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2017 ECONOMIC OUTLOOK: SEVEN ECONOMISTS FORECAST THE 2017 HOUSING MARKET

Seven prominent real estate economists give their prognosis on what lies ahead as we begin a new year, including how President Trump could impact housing in 2017.

SURVIVING REAL ESTATE IN 2017


CLEVELAND HOUSING: A TALE OF TWO TEAMS

The Cleveland housing market is a study in contrasts. Home prices are on a winning streak, up for 18 consecutive quarters to just 5 percent below their pre-recession peak. But the share of homes still underwater in the metro area still ranks third highest in the nation behind Las Vegas and nearby Akron. Local experts give insight into the opportunities and risks in the Cleveland market, and whether the true nature of the market looks more like its NBA Championship Cavaliers or 1-15 Browns.

BOOK REVIEW ‘BIG SHIFTS AHEAD: DEMOGRAPHIC CLARITY FOR BUSINESS’

By John Burns and Chris Porter. In “Big Shifts Ahead,” authors Burns and Porter argue that broad demographic changes will reshape housing in America, creating new opportunities for businesses of all kinds. From the rise of affluent immigrants to the growing ranks of female executives, big shifts in America's population will have profound impact on U.S. residential real estate.

LEGAL BRIEFS

NEWS BRIEFS
2017 ECONOMIC OUTLOOK
Seven Economists Forecast the 2017 Housing Market

BY OCTAVIO NUIRY, MANAGING EDITOR
**GUEST ECONOMISTS**

**Lawrence Yun**  
Chief Economist, SVP at National Association of Realtors

“On potential positive policy changes, some changes to Dodd-Frank will permit more construction loans for home building and less lawsuit threats coming from the Consumer Financial Protection Bureau (CFPB) towards lenders could open up the credit box to more qualified borrowers.”

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**Jonathan Smoke**  
Chief Economist at realtor.com

“Despite declining affordability from higher rates, demand will remain strong and the market will remain an overall “sellers' market.”

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**Matthew Gardner**  
Chief Economist at Windermere Real Estate

“I believe that 2017 will be the year that Millennials get into the market in full force — we will also see substantial growth of first-time buyers of all ages.”

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**Alex Villacorta**  
Vice President, Research and Analytics at Clear Capital

“Virtually all major metro areas have reported some level of price growth over the last year, but the degree of performance has differed widely between individual markets. This theme will continue in 2017...”

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**Allan Weiss**  
Chief Economist at Weiss Analytics

“The most important trends in housing this coming year will be the pervasive effects of rising interest rates.”

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**Peter Muoio**  
Chief Economist at Auction.com

“Housing inventory will be a key determining factor in the housing market. We expect further price growth to entice more homeowners to list their homes, particularly as existing homeowners have greater equity...”

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**Sean Becketti**  
Vice President and Chief Economist at Freddie Mac

“Homebuyer affordability challenges (combination of higher mortgage rates and higher home prices) will be the biggest single challenge facing housing markets in 2017.”
Two thousand and seventeen. This year should be an interesting year for the U.S. residential housing market.

Not only is President Donald J. Trump moving into the White House, but a new group of cabinet appointments are surely going to shake up U.S. property markets. At Treasury, Steven Mnuchin, a Wall Street veteran and former Goldman Sachs banker, said he wants to privatize Fannie Mae and Freddie Mac, the mortgage finance giants nationalized in September 2008.

At the U.S. Department of Housing and Urban and Development, Dr. Ben Carson, the retired neurosurgeon, will run the $48 billion bureaucracy with 8,500 employees created in 1965 by President Lyndon Johnson’s Great Society initiative.

Nobody really knows what to expect in 2017.

But one word summarizes the new GOP administration: uncertainty. With that in mind, Housing News Report asked several leading housing economists to take a glimpse into what might happen as President Trump journeys to “Make America Great Again.”

Here’s what the experts are projecting for the residential real estate market in 2017:

1) What will be the most important housing market trend(s) in 2017 and why?

Yun: Demographics and improving economy suggest that first-time homebuyers will come back in 2017. But potential policy changes could wield a larger influence. Changes to mortgage interest deduction can sap consumer confidence about buying a home or changes to Fannie/Freddie could disrupt the mortgage market. On potential positive policy changes, some changes to Dodd-Frank will permit more construction loans for home building and less lawsuit threats coming from the Consumer Financial Protection Bureau (CFPB) towards lenders could open up the credit box to more qualified borrowers.

Smoke: Three overarching trends crash into each other in 2017. More demand from first-time buyers has the potential of pushing the share of first-time buyers closer to normal. Yet at the same time, mortgage rates are now higher than they have been in more than a year and are likely to continue increasing by at least another 50 basis points in 2017. Despite declining affordability from higher rates, demand will remain strong and the market will remain an overall “sellers’ market,” characterized by low and fast-moving inventory like we have been seeing for the last two years.

Continued and even stronger economic growth will keep demand strong and will produce gains in sales and prices, but the higher rates and tight supply will act to constrain some of the growth.

Muoio: Housing inventory will be a key determining factor in the housing market. In 2016, we saw low inventories constrain sales growth and enable substantial price gains, which has in turn weakened affordability for prospective homebuyers. We expect further price growth to entice more homeowners to list their homes, particularly as existing homeowners have greater equity, though this mild uptick will still leave inventory below prior cyclical

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levels. New home supply should also increase, though it is not enough to shift the overall landscape of housing inventory, which will continue to hold a sizeable influence over sales and price growth in 2017.

Rising interest and mortgage rates will also likely have an impact on the housing market in 2017, as the departure from the extremely low rates seen in 2016 could hamper sales growth and limit recent price gains amid weakened affordability.

The economic backdrop should remain favorable, in particular the healthy labor market.

**Gardner:** I believe that 2017 will be the year that Millennials get into the market in full force — we will also see substantial growth of first-time buyers of all ages. For the better part, would-be buyers have remained “on the fence,” but I see a definitive shift in attitude, as well as increased intent to buy. Look out. They’re coming!

**Villacorta:** National home price growth will remain positive through the end of 2017 but is predicted to continue on the same decelerating pace of the last several years. Conservative forecasts are predicting considerably slower annual growth of around 2 to 3 percent during 2017, around only half of the observed 5.6 percent annual price growth in 2016. While overall national growth is predicted to moderate over the course of the coming year, this shouldn’t be a major cause for concern for all homeowners.

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across the nation. As individual housing markets continue to follow unique paths of recovery, perhaps the biggest trend for housing in 2017 revolves around this very diversity — increasingly localized housing market sub-climates with varied performance across the nation and within individual regions.

Virtually all major metro areas have reported some level of price growth over the last year, but the degree of performance has differed widely between individual markets. This theme will continue over the next year as markets that greatly outperformed the national average in 2016, primarily in the West and South, will likely follow a similar path of relatively high growth over the next year.

**Beckettii: Homebuyer affordability challenges (combination of higher mortgage rates and higher home prices) will be the biggest single challenge facing housing markets in 2017. For the past two years interest rates have trended down, helping to boost homebuyer affordability. While we don't forecast interest rates to rise rapidly, we do expect them to gradually drift higher most of next year.**

We also expect that house prices will rise, but at a more moderate pace than this year.

**Weiss:** The most important trends in housing this coming year will be the pervasive effects of rising interest rates. We have been living in a flat or declining interest rate environment for so long, it's hard to remember what rising interest rates are like. Many people in the mortgage industry have never experienced a rising interest rate environment in their entire careers.

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2) What is your outlook for existing home sales and prices in 2017 (up, flat, or negative)?

**Yun:** Existing home sales will roughly remain the same as in 2016, which was a decent year. Higher mortgage rates are a clear negative, but it is hoped that increases are manageable and nothing alarming with the 30-year fixed rate not moving above 5 percent. The impact of higher rates will partly be neutralized by expected 2 million net new job additions and higher wage growth. Existing home price will rise by around 4 percent in 2017 — there is still a housing shortage.

**Smoke:** The existing home market will be up but only moderately compared to the gains enjoyed in recent years. Our initial 2017 forecast for the existing home market expects 1.9 percent growth in sales and 3.9 percent growth in the median existing home price.

**Muoio:** We expect both existing home sales and prices to rise over the course of 2017. The keys for underlying demand remain strong: a firm labor market is adding jobs at a healthy clip, unemployment is reaching cyclical lows, and wage growth continues to progress.

Nonetheless, tight housing inventory remains a constraining factor limiting stronger sales growth, while also pushing home prices out of range for some households. Higher mortgage rates could also be a constraint on sales and pricing as affordability continues to deteriorate, though the rise while dampening affordability should not make housing prohibitively expensive.

**Gardner:** Existing home sales should rise to 5.548 million units in 2017. I am forecasting existing home prices to rise to a median of $242,700 in 2017 — an increase of 4.5 percent from 2016.

**Villacorta:** Existing home sales and prices will continue to climb in high-demand housing markets like Dallas, Nashville, and Denver during 2017. Price growth in these increasingly popular areas will be able to sustain a potential drop in demand in the event of an interest rate increase and remain in the black for the year.

However, markets that are widely considered to be already overheated

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**NEW HOME SALES, EXISTING HOME SALES & FORECLOSURE FILINGS**
— namely San Francisco, San Jose, and some select Southern Californian cities — will likely not see impressive growth over 2017 due to affordability concerns. Rapid, unsustainable price growth over the last several years has pushed home prices far out of the affordable range for the majority of potential buyers in some areas, and growth rates are already teetering on the edge of going negative for the first time in 5 years. Any unfavorable market shocks such as additional interest rate hikes could disproportionately affect these areas, blocking even more potential homebuyers from entering the market and leading to a flat or even negative growth year.

Beckettini: Sales down. Prices up.

Weiss: However, in the first year of this shift, 2017, I expect that rising rates will have the opposite effect than many expect; rising rates will increase demand for homes across the spectrum except for those who could barely qualify and afford a home prior to the rise. The first wave of this effect will be the fence sitters who couldn’t decide if they are ready to buy. Given that each 50 basis points will add over 20 percent to a monthly mortgage payment these people will want to act quickly to lock in a rate before rates climb higher. This may be a very large number of buyers and alone could make the spring season a feeding frenzy.

Others who have been thinking about perhaps buying soon will take note of this frenzy and observe an acceleration of rising home prices. They will therefore have two motivators to reconsider their passive wait-and-see approach as they pay rent every month. Most people have not thought deeply about how inexpensive owning is compared to renting in many markets. In the top 10 metros, a 2,000 square foot apartment can cost nearly double that of owning a home. This was not enough of a motivator when rates were low and kept getting lower for these people because renting amounted to a free option to jump in later with the same benefit. But as people see that waiting will eat into the owning advantage, they will quickly move through the stages of fence sitter, shopper and bidder. This will be the second phase of the frenzy.

3) What is your outlook for new home sales and prices in 2017 (up, flat, or negative)?

Yun: New home sales will do well, rising possibly by 10 percent or more. Inventory shortage assures quick sales of newly constructed homes. Moreover, the more expensive new homes will benefit from the tax cut that is likely to be skewed towards the upper income and from the current wealth gains at the top from an all-time high stock market. New home prices are also expected to rise around 4 percent.
Since the beginning of 2016, the national average for days on market has decreased by over a week to around 40 days for both performing and distressed properties, indicating that the demand for homes is still far outpacing any previous increases in supply. In 2017, a steady stream of new homes will be added to the existing housing stock as the result of a multi-year trend in increasing housing starts, providing an improvement to the housing supply and helping to relieve areas particularly stricken by low inventory. In these tight markets, new home sales are likely to moderate runaway price growth and aid in affordability. In areas where the housing supply is already well serving homebuyer demand, any increase in the supply of homes on the market could result in lower home prices for both new and existing homes.

Becketti: Sales up. Prices up.

Weiss: Renters who are accustomed to higher end apartment living will put a premium on new construction because it is most like renting. Spanking new appliances, and a “full service” professional seller, eager to provide amenities and customizations will be familiar and worth the premium. This will put upward pressure on new home sales prices.

4) Where are mortgage interest rates headed in 2017 (up, stay the same, or negative)?

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U.S. HOME PRICES & INTEREST RATES JAN 2000 TO DEC 2016

- Median Sales Price
- Freddie Mac Conforming 30-Year Fixed-Rate Mortgage Rate

Gardner: Last year, I suggested that we would see a major increase in new home sales and, by years’ end, we are likely to see sales up by about 14 percent. In 2017, I anticipate sales will continue to increase, but by a slightly more modest 12.2 percent. I anticipate that new home prices will rise by a fairly modest 3.1 percent as construction costs weigh on prices.

Villacorta: New home sales are also likely to increase in 2017. According to the U.S. Department of Commerce, housing starts reached a post-recession high this fall and for most major metros across the nation, positive performance during 2016 suggests there is a healthy appetite for continued construction.
Yun: The era of ultra-low mortgage rates is over. Mortgage rates are expected to rise to 4.5 percent by the year-end 2017, and even higher by the year-end 2018. Inflation will be noticeable as rent growth continues. A larger federal budget deficit will also nudge up rates.

Smoke: Mortgage interest rates will be up by at least 50 basis points in 2017 on top of where they will end 2016, which is likely to be the highest rates seen in more than a year.

Muolio: Mortgage rates are likely to rise in 2017. Mortgage rates spiked following the election on expectations for a higher-inflation environment due to rising expectations of increased spending and tax cuts. Treasury yields could continue to rise in alignment with these expectations. The Fed is also likely to continue raising the federal funds rate after holding tight through most of 2016, suggesting mortgage rates should increase beyond the historical lows seen in 2016, though rates remain very low by historical standards and we are expecting the Fed to continue taking a gradual approach.

Gardner: The election sparked a major jump in bond yields which pushed rates up very quickly. Given this jump I have recalibrated my forecast and the result suggests that the average 30-year fixed rate will end 2017 at around 4.4 percent.

Villacorta: Mortgage interest rates are likely to remain relatively low in 2017, albeit markedly less attractive than the rock bottom rates of 2016 to both buyers and homeowners. The Fed’s ‘relatively soon’ interest rate hike will result in a housing market with less affordable homes nationwide. While the cost of borrowing is still relatively low for many buyers, any additional rise in interest rates would further stifle market activity and could result in

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NET HOUSEHOLD FORMATION, 1961 - 2025
12.5 million households will be formed over the next decade.

Source: John Burns Real Estate Consulting LLC calculations using U.S. Census Bureau decennial data.  |  *projection
underperformance in areas where affordability is already hindering price growth, particularly in the low and middle price tiers. Any increase to mortgage rates would disincentivize a large portion of owners looking to capitalize on the current market climate and refinance at a lower rate, greatly cooling off a refinance market that saw sky-high levels of activity during 2016.

A substantial rate hike in 2017 would be detrimental to the national housing market for borrowers, and for this reason is unlikely. However, because rates remain near such historic lows, it is unlikely that 2017 will bring lower rates. Expect interest rates to remain slightly higher than 2016 with the potential for modest increases later in the year.

**Becketti:** Up.

**Yun:** A new president always brings energy and excitement and thereby a modest boost to the broad consumer confidence. But given the deeply divided electorate in the recent election, the Trump administration also bring along great dismay. How major shifts as related to immigration, trade protectionism, and foreign entanglements remains uncertain and could be even more influential than real estate specific policies like changes to GSEs or Dodd-Frank. Unpredictability has been President(-elect) Trump’s mantra and therefore, for better or worse, the forecasts carry a large variation in potential outcomes than normal.

**Smoke:** Without specific policies and actions to judge, it is too early to gauge the impact to the economy, let alone the real estate market. However, we can already see one big impact in interest rates as a result of financial markets expecting more inflationary pressure. Economic growth could accelerate somewhat with discussed tax cuts and expanded infrastructure spending. Both of these actions would likely be inflationary since the job market is already reaching full employment so more growth would drive wages and household income up. Higher wages and income would help buyers and should maintain and even build consumer confidence. However, these fiscal expansion programs won’t help us resolve tight inventory and lack of needed growth in new construction. If anything, construction labor will be even more constrained in 2017 with a combination of more competition from large-scale public works projects as well as challenges to immigration.

**Muioio:** A number of potential policies from the new presidential administration could impact the U.S. residential real estate market moving forward, though the timing and impact remains to be seen until further policy specifics are revealed.

Higher interest rates will limit some of the growth in demand. Overall the net effect of the potential changes will likely be marginally positive for residential real estate.

5) How will the new presidential administration impact the U.S. residential real estate market?
residential real estate. Tighter lending standards have kept some potential buyers out of the market, and the potential for easing of these standards would fuel additional demand for home buying that was previously being funneled into renting. This would provide a boost to sales and prices in the short term, though it could also increase longer term systemic risks for the housing market if the pendulum swings too far. The greater unknown at this point is how soon and to what extent regulation will be loosened.

The potential for reduced immigration could also hamper housing demand in certain regions that have been driven by demographic trends in recent years. Limiting immigrant workers that comprise a notable portion of the construction work force could also put a constraint on new home construction if it were to not only limit the labor pool but drive up construction labor costs.

Treasury Secretary Nominee Steven Mnuchin has suggested that the popular mortgage interest deduction will be capped, but continue to allow some deductibility. Depending on where the cap would land, this could adversely affect higher-end homebuyers and higher prices markets. Mnuchin has also said that he wants to get Fannie Mae and Freddie Mac out of government control, and while details are sparse, it could elevate financing costs and put a constraint on lower income or first time buyers. There does not appear to be much clarity at this time, but these are potentially significant issues that should be monitored going forward.

More broadly, if the Congress in conjunction with the new administration were to seriously revamp the tax code, cutting rates as they have suggested, while also boosting the economy through measures that improve business confidence and reduce regulatory burdens, it could provide a boost to economic growth, and with it household incomes and household formations, and the underlying demand profile for housing could see a concomitant boost. However, this remains purely speculative at this time until policy specifics are unveiled and enacted.

Gardner: This is certainly the big question. As far as housing is concerned, mortgage rates are likely to rise a little quicker than previously expected; however, the marginal increase is fairly modest. That said, it will likely act as a bit of an anchor when we look at home price growth.

Anticipated changes to, or possible repeal of, the Dodd-Frank Act could allow banks more freedom to lend which, in turn, will also add households with less than stellar credit to obtain a mortgage. This would certainly put additional pressure on the limited housing supply.

Finally, a Trump presidency can also remove some obstacles currently in builders’ path. It is possible that they will see some additional tax breaks, and
state incentives that could limit regulations and possibly encourage additional lending to builders. As around 25 percent of the cost of a home is “regulation,” any change in this will certainly help builders and also consumers.

Villacorta: With promises to reform tax code, immigration policy, and regulations surrounding the mortgage lending industry, the new presidential administration will certainly have its hands full from the start. At minimum, there will be a degree of uncertainty by all corners of the market, especially with consumers, that will likely lead to more of the ‘wait and see’ approach that has limited active engagement from many sectors of the traditional home buying demographic. At the end of the day, the overall impact to the U.S. residential real estate market will largely be tied to performance of the rest of the economy. Though early reads of consumer confidence suggest a positive expectation to the incoming administration, that optimism will have to reinforced by increases in wages and housing affordability before meaningful impacts will be felt in a housing market that is still struggling to find firm footing eight years removed from the height of the housing crash.

Becketti: At this moment, discussion of the new Administration’s proposals and of their likely fate in Congress is triggering increased uncertainty among investors. Markets appear to believe that the proposals, in whatever form they are finally enacted, will generate a moderate increase in both growth and inflation, and we agree with that consensus. Benchmark interest rates already have jumped to price in that expectation. However, even before the U.S. presidential election, mortgage originations had begun to cool as interest rates stabilized after the post-Brexit rally. The recent Treasury sell-off raises the possibility that the 40-year secular decline in mortgage rates may finally be at an end. If that turns out to be the case, originations will drop sharply, refinances will dry up, durations will extend, and home sales activity will grind lower.

Weiss: The wild card in this story of home buying mania is the risk of bumps in the road as we transition to the new administration of President Trump. Things may go quite smoothly but many approaches will be different, more different than any transition that I can remember. Changes may cause a boom in the economy, high employment, and modest inflation or they may cause trade wars, a recession and any number of unnerving international tensions and risks. Markets hate uncertainty and risk. Economies hate what markets hate. If things go in that direction, then you can ignore everything I said above. What are the odds we end up in such a fog? I am an optimist by nature and I think the odds are low. I think most homes will be more valuable in a year than they are now and most people who bought a home within the next year — with a 30 year mortgage — will find that they made a good decision.
The Norris Group holds an annual charity event called "I Survived Real Estate." The title was coined in 2008 when the event launched to capture exactly what real estate professionals were feeling at the time (if they were still working in real estate).

Since 2012, real estate has become easier and easier to survive and even thrive in. Last year, I had the privilege of speaking to the Apartment Owner’s Association meeting held in Los Angeles. The room was packed; standing room only. I asked, “This is a huge crowd. You are either really excited or really concerned.”

A bit of laughter rolled across the crowd and then someone stood up and asked, “We all want to know, are we in an apartment price bubble?”

My experience is predicting long-term trends for the residential housing market, but I did think of a good question to ask this nervous audience. “How many of you would buy your apartment building today at its current valuation?”

The whole room laughed! They had answered their own question. What’s the definition of a bubble? When no experienced buyer will risk their money for the rate of return available.

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We’re currently in research mode for our upcoming California market timing report in February. We do this event every few years and have since our first report in 1997. The name of that report was *The California Comeback: Why Prices Will Double in the Next Eight Years*. We wrote another report in late 2005 entitled, *The California Crash: Why Foreclosures Will Explode and Prices Crash*. So, in February, we’ll take our best shot at saying what’s next.

**Forecasting the 2006 Housing Crash**

Just like in late 2005, most everyone involved is sitting on a pile of equity. In late 2001 and again in 2006, John Burns invited me to debate the topic of the possibility of California having a price crash. The audience was made up of all California builders. Imagine telling a builder in 2006 to sell every lot, land project and house immediately to avoid a huge loss. That was a tough sale in 2006 because every indication was a rosy outcome for the housing industry.

I love when people tell me they saw the crash coming, too! “Gosh, I’m so glad to hear that. Can I see a copy of what you wrote at the time?” Crickets! So, was it really that easy to see it coming? Let me share some charts with you after I ask you to take a little test.

1. **As affordability declines (less people can afford to buy), what happens to the volume of sales?**

2. **As affordability declines (less people can afford to buy), what happens to the number of new homes being built?**

3. **As affordability declines (less people can afford to buy), what happens to the number of foreclosures that occur?**

A few questions before you look at the charts. How sure are you of your answers?

Would you be able to look at these charts and get out of harm’s way in 2006?

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**CALIFORNIA AFFORDABILITY VS SALES**

![CALIFORNIA AFFORDABILITY VS SALES](source)

**CALIFORNIA AFFORDABILITY VS NEW HOME CONSTRUCTION**

![CALIFORNIA AFFORDABILITY VS NEW HOME CONSTRUCTION](source)
In every cycle, from the mid to late 1970s to 2006, what happened as affordability went down?

1. Volume of sales soared as affordability went down
2. Volume of new homes being built soared as affordability went down
3. Volume of foreclosed properties declined steadily as affordability went down
4. Unemployment improved as affordability went down

So, how did you do?
Most people get a zero on the test because it doesn’t seem to make sense. How can you have more homes sell and more new homes built as people can afford less?

The main reason I have come up with is, as long as there is affordability left in a given cycle, prices will continue to increase. Why? Human participants are on all sides of the transaction. If lending policies allow, we all continue to buy and everything real estate does better until it hits a wall.

You cannot tell you are coming to an end of a cycle by how you “feel.” Nearly everyone felt exuberant in 2006 including expert builder and consumer alike. It didn’t stop a crash from occurring.

As we look at the past few years, as affordability declined, virtually nothing happened to sales volume and there was very little improvement in single home construction. This is not normal.

What’s holding us back?

There are few things that are working together that are creating a downward draft. 1. Lending policies are still too restrictive. 2. Some still have a bad “feeling” about owning a home due to past loses. 3. We have a group highly educated young adults who have accumulated a lot of college debt and many are still under-employed. 4. Our young adults are waiting to get married and start a family.

I think 2017 will be a decent year for real estate; sort of mimicking 2016. My main concern is what happens after that.
Which Cleveland professional sports team best reflects the nature of its housing market?

At first blush the area's housing market might look most like the 2016 NBA Champion Cleveland Cavaliers.

Median home prices across the five-county metropolitan area have been on a winning streak, increasing on a year-over-year basis for 18 consecutive quarters through the third quarter of 2016 to just 5 percent below the pre-recession peak in the third quarter of 2005, according to sales deed data collected by ATTOM Data Solutions. And demand for homes is gaining strength, with the volume of Cleveland-area home sales up on a year-over-year basis for six consecutive quarters ending in the second quarter of 2016.

“The (Cleveland) market had a good year in 2016, which I attribute to catching up after slow growth the past couple years,” wrote Joel Elvery, economist at the Federal Reserve Bank of Cleveland, in an email interview with Housing News Report.

But Elvery hesitated to put the housing market in the same category as the Cavaliers or even the Cleveland Indians, who made it to the 2016 World Series only to lose in seven games to the Chicago Cubs.

“While the Indians and Cavs were exceptional this year, Cleveland’s real estate market just had a solid season,” Elvery wrote. “Price growth was strong, but the number of new units, vacancy rates, and rent followed trend.”

In fact, some Cleveland housing metrics for 2016 more resemble the Cleveland Browns, whose 1-15 regular season record was the worst in the NFL for the 2016 season and ties for the third worst in NFL history.

ATTOM data shows 22.8 percent of Cleveland homeowners were seriously underwater on their homes — owing at least 25 percent more than the home is
worth — as of the third quarter of 2016, the third highest among 88 major metro areas nationwide and behind only Las Vegas and nearby Akron.

Additionally Cleveland’s vacancy rate is the sixth highest in the nation among 82 metro areas with at least 200,000 people, according to an analysis of real property and postal data by ATTOM.

“It’s a tale of two cities,” said Jim Rokakis, former county treasurer with Cuyahoga County, the central county in the metro area where the city of Cleveland is located. “There are areas that are doing extremely well. There are areas that are not doing well.”

The Fight Against Blight
As vice president of the Western Reserve Land Conservancy, Rokakis now helps lead the charge in removing blight resulting from vacant, abandoned properties still scattered across the city.

“We had this huge oversupply of housing. We have focused on removing a lot of this housing,” said Rokakis, who noted that hundreds of millions of dollars from various sources, including the foreclosure robo-signing settlement, U.S. Treasury Hardest Hit Fund and Cuyahoga County, has been spent to demolish vacant homes across the region. “And we’ve done it. ...We’ve taken down 11,000 already (in the city of Cleveland alone).”

About 15,000 vacant structures still remain across all of Cuyahoga County, with about half of them requiring demo, according to Frank Ford, senior policy advisor with the Western Reserve Land Conservancy.

“The significance is where they are located. Because the 7,500 that are worse off tend to be in the east side neighborhoods that are predominantly African-American and the close-in suburbs on the east side that are heavily African-American,” said Ford, who chairs a countywide housing policy group involving more than 20 agencies that has been meeting monthly over the past 11 years to address foreclosure, blight and abandonment challenges in Cleveland.

“I view myself as part of a market recovery coalition,” Ford explained. “We have housing market recovery in the outer suburbs and a handful of the hottest inner city areas. But those are the exceptions. ... How do we deal with the remaining vestiges of the foreclosure crisis? ... The tsunami wave receded but it

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Real estate investors are helping with that cleanup, but primarily in submarkets that are already recovering, according to Josh Cantwell, a real estate investor and coach who is also CEO at Freeland Ventures, a Cleveland-based private money lender for investors both in Cleveland and across the country.

‘So Much Fun’ Downtown
“The downtown Cleveland area has made such a roaring comeback, noted trend is driven by 25- to 40-year olds moving back to downtown and adjacent neighborhoods such as Tremont and Ohio City. “Because the downtown is so much fun, now you see investors like me buying up any lots in areas adjacent to downtown.

“Both sides of the flats are seeing a rebirth with new condos, restaurants, night clubs,” Cantwell added, referring to the low-lying neighborhoods along both sides of the Cuyahoga River, which winds its way along the western edge of downtown Cleveland.

But Elvery, the Federal Reserve economist, cautioned that the rapid growth in real estate in and around downtown Cleveland also poses the biggest risk for the area’s housing market going forward.

“I think the biggest risk is overbuilding high-end condos and apartments in and near downtown,” he wrote. “There are a lot of units that will be coming online in the next two years and, since the region’s population is flat, the investors are counting on rising interest in units in large buildings near downtown. If that shift isn’t as large as expected, supply will outpace demand and there will be downward price pressure.”

Rokakis attributed the downtown renaissance largely to millennial buyers and renters.

“Proximity to downtown coupled with unique historic housing has made them hot again,” he said, referring to neighborhoods such as Detroit Shoreway, Ohio City, Tremont, University Circle, Kamm’s Corner and West Park. “They’ve kind of been discovered by millennials, and millennials are flocking to them.

“Cleveland is very affordable. For a lot of kids who are facing issues of overwhelming college debt ... you can live here very affordably for about one-fifth of the average rent you would pay in San

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Josh Cantwell | Real estate investor, coach and CEO of Freeland Ventures

The downtown Cleveland area has made such a roaring comeback. Because the downtown is so much fun, now you see investors like me buying up any lots in areas adjacent to downtown.”
The demand from retail buyers for that is enormous.”

**Cleveland Flipping at 10-Year High**
A total of 1,589 single family homes and condos across the Cleveland metro area were flipped — sold for the second time within a 12-month period — in 2016, according to ATTOM data. That was a 10-year high in terms of the number of homes flipped and represented 6.2 percent of all home sales for the year.

Investors who completed a flip in the third quarter of 2016 sold the property for $70,525 above their purchase price on average, a gross return on investment (not including rehab costs and carrying costs) of 155 percent — the highest gross ROI among 92 metro areas nationwide analyzed in the ATTOM Data Solutions Q3 2016 Home Flipping Report.

Among 71 Cleveland-area zip codes with at least one home flipped in the third quarter of 2016, those with the top five most flips during the quarter were 44128 in the city of Cleveland (23 flips); 44107 in Lakewood (20 flips); 44125 in the city of Cleveland (19 flips); 44137 in Maple Heights (17 flips); and 44060 in Mentor (15 flips).

Investor Mike Dagget found success flipping an older home in Grand River, a northeastern suburb next to Mentor and bordering Lake Erie. He said he purchased the 1908 bank-owned home for $35,000 in July 2013, put $40,000 into rehab and sold a year later for $113,000.

“In the suburbs, those buyers are just looking for something that’s new. We usually have 10 to 15 rehabs going on at any one time,” he said, noting that many of the homes are older and need major rehab involving plumbing and electrical systems, but are appealing to buyers looking for homes that feel “brand new” in established neighborhoods. “It’s not new construction, (but) for the buyer it feels like new construction so they are choosing that over other products in the marketplace.

“People love fresh wide open spaces,” he noted. “Dark floors and white finishes have brought in a lot of buyers looking for that fresh 2016, 2017 décor.

**Upside-Down Rainbow**
Cantwell, who bought his first investment property in 2001 in the southwestern Cleveland suburb of Parma, described the Cleveland region as an upside-down rainbow with varying degrees and types of investment opportunity on each ring of the rainbow.

Cantwell said the outer ring of the rainbow, comprised of suburbs such as Lakewood and Rocky River to the west and Pepper Pike and parts of Shaker Heights to the east, is best for flipping homes.

“In the suburbs, those buyers are just looking for something that’s new. We usually have 10 to 15 rehabs going on at any one time,” he said, noting that many of the homes are older and need major rehab involving plumbing and electrical systems, but are appealing to buyers looking for homes that feel “brand new” in established neighborhoods. “It’s not new construction, (but) for the buyer it feels like new construction so they are choosing that over other products in the marketplace.

“People love fresh wide open spaces,” he noted. “Dark floors and white finishes have brought in a lot of buyers looking for that fresh 2016, 2017 décor.

**Francisco,” Rokakis continued, citing two young employees of the Western Reserve Land Conservancy hailing from Oregon and Florida, both of whom are planning to put down roots in Cleveland. “They’ve come to love Cleveland and want to stay here.”**
property had been vacant for three years before he purchased it, sight-unseen. “I bought it cash and I got a rehab specialist to come in. ... I lived in it for a year... It was a Fannie Mae property so to buy it owner-occupied I had to live in it for a year.”

Cantwell cautioned that even in the outer-ring suburbs, not all neighborhoods are created equal.

“In Cleveland you want to be careful because there is not a lot of job growth. So you want to pick the areas with the real good school districts ... or areas that have special amenities,” he said, adding that when given a choice between investments in two different school districts, “always opt for the best school district.”

Cash-Flow City
The middle ring of the upside-down rainbow, comprised of neighborhoods such as Cleveland Heights, Parma, and Berea, is better for buying cash flow rental properties, according to Cantwell, who said he still owns the first rental property he purchased in Parma — a duplex — to this day.

“We want to be all in (purchase and rehab costs) for less than 80 grand. But in these cash flowing markets we are often able to go all in for less than 80 grand,” said Cantwell, noting that his finance company often works with out-of-town investors attracted to Cleveland because of the good cash flow opportunities available. “We love the Cleveland market. If you want cash flow, Cleveland has to be one of the most undervalued markets in the country.”

Cleveland-based real estate financier Brian Stark, who also works with investors from across the country, noted that the prime cash flow rental property opportunities in Cleveland are drawing not just out-of-state investor but also out-of-country investors to the city.

“There are some markets where it is almost impossible to buy and rehab for 65 percent of after repair value. ... Cleveland is one of the best. People come from all over the world to buy here,” said Stark, CEO at Nuvida Companies.

An ATTOM Data Solutions analysis of investment homes owned by out-of-state owners shows that 5,970 of the 37,230 non-owner occupied single family homes in Cuyahoga County are owned by out-of-state owners (14 percent). That’s below the national average of 16 percent but above the statewide average of 11 percent.

Continued on next page
Forgotten Neighborhoods

Stark said investors willing to bet on some of those down-and-out neighborhoods could realize a big payday down the road.

“The great opportunity is to find the two or three pocket neighborhoods. … neighborhoods that are forgotten,” he said. “Work with the community, work with developers. If you picked the right pockets you will have hundred thousand dollar properties. Someone is going to make millions of dollars this way.”

Stark, a longtime member of the Cleveland Restoration Society, said many of the forgotten Cleveland neighborhoods have solid, historic homes just waiting to be discovered.

“There are many neighborhoods with beautifully built three- and four-bedroom colonials … that have good hardwood floor and have good roof structure. … The bones are there — just waiting for the flesh to come alive,” he said. “It is happening in some neighborhoods. Usually it’s a radiation out from an existing, viable neighborhood. … starting to annex a forgotten neighborhood to a gentrified neighborhood.”

CONTINUED ON NEXT PAGE ›
Still, Stark acknowledged that in some cases the demolition advocated by stakeholders like Ford, the senior policy advisor with the Western Reserve Land Conservancy, are necessary.

“It's unfortunate that not every structure can or should be saved. There are some homes that are in such disrepair and in neighborhoods with such little economic viability that the best solution is to raze a number of them and repurpose them,” he said. “We don't have to save everything.”

Ford is cautiously optimistic that the funding available for demolition is just enough to clear out the blight still lingering in Cleveland.

“What we have coming in is just about the amount we would need to demo the 7,500 properties in these blighted neighborhoods,” he said, adding that some are arguing for a balanced approach that involves rehabbing some of those properties instead of demolition. “About 2,000 of 7,500 structures would be left standing if they did a balanced approach involving 1,000 rehabs.”

Although he acknowledges that “nobody wants to do demolition,” Ford believes demolishing the worst of the blighted properties will be best for the neighborhoods those properties are in and the Cleveland market overall.

“I think that in five years if we are able to remove that existing blight that we have combined with the fact that foreclosures are so low, we've got an opportunity to remove the existing blight without a lot of new blight taking its place,” he said. “That means that in five years we could have a recovery even in the most distressed areas.”

Ford does see more interest from real estate investors at the public foreclosure auctions — called sheriff’s sales — in Cuyahoga County, which he attends to observe periodically.

“We now go to a sheriff’s sale, and the room is packed. And I noticed that increase started a couple of years ago,” he said, adding that although there were some “reckless” out-of-state investors prevalent in the Cleveland housing market about 10 years ago, those type of investors are no longer as prevalent because the local municipalities have cracked down on property code violations thanks in large part to one strict housing court judge. “That activity has slowed. What has taken its place is local mom-and-pop investors trying to do the same thing”.

CONTINUED ON NEXT PAGE

“

We’ve got an opportunity to remove the existing blight without a lot of new blight taking its place. That means that in five years we could have a recovery even in the most distressed areas.”

Frank Ford | Senior policy advisor, Western Reserve Land Conservancy

Cleveland Ohio City Skyline
East Side Avoidance
Ford said savvy real estate investors will mostly avoid blighted areas like the east side of Cleveland, but he's more concerned with less savvy investors who might get in over their heads with highly distressed properties in blighted neighborhoods and end up walking away from the investment.

Cantwell said he learned early on in his investing career to invest in markets he was very familiar with and that represented less risk.

“We learned pretty much to avoid the east side. We stayed pretty much on the west side and the southwest suburbs,” he said, noting that the foreclosure crisis came early to Cleveland, starting around 2003 as risky mortgages quickly failed. “I knew that the east side was going to be in trouble because there were so many investors coming out of the woodwork, buying with no money down ... a lot of those deals we just walked away from because we knew something was funky.”

In 2011 during a battle with pancreatic cancer, Cantwell closed a privately funded deal in which he outsourced the rehab because he was in the hospital for surgery. That deal gave him an epiphany about his business going forward.

“That deal changed my personal investing career forever because I realized I wanted to understand the financing side almost exclusively,” he said. “I realized if I controlled the money, I could control the deal flow. (Now) People come to us all day bringing us incredible deals in Cleveland and all over the country because we have millions and millions of dollars in funding.”

Daggett, the investor who flipped a bank-owned property in the northeastern suburb of Grand River, is one of those investors. He's applying with Cantwell's Freeland Ventures to get funding to buy more distressed properties to flip. He’s focusing on neighborhoods in the northeastern suburbs that he knows well and holding out for a “screaming deal.”

“This is what I focus on, a neighborhood of about $150,000. I try to get those properties for less than 100 grand or not much over,” he said, noting he's bid on three properties unsuccessfully. “The first someone outbid me. The last two I bid on, they are still on the market, which means I didn't get outbid, but it's almost as if the banks are holding out for a certain price. ... (If) I'm coming in too low for the banks, just move on.”

And Daggett is also staying disciplined about the neighborhoods where he purchases.
“There’s parts of Cleveland I won't even consider … with bad neighborhoods and crime,” he said.

### Demo Doesn’t Solve Deeper Issues

Rokakis and Ford believe the demolition of the 7,500 homes in some of the highly distressed neighborhoods will create a foundation for those neighborhoods to bounce back, but Rokakis noted that demolition won’t remove some of the root issues contributing to the distress.

“I'm upbeat because we've dealt with blight ... but it doesn't solve all our problems. We have societal issues, we have racism that affects the market,” Rokakis said. “If you give a carpenter a hammer, the whole world is a nail. I don't think taking down these houses will address some of the deeper societal and economic issues we face.”

Stark, the real estate financier, sees evidence that some of the deeper societal issues are healing in Cleveland.

“Cleveland is an amazing melting pot of virtually every cultural heritage. ... We have Arabs and Jews and Muslims and Bahai ... we have all kinds of people here and generally people get along very well,” he said, adding that he also has hope that some of the deeper economic issues facing the city will be addressed if incoming president Donald Trump follows through on his campaign rhetoric.

“From a real estate perspective, Donald Trump said many times in his campaign ... we’re going to fix our inner cities. I’m very excited to see what President Trump will do to fix our inner cities. Our inner cities hold some of our greatest promise and some of our greatest potential because they have fallen so far that any rebirth would represent a great resurrection,” he said. “If President Trump's economic policies provide American companies more latitude to produce ... ultimately jobs, it will be great for Northeast Ohio and for the real estate market here.”
Sweeping changes in the nation’s demographic makeup will have profound effects on the nation’s housing industry, according to “Big Shifts Ahead: Demographic Clarity for Businesses,” (Advantage Media Group, 2016), a new book by authors John Burns and Chris Porter.

They argue that broad demographic shifts will reshape housing in America in the next decade, creating new opportunities for businesses of all kinds. Rising numbers of female executives, affluent immigrants, growing numbers of younger and older workers and a ballooning retiree population will have a profound influence on residential real estate in the U.S. over the next 10 years, according to Burns and Porter.

Generations By Decade
The book is organized into three sections. In part one — titled “Generations By Decade” — the authors outline one of the main frameworks of the book; renaming generational groups. They break down the generations in a novel and interesting way. Burns and Porter group the U.S. population by the decade they were born, rather than by generational groupings, i.e., Baby Boomers, Millennials or Gen-X.

For example, the duo calls Baby Boomers the Innovators because their generation has created so many innovations.

The authors see a retiree surge among the Innovators. Only 10 years ago, 2.2 million people were turning 65 each year. That number has surged to 3.5 million in 2016 and will grow to 4.2 million in 2025. These aging Innovator retirees will completely transform housing, argue Burns and Porter.
Born in the 1970s to dual-income and divorced parents, **Balancers** are teens who embraced television and video games. Unlike their workaholic parents, Balancers divorce less, stay home with their kids more and have children later in life. One-third of Balancers are foreign born.

Next in the generational grouping are the **Sharers**. Born in the 1980s, the Sharers invented the sharing economy out of necessity, embracing new technologies. They are the most educated cohort ever, but they are racked by student debt, under-employment, and 20 percent live below the poverty line.

Raised by a single parent and born in the 1990s, the **Connectors** are wirelessly connected 24/7 to friends, family and the knowledge economy. Many Connectors are still in school; they are highly educated, underemployed and wary of credit.

**4 Big Influencers**

Next, Burns and Porter identify 4 Big Influencers that shape generational shifts, namely government policies, economic cycles, new technologies and societal shifts.

In part two — titled “The Biggest Demographic Opportunities” — they outline four big shifts impacting society, including the growth of college-educated women, new streams of affluent immigrants, workaholic retirees and young adults born after 1980 — the Sharers and the Connectors — who will dominate the next decade.

“We wrote *Big Shifts Ahead* primarily for ourselves,” writes Burns and Porter in the introduction. “As consultants to the construction and investment industries, we need to understand the demographic shifts transforming the country. We also need to communicate the trends to our clients in a way that makes the information digestible and usable for decision making.”

In part three — titled “Lifestyle Shifts” — they chronicle other trends, including the growth of the sharing economy, the migration southward and the new “surban” way of life. They believe people and millions of jobs will move from north to south. Americans will migrate south, leaving New York, Pennsylvania and Illinois to the Sunbelt states of Texas and Florida, seeking affordable housing and urban-like environments they call “surban” living.

**“Surban” Living**

In Chapter 10, the authors claim that surban living — a blend of the best of urban living with a more affordable suburban environment — will see the bulk of new household formation in the next decade. They present evidence of a denser, more urban vision of suburbia that is powered by social and demographic shifts involving working women, affluent immigrants and both younger and older adults.

Along the way, they also make several 21st century forecasts, including some unexpected ones:

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*FOREIGN-BORN SHARE OF U.S. POPULATION*

13% of Americans are immigrants, the highest percentage in 90+ years.

**Source:** John Burns Real Estate Consulting LLC calculations using U.S. Census Bureau decennial data.
Rising rental rates: Burns and Porter see a soaring demand for rental units, especially since home ownership rates have declined from 69.2 percent in 2004 to 62.9 percent today. The sharing economy’s de-emphasis on homeownership will be reflected in soaring demand for rental units. By 2025, home ownership rates are anticipated to drop to 60.8 percent, the lowest since the 1950s, the authors forecast.

Surge in household formation: Over the next decade, household formation is expected to increase by 86 percent, with well over half of the 12.5 million new households formed choosing to rent rather than own, according to Burns, founder and CEO of John Burns Real Estate Consulting, and Porter, the firm’s chief demographer.

So what are Burns and Porter’s prophet-like secrets for spotting trends?

They see hidden patterns that others don’t fathom. Part of their genius is to look at vast amounts of data, find the connections and reveal big-picture concepts that contradict common wisdom in simple and easy to understand terms.

“Big Shifts Ahead” is an amazing book. From the impact of immigration to the coming boom in household formation by millennials, Burns and Porter masterfully point to the future demographic trends that will drive business in the 21st century.

Burns and Porter are the John Naisbitt (Megatrends) and Alvin Toffler (Future Shock) of housing forecasting. If you’re a new home builder, a Realtor, real estate investor or developer, “Big Shifts Ahead” is a must read. ■

ESTIMATED SHARE OF HOUSEHOLD GROWTH (2016 - 2025)

Source: John Burns Real Estate Consulting LLC

ABOUT THE AUTHORS

John founded John Burns Real Estate Consulting in 2001 to help executives make informed investment decisions. Before founding the company, John worked at a national consulting firm for 4 years and for 10 years at KPMG Peat Marwick.

As Chief Demographer at John Burns Real Estate Consulting, Chris helps clients understand the role demography plays in shaping the demand for their business. Before joining the company in 2005, Chris worked for Reed Business Information and was Director of Electronic Media for Reed’s Building and Construction Group.
Time To Privatize the GSEs?

Even before taking office, Treasury secretary-designate Steven T. Mnuchin said he wants to return mortgage finance giants Fannie Mae and Freddie Mac to the private sector from government control, but House Financial Services Committee chairman Jeb Hensarling (R., Texas), and Sen. Mike Crapo (R., Idaho), have each put forward their own plans that would wind down the two companies.

“We got to get Fannie and Freddie out of government ownership,” Mnuchin told Fox Business. “It makes no sense that these are owned by the government and have been controlled by the government for as long as they have.”

The federal government took over Fannie and Freddie in September 2008, placing them under Treasury conservatorship at the height of the financial crisis and bailing them out to the tune of $187 billion. Look for the Mnuchin Treasury to reform, recapitalize and then released the GSEs from conservatorship.

Still, ending the government’s conservatorship will not be easy.

SOURCE: Fox Business, New York Times

Mortgage Rates Rising

While mortgage rates remain low by historical standards, they've risen sharply over the past couple of months, pushing the average rate on a 30-year, fixed-rate mortgage (FRM) to 4.32 percent the last week of December 2016, according to Freddie Mac. Meanwhile, a 15-year, fixed-rate mortgage averaged 3.55 percent. A year ago, the 15-year, FRM averaged 3.24 percent.

Average rates for 5-year Treasury-indexed hybrid adjustable rate mortgages (ARM) clocked in at 3.30 percent in the last week of December 2016, reported Freddie Mac. A year ago, the 5-year ARM average 3.08 percent.

As mortgage rates continue to increase, home sales and affordability will continue to be a concern for housing in 2017.

SOURCE: Freddie Mac

PRIMARY MORTGAGE MARKET SURVEY® (PMMS®) U.S. Weekly Averages

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Quicken Loans Gets Lawsuit Relocated to Detroit

A federal judge moved the Quicken Loans case against the Department of Justice and the Department of Housing and Urban Development from Washington, D.C., to the mortgage lender's hometown in Detroit.

U.S. District Court Judge Reggie B. Walton said moving the case to the Eastern District Court in downtown Detroit would be more appropriate and convenient venue for the fraud allegations against Quicken Loans to be heard.

Quicken, which is the nation's largest Federal Housing Administration-backed mortgage lender, sued the DOJ and HUD in April 2015, claiming that it was left with no alternative but to sue due to the DOJ's demands. The government countersued Quicken six days later.

The case is United States v. Quicken Loans, Inc.


Real Estate Cases to Watch in 2017

Rules and regulations governing short-term rental platforms like Airbnb and VRBO in cities across the country are among the areas of real estate law litigators will have their eyes on in 2017.

While New York, San Francisco and New Orleans have been in the headlines over the past several years with regard to efforts to codify or enforce city laws on short-term rentals, a pair of cases in Chicago could provide more clarity on the issue this year.

On June 22, 2016, the Chicago City Council adopted a short-term rental ordinance that now requires property owners wishing to rent on a short term basis to apply for and obtain a license, plus pay a 21 percent tax increase. The vote was 43-7.

Backed by Democratic Chicago Mayor Rahm Emanuel, the new ordinance slaps a 4 percent surcharge tax on home-sharing bookings on top of Chicago’s 17.4 percent hotel tax, and sets the stage for a sharing economy showdown similar to the one brewing between the taxicab industry and Uber and Lyft over a plan to license ride-sharing drivers.

Meanwhile, a group of homeowners is suing the city of Chicago, alleging the city’s new “draconian and unintelligible restrictions” on Airbnb and other homesharing platforms are unconstitutional and punish responsible homeowners.

On Nov. 4, 2016, Benjamin Thomas Wolf, president of Keep Chicago Livable, filed suit against Chicago’s new regulations on Airbnb rentals (Keep Chicago Livable and Benjamin Thomas Wolf v. City of Chicago); a second lawsuit with different plaintiffs was filed Nov. 15, 2016 (Mendez v. City of Chicago).

SOURCE: Chicago Tribune, Crain’s Chicago Business
## 2016 YEAR-END FORECLOSURE ACTIVITY BY STATE

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</table>
Housing News Report is a monthly publication dedicated to helping investors succeed by providing them with timely and relevant information about the residential real estate market.

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