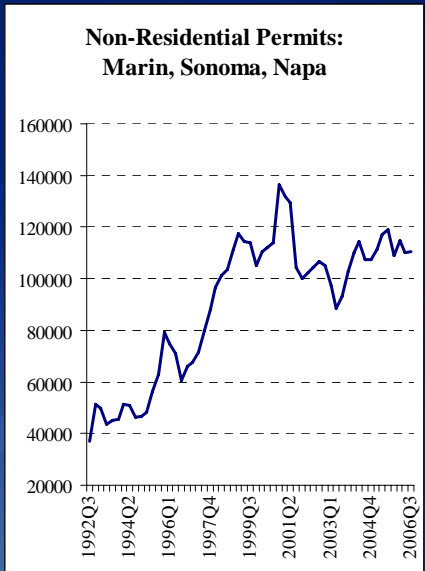
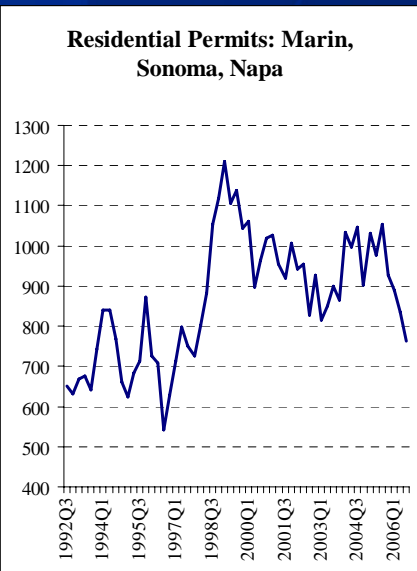
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So-Cal Residential Permits



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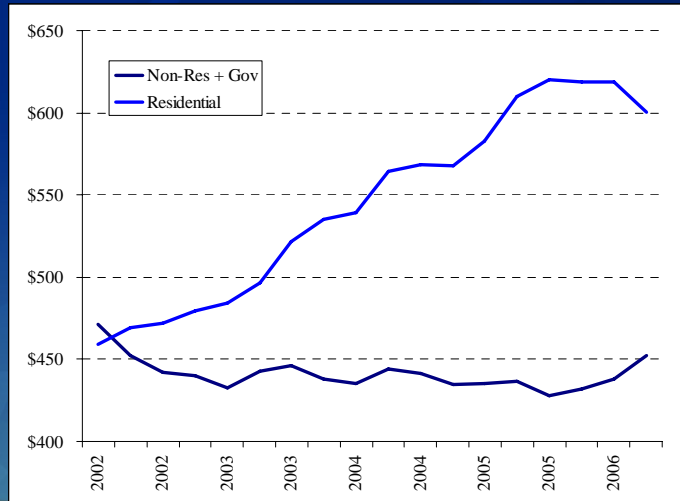
North Bay Res Permits: Slowing



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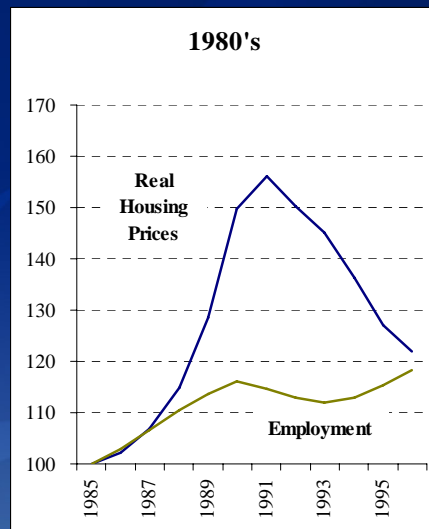
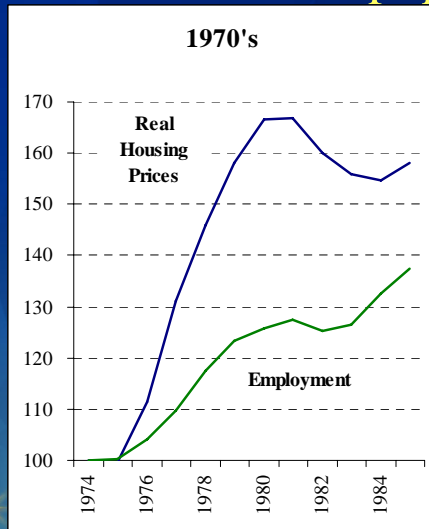
Non-Res to pick up the slack?

Investment, SAAR \$Billions, Real



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Which 'pop' will it be?



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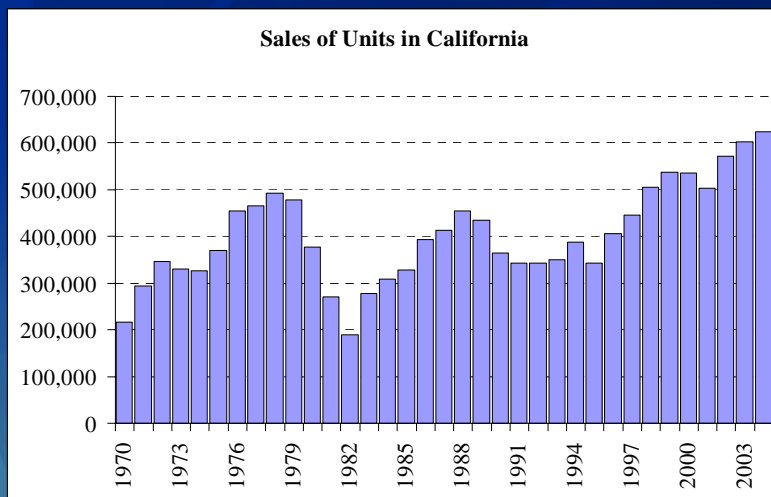
The good news

- Housing is not that big a component of the economy
 - Still a return to normalcy is a large drag
- The dollar is down, and will likely to continue to soften
 - Demand for exports is up
 - California is an export oriented state both for goods and services.
 - A falling dollar will drive rates up, though
- Corporations are sitting on large war-chests
 - Cash in the bank will help them weather future slowness
- Cyclical employment limited by lack of build-up
 - Weak job growth in retail and manufacturing may mean less job growth
 - Without a potential for large job losses, the slowdown in real estate may be gradual enough



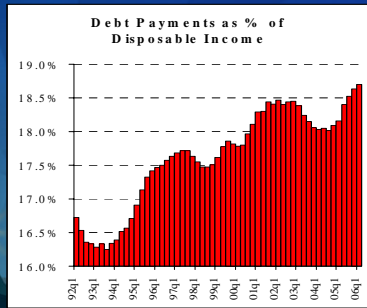
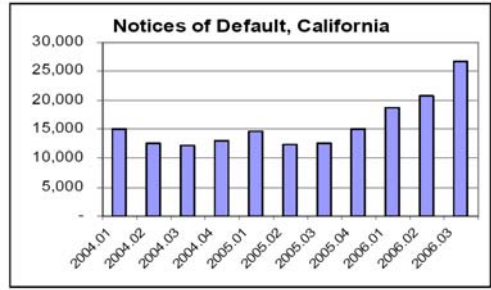
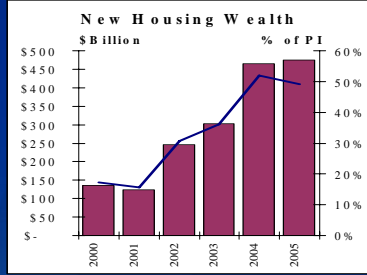
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The Bad News For the Real Estate Industry



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The wild card: wealth and debt



Loose Lending Standards Leading To Early Mortgage Defaults

By Danielle Reed, Of DOW JONES NEWSWIRES

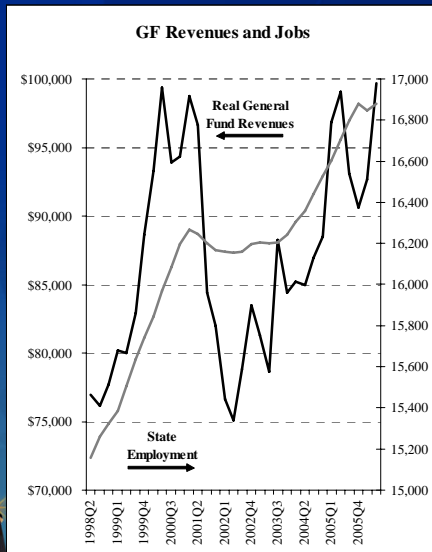
NEW YORK -(Dow Jones)- Early defaults of loans made to borrowers v continued to rise in 2006, and the cause seems largely to be loose len RBS Greenwich suggests.

Increases in early payment defaults on subprime loans are being close investors, as it means lenders are obligated to pay bondholders back f investors who paid above par - or more than 100% of face value - for the large numbers of loans paid back early can result in losses.

Mortgage bond investors also look to early payment rates to judge whe for the risk they're taking.

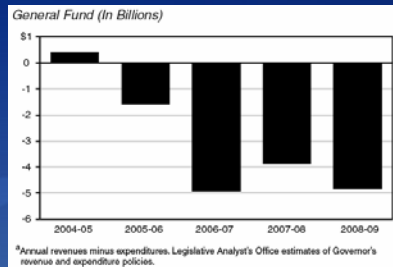
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Sales and Revenues Growth Strong



Current General Fund Budget

	2005-06	2006-07	
Reserves	\$9,634	\$7,031	
Revenues	\$87,691	\$91,545	4.4%
Expenditure	\$90,294	\$97,902	8.4%
Remaining	\$7,031	\$674	



Source: LAO

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Where is it going?

	05-06		06-07	
K-12 Education	\$ 37,855	\$ 40,510		40.0%
Health and Human Services	\$ 26,965	\$ 29,304		28.9%
Higher Education	\$ 10,395	\$ 11,368		11.2%
Corrections and Rehabilitation	\$ 7,838	\$ 8,751		8.6%
Legislative, Judicial, Executive	\$ 3,093	\$ 3,417		3.4%
Business, Transportation & Housing	\$ 1,723	\$ 3,029		3.0%
General Government	\$ 2,238	\$ 2,293		2.3%
Resources	\$ 1,885	\$ 1,826		1.8%
State and Consumer Services	\$ 576	\$ 576		0.6%
Labor and Workforce Development	\$ 89	\$ 99		0.1%
Environmental Protection	\$ 73	\$ 88		0.1%
Total	\$92,730	\$101,261		

General Fund Revenues ONLY



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The economy in the short run

- Positives
 - Short run inflation forces are moderating / long run forces not an issue
 - The Fed will continue to hold
 - Employment / Income on track
- Negatives
 - Fundamentals still out of whack
 - The real estate bubble continues to pop, we have not hit the bottom yet!
- Overall, 2007 overall economic outlook remains very shaky



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California Faces This Challenge and More

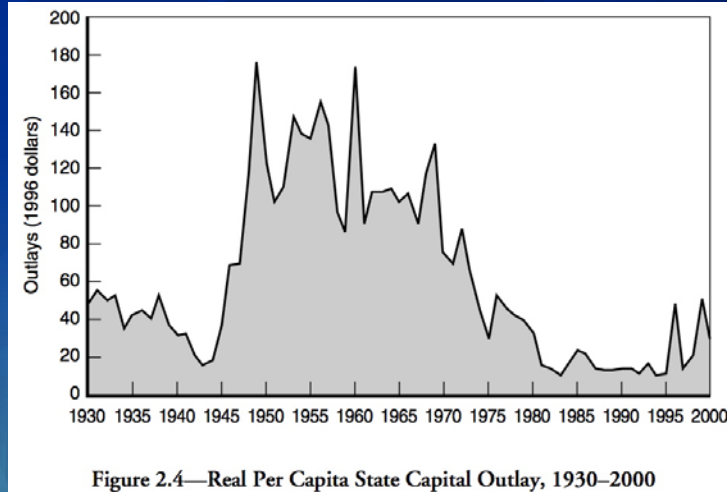
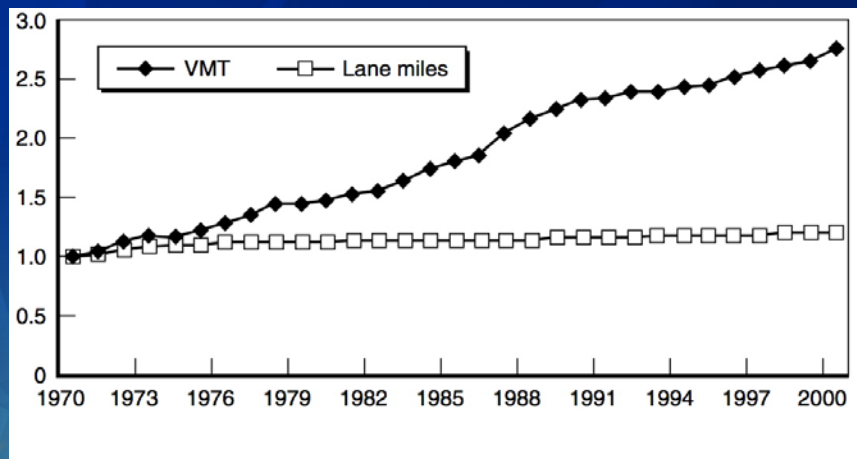


Figure 2.4—Real Per Capita State Capital Outlay, 1930–2000

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Investment is not keeping up!



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Bond Initiatives

- 1A – Gas Sales Tax Security
- 1B - Transportation
- 1C - Housing
- 1D - Education
- 1E - Flood Protection
- Related:
 - Prop 84, 87, 90



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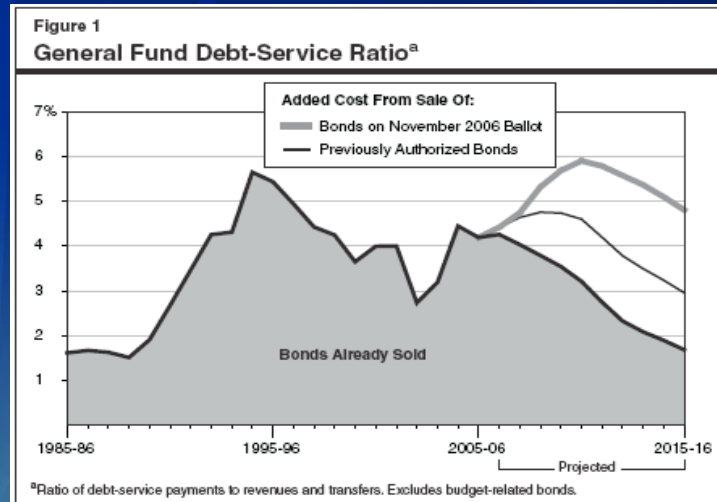
Initiatives by the Numbers: \$37.2B

- 1A: restricts the use of ~\$2B/yr
- 1B: \$19.9B Transportation
 - \$11.3B congestion relief/road improvements
 - \$ 4.0B public transportation
 - \$ 3.1B trade infrastructure
 - \$ 1.5B safety and security
- 1C: \$2.85B Housing
 - \$1.35B development programs
 - \$625M home ownership programs
 - \$590M multifamily housing programs
- 1D: \$10.4B Education
 - \$7.3B K-12
 - \$3.1B higher education
- 1E: \$4.1 Flood Control
 - \$3.0B central valley



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Budget Implications of the Nov. Bond Initiatives



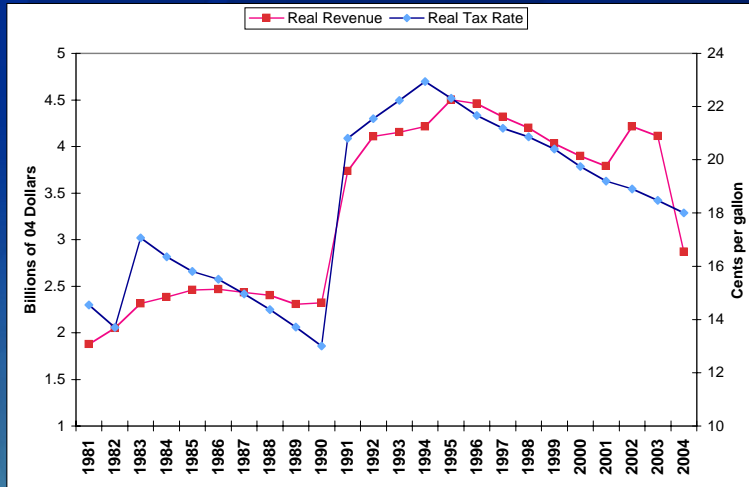
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Alternative funding sources

- Pay as you go
 - Allocate funds from general revenues
 - Quite the opposite of common practice
- Revenue bonds
 - Whatever happened to public/private partnerships? SB 760?
- User fees
 - Tolls, gas taxes

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Gas Taxes: Rates and Revenues - Inflation Adjusted -



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California: A high tax state?

	California	Rank	US Avg
Taxes and Fees Per Capita	\$5,267	9	\$4,706
Taxes and Fees % Income	15.6%	20	15.1%
Property Taxes	17.0%	38	21.1%
Sales Taxes	23.3%	26	24.5%
Income Taxes	21.5%	11	17.4%
Other Taxes and Fees	38.2%	27	37.0%

We aren't a high tax state, we are a dumb tax state.

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Summary of Ballot Propositions

- **Bonds are not a free lunch!**
 - Implicitly tax health and education spending
- **They are temporary fixes for a long term problem**
 - This is not the end of infrastructure projects in CA
- **This appears to be the only way to address the problem**
 - The political will to do the right thing is not there



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