The Future of Anchorage Housing Markets

Housing prices in Anchorage should begin to increase as we move into the 1990s. The recession that caused serious problems in the housing market appears to have subsided in late 1988. But prices probably won’t rebound to their 1985 levels until some time between 1993 and 1996.

Depressed prices have enabled many city residents to move into better housing in the past three years. And if all the properties that are now in foreclosure and vacant were occupied, Anchorage residents would enjoy still better housing quality.

Thousands more homeowners with negative equity are likely to lose their homes to foreclosure in the next few years. And the current financing and insuring policies of mortgage lenders and insurers make it very difficult for individuals to sell their homes, thereby worsening market problems.

These are among the findings in a recent report prepared for the Alaska Housing Finance Corporation (AHFC) by the Institute of Social and Economic Research (ISER). AHFC asked the institute to look at Alaska’s urban housing markets, project how fast those markets are likely to recover, and recommend ways AHFC might help them recover more quickly.

Report Findings

- Anchorage residents have moved into better quality housing over the past three years as the population dropped and prices and rents fell. We estimate the value of that "flight to quality" at $35 million per year (in 1988 prices).

In other words, Anchorage households in 1988 were willing to pay $35 million more to live in the houses they occupied in 1988 rather than continue living in the housing they occupied in 1985.

For the average household, that translates into $456 worth of better housing per year. (Figure 1 and Table 1.) And if all the properties that lenders have acquired through foreclosure and haven’t yet re-sold were occupied, the average household could enjoy another $264 worth of improved housing per year—because many of the foreclosed properties are nicer than some of

<table>
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<th>Table 1</th>
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<td>Improved Housing Quality, Anchorage Households</td>
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<thead>
<tr>
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<th>1985-88</th>
<th>Potential</th>
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<tr>
<td>Avg. Household per month</td>
<td>$38</td>
<td>$2.9 million</td>
</tr>
<tr>
<td>annual</td>
<td>$456</td>
<td>$35 million</td>
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<tr>
<td>All households per month</td>
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<td>$1.7 million</td>
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<tr>
<td>annual</td>
<td>$264</td>
<td>$20 million</td>
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the housing Anchorage residents currently occupy. That would mean another $20 million per year gain in housing quality for Anchorage households altogether.

Lower prices and rents have enabled thousands of Anchorage households to move into bigger or better housing since 1985. Of course, not all households have moved. Many thousands are kept in their current homes by negative equity. Some simply don't want to move. Nevertheless, by looking at occupancy rates among various kinds of Anchorage housing in 1985 and in 1988, and at the quality of foreclosed properties as compared with all occupied stock, ISER has quantified the shift to better housing that has already occurred and the remaining potential improvement.

Current prices of single-family houses in Anchorage are at about 75 percent of their 1985 levels. Prices won't rise to their previous levels until vacancies have been absorbed and new construction begins. Vacancies likely won't be low enough to spur substantial new building until 1993 at best and possibly not until 1996.

Anchorage had a 17 percent vacancy rate in mid-1988. ISER projects that Anchorage's population will grow in the range of 1 to 2 percent annually from now through the mid-1990s. If we take the mid-range of those projections, the growing population should absorb enough vacancies to warrant new construction by 1995.

The mid-range projections are based on conservative economic assumptions. If future growth were somewhat faster, construction could start as early as 1993. There are, however, factors that could delay economic recovery — mainly another collapse in oil prices, or sudden, very large cuts in the state budget that eliminate jobs and income.

Figure 2 shows historical and projected "normal" and "excess" vacancies — based on our mid-range projections. In any housing market you expect some vacancies, and such normal vacancies don't hinder construction. Excess vacancies, on the other hand, have to be absorbed before builders can feel confident there will be occupants for new housing.

The figure shows how we project excess vacancies to be whittled down over the next several years. The high-quality vacancies will be filled first, followed by the vacant properties that have been in foreclosure, and finally by the low-quality vacancies. By 1991 there should be essentially no excess vacancies in high-quality housing, and by 1993 few vacant foreclosures.

If vacancies are absorbed as we project in Figure 2, house prices will likely increase about 3 percent more per year than overall inflation between now and the mid-1990s. (Figure 3.)

Prices of existing houses are typically somewhat lower than replacement cost — the cost of building the same house at prevailing prices — because houses depreciate. But prices have to come close to replacement costs before new houses will be built. House prices in Anchorage in 1988 were only 75 percent of replacement cost — a clear sign of the depressed housing market.

We are not projecting that prices will definitely increase in 1989. Figure 3 is intended to show price and cost trends rather than specific dollar projections. It assumes replacement costs rise at 4 percent a year.

Anchorage condominium prices in 1988 were just over 50 percent of replacement cost. (Figure 4.) Even given the current condominium glut, we would not expect prices to be that far below replacement cost. If new construction does begin in 1995, condominium prices would have to increase an average 7 percent faster than annual inflation between now and the mid-1990s for prices to come close to replacement costs.

Figure 4 (which assumes replacement costs will rise 4 percent a year) is intended just to show trends of prices and replacement costs; we don't intend for it to be used as a prediction of specific prices in given years.

Under reasonable assumptions about holding costs and other factors important in determining prices, current condominium prices shouldn't be as low as they are. Potential
buyers apparently think buying condominiums right now is so risky that they are unwilling to pay as much as market factors suggest they are worth.

![Figure 4. Projected Cost and Price Anchorage Condominium*](image)

- Alaska foreclosures peaked in 1987 and 1988, but are likely to stay relatively high for a few more years before dropping sharply. We project that 25 percent fewer homes will be taken under foreclosure in 1989 than in 1988, but most of that decline will be for lenders other than AHFC. Foreclosures by all lenders will drop nearly 20 percent in 1990, and 35 percent a year in the early 1990s. (Figure 5.) Somewhere in the neighborhood of 16,000 residential properties went into foreclosure in Alaska between 1985 and 1988—mostly in 1987 and 1988. Roughly 60 percent of these foreclosures were in the Anchorage area. We expect the rate of foreclosures after 1988 to drop for two reasons. As time goes on and more homeowners default, the total number of loans at risk is declining. We define homeowners at risk of defaulting as those who took out loans during most of the 1980s, when prices were higher than today, and who now find themselves with negative equity.) Second, as market conditions gradually improve and prices begin to rise, equity of homeowners will slowly improve and homes will sell faster.

Still, despite the good news, plenty of bad news could remain. As many as 14,000 more Alaska properties could go into foreclosure over the next seven years, so that total Alaska foreclosures between 1985 and 1995 could reach 30,000. Nearly two-thirds of that total—20,000—would likely be AHFC properties (including mobile homes) since AHFC holds the lion's share of loans made in the first half of the 1980s.

Why might there be so many foreclosures yet to come? Despite improving economic conditions and a declining number of homeowners at risk of defaulting, there remain thousands of homeowners with substantial negative equity. They still won't be able to sell their properties for what they owe on them for years to come. This is particularly true of condominium and mobile home owners.

Our projections of potential foreclosures are based on conservative assumptions about future economic growth, so actual foreclosures will probably be fewer but still numerous. The major mortgage lenders and insurers might be able to further reduce foreclosures if they adopted the policies described below.

**Report Recommendations**

- AHFC should try to get its foreclosed properties occupied as soon as possible.

AHFC in 1988 had more than 4,000 largely unoccupied properties taken under foreclosure throughout Alaska. About 60 percent of those were in the Anchorage area. To date FNMA and FHA have marketed their properties much more intensely than AHFC has—although AHFC has increased marketing and sales in recent months. If all the housing in Anchorage that is now in foreclosure and vacant were occupied, prices could drop about 3 percent for single-family houses and 10 percent for condominiums. Rents could also drop by as much as $50 per month. At this point the default rate among homeowners would be affected little by such a price drop—because owners who already carry tens of thousands of dollars in negative equity are very likely to default in any case. As illustrated in Figure 1 and Table 1, there would be significant social benefits if all the vacant foreclosed properties were occupied.

- AHFC and the other big mortgage lenders should avoid foreclosing whenever possible.

Foreclosing on and holding properties is enormously expensive. Large inventories of foreclosed properties being marketed under extremely favorable terms by the big institutional lenders make it very difficult for private individuals to sell their homes.

Lenders and insurers should work together to devise more flexible, expedient means of holding pre-foreclosure sales when it becomes apparent that properties are other-
wise headed into foreclosure. AHFC should work to get the agreements it needs from its insurers to make such sales.

- AHFC should consider alternative financing programs for condominiums in complexes that don’t meet the 70-percent owner-occupancy rule, and try to find new sources of private mortgage insurance for condominiums.

In Anchorage today, the problems created by the glut in the condominium market are being compounded by problems with financing and insurance. None of the big lenders will finance private sales — sales where the seller is a private individual rather than an institution — of units in complexes where fewer than 70 percent of the occupants are owners. This rule prevents most private owners from selling condominiums, because so many complexes in Anchorage today don’t have 70 percent owner-occupants.

AHFC is currently unable to waive that 70-percent rule because of the terms of its loan guarantor agreement. AHFC raises most of its money through bond sales. To get the best ratings on its bonds and the most favorable interest rates, AHFC must have a loan guarantor — in other words, AHFC secures its loans with somebody else’s money. The Federal Home Loan Mortgage Corporation (Freddie Mac) is the current loan guarantor; the Federal National Mortgage Association (FNMA) and Mortgage Guaranty Insurance Corporation (MGIC) guaranteed AHFC loans in earlier years. None of the potential loan guarantors is presently willing to bend that 70 percent rule for private sales.

AHFC and MGIC recently announced the start of the Condominium Stabilization Program, which will among other things concentrate owner-occupants in designated complexes in order to bring those complexes up to the required 70 percent owner-occupancy. That program will certainly help condominium owners, but many complexes are not eligible under the initial program.

It is critical to the future health of the condominium market to get financing for private sales as soon as possible. We recommend that AHFC consider developing two distinct new condominium financing programs — one for owner-occupants and one for investors. Because they would waive the 70-percent rule, these programs would require developing new sources of insurance and financing.

Another roadblock for condominium owners and buyers is that no private mortgage insurer will insure condominium loans in Anchorage now — even in those complexes that still have 70 percent owner-occupants. Typically, the big lenders require borrowers to carry private insurance on any loan amount above 75 or 80 percent of the purchase price. Lenders — again with the exception of AHFC — are waiving that requirement when selling their own foreclosed condominiums. (AHFC can’t waive the requirement because of its loan guarantor agreement.) This means that anyone who wants to buy from a private individual has to either qualify for a federally insured loan (through FHA or VA) or make a 20 percent or more down payment.

We recommend that AHFC more aggressively pursue private mortgage insurance, and consider putting together its own insurance pools with lenders in other regions.

- AHFC and the other big mortgage lenders should consider a new financing method that might be especially suited to the up-and-down Alaska housing markets.

Homeowners now enjoy all the benefits of rising prices but also carry all the risks of falling prices — which leads to widespread defaults when the market collapses, as Anchorage’s did in the late 1980s. Appreciation-sharing mortgages, on the other hand, would better divide the benefits and risks of home financing between lenders and borrowers. Such mortgages would be set up so that the borrower and the lender would share a portion of the gains or losses at the time a property was sold.

Establishing appreciation-sharing mortgages is of course a long-term proposition that would require developing a secondary market for a new type of mortgage-backed security.

Editor’s note: This summary is based on Stabilizing Alaska’s Housing Markets, by Matthew Berman and Linda Leask. The 150-page report is available for $7.00 from ISER on the second floor of the Library on the UAA Campus (786-7710).

RESEARCH SUMMARY (No. 42)
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