CURRENT TOPICS AND PRACTICES IN LAND-SECURED AND DEVELOPMENT FINANCE

MAY 22, 2024

POMONA, CA

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION:
LAND-SECURED FINANCING CURRENT TOPICS AND PRACTICES

PROSPECTS FOR NEW LAND-SECURED FINANCINGS

CURRENT MARKET CONDITIONS UNIQUE:
PRICE APPRECIATION STRONG DESPITE HIGH MORTGAGE RATES!

WHEN WILL HOUSING MARKET RETURN TO NORMAL CONDITIONS?

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MAY 22, 2024

OVERVIEW OF PRESENTATION

Purpose: provide an economic-housing market framework that each of you can utilize for structuring various land-secured financings

1. There have been **two major macroeconomic factors** underlying housing price changes, but which one is **riskier?**

2. Since the onset of COVID-19, how have the **Federal Reserve Board (FRB) policies** impacted the housing market resulting in unique market conditions?

3. What types of **pricing structures** are being utilized by builders
   And how do these impact price point studies for setting special taxes?

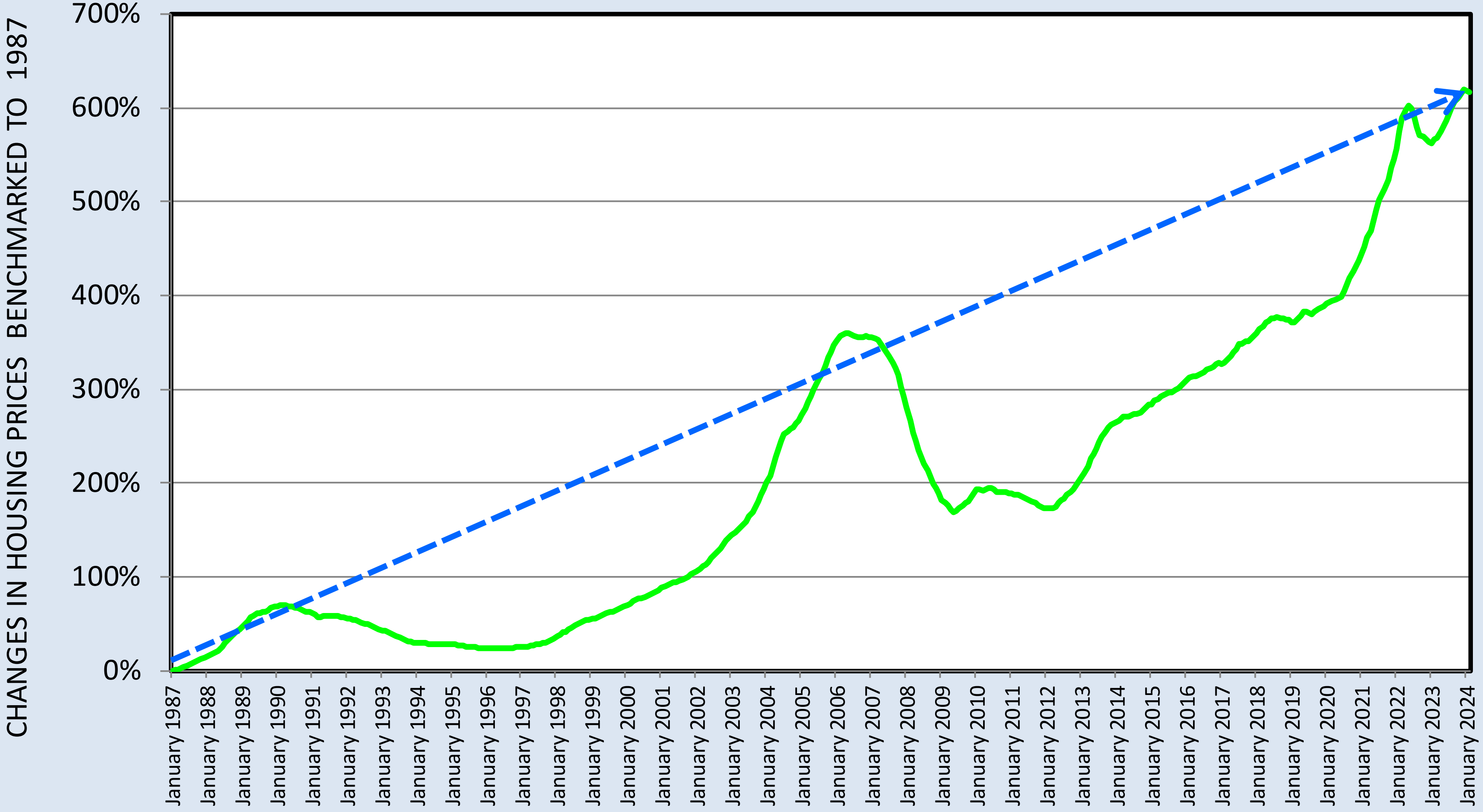
4. **Conclusions:** looking ahead, what is likely to happen to residential values, and what types of safeguards should be considered for land-secured financings?

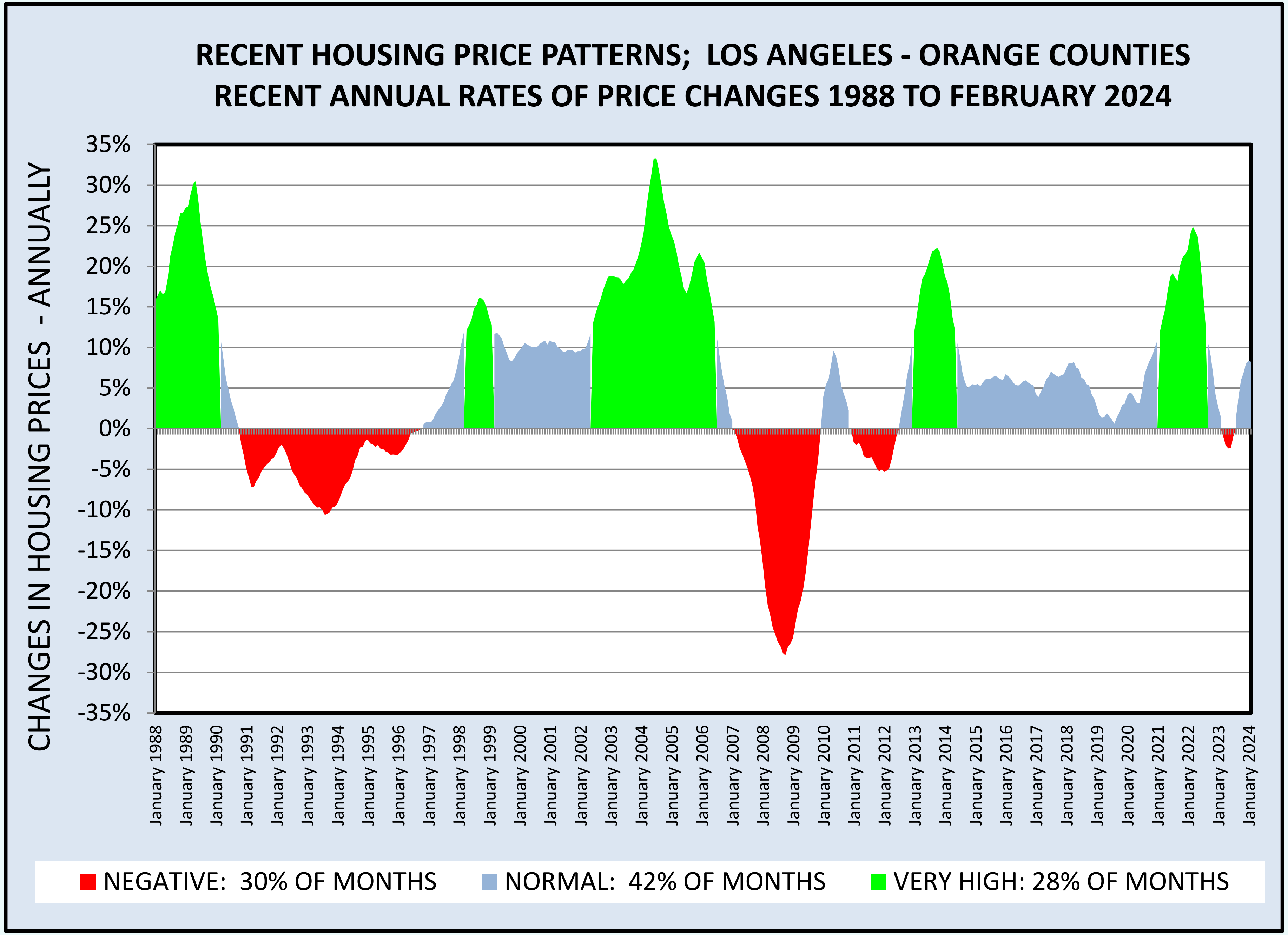
PART 1

There are **two major macroeconomic factors** underlying housing price changes,

But which one is **riskier**?

HOUSING PRICE PATTERNS; LOS ANGELES - ORANGE COUNTY REGION
LONG TERM TRENDS; CASE-SHILLER PRICE INDEX
SINCE 1987 TO FEBRUARY 2024 PRICES INCREASED SIX -FOLD
5.20%/YR., AVG (BLUE LINE)




RECENT HOUSING PRICE PATTERNS; LOS ANGELES - ORANGE COUNTIES
RECENT ANNUAL RATES OF PRICE CHANGES 1988 TO FEBRUARY 2024
CHANGES IN HOUSING PRICES - ANNUALLY
35%
30%
25%
20%
15%
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-30%
-35%
January 1988
January 1989
January 1990
January 1991
January 1992
January 1993
January 1994
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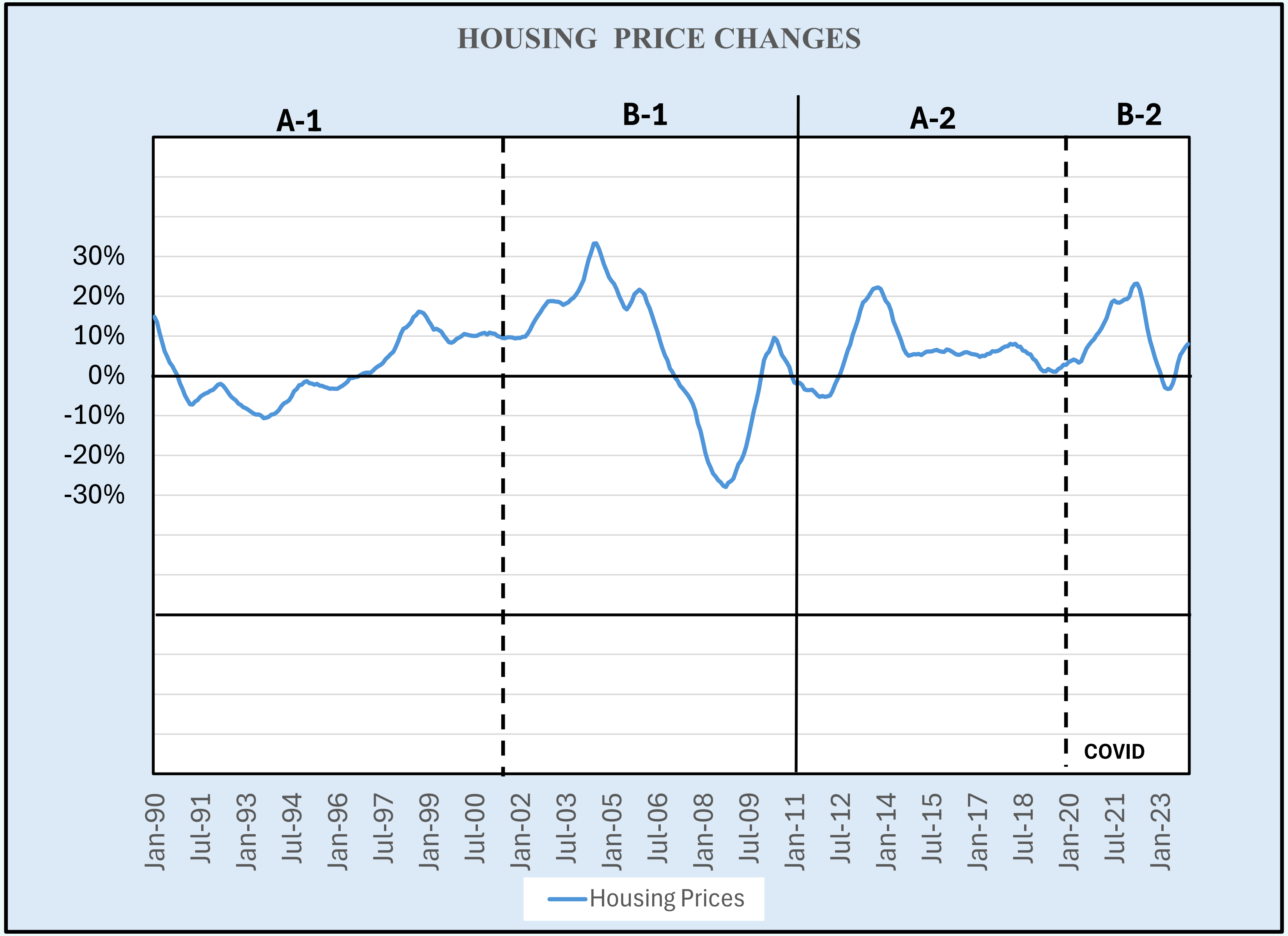
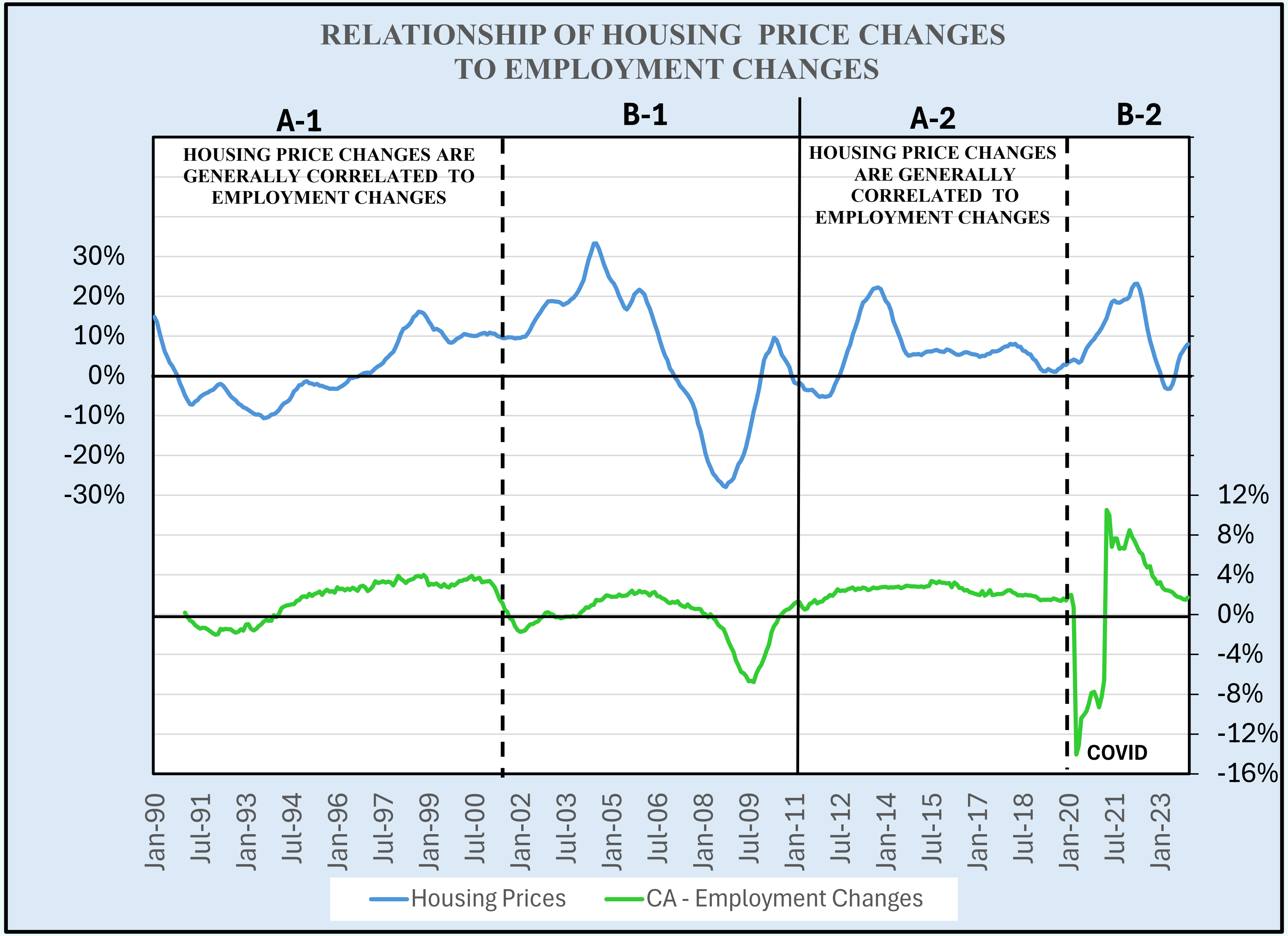
January 2016
January 2017
January 2018
January 2019
January 2020
January 2021
January 2022
January 2023
January 2024
NEGATIVE: 30% OF MONTHS
NORMAL: 42% OF MONTHS
VERY HIGH: 28% OF MONTHS

HOUSING PRICE CHANGES 1990-2023



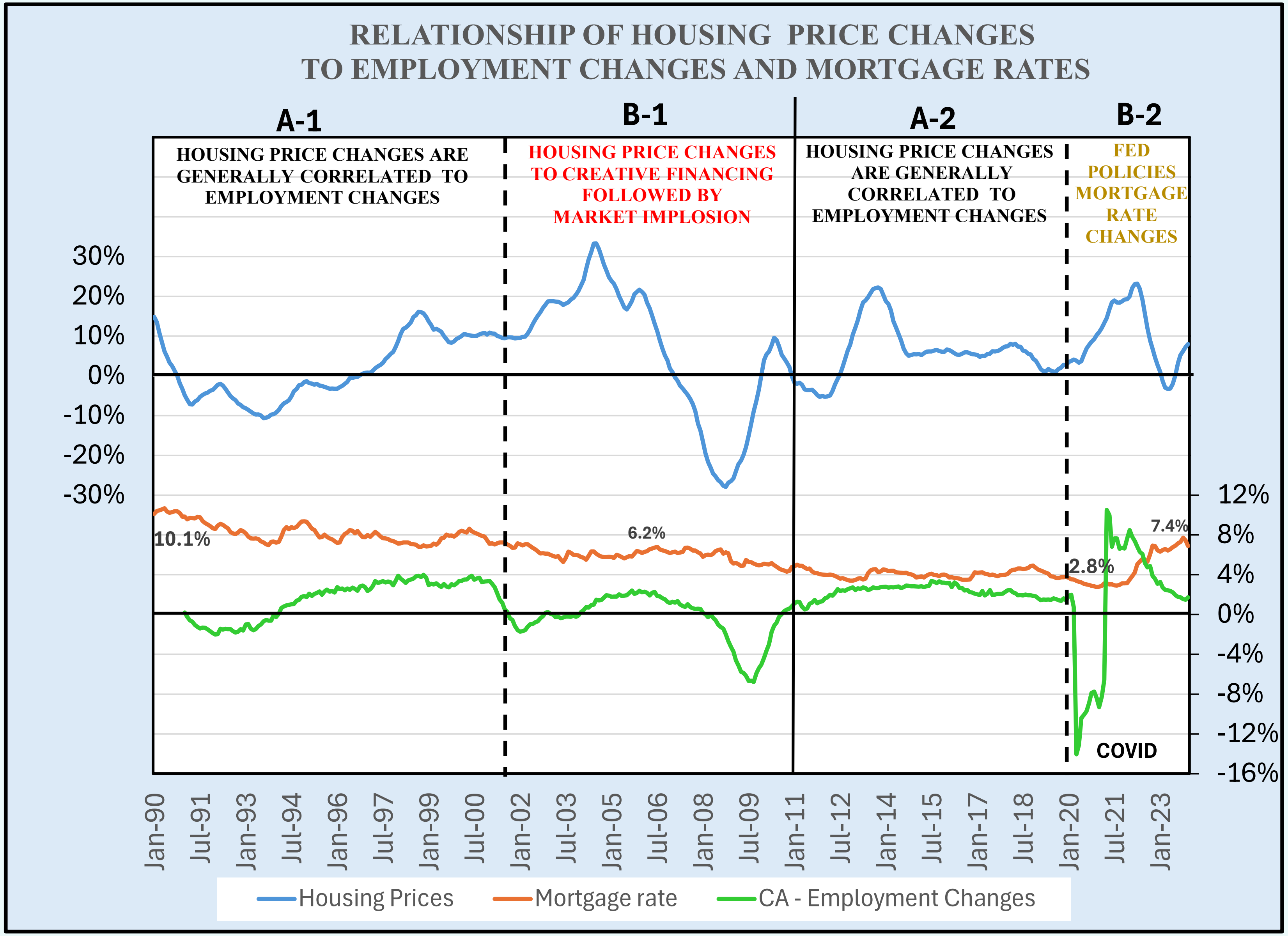
EMPLOYMENT CHANGES HAVE BEEN THE PRIMARY DRIVER OF PRICE CHANGES; 1990-2023



Employment changes have been the primary driver of price changes between 1990-2023

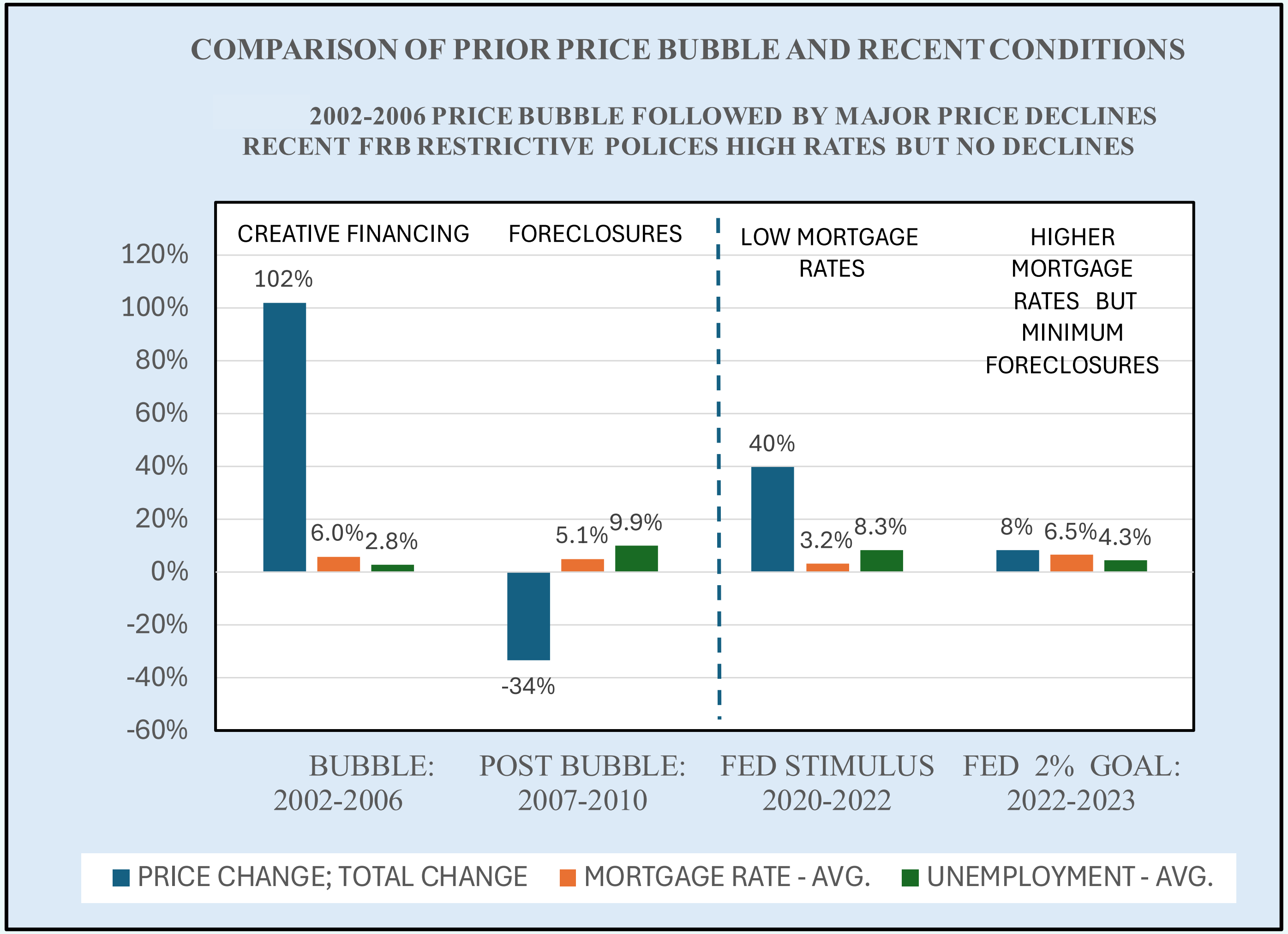
***Except* for creative financing (2002-2006)**

And recent historically low mortgage rates (2020-2021)



COMPARISON OF PRICE BUBBLE/IMPLOSION VS. RECENT HOUSING CONDITIONS

Creative financing between 2002-2006 followed by price declines and high unemployment
From 2022-2023, prices are stable despite high mortgage rates - low inventory



PART 2

Since the onset of COVID-19, how have **Federal Reserve Board (FRB) policies** impacted the housing market, **resulting** in unique market conditions?

FED POLICIES RESULT IN MAJOR CHANGES IN THE HOUSING MARKET FROM BURST OF ROBUST ACTIVITY TO CHALLENGING CONDITIONS

Federal Reserve Board (FRB) Policies Primary Driver of Economy and Housing Market
Mid-2020 To April 2022 - Housing Friendly

- FRB lowered interest rates and purchased mortgage loans AS WELL AS treasury bonds
- Robust housing price appreciation
- New and existing homeowners secured low mortgage rates

Since the April 2022 Peak Level – Housing Adversely Impacted

- Fed Restrictive Policies: Higher Interest Rates and Selling Mortgages from its Portfolio
- Higher Mortgage Rates
- Homeowners with Low Mortgage Rates Constrain Supply-Inventory

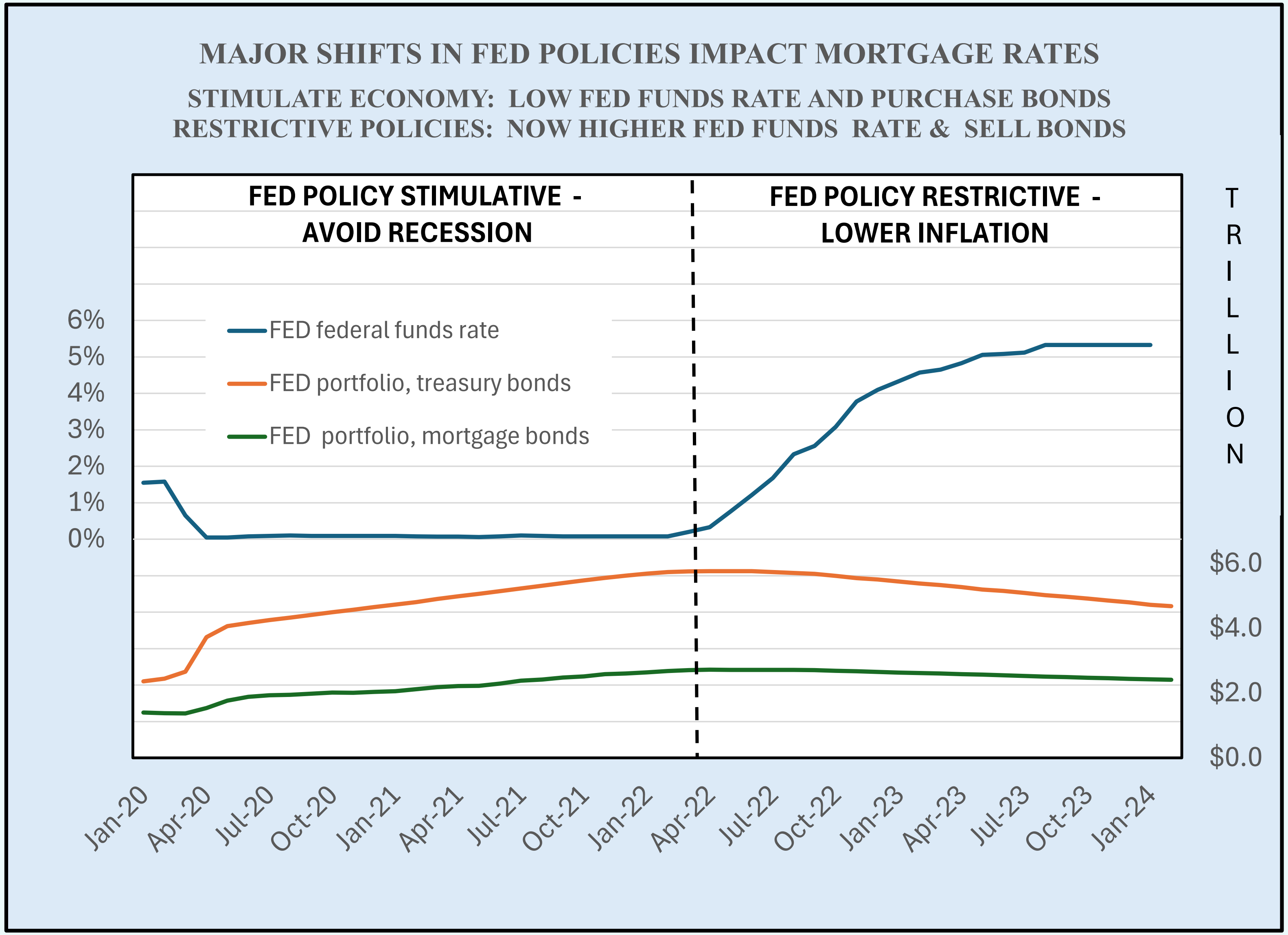
Outlook - FRB Goal of a 2% Inflation Rate

- Progress being made
- Expectation of a "soft economic landing" – no recession
- As the 2.0% goal is approached, mortgages rates decline BUT at a SLOW pace

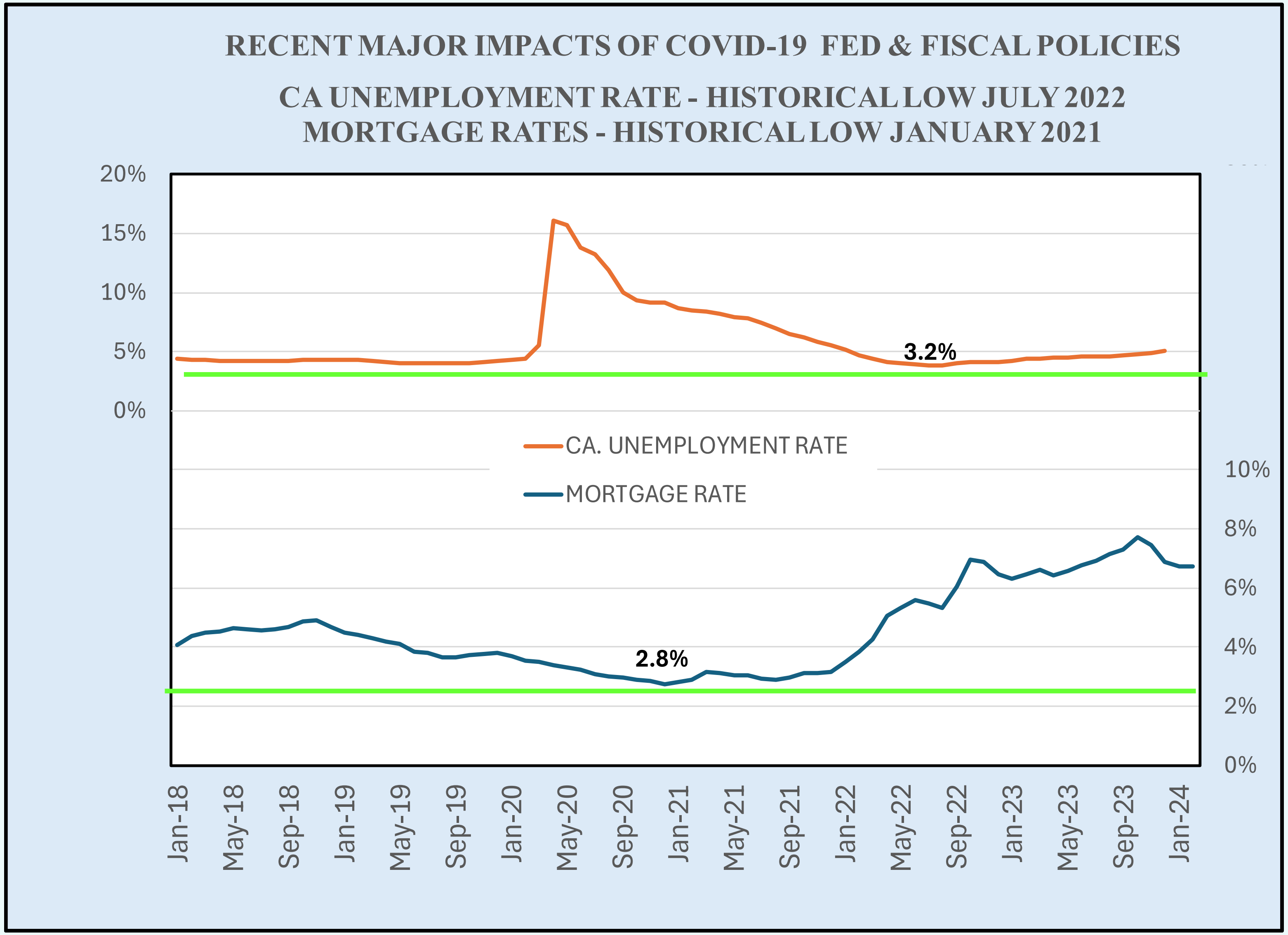
US-GDP is $28.2t while mortgage loans amount to $12.2t

The Fed stimulus policies provided an enormous financial windfall
to homeowners securing low mortgage rates

FED POLICY SHIFT FROM STIMULATIVE TO RESTRICTIVE



MACROECONOMIC FACTORS: RECENT HISTORICAL LOWS FOR UNEMPLOYMENT AND MORTGAGE RATES 1990-CURRENT



TRENDS/PATTERNS FOR U.S. MORTGAGE RATES SINCE 2018

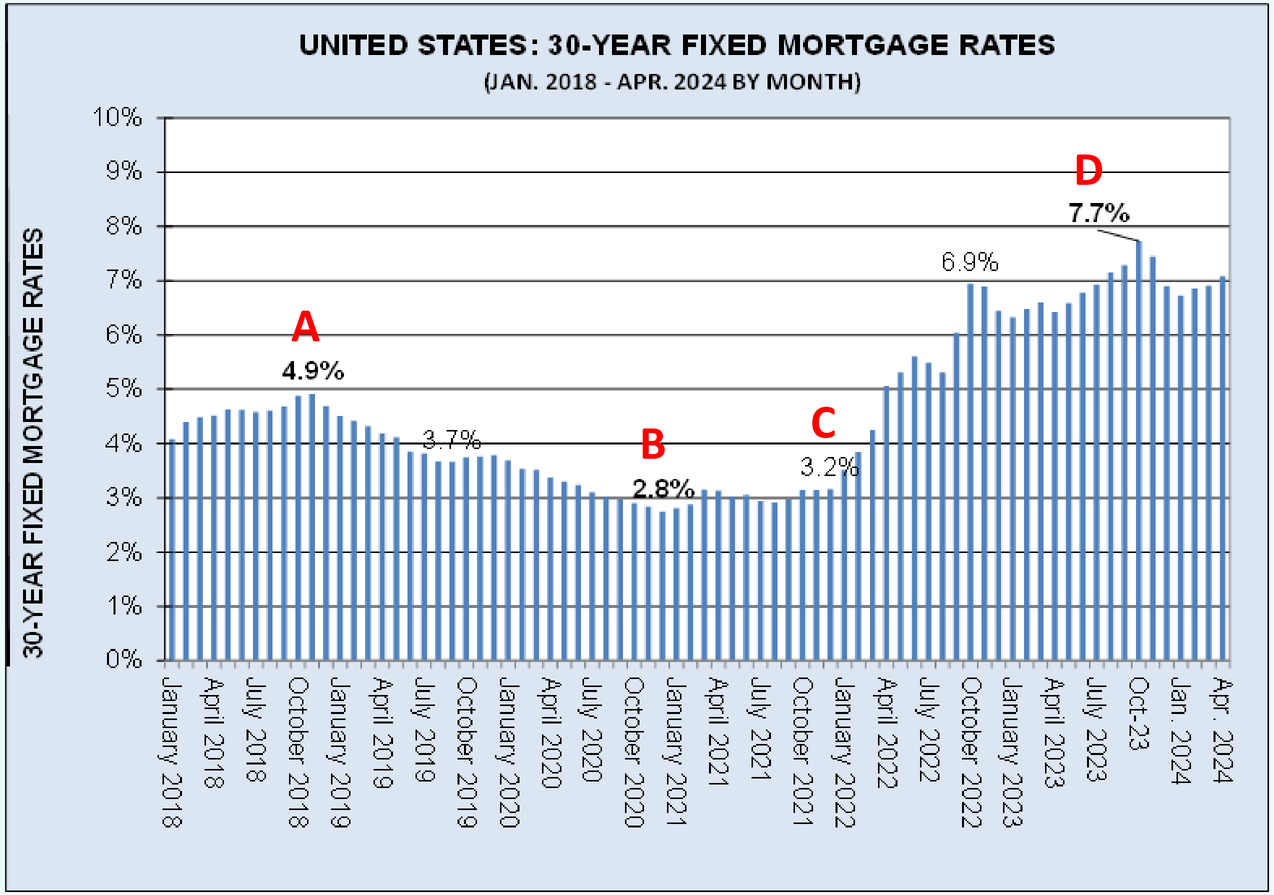
Mortgage rates are a secondary driver of housing demand; employment growth is typically the primary driver.

A. Mortgage rates peaked in November 2018 at **4.9%.**

B. Rates then declined to their **lowest level of 2.8% in January 2021** due to Fed policies stimulating the economy.

C. Rates remained at historically low levels, **below 3.2%, through December 2021**.

D. Due to Fed policies aimed at reducing inflation, **mortgage rates rose to 7.7% in October 2023**, but **recently were 7.1%.**



INLAND EMPIRE CITY HOUSING SUPPLY & DEMAND, AND PRICE APPRECIATION (JAN. 2018 – DEC. 2023)

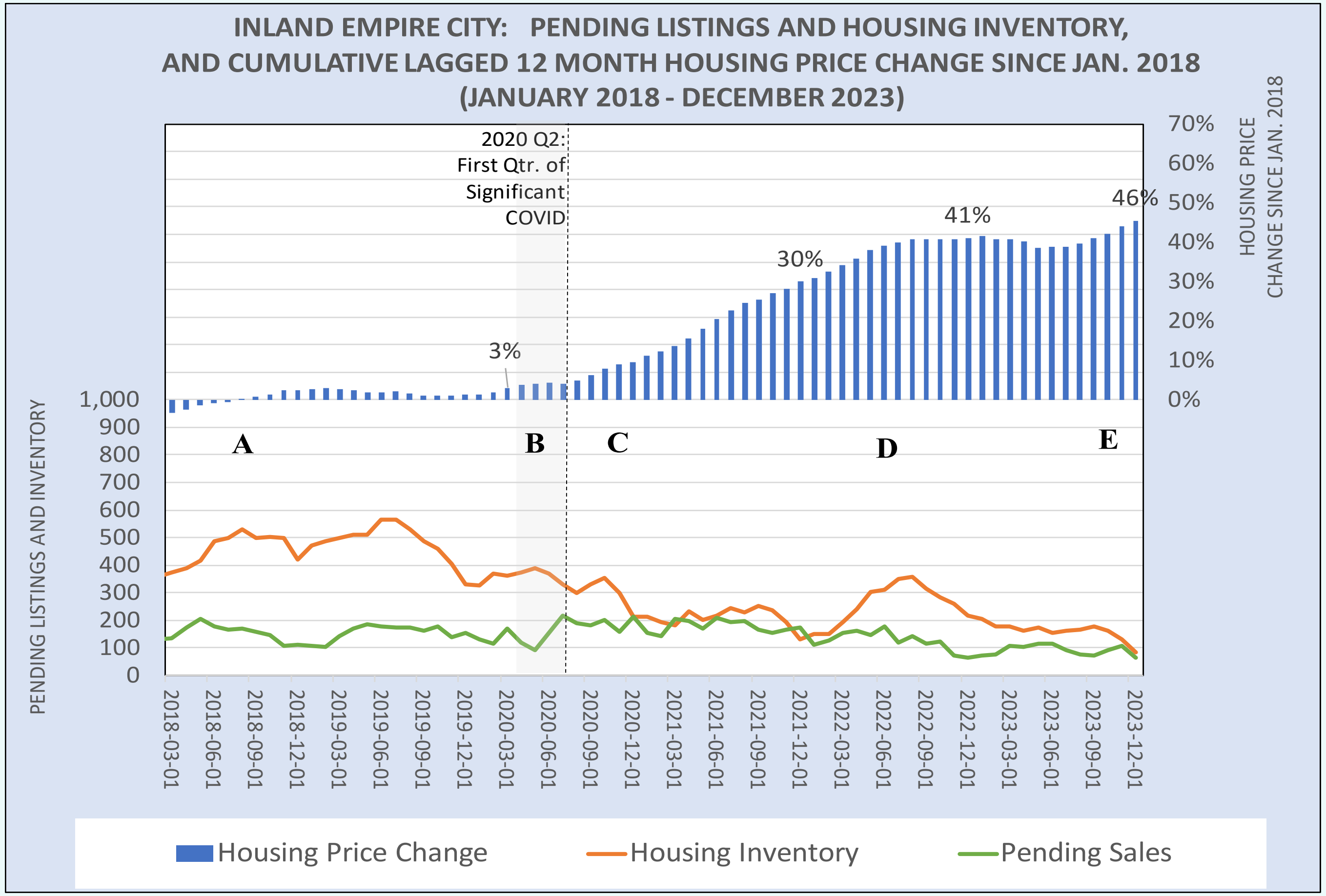
A. **In 2018 to early 2020**, the city housing inventory *(supply/orange)* **exceeded** pending sales **(demand/green), normal**

B. However, beginning in the **2nd quarter of 2020, housing demand and supply started to converge and met in 2021, COVID-19**

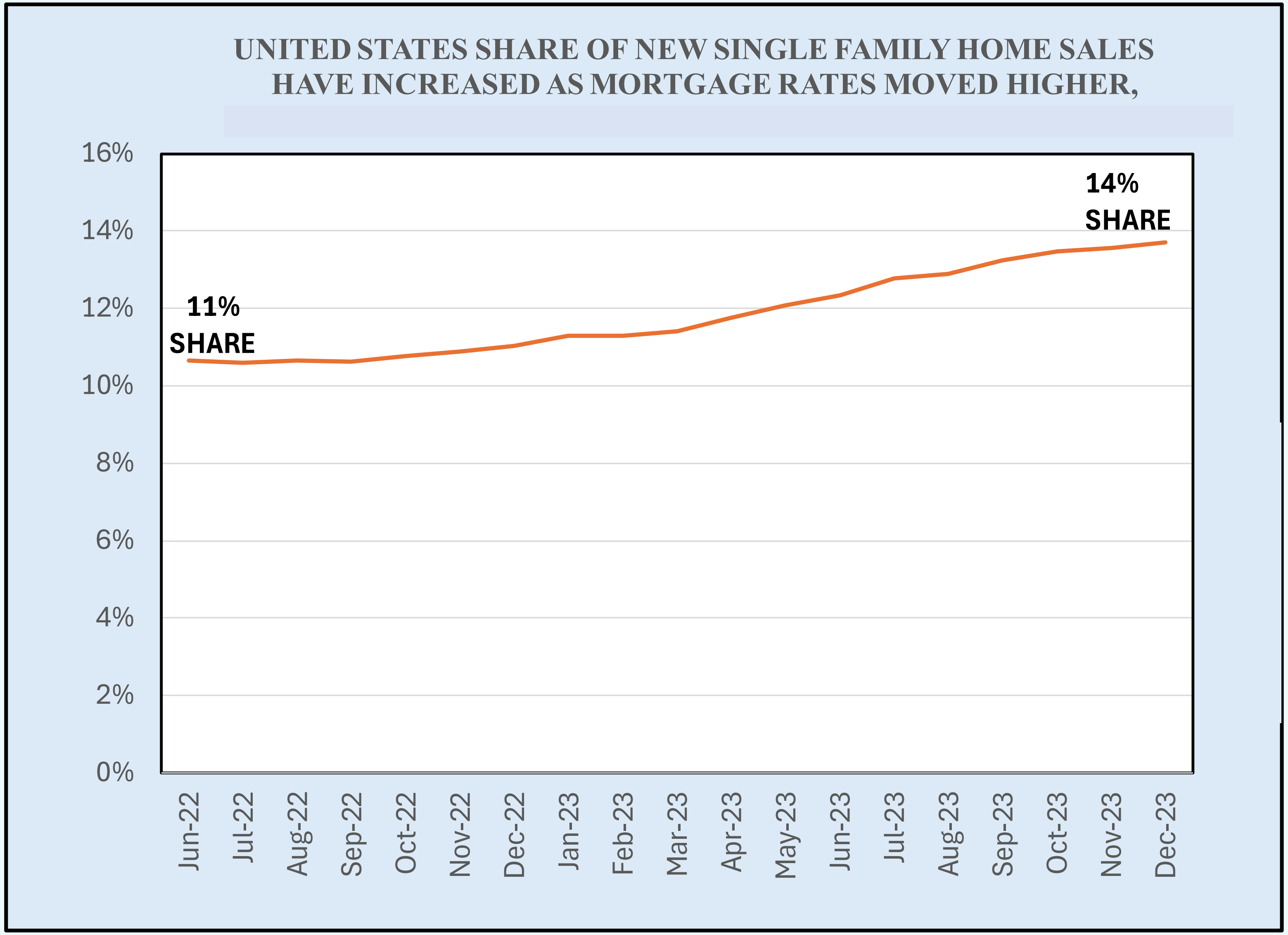
C. Once supply and demand curves started to converge, this resulted in a significant increase in **price appreciation**

D. **During 2022, inventory exceeded pending sales,** but inventory is still relatively low

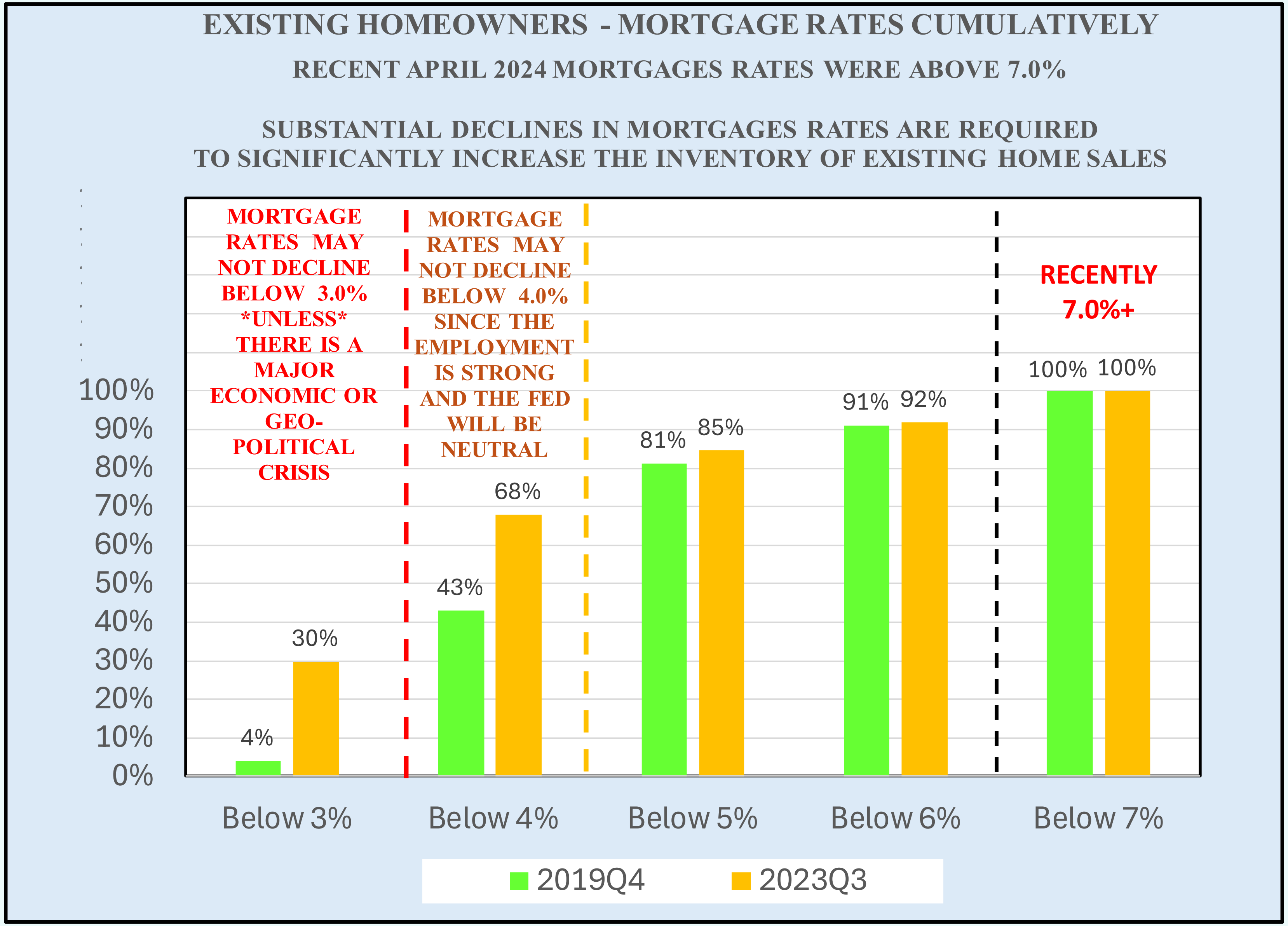
E. **During 2023, with high mortgage rates, inventory declined** and converged with low sales in December 2023.



SHARE OF U.S. NEW SINGLE-FAMILY HOME SALES



EXISTING HOMEOWNER MORTGAGE RATES BY CUMULATIVE COHORTS 2019Q4 AND 2023Q3



SOME FORECASTS OF MORTGAGE RATES

Empire Economics does not perform macroeconomic modeling of economics conditions that provide mortgage rate forecasts but does rely on such forecasts to analyze how various levels of mortgage rates are likely to impact the housing market.

The above analysis identified that declines in mortgage rates are a critical factor for increasing the market supply of for-sale homes as well as increasing demand as monthly payments become more affordable, thereby moving the market back to a "normal" balance of supply/demand.

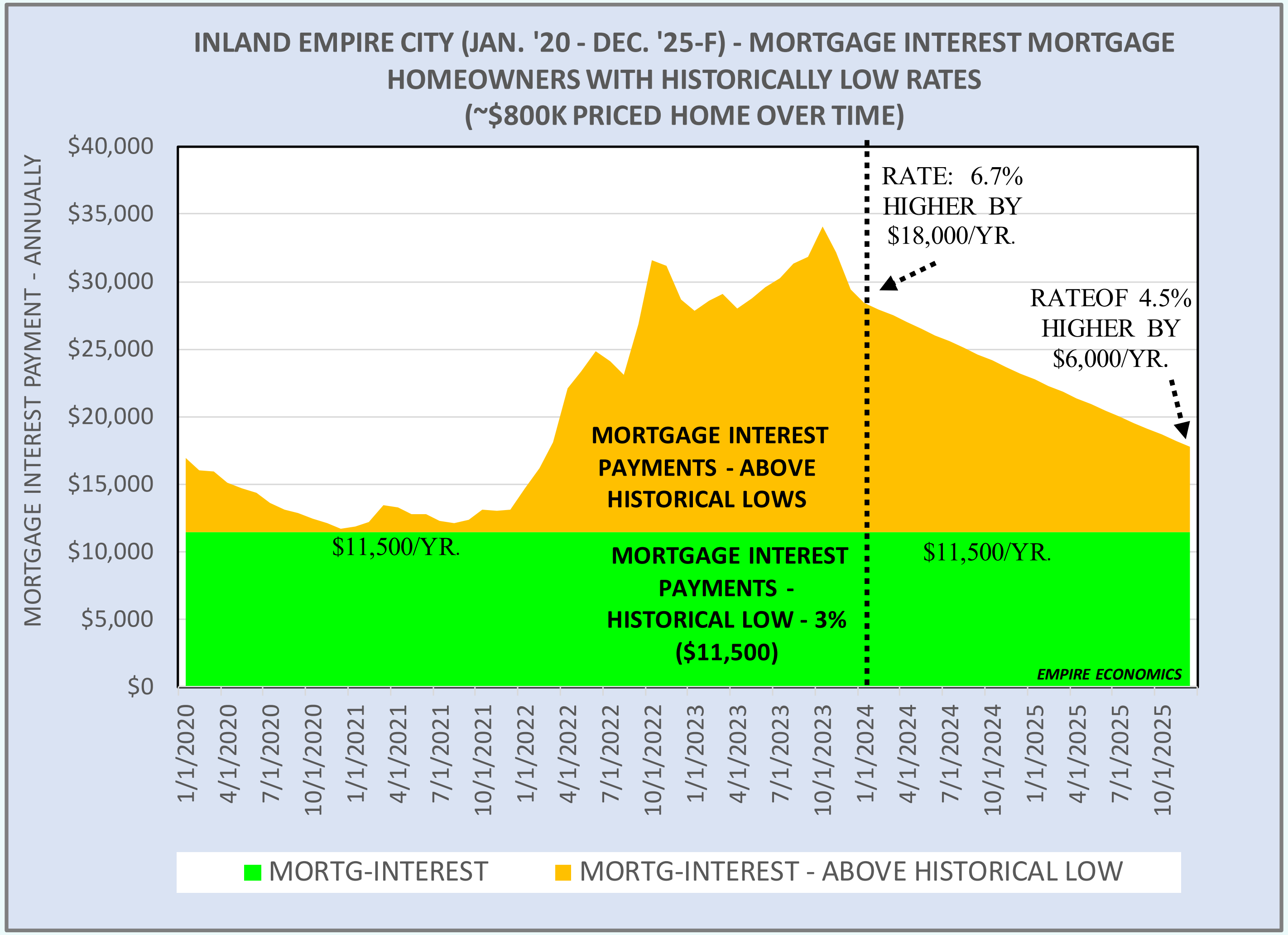
Accordingly, below are some forecasts from various organizations:

Forecasters (4/30/2024)	Q2 2024	Q3 2024	Q4 2024		Q1 2025	Q2 2025	Q3 2025	Q4 2025
Fannie Mae	6.7%	6.6%	6.4%		6.2%	6.1%	6.0%	6.0%
Mortgage Bankers Association (MBA)	6.7%	6.6%	6.4%		6.3%	6.2%	6.1%	5.9%
National Association of Realtors (NAR)	7.1%	6.7%	6.5%		6.3%	6.2%	6.2%	6.1%
Wells Fargo	7.1%	6.8%	6.5%		6.3%	6.2%	6.0%	5.9%

INLAND EMPIRE CITY – MORTGAGE INTEREST PAYMENTS (JAN. 2020– DEC. 2025F)

For a ~$800,000 house purchase, households that used a **3% mortgage rate in 2021** have mortgage interest rate payments of about **$11,500 a year**

As mortgage rates decline, the incentives for homeowners to stay in their current homes with historically low rates diminishes, and so the supply of homes for-sale increases.

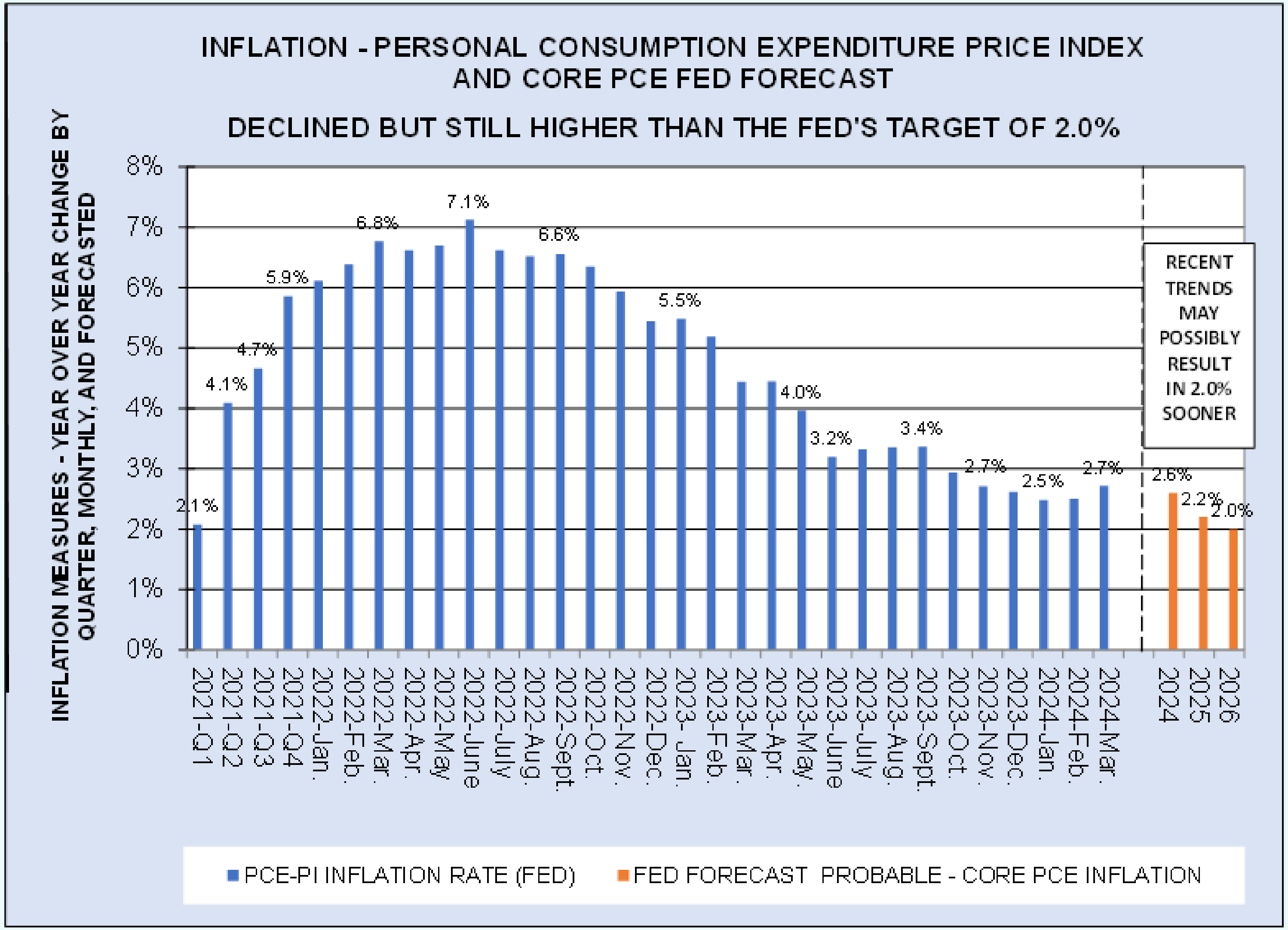


CURRENT FRB MONETARY POLICIES EXPECTED TO REDUCE CORE INFLATION TO THE 2% GOAL BY 2026

Fed is adopting a conservative posture to ensure inflation remains low

Remaining vigilant as economy/employment is sturdy - soft landing

***** Mortgage rates will decline, but at a slow pace *****



SOURCE OF FED FORECAST (ORANGE BARS)

FEDERAL OPEN MARKET COMMITTEE, ECONOMIC PROJECTIONS, DECEMBER 13, 2023 TABLE 1 MEDIAN

RECAP → POETIC VERSION – AI

With each uptick in rates, demand took flight,
Yet those with low rates clung tight.

Nestled in dwellings with rates of yore,
Content in the homes they adore.
They watched the market with speculative eyes,
As excess demand pushed prices to the skies.

The Fed with its target, firm at two percent,
Aims for stability, that's their intent.
As rates recede, like a low tide's retreat,
Hope for buyers begins to replete.

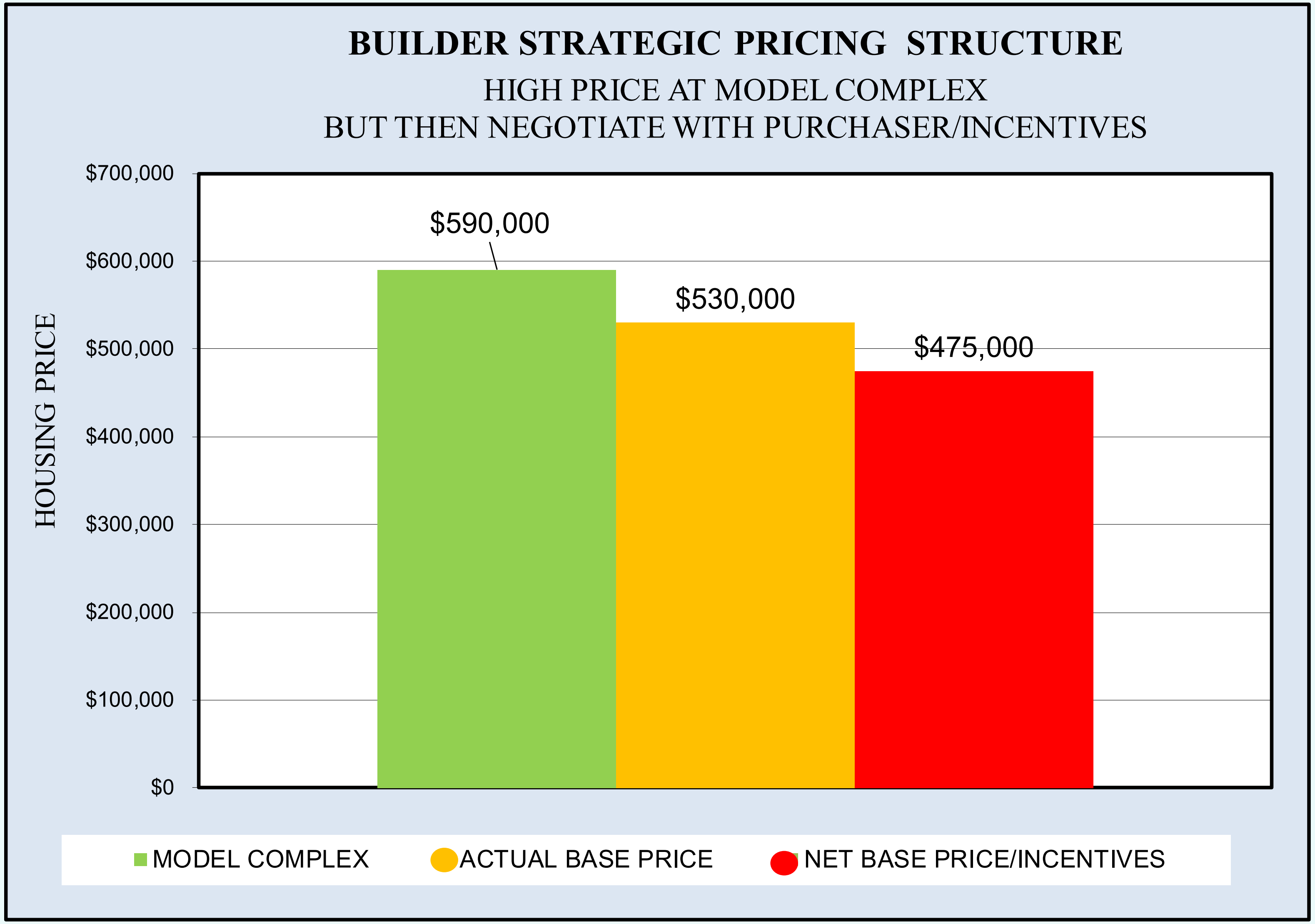
With the promise of rates that gently decline,
Dreams of ownership once more align.
Yet, as housing demand starts to renew,
The supply constricted, still options too few.

PART 3

What types of **pricing structures** are being utilized by builders?

How do these impact price point studies for setting special taxes?

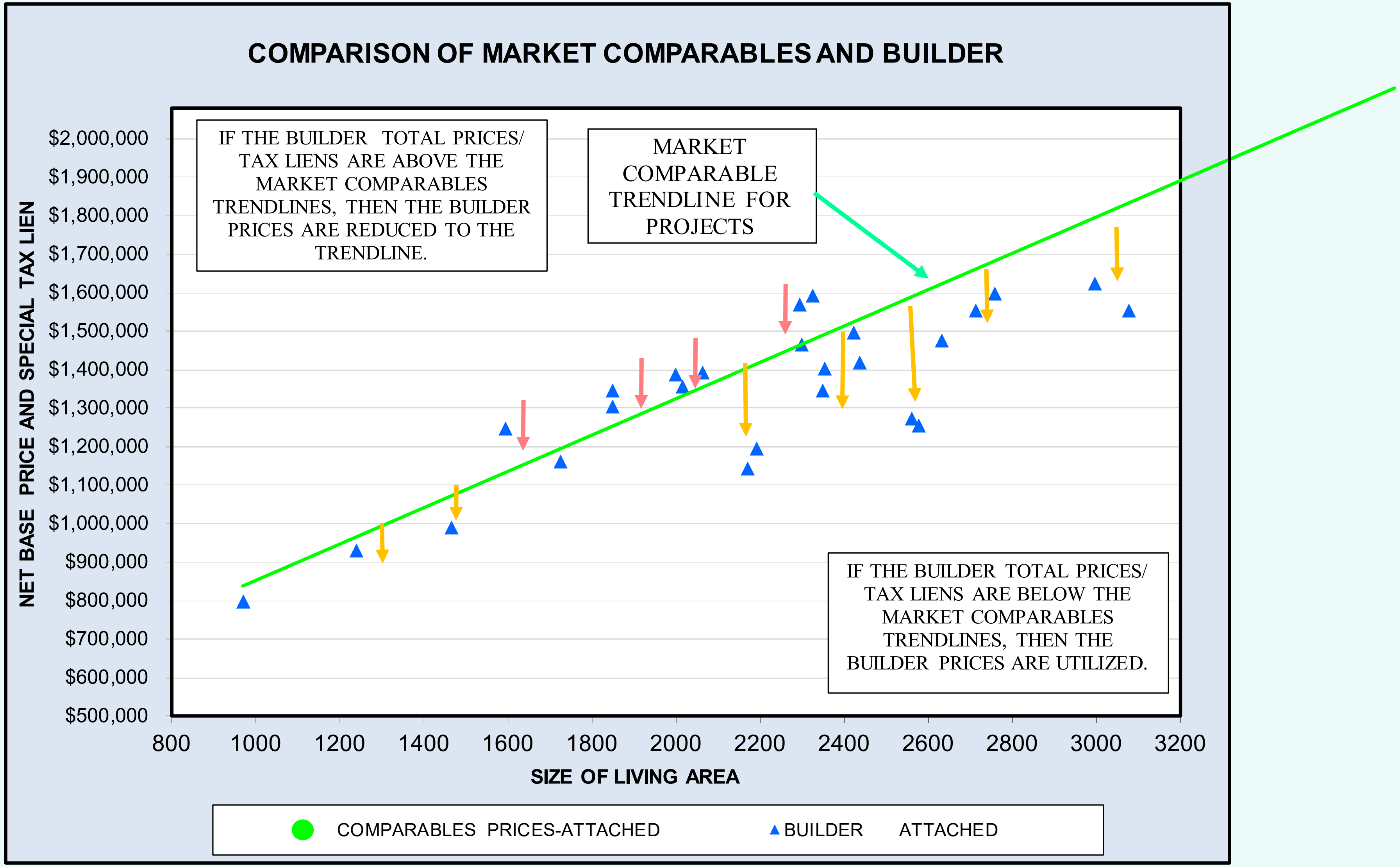
BUILDER STRATEGIC PRICING STRUCTURE



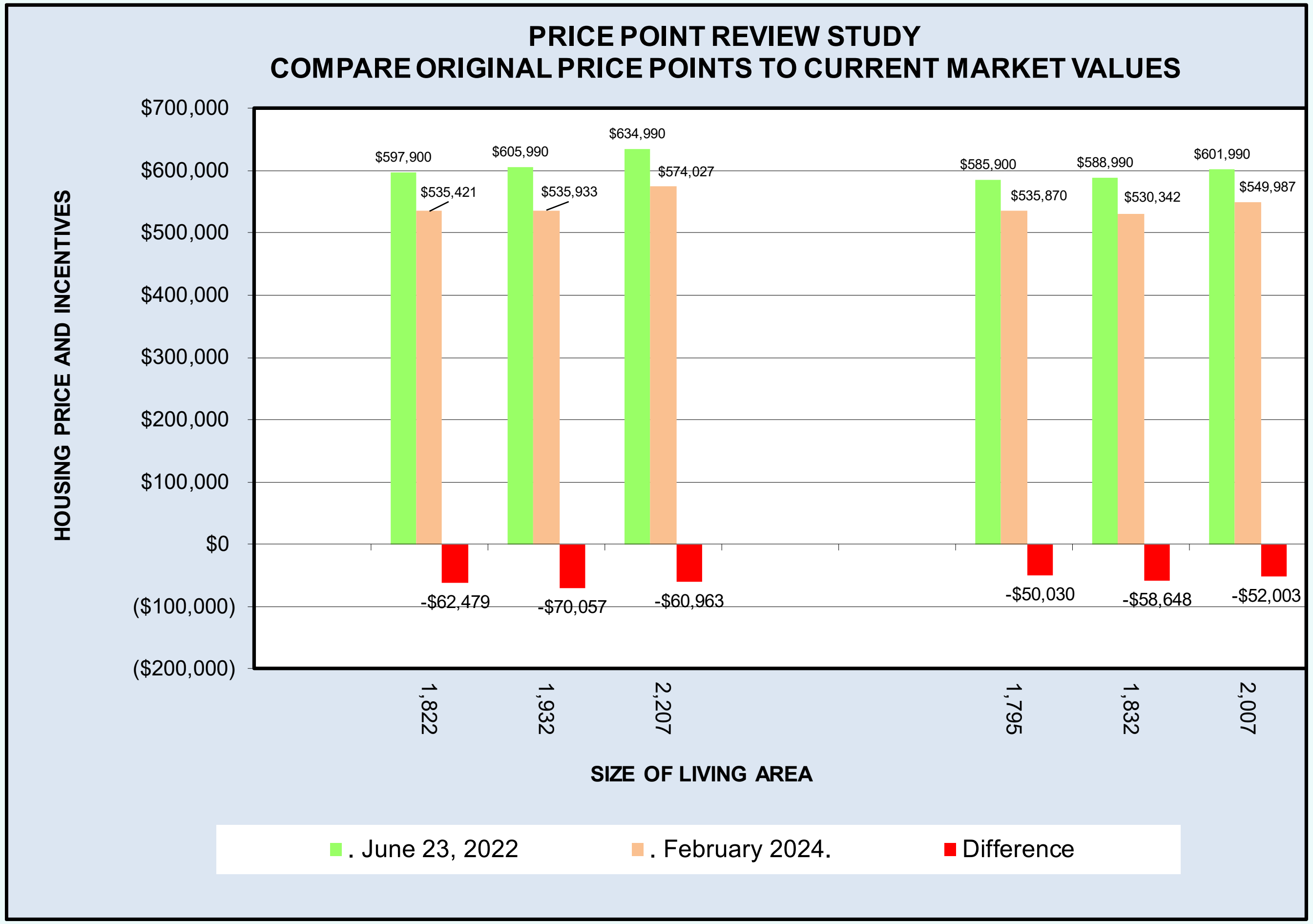
CURRENT PRICING STRATEGIES UTILIZED BY BUILDERS AND THE ESTIMATION OF "REAL" MARKET VALUE

- Model complexes offer homes for sale at base prices.
  - Builders reluctant to directly reduce base prices because of homes in escrow.
- If the rate of home sales is below expectations, then builders offer incentives.
  - Incentives include free upgrades, lower closing costs and mortgage assistance.
- Negotiations between the builder/purchaser result in a net sales price.
  - The net sales prices is the most accurate indicator of current market value.
- This valuation is Empire's Price Point for purpose of a public entities' CFD program.
  - This price is used to ensure compliance with the public entity's total tax burden.
- Hypothetically, if a resale were to occur immediately, it would be the net base price.

PRICE POINT STUDY FOR CFD FORMATION



PRICE POINT *REVIEW* STUDY PRIOR TO BOND SALE
COMPARE CURRENT MARKET VALUES TO ORIGINAL PRICE POINTS



"Price Point" means, with respect to each Project/Plan,
the estimated minimum base price:
*Deducting any incentives and concessions, including mortgage assistance.
*Excluding potential appreciation or premiums as well as free options or upgrades.

PART 4

CONCLUSIONS

Looking ahead, what is likely to happen to residential values, and what types of safeguards should be considered for land-secured financings?

A. Price appreciation supported by employment growth provides a "substantive" foundation because newly employed households have the economic wherewithal to purchase homes.

B. **Price appreciation due to financial factors is different**

1. **Housing price bubble (2002-2006)** price appreciation occurred due to creative financing which subsequently imploded resulting in numerous foreclosures.

B. Price appreciation due to financial factors is different (continued)

2. **Fed policy goal of 2%** inflation (2020-2023) initially utilized historically low rates to stimulate the economy but then restrictive policies to reduce inflation raised mortgage rates.

2-a **Higher mortgage rates** *reduces* both demand and supply, resulting in excess demand and price appreciation.

2-b **While lower mortgage rates** *increase* demand and even more so supply, this results in lower/stable prices, along with higher levels of sales.

Therefore, recent housing price increases have been driven primarily by financial mortgage rate factors, rather than employment growth.

Furthermore, forecasters expect mortgage rates to be above 6% through 3rd-qtr 2025.

Accordingly, public entities utilizing land-secured structures may want to consider integrating various **safeguards** into their financings such as **reasonable** levels of tax escalators, among others.