

Home Prices Falling, Affordability Rising— Still a Ways to Go

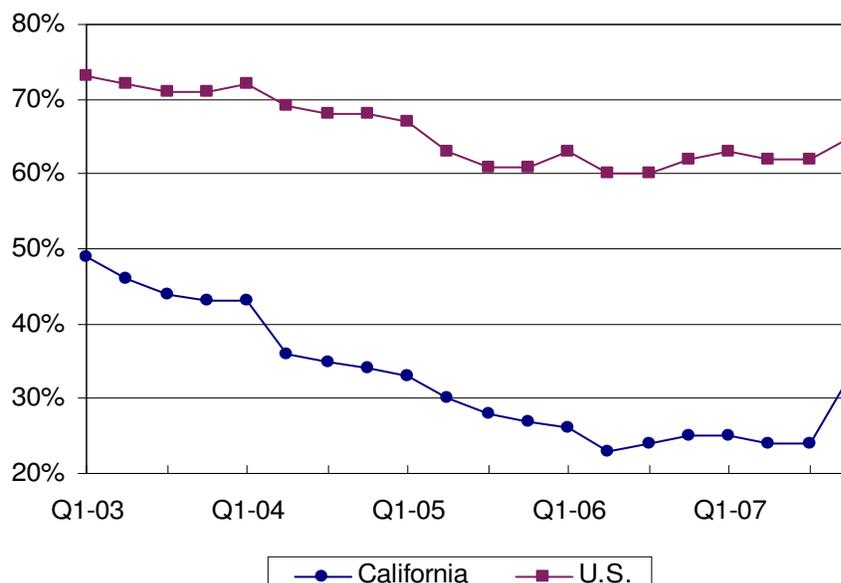
Home prices in California continue to decline and are falling at a pace few expected just six months ago. Three reports released in the last week of February show the fast pace of housing price decline throughout California.

The California Association of Realtors announced that median resale prices in January 2008 were down 22% from a year earlier. Case Shiller, using data that takes account of the mix of housing, reported that median prices were down 14% in the Los Angeles area, 11% in the Bay Area and 15% in San Diego between December 2006 and 2007.

And the Office of Federal Housing Enterprise Oversight (OFHEO) reported that California had the highest year-over-year price decline of any state and had 11 of the 20 metro areas in the nation with the greatest price drops led by the Merced, Modesto and Stockton metro areas—all adjacent to the San Francisco Bay Area.

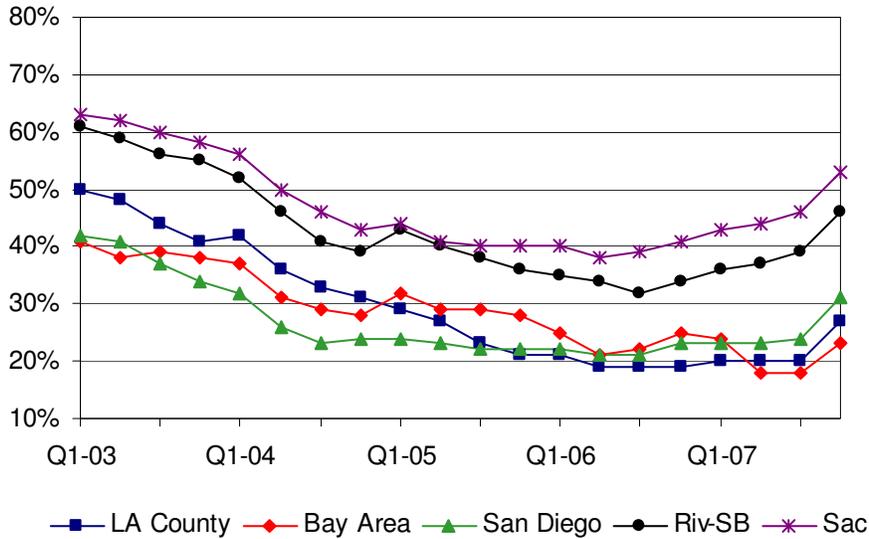
Falling home prices are beginning to boost housing affordability. In California, 33% of first-time buyers could afford to buy a home in the fourth quarter of 2007 up from 24% in the previous quarter according to the California Association of Realtors, the highest share since late 2004.

First-Time Buyer Affordability Index



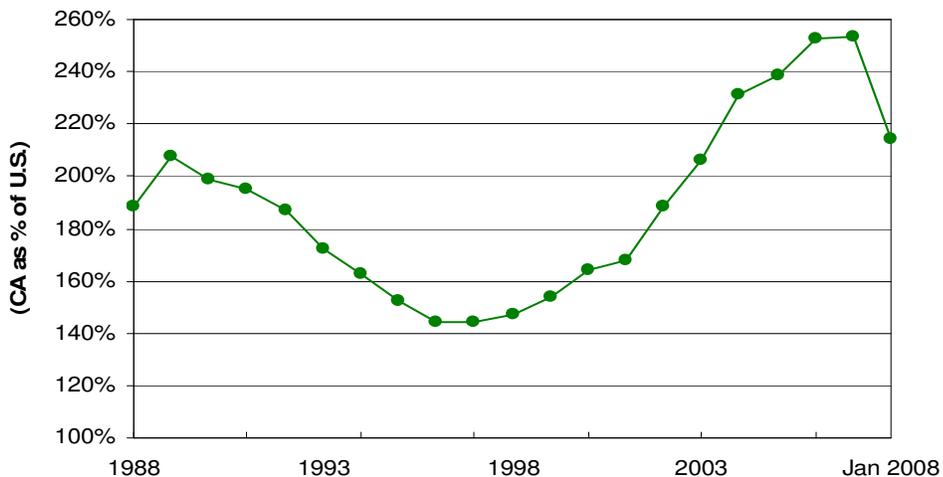
Affordability rose broadly throughout the state in the fourth quarter of 2007. Affordability jumped sharply in the Riverside-San Bernardino and Sacramento areas, which had sharp price declines. Smaller affordability gains were recorded in the Los Angeles, Bay Area and San Diego markets. However, housing affordability throughout the state is still well below the levels of a few years ago and well below the 60%+ first-time affordability index for the nation as a whole.

First-Time Buyer Affordability Index



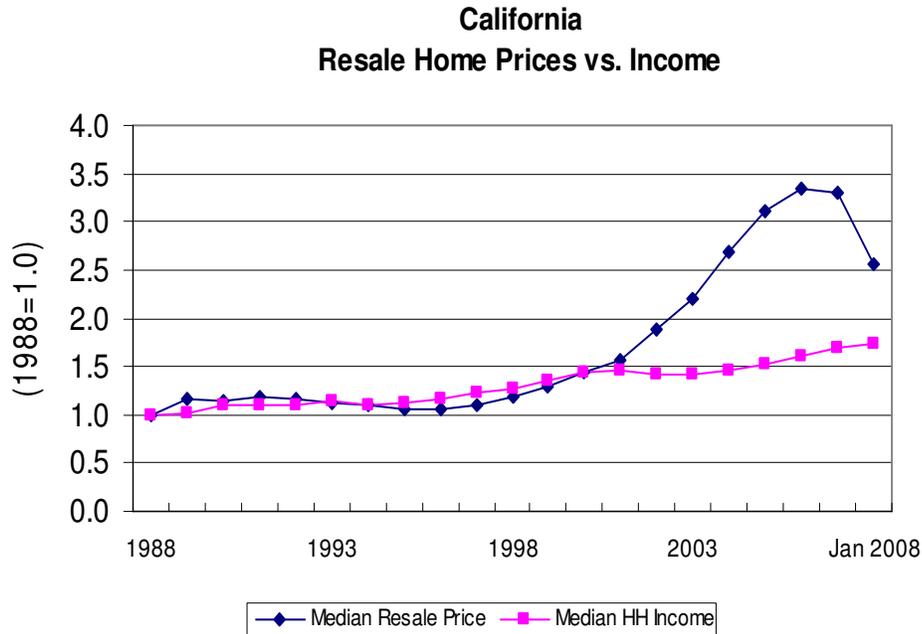
And that is because housing prices in California are still near historic highs relative to prices throughout the nation. In both 2006 and 2007 median prices in California were more than 2 ½ times the national average. There was a correction in relative prices in recent months, though probably not as much as shown on the graph below.

Median Existing Home Prices California as Percent of U.S.



The January 2008 data overstate the drop in housing prices as the state median price fell partially as a result of the lack of sales in higher-priced homes.

And prices in California remain very high in relation to median household income.



Housing Price Declines—Still a Ways to Go

The housing price correction in California markets will likely continue throughout 2008 until sufficient affordability is restored to boost housing demand.

The high ratios of housing prices in relation to income and the low affordability indices were maintained by lending practices that are no longer available. Looser lending criteria, combined with low interest rates and the psychology that prices could only go up, caused home prices to double since 2000 in most California regional markets. In the absence of aggressive lending and aggressive buying psychology, home prices still have a ways to decline in order to restore sustainable levels of affordability in most markets in California.

After the Price Correction is Completed

CCSCE is working on the 2008 edition of *California Economic Growth*, which should be available by June. The state of housing affordability will be an important determinant in projecting job growth in the state and major economic regions. At the same time, a tidal wave of demographic change is due in California's housing and labor markets as the first wave of baby boomers turns 62 this year.

When the price correction is completed, there should be an upsurge in housing demand but changing demographics combined with the links between land use, climate change and state policies will have a great influence on the amount and location of job and housing growth throughout California.

Data Sources

Estimates of median resale housing prices and first-time buyer affordability were taken from the California Association of Realtors (www.car.org) and the National Association of Realtors (www.realtor.org). In addition, data on national housing price trends was compiled from OFHEO (www.ofheo.gov) and Case Shiller (http://www2.standardandpoors.com/portal/site/sp/en/us/page.topic.indices_csm_ahp/0,0,0,0,0,0,0,0,0,1,1,0,0,0,0,0.html).

Estimates of median household income are from the American Community Survey (<http://www.census.gov/acs/www/>) updated by CCSCE.