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The California Economy and Real Estate - Recovery in the Slow Lane

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Publication Date

1995-08-01

Research Report

Fisher Center for Real Estate and Urban Economics • University of California, Berkeley • August 1995

The California Economy and Real Estate — Recovery in the Slow Lane

Data from public and private sources suggest that California's economic downturn has ended, but without a robust upward swing. A very slow start to job growth and faltering real estate markets are signs that the state is not experiencing a return of the boom period of the 1980s. Rather than a typical rebound, echoes of the changes brought about by the recession are still being felt in the type of job growth experienced, where job growth is occurring, and the health of real estate markets throughout the state. This article highlights current trends in California employment and population growth and describes the conditions of major real estate markets in the state.

When Did Recovery Begin? The Latest Estimates

California is already in recovery, in terms of output, income, unemployment and job growth. Technical data limitations make a full measure of this recovery difficult. Output and income figures show that California's economy began recovering in 1992, but that the recovery faltered in 1993, keeping the state's economy weak as U.S. growth took off (see Figure 1). Real growth in GSP was 1.5% in 1992 but was only 0.3% in 1993. Real total personal income, which also grew at 1.5% in 1992, decreased by 0.3%, in 1993. In contrast, real GDP at the national level grew by

2.3% in 1992 and by 3.1% in 1993. Preliminary income figures for 1994 show California once again with positive real income growth (about 1%), but still lagging the U.S. by at least two percentage points. (1994 product figures are not yet available.)

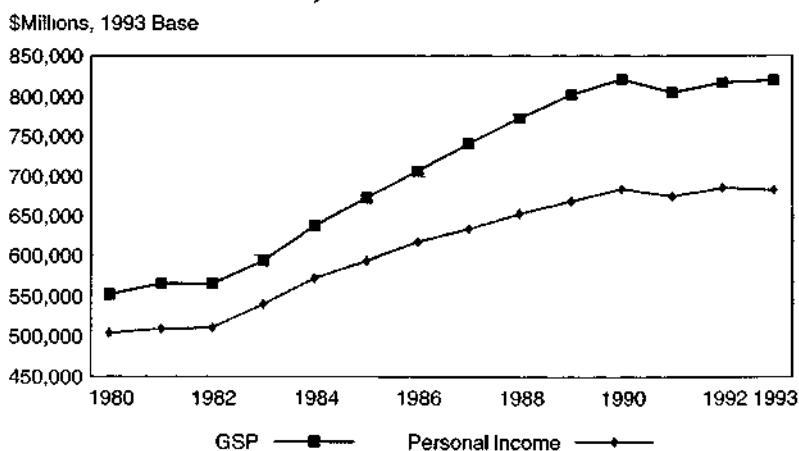
Employment figures have undergone several revisions, making it difficult to track the state's progress during this period of weak income and output growth. Revisions to state employment data (for the 1992-1994 period) were released by the California Employment Development Department and the U.S. Bureau of Labor Statistics in March

1995. These figures show a pre-recession peak of employment at 12.6 million in December 1990, and a low point of 11.9 million reached in January 1994. Annual average employment peaked at 12.5 million in 1990, and hit a low of slightly above 12 million in 1993. On an annual average basis, the overall drop in employment during the three-year period was 455,000.*

Estimating the number of jobs gained in recovery is complicated by the seasonal variations and changing employment estimates. Annual average employment increased by 0.8% between 1993

(Continued on page 2)

FIGURE 1
California GSP and Total Personal Income
1980-1993, Constant 1993 Dollars

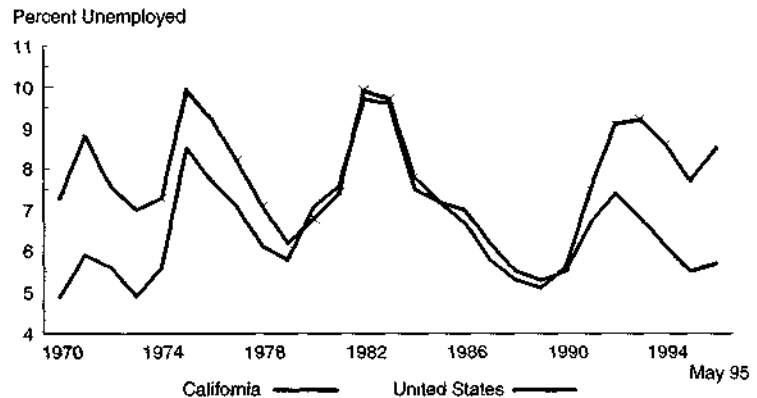


Source: CREUE from California Dept. of Finance.

and 1994. Employment changed between first quarter 1994 and first quarter 1995 by 1.1%. An estimated 136,000 jobs were added to the state between the first quarter of 1994 and the first quarter of 1995. If the rate of employment growth continues at the first quarter rate for the rest of the year, the 1993 to 1995 job growth will have brought back about half of the jobs lost in the first four years of the decade.

It is possible that even this weak level of recovery will stall as the rest of the country appears headed for a slowdown (at the least) or (at worst) another recession. California appears to once again be moving in the same direction as the U.S. economy, unfortunately at a time when the brakes have been put on sharply. BLS figures show March and April growth

FIGURE 2
California and U.S. Unemployment Rates
Seasonally Adjusted 1970-1994P



Source: Bureau of Labor Statistics.

TABLE 1
Shifts in California's Employment Base

Sector	Employment (1000s) 1995-Q1	Share of Total Employment		Employment Change		
		1990	1995-Q1	1990-1993	1993-1994	94Q1-95Q1
Total Nonfarm	12121	100.0%	100.0%	-454.6	90.8	135.8
Construction	450.3	4.5%	3.7%	-116.1	19.8	16.9
Manufacturing	1756.5	16.6%	14.5%	-263.7	-34.3	6.5
Durable	1064.3	10.9%	8.8%	-247.7	-36.9	-8.6
Nondurable	692.3	5.7%	5.7%	-15.8	2.5	15.2
TCU	605.1	4.9%	5.0%	-1.6	3.0	-2.6
Wholesale	698.4	6.2%	5.8%	-82.2	9.6	10.6
Retail	2097.8	17.8%	17.3%	-98.6	-0.2	2.9
FIRE	772.3	6.5%	6.4%	-14.6	-4.4	-25.7
Finance	371.9	3.1%	3.1%	-5.9	-3.0	-16.3
Insurance	212.2	1.8%	1.8%	-0.2	-3.5	-7.1
Real Estate	188.2	1.6%	1.6%	-8.4	2.0	-2.4
Services	3591.6	26.7%	29.6%	119.3	86.4	113.8
Hotels	179	1.5%	1.5%	-15.0	-1.0	5.0
Business	821.3	5.7%	6.8%	44.7	43.1	50.6
Motion Pictures	142.5	1.0%	1.2%	10.0	10.2	6.7
Amusement/Rec	170.8	1.2%	1.4%	11.4	2.1	11.4
Engineering/Mgt	392.8	3.1%	3.2%	-9.2	10.0	5.8
Government	2118.9	16.6%	17.5%	5.8	13.4	16.3
DOD	99.6	1.0%	0.8%	-15.7	-10.1	-8.1

Source: CREUE from unpublished BLS data.

TABLE 2
Employment Change in California MSAs

Metropolitan Area	Employment (1000s)		Employment Change		Percent Change		
	1990	95Q1	93-94	94Q1-95Q1	1990-93	1993-94	94Q1-95Q1
California	12499.9	12121.0	90.8	135.8	-3.6%	0.8%	1.1%
Southern California	7363.5	6910.9	25.4	75.1	-6.6%	0.4%	1.1%
Los Angeles	4133.3	3714.2	-3.6	43.2	-10.3%	-0.1%	1.2%
Orange	1172.4	1124.7	11.0	13.3	-4.9%	1.0%	1.2%
Riverside/San Bernardino	712.6	753.5	11.1	15.4	3.0%	1.5%	2.1%
San Diego	966.6	945.7	2.7	1.4	-2.0%	0.3%	0.1%
Santa Barbara	148.3	143.1	0.3	0.4	-3.3%	0.2%	0.3%
Ventura	230.3	229.7	3.9	1.4	-1.4%	1.7%	0.6%
San Francisco Bay Area	2918.3	2836.1	-7.3	3.7	-1.9%	-0.3%	0.1%
Alameda/Contra Costra	879.2	865.7	0.7	-2.7	-0.7%	0.1%	-0.3%
San Francisco	947.3	898.2	-6.6	4.1	-4.1%	-0.7%	0.5%
Santa Clara	814.5	785.7	-4.1	-3.2	-2.2%	-0.5%	-0.4%
Solano/Napa	138.0	139.4	0.2	1.6	2.0%	0.1%	1.2%
Sonoma	139.3	147.1	2.5	3.9	3.4%	1.7%	2.7%
Central Valley (largest)	1240.0	1259.1	11.9	11.1	1.4%	0.9%	0.9%
Fresno	243.2	254.0	1.9	2.4	4.9%	0.7%	1.0%
Kern	170.7	168.2	-0.7	0.3	-0.5%	-0.4%	0.2%
Modesto	117.5	119.0	0.4	0.9	3.5%	0.3%	0.8%
Sacramento	555.9	564.7	10.2	6.7	-0.3%	1.8%	1.2%
San Joaquin	152.7	153.2	0.1	0.8	2.4%	0.1%	0.5%
Rest of State	978.1	1114.9	60.8	45.9	7.4%	5.8%	

Source: CREUE from BLS unpublished data.

point, a drop larger than would be expected from seasonal factors alone. The DoF interim employment series is based on payroll reports rather than the surveys that underlie the BLS/EDD official data. Payroll reports suggest that California may have added as many as 100,000 additional jobs between first quarters of 1994 and 1995, beyond those counted by BLS/EDD, mainly in new and small businesses. This would give an annual rate of growth of 2.0%. April and May growth, according to these estimates, was slightly higher than in the first quarter, at 2.1%. If these figures more accurately reflect the trends in the California economy than the BLS/EDD estimates, then there is reason for optimism about the California economy. The state may continue adding jobs even as the rest of the economy slows down.

Growth Concentrates in Nonmanufacturing Sectors

Significant structural changes have occurred in the state's economy since 1990, as can be seen in Table 1. More than half of the jobs lost between 1990 and 1993 were in manufacturing, and the share of California nonagricultural jobs in manufacturing has dropped from 16.6% in 1990 to 14.5% in the first quarter of 1995. By far the largest share of manufacturing jobs lost was in durable manufacturing, which accounted for 54.5% of jobs lost in the 1990-93 recession. Nondurable manufacturing accounted for only 3.5% of jobs lost.

The gap left by shrinking manufacturing jobs is being filled by services jobs. Services employment grew both during the 1990 to 1993 period and during the

recovery, with the share of employment in services rising from 26.7% in 1990 to 29.6% in 1995. Within services, job growth varied greatly among sectors. Business services employment grew by 6.3% over the 1990 to 1993 period, and the business services sector alone accounted for 47.5% of employment growth in the first year of recovery (1993-1994). Sectors such as hotels and lodging places, educational services and engineering and management services all lost employment during the recession, but have also begun recovering employment since 1993 or 1994. The mix of expanding services sectors offers both high and low wage employment opportunities.

Construction also shows recovery in employment since 1993. One of the

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Calif. Economy...

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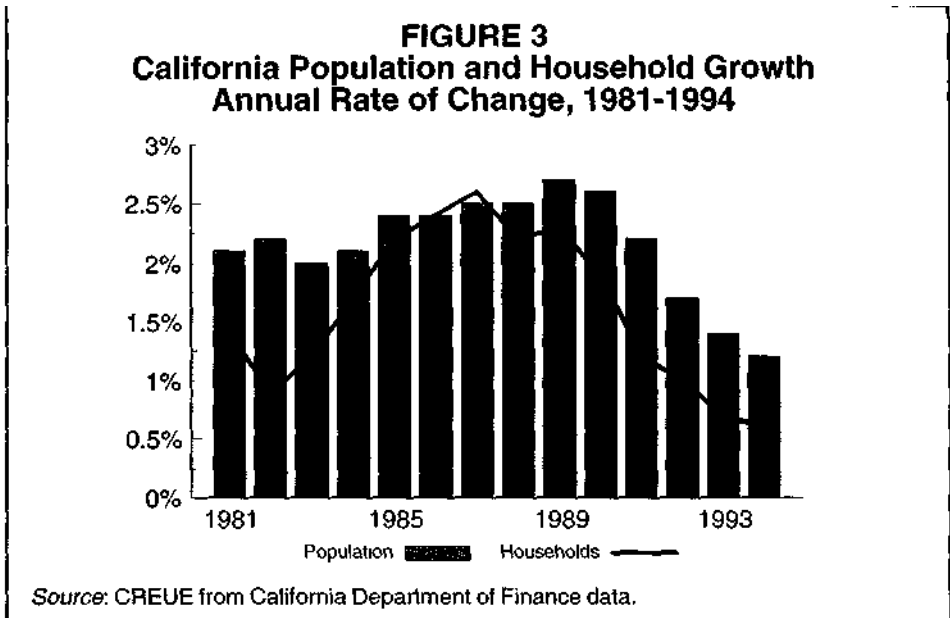
largest job loss sectors in the recession, construction employment accounted for one-fourth of the job loss in the 1990 to 1993 period, but has accounted for 22% of jobs added between 1993 and 1994 and 12% of jobs added in 1995. Nevertheless, construction employment in California remains at least 80,000 below its 1990 level.

A Recovery Characterized by Regional Disparities

Just as the recession affected different industries of the state unevenly, the recovery has also spread disparately to different regions of California. From 1990 to 1993 (on an annual average basis), five Southern California counties, including Los Angeles, Orange, San Diego, Santa Barbara and Ventura, lost over 500,000 jobs. This was 12% more than the total jobs lost in California during the period. (Growth in other parts of the state counteracted some of this job loss.) Los Angeles alone lost more than 10% of its wage and salary jobs.

The three largest metropolitan areas in the San Francisco Bay Area, including Alameda/Contra Costa, San Francisco, and Santa Clara, lost an additional 62,700 jobs. The largest losses were in San Francisco, which experienced an employment drop of 39,000, or 4.1 % of jobs. Much of the rest of the state experienced job growth. The Riverside/San Bernardino, Sonoma and Solano/Napa metropolitan areas, continued to add jobs for much of the recession, as did many Central Valley places.

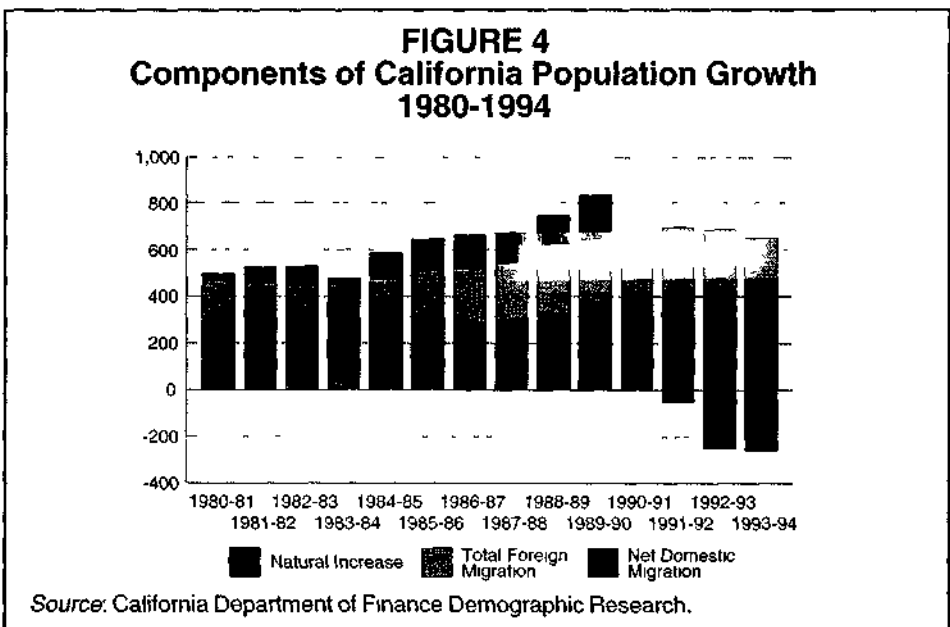
The smaller metropolitan areas and nonmetropolitan places have shown the greatest strength since 1990. Areas outside of Southern California, the San Francisco Bay Area, and the five largest Central Valley MS As, added 72,000 jobs from 1990 to 1993, while most of the



larger MSAs were losing jobs. These areas added the bulk of new jobs in the first year of economic recovery as well, as shown in Table 2.

In the recovery period, both Southern California and the Central Valley have performed more strongly than the San Francisco Bay Area. Southern California accounted for 28% of new jobs added in the first year of recovery, and for more than half of the job growth in early 1995. The Central Valley's largest MSAs accounted for 13% of new job growth in

the 1993-94 period, and for 8% of growth in early 1995. In contrast, growth has been slow and uneven for many parts of the nine county San Francisco Bay Area. The region continued to lose jobs in 1994 and has grown at an annual rate of only 0.1% in 1995. Santa Clara County, according to BLS figures, lost jobs at a rate of about 0.5% annually in 1994 and first quarter 1995. The San Francisco MSA (counties of San Francisco, San Mateo and Marin) lost jobs in 1994 and is growing at only 0.5% this year, while



the Alameda/Contra Costa area grew minimally in 1994 (by 0.1%) and has had a slight job loss in the first quarter of this year (0.3%). Only the smaller MS As on the outskirts of the region are growing faster than the state average.

These disparate rates of growth reflect several trends. First, the Central Valley and the counties on the outskirts of the coastal metropolitan regions appear to be recovering their competitive advantage for job growth. Prior to the recession, these areas attracted firms leaving the more costly coastal central areas, as well as firms looking for a new California location and firms seeking to serve areas with growing populations. These factors are once again supporting job growth in parts of the state.

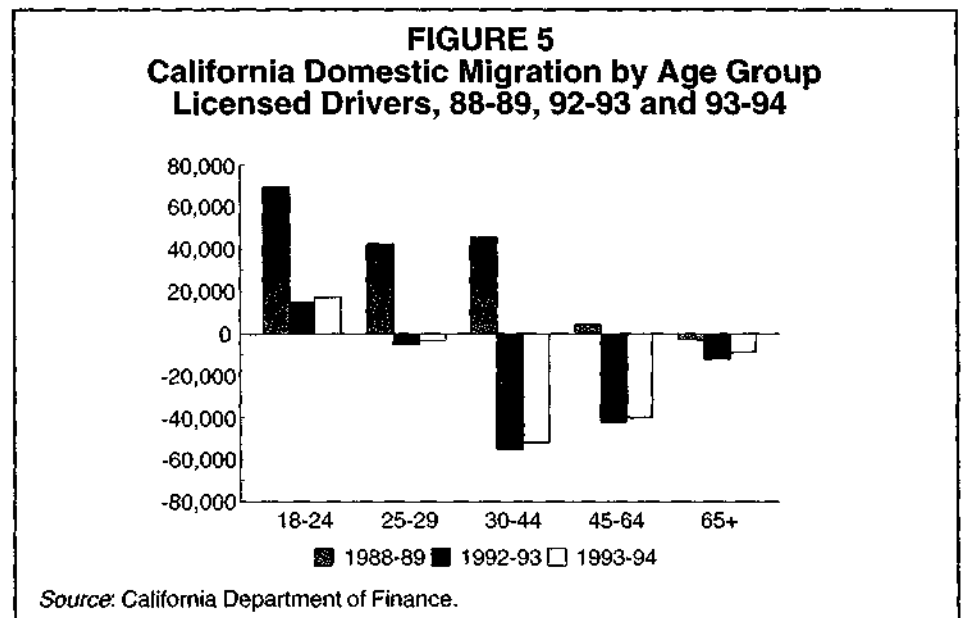
Second, as the pace of loss of defense industry jobs decelerates in Southern California, growth in services sectors has occurred strongly enough to counterbalance the defense-generated losses. Employment recovery also appears tied to revived building activity. Construction jobs have picked up strongly, as have some nondurable manufacturing sectors, such as apparel and lumber and wood products.

Third, the slower recovery of the San Francisco Bay Area reflects the continuing restructuring that is occurring, but is not an indicator of long-term problems for much of the region. The largest shocks to the economy of the Alameda/Contra Costa area are losses of jobs in finance and insurance, and government job losses related to base closures. The area has had significant increases in manufacturing employment, while services employment is growing more slowly than statewide. The San Francisco metropolitan area has experienced losses in transportation and public utilities related jobs and a major cutback in federal government employment. Its losses in finance are significantly less than statewide, while its growth in business and tourism related services has been strong. Santa Clara County shows the weakest

performance of Bay Area MS As. Santa Clara County's manufacturing employment continues to drop in both durable and nondurable products, but two key sectors—electronics and machinery (including computers), have experienced job gains this year. Services employment growth has been very weak in the first quarter of the year, reflecting the continuing loss of employment in engineering and management services offsetting modest growth in business services and health services.

from California to other parts of the United States. The rate of outflow was as high in 1994 as in 1993, despite the improving economy—reaching close to 250,000 according to Department of Finance estimates. The 1994 figures show that as in 1993, California tended to lose experienced workers to other states, as people in their thirties and older migrate to other parts of the nation (see Figure 5).

The very low levels of household formation reflect a number of factors



Population Shifts Continues

California's rate of population growth and household formation continued to decline in 1994. California's population grew at 1.2%, down slightly from the 1993 rate of growth and substantially less than population growth in the late 1980s. Household formation dropped to 0.6%, lower than the formation rate experienced during either the most recent recession or the previous 1982 recession, as shown in Figure 3.

Population increase in California since 1991 has come entirely from natural increase (births minus deaths) and foreign immigration, as shown in Figure 4. There continues to be a net outflow of migrants

beyond the slowing rate of population growth. Much of the population growth has come from natural increase (adding children) or from population groups that tend to have larger households (e.g., foreign immigrants, with multi-generational households). Economic uncertainty has also contributed to slower household growth. Young wage earners are less likely to form new households under these conditions, and older primary wage earners are more likely to be moving out-of-state than into California.

The most significant slowdown in population growth has been in Los Angeles County, where an upturn in job for-

(Continued on page 6)

Calif. Economy...

(Continued from page 5)

mation and a downturn in unemployment are not yet reflected in population growth figures. Between January 1994 and 1995, Los Angeles County's population grew by only 0.3%, while the city of Los Angeles lost population at a rate of 0.7%. Population grew relatively strongly in other parts of Southern California. Orange County grew by 1.7%, and accounted for 11% of the state's total population growth. San Diego County grew at 1.2%, while Riverside County grew twice as quickly, at 2.4%.

Despite relatively slow economic growth in 1994, the San Francisco Bay Area's population expanded more rapidly than the statewide average. Region-

wide, Bay Area population grew by 1.4%, with the counties impacted by base closures growing most slowly (Alameda, San Francisco and Solano, all at 1.2%). The most rapid expansion was in Napa and Contra Costa counties (at 1.7%). Population in Santa Clara County grew by 1.5%, despite continued job loss in 1994. Just south of the Bay Area, Monterey County grew by only 0.2%, affected by both base closure and by the lack of job growth in Silicon Valley.

The state's smaller, inland metropolitan areas and nonmetropolitan areas grew more rapidly than the coastal regions, overall. Sacramento County grew by 1.6%, Kern by 1.8%, and Fresno by 2.1%. Almost 16% of the growth in the state went to counties with populations of under 250,000, located outside the major coastal metropolitan areas of the state. Population in these smaller metropolitan areas grew on average by 1.9%.

Housing Market Stalls

The housing market, which rebounded strongly in the first half of 1994, showed slower growth in the second half of the year and slumped in the first half of 1995. Building permit activity for single family homes was up 10% statewide in 1994, but dropped by 22% in the first six months of 1995, according to data compiled by the Construction Industry Research Board. Multi-family permits were up 34% in 1994, from a very low level in 1993, but dropped by 25% in the first half of 1995. Southern California had the strongest recovery in 1994, with an 18.1% increase in single-family permits and a 56.1% increase in multi-family permits. The slowdown in 1995 has been fairly evenly divided among the three major regions. The San Francisco Bay Area shows the weakest performance in

(Continued on page 10)

TABLE 3
Trends in Residential Building Permits, California, 1994 and 1995

County	Percent Change—Single-Family Units		Percent Change—Multi-Family Units	
	1993-94	1994-95 (Jan-June)	1993-94	1994-95 (Jan-June)
Southern California	18.1%	-18.4%	56.1%	-28.8%
Los Angeles	4.6%	16.0%	4.9%	44.1%
Orange	67.9%	-39.9%	166.9%	-52.3%
Riverside/San Bernardino	-0.7%	-22.2%	-5.6%	-66.8%
San Diego	28.7%	-13.0%	10.6%	19.1%
Santa Barbara	13.3%	7.5%	157.4%	-8.7%
Ventura	41.4%	10.8%	295.6%	-68.4%
San Francisco Bay Area	18.7%	-22.3%	8.9%	-37.2%
Alameda/Contra Costra	19.2%	-20.6%	2.4%	-36.2%
San Francisco	41.6%	25.3%	8.0%	8.4%
Santa Clara	16.7%	-6.0%	13.0%	-51.8%
Solano/Napa	3.0%	-41.1%	-23.6%	-22.2%
Sonoma	25.2%	-47.0%	32.5%	-55.8%
Central Valley	-2.5%	-23.7%	38.8%	-21.5%
Fresno	-4.1%	-19.8%	82.9%	12.1%
Kern	-13.2%	-14.4%	50.6%	-26.3%
Sacramento	11.5%	-32.2%	28.9%	-71.9%
San Joaquin	-12.6%	-19.4%	-38.6%	-95.7%
Stanislaus	-22.4%	-12.7%	-50.0%	-72.9%
California	10.2%	-21.5%	34.1%	-25.7%

Source: CREUE from Construction Industry Research Board data.

News From Bear Territory - Alumni Update

NAMES IN THE NEWS

Hampton Lyons, BA Rhetoric '71, MA Rhetoric '73, is a Senior Account Executive for First American Title Company in Walnut Creek and is responsible for marketing the company to national high-liability commercial, industrial, and multifamily accounts. Hampton serves on the board of NAIOP as Program Director and is active in BREA.

Michael Jameson, MBA '90, was promoted to VP at Prudential in SF late last year. His wife Sara and their two children Anna and Ryan are enjoying their new home in Walnut Creek. Mike has done a wonderful job of re-landscaping his spacious rear yard.

Al Timpson, B A Development Studies '77, is VP for Bank of the West in Walnut Creek. Al manages the construction lending group for the bank. A true Cal alumnus, Al recently vacationed at the Lair!

James J. Didion, BA '62, is CEO and Chairman of CB Commercial Real Estate Group, Inc. Didion was the driving force behind the management buyout of CBC from Sears in 1988 and has successfully guided the company through the recent recession. Mr. Didion serves on the Haas School advisory board.

Austin Garrison, MBA '90, also at CB Commercial, reports to Didion and was recently promoted to Managing Director for the firm. Austin recently became engaged to Ms. Katie Smock and they plan to wed in September. **Bill Sumski**, MBA '96, is also working at CBC as a summer intern.

Patrick Costanzo, Jr., BS Civil Engineering '86, MBA '90, was recently married to Wendy Webber and they honeymooned in Jamaica. Pat is Director for Land Development for Greenbriar Homes Company in San Jose

where he is responsible for land acquisition through design and entitlements for single family detached homes. Pat is actively involved with the BIA where he is a member of the Board of Directors.

Paul Churchill, B A Business '82, JD Boalt' 86, is a partner with the law firm of Cooley, Godward, Castro, Huddleston & Tatum in SF and heads their real estate group. Paul represents developers, financial institutions, and pension fund advisors in connection with organization and restructuring of real estate secured transactions in leasing and disposition matters.

Judy Riffle, MBA '92, is an Assistant VP with Citicorp Real Estate in SF and extends her congratulations to **Scott Poland**, MBA '94 on his acceptance of a Management Associate position with the firm. Scott was hired by the SF office after a successful summer internship.

Bahram Motamedian, MBA '95, is involved in U.S. acquisitions and international emerging market real estate development with Hines in Houston, Texas.

Bruce Ballmer, BS Economics '66, was on the Cal Basketball team in 1964. Today, Bruce is an attorney specializing in redevelopment issues for municipal clients. Ballmer is a partner with Kane, Ballmer, & Berkman in LA and resides in Pasadena. Ballmer's son recently graduated from Cal!

Kevin Andrade, MBA '91, is working for Trammel Crow Residential in Kirkland, WA. He is a Development Associate in charge of development in Washington and Northern Idaho.

FACULTY PROFILE: Robert H. Edelstein

Cal's real estate program has gained national recognition due in large part to the faculty's role in the industry at large. In this issue of the alumni update, this larger role is examined up close with Haas Professor Robert Edelstein, Co-Chairman of the Fisher Center for Real Estate and Urban Economics (FCREUE) since he became affiliated with UC Berkeley in 1985. Additionally, we have asked Professor Edelstein to comment on the state of the real estate program at Cal.

What has been your most recent involvement in the real estate industry?

I just completed testifying before the Subcommittee on Financial Institutions and Consumer Credit House Committee on Banking and Financial Services. There I outlined the economic implications that the 1994 Rodash v AIB Mortgage decision will have upon residential finance activity, the housing finance system and the U.S. economy. Rodash was a recent case where the courts determined that a mortgagee could rescind their mortgage for up to three years after the closing based on the right of rescission embedded in the Truth in Lending Act. Without getting into too much detail, due to a \$10+ misclassification in the closing loan documents, the mortgagee, in this case Rodash, could rescind their loan up to three years after the fact; they would then be entitled to reimbursement of all costs associated with the loan over those

Alumni Tailgate

tjrfarkyou calendars for Alumni Update^ fkickoff and corr&sponding tailgate bar^ b-que to be held before the Cal- USC battle on the gridiron, Saturday, Oo tober 14. The afumnt board has, reserved a block of seats at the gamA for \$30 each, so we need your money-;, now. Please call Jaimie Lasher (415) 772-5900, ext. 116, to make yo reservation and to obtain tailgate ah game time information.



years including full reimbursement of all interest paid. Obviously the decision the courts made has great economic implications for the housing finance system as we know it and the overall economy.

Early this year you were a panelist at an investment symposium in China. Any words of advice for those alumni who are interested in investing in Asia?

Real estate is clearly a hot topic in Asia; but Asia is in flux. China, for example, is going to change from what we know it as now. Both the one child rule, and the skewed growth in the coastal region, are going to have lasting implications. China is an area that has known rural revolts in the past and its recent economic prosperity has brought a decrease in control, specifically communication control due to the use of faxes and telecommunications. The government is going to have difficulty controlling communication and its people while promoting growth.

How else are you spending your time in Asia?

I have spent more and more of my time advising Asian investors in their U.S. investments, specifically Los An-

geles real estate. The decline in real estate values has reduced the cost of doing business in L.A., making it a very competitive place to start a business. Most people don't realize it, but the San Pedro port in LA is the largest volume, most active U.S. port. Carefully chosen real estate in California, and to a greater extent L.A., is a very attractive play right now.

Have you been involved in any specific research on campus that our readers may find of interest?

I am currently at work on a theory of market dynamics that may prove to be very useful in evaluating and predicting real estate cycles. Until this time, virtually no formal, systematic theory has evolved to explain the interrelationships among economic, real estate income and real estate value cycles. My colleagues and I have developed a model which we believe is the first theoretical model of real estate cycles that is able to "replicate" the observed real estate income and value cycles.

Can a developer, investor or lender use this model to assist them with decision making?

Almost. We were able to transform our theoretical framework into a formal, empirically testable statistical model

Edelstein...

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with superb results. The next step is for the profession to come of age and for the real estate business community to link models with recently created data bases by devising its own appropriate models, such as the one we created. Advancing the intellectual framework and translating it into empirically estimable and testable models is now possible and feasible, it just needs to be done.

The Dean rarely recognizes the real estate program at Cal, yet I have read recent quotes that indicate his desires to model other disciplines after the Fisher Center for Real Estate. What else has the Dean recognized about the program, and do you foresee any changes due to his strategic vision? The Dean has recognized the financial viability of FCREUE and is modeling several other centers, including the Center for Information Technology and Management, after our program. Just as important is the fact that we have taken our real estate expertise and broadened it internationally. While real estate perse may not be a strategic focus of the business school, international business is, and here we have shown results. FCREUE was just given a prime location on the sixth floor of the new building so that must say something about our future.

I Career Opportunities

The Center provides job opportunity information for Cal students and alumni. If your firm has an opening or you know of an opening in another firm, please send a brief description of the job along with the contact person and to apply for the position to:

University of California at Berkeley. »
Fisher Center for Real Estate
and Urban Economics,
Haas School of Business
602 Faculty Bldg. f 6105
Berkeley, CA 94720-6105

Letter from the Real Estate Club President

Berkeley's graduate real estate program continues to grab national as well as local attention and honors. On a national level, the March 20, 1995 issue of U.S. News and World Report ranked the real estate program #2 nationally, behind Wharton and ahead of the University of Wisconsin, Madison. On a local level, the Haas real estate program once again flexed its muscles, helping UC Berkeley to win first place in two annual real estate development competitions, the NAIOP Development Challenge and Bank of America Affordable Housing Challenge.

The Berkeley Real Estate Club has planned a number of events to encourage interaction between students, alumni, CREUE, and the top-rated Berkeley real estate faculty. New this year is a student/alumni day of service, where we are tentatively scheduled to affiliate with Habitat for Humanity. Mark your calendars for the upcoming Berkeley Real Estate Club student/alumni events:

- | | | |
|------------------------------|---------------|---------|
| • 1st Annual Service Project | Sep. 23, 1995 | 9-2 pm |
| • Alumni Tailgate | Oct. 14, 1995 | 10-4 pm |
| • Alumni Cocktail Party | Nov. 1, 1995 | 6-9 pm |
| • Firm Night | Feb. 15, 1996 | 6-10 pm |

We are confident that 95-96 will be a busy, productive year at Haas and look forward to meeting alumni at Real Estate Club and CREUE events. For more information about alumni events, contact Bill Sumski, President at (510) 441-6166, John Hudson, VP, (510) 388-1716, or Darrell Campos, VP, (510) 644-2161.

Real Estate Competition Sweep

Cal defeated Stanford for the second straight year in the NAIOP Development Challenge, considered the "Big Game" of real estate. The annual competition is sponsored by the National Association of Industrial and Office Parks, (NAIOP), and was founded six years ago by Haas Professor Steve Chamberlin. With their victory, the Bears retain the competition's trophy, affectionately known as "The Shovel." The series is now tied 3-3.

The contest required each team to prepare a full development proposal for an actual piece of land, including a market analysis, site plans and detailed financial analyses. This year's site was a 6.5 acre undeveloped site in San Leandro located across the street from the BART station and two blocks from downtown.

The Cal team's proposal "Ribiera Plaza" included a 10-screen movie theater, an entertainment retail center, and a profession career college. Central to Cal's proposal were a shared parking agreement with BART, letters of intent from their tenants, letters of support from the community, financial commitments from their bankers, and an equity partnership agreement with the City.

Stanford proposed a similar plan that included a six-screen cinema complete with a retail component and a partnership with the city. Their proposal also included a virtual reality center and a plan for the phased future development on a portion of the site.

Head Juror Mike Covarrubius stated that the city's desire to develop the entire parcel without a phased plan and the jury's lack of understanding of virtual reality were the critical factors in the decision to award the top prize to Cal. After the competition was over, he added, "People who didn't see the written proposals must have thought this was even closer than it was. We were very impressed with Cal's book." Apparently, so were the City of San Leandro and its Redevelopment Agency. Shortly after the competition, the Agency issued a RFQ to select a developer for the site. Their preferred use: a mixed use project anchored by a theater.

Calif. Economy...

(Continued from page 6)

the multi-family market in 1994 and 1995, while single-family permits have been weakest in the Central Valley (see Table 3).

Home sales activity showed a very similar pattern to building permit activity in the last year and a half, according to California Association of Realtors data. Sales activity of existing single family homes exceeded an annual rate of 500,000 homes per year in the first quarter of 1994, but the overall rate for 1994 was about 483,000. In the first quarter of 1995, sales activity dropped below 400,000, equivalent to the weakest months in the 1991-92 recession. Weather, higher interest rates, and continuing uncertainty about the economy may all play a role in the slower home sales activity.

Statewide, home prices have not rebounded. The median price of homes in California was down 4.9% in the first quarter of 1995 from a year earlier, according to data from the California Association of Realtors. This compares to an increase of 0.1% at the national level.

**TABLE 4
Apartment Market Conditions
Selected California Areas, 1995**

Area	Rent/Sq.Ft.	Percent Change
	1994Q4	1994Q2-1994Q4
National	\$10.24	1.7%
California Region	\$12.04	2.7%
Los Angeles	\$11.73	3.4%
Oakland-East Bay	\$13.02	-0.5%
Orange County	\$12.57	3.3%
Riverside/San Bernardino	\$8.75	1.9%
Sacramento	\$7.82	2.4%
San Diego	\$11.84	1.0%
San Francisco	\$15.40	1.6%
San Jose	\$14.20	7.4%

Source: National Real Estate Index Market Monitor and CREUE calculations.

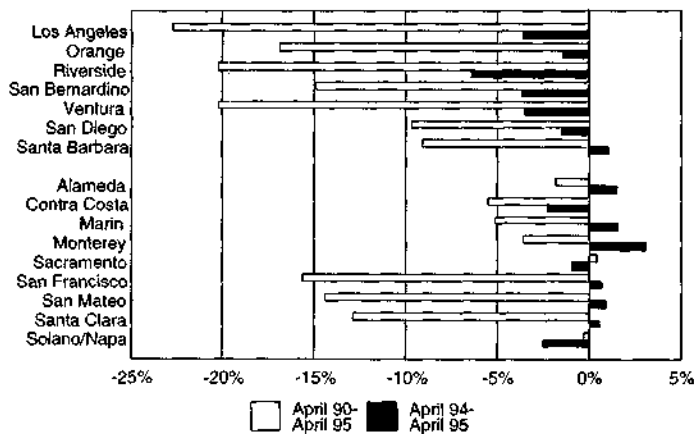
On a more local level, some price recovery has begun, based on statistics from the Real Estate Research Council (RERC), but only in selected areas, primarily in Northern California.

Despite a slow economy in the San Francisco Bay Area, since mid-1994, prices have held steady for the eleven county Northern California area tracked by RERC. Prices in April 1995 remained 7.2% below their October 1990 peak. The April 1995 index showed slight price increases compared to one year earlier

for Alameda, Marin, Monterey, San Francisco, San Mateo and Santa Clara counties. Contra Costa, Sacramento, and Solano/Napa counties all continued to see slight price declines, while prices in Santa Cruz have held steady since October 1994. Prices in Southern California continued to drop this spring, with the April 1995 price index 17.9% below the April 1990 peak. Of the seven counties tracked by RERC, only Santa Barbara County showed an increase in the index over April 1994 (see Figure 6).

Two positive signs for the housing market are in the affordability index and the foreclosure rate. The affordability index calculated by CAR remains far above levels of the late 1980s for most California markets. The rise in interest rates caused only a slight dip in affordability levels since their peak in January 1994, because prices have dropped or remained steady in most markets. Statewide, the CAR index showed 38% of California households would be able to buy the median priced single-family home in March 1995, compared to 41% in March 1994 and only 16% in March 1989. (For the U.S. as a whole, the affordability index was 55% in March 1995, 59% in March 1994, and 45% in March 1989.) Foreclosure rates peaked in

**FIGURE 6
Price Index Changes, California Markets
Selected Periods**



Source: Real Estate Research Council, April 1995.

second quarter 1994 and declined in each of the subsequent quarters for 1994.

Despite fluctuations in building permits, the rental market shows signs of recovery. Apartment rents as reported by the National Real Estate Index remain above the U.S. average for much of California. Rents remained steady or dropped in many markets during the recession, but are now rising at the national rate or more rapidly since mid-1994, as shown in Table 4.

Recovery Begins in Nonresidential Sectors

Unlike the residential sector, nonresidential building activity has continued to recover in 1995, although the pace of recovery is uneven among sectors, as shown in Table 5. After 10 years of steady decline, office building activity has picked up in 1995, and industrial permits have continued an increase that began in 1994. Retail is the only non-residential sector that has not rebounded statewide in 1994 or 1995. The stronger rebound of office and industrial activity relative to retail is in large part explained by the *very* low levels of production of these two sectors during the recession. The drop off in retail was much less severe in the recession, leaving less of an immediate need for new space (and a smaller percentage increase when growth occurs).

Office Building Activity Begins Modest Come-Back as Vacancy Begins to Drop

Office construction statewide shows its first signs of recovery in 1995. Building permits rose by 14.8% in the first half of 1995 compared to a year earlier. (It should be noted, however, that office permit activity ended 1994 at 87% below its 1985 peak). Recovery began in the San Francisco Bay Area in 1994, with the Southern California area showing recovery signs only this year. Central Valley office permits have continued to drop in 1995.

TABLE 5
Trends in Nonresidential Building Permits, California 1994 and 1995

Building Activity by Area	Percent Change in Dollar Value	
	1993-94	1994-95 (Jan-June)
Total Nonresidential	0.3%	6.0%
Southern California San	2.3%	4.2%
Francisco Bay Area Central	8.6%	16.9%
Valley (5 MSAs)	-	-1.0%
	2.3%	
Office		14.8%
Southern California San	-23.8%	11.4%
Francisco Bay Area Central	-	16.6%
Valley (5 MSAs)	27.2	-5.4%
	%	
Retail		-1.0%
Southern California San	11.6	7.9%
Francisco Bay Area Central	%	-9.9%
Valley (5 MSAs)	-43.2%	-
	0.1%	12.7%-
Industrial		
Southern California San	0.6	6.7%
Francisco Bay Area Central	%	33.6%
Valley (5 MSAs)	12.3%	15.1%

Note: Regions include the following counties: Southern California (Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, Ventura); San Francisco Bay Area (Alameda, Contra Costa, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano, Sonoma); Central Valley (Fresno, Kern, Sacramento, San Joaquin, Stanislaus). *Source:* CREUE from Construction Industry Research Board data.

The lack of building activity in recent years shows up in statistics from commercial brokers throughout the state. According to data from Grubb and Ellis (Los Angeles, Orange, Riverside/San Bernardino, Ventura, Santa Clara, Marin, Fresno), CB Commercial (Contra Costa, San Diego, San Joaquin), and Cushman and Wakefield (San Francisco, Alameda), very little commercial office space has been added to the stock available for lease in major California markets in the 1990s. Statewide, less than two million square feet of space was added to major California office markets in 1994, with about half added in the Bay Area counties of Marin, San Francisco and San Mateo. In comparison, the average annual increase in office stock was 33.1 million statewide in the 1980s, and has been over six million annually since

1990. Net absorption was more than 20% below construction in the 1980s, accounting for the huge rise in vacancies over the period. Since 1990, net absorption has exceeded construction, most dramatically in 1994. As a result, our composite calculation for office vacancies statewide has dropped from 16.9% at the end of 1993 to 15.2% at the end of 1994 (see Table 6).

The lowest vacancies are found in the San Francisco Bay Area, while the highest vacancies continue to be found in Southern California. San Francisco Bay Area vacancies range from a low of 6.7% in San Mateo County to a high of 18.4% in Alameda County, with vacancies below 10% also found in Central Contra Costa and San Francisco markets.

(Continued on page 12)

TABLE 6
Recent and Historic Trends in California Office Markets
(All stock, construction and absorption figures in millions of square feet)

Area	Stock	New Construction	Vacancy	Net Absorbed**	Average Absorbed Annually		Average Constructed Annually	
	12/94	1994	12/94	1994	80-89	90-94	80-89	90-94
Southern California	263.7	0.5	18.2%	2.4	16.7	3.6	21.2	3.9
Los Angeles	150.8	0.1	19.4%	0.5	7.5	1.2	9.4	2.8
Orange	54.8	0.2	15.2%	0.3	5.6	1.1	6.9	0.7
San Diego	39.0	0.0	17.9%	0.8	1.9	0.8	2.7	0.2
Riverside/San Bernardino	12.2	0.2	19.8%	0.6	1.3	0.2	1.7	0.0
Ventura	6.6	0.0	16.4%	0.3	0.4	0.3	0.5	0.1
San Francisco Bay Area	169.7	0.8	11.2%	3.1	6.7	2.5	8.6	1.3
Alameda	21.7	0.0	18.4%	-0.5	0.7	0.0	0.6	0.1
Central Contra Costa	33.0	0.0	9.2%	0.6	2.5	0.8	3.1	0.2
Marin	5.8	0.4	16.5%	-0.1	0.4	0.0	0.3	0.1
San Francisco	57.9	0.3	9.5%	1.9	0.6	0.8	1.4	0.2
San Mateo	18.3	0.1	6.7%	0.8	0.7	0.6	1.0	0.2
Santa Clara	33.1	0.0	13.0%	0.4	1.7	0.2	2.2	0.3
Central Valley*	47.7	0.3	12.9%	1.2	2.6	1.1	3.2	1.0
Fresno	9.8	0.1	12.7%	0.2	0.5	0.2	0.6	0.1
Sacramento	33.5	0.2	13.0%	1.1	2.1	0.8	2.7	0.9
San Joaquin	4.4	0.0	12.3%	0.0	NA	0.1	NA	0.0
California*	481.2	1.6	15.2%	6.7	26.0	7.2	33.1	6.2

* Sums exclude San Joaquin, where data is not available (San Joaquin is a very small part of construction and absorption activity during this period).

** Where there has been no addition or subtraction of existing buildings to or from the stock, CREUE calculates net absorption as the change in occupancy levels over the year. Some of the numbers in the table therefore differ from numbers reported by the brokerage firms, perhaps by as much as 50%.

Source: CREUE calculations from data provided by commercial brokers, as listed below. Grubb & Ellis: Los Angeles, Orange, Riverside/San Bernardino, Ventura, Santa Clara, Marin, Fresno. CB Commercial: Contra Costa, San Diego, San Joaquin. Cushman and Wakefield: San Francisco, Alameda.

Calif. Economy...

(Continued from page 11)

Vacancies in the Central Valley are in the range of 12-13%, while vacancies in Southern California range from 15-20%. The highest levels of vacancy are found in Los Angeles and in the Riverside/San Bernardino area. Rents have held steady or dropped in most markets, with small increases showing up in a few Bay Area markets.

Industrial Vacancies Drop Despite Rising Construction

Industrial markets throughout the state have seen very modest construction activity compared to the levels of net absorption. As a result, vacancies have dropped sharply from a year ago in all markets for which data is available (see Figure 7). According to data received from industrial brokers (Grubb and Ellis in their annual reports, and unpublished data from CB Commercial), we estimate that approximately 10 million square feet of for-lease industrial space were added to California's major metropolitan markets in 1994. As with office construction,

about half of the new space was located in the San Francisco Bay Area and surrounding counties. Net absorption was strong in 1994 (again, according to broker-tracked activity and our calculations), with over 30 million square feet of space absorbed. Vacancy rates have dropped in all of the markets for which historical data is available, with the lowest vacancies found in Marin, San Mateo, Ventura and San Diego counties.

California Real Estate Markets Face Uncertain Future

The California economy bears careful watching over coming months. Despite

the changes that occurred during the recession (many of which permanently affected the state's economic structure), California continues to have a diversified base that offers a strong basis for future growth. However, several factors make the state particularly sensitive to changing national and international conditions. Because California is recovering later and more slowly than the nation as a whole, the economy is particularly sensitive to monetary policy. The rise in interest rates over the past year contributed to the truncated real estate recovery and may also explain why businesses did not stabilize and rising interest rates caused the dip in the single family housing market. If economic growth is at the DoF level estimated rather than the BLS/EDD level, a

could be stimulated in the near future. If employment figures continue to show slower growth, however, a modest drop in interest rates may have little effect on the pace of home sales or on price changes. The changing demographic base of the state may have longer term impacts on the residential market. The shift towards larger but more moderately priced housing is likely to continue, at experienced in the 1980s. The uneven pace of economic recovery, structural changes involving the type of workforce needed, and technological changes that affect where work may occur, make the long term growth in demand very difficult to predict. The amount of space vacant in many markets still offers years of absorption activity at today's levels, suggesting that any new construction should proceed only

after a careful evaluation of the specialized local conditions that might make new space attractive in the market. Nevertheless, changing needs of employers make it likely that some markets will see expanding demand for new product over the next few years.

**Cynthia A. Kroll
with the assistance of
Ashok Bardhan and Jee Woo**

* As the recession progressed, it was popular to measure job loss on a peak-to-trough basis using monthly employment figures. Under this approach, the total loss in jobs was over 700,000, but seasonal factors play a significant role in producing this larger number.

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