



Cycles Happen

“Irrational Exuberance!”

The phrase, irrational exuberance, coined by former Fed Chairman Greenspan, to describe the late 1990s’ stock market now appears to have meaning in Utah housing market.

Utah’s new housing construction market, which boomed from \$2 billion per year just four years ago to \$5 billion in 2006 has begun to unwind. Statewide through August 2007 new residential permit values were down almost 9 percent compared to last year. Preliminary September data points to a precipitous 33 percent drop in permit values. Why does this matter to Utah’s cities? League economists estimate that for every \$1 billion of decrease in residential construction values, taxable sales can drop almost 3 percent.

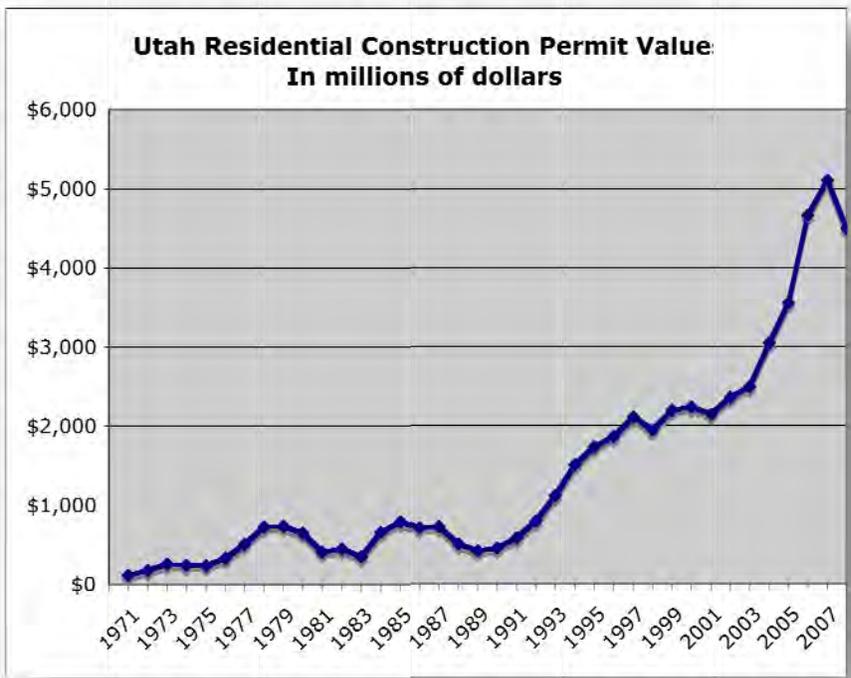
A key indicator, which foretold the end of easy housing money, was the liquidity curve. When short term interest rates began to exceed long term rates late last year, the endless supply of funds began to wane. The shakeout in the sub-prime market meant not only the demise of several hedge funds, but also the beginning of the end for sub-prime and other non-prime loans. Through August 2007, year-to-date residential construction values were off 8.5 percent nationwide. Single family units, representing nearly 70 percent of all units, were down 21 percent. Multifamily units were up nearly 20 percent, but represent a smaller share of all units and a smaller average value.

Contents

Special Interest Articles

Construction Cycle	1
Residential construction	2
Nonresidential construction	3
Property taxes	4





Residential vs. Commercial

In 2006 record breaking job growth, record home value increases, and the lowest unemployment rate in the nation were all signs of a strong Utah economy and created a huge budget surplus (income tax collections increased by over 18%). However, none of us assume the economy could be sustained at this level. So what has happened in 2007?

- Home sales in Salt Lake County **down 33.8%** from 2006, (through July-September)
- New home demand during September 2007 was the lowest in 17 years.
- In September 2006 builders took out permits for 1,171 homes in September 2007 438 permits were issued (Wasatch Front and Washington County).
- Beginning in 2006 and early 2007 subprime lending began to collapse nationally (over 100 subprime lenders have filed bankruptcy).

Just like that feeling you get at the top of Lagoon’s roller coaster, we are going to be in for an interesting ride. Decreasing residential construction values will negatively impact many of Utah’s taxable sales business sectors: construction, manufacturing, wholesale durable goods, retail-building and garden and retail-furniture and home furnishing store sales will see declining sales very soon. Any negative numbers in these and other sectors will cut 2006’s heady taxable sales of almost 12 percent growth down to about 4 percent.

Residential building permits, Sept 06 and Sept 07			
	September 2006	September 2007	Percent Change
Salt Lake	348	130	-62.6%
Utah	172	68	-60.5%
Weber	417	124	-70.3%
Davis	105	34	-67.3%
Washington	129	82	-36.4%
Total	1,171	438	-62.6%
Source: Construction Monitor			

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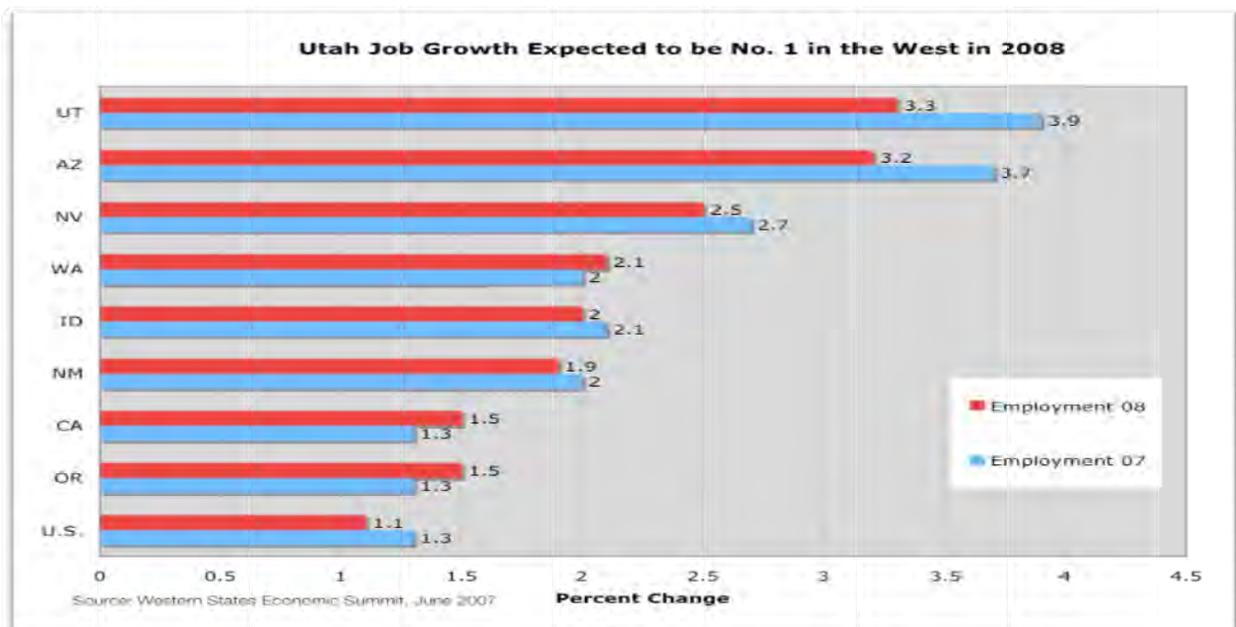
- Utah's nonresidential construction level is near a record level \$2 billion for 2007 (the last time Utah nonresidential reached this high was 1997 during the development of the Grand America Hotel and LDS Conference Center)
- In 2006-07 the construction industry added 14,000 new jobs in Utah.
- The strong nonresidential construction activity is bolstered by multimillion dollar projects in cities in every region of the state.
- Through November nonresidential construction is up \$200 million from 2006.

The economic news isn't all bad. Nonresidential construction permitted values were up 40 percent through August.

Several large projects, which probably acquired funding prior to the sub-prime meltdown, were permitted this summer which will help offset the decline in housing market. Although the nonresidential sector runs between 1/4th to 1/2 of residential, the increase from \$1.03 billion from January through August 2006 to \$1.45 billion year-to-date August 2007 will keep many suppliers and contractors busy. Permits this summer went to the following projects:

- City Creek excavation - \$9 million,
- Hamilton Partners office building - \$79 million,
- Sandy soccer stadium - \$60 million,
- Kennecott warehouse - \$18 million
- Provo hospital \$67 million.

Meanwhile, Utah's job market continued its steady upward trajectory. However, double-digit wage growth in certain sectors are not expected to repeat themselves -- especially in the finance and real estate sector. The figure below indicates that Utah's employment growth is expected to outpace its neighbors in the West in 2008. In fact, these estimates made last June appear to be on the low side, since Utah's job growth rate has stayed well above 4 percent from July to August. Recent estimates of "gross" immigration indicate that more than 120,000 people are coming to the Beehive State each year, while only about 40,000 are leaving.



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What about property taxes?

Utah's home value appreciation went from last in the nation to 10th in the nation in three years. This significant home value increase creates a lot of attention on property tax as a source of local government revenue. Property taxes have filled the headlines of local newspapers as Utahns have questioned property tax increases and legislators have considered property tax reform ideas. However, with a closer analysis we see that property tax as a revenue source has not increased the way many perceive. The truth in taxation law requires that as property values rise, property tax rates must fall. We see in the figure below that change in home value over time is very cyclical. However, truth in taxation prevents large spikes in revenue. In September 2007, the *Deseret Morning News* editorial stated:

Before state lawmakers begin tinkering with the way counties levy and assess property taxes, they need to take a deep breath, then wait for the urge to disappear....Clearly, some lawmakers need to educate themselves about Utah's tax system before they heed the urge to champion solutions for which there are no problems.

As the *Deseret Morning News* stated Utah's property tax system isn't broken. In fact, it is one of the most stable and least burdensome taxes Utahns pay. In addition to the strength of stability the property tax has a high degree of transparency. Each year residents get a detailed breakdown of their tax bill, unlike sales tax or many other fees or taxes citizens pay. This transparency is another strength of the property tax. While property tax revenue in the aggregate has increased in 2007 few municipal governments have raised property tax rates. In fact only 10% of all cities increased their municipal rate in 2007. A few facts about Utah's property tax:

- Utah's property tax burden ranks 37th nationally (Utah Foundation)
- On average 15% of the total property tax bill is distributed to municipal government
- 25 cities in Utah raised property tax rates in 2007 – 18 of these cities have seen their population grow between 30% and 300% through the last 5 years.

