

## California Market Watch

August 29, 2008

# Housing Cycle: Double-Digit Price Increases Expected Again

In nearly four decades, California's existing home market recorded 33 years of positive price appreciation. On average, California's reliable existing home market has provided homeowners an 8.1% return, shown by the red line in the chart below. While there are always fluctuations in prices, the state's impressive record is supported by California's attractive quality of life, limited land supply caused by a restrictive entitlement process, diverse and strong employment base, and constant population growth. These factors will stimulate the local housing market to rebound again, spurred on by relatively modest job loss, comparatively low rates, and increased FHA limits.

- California has only experienced price depreciation in six of the last forty years.** Five of the six years of loss were recorded from 1990 to 1995 when the state shed nearly 500,000 jobs. The current downturn is the most precipitous decline the state has experienced, down an estimated 28%. Fire-sale prices driven by short sale and foreclosures have contributed to the massive drop in prices. The substantial slowing in appreciation was inevitable as prices reached high levels relative to interest rates, rents, and incomes.
- Double-digit gains have occurred in multiple years in three of the four decades.** The run-up in prices enjoyed in the mid-1970's was the longest stretch of sharp price appreciation, when home prices tripled from 1974 to 1980. By the mid-1980s, inventory levels reached record lows and California realized another boom in home prices. By 2000, rock bottom mortgage rates and looser lending standards resulted in home prices turned upward again to record levels. Important to recognize, the market has recorded 15 years of double-digit price appreciation.
- Periods of recovery.** Annual appreciation has only dropped below the average for three periods in this four-decade timeframe. From 1982 to 1987 prices flattened out below the 8% mark, but never recorded declines. The subsequent decline from 1990 to 1998 was longer and more drastic, creating a nine-year recovery situation that took longer because our employment markets had to regain jobs in order to bolster demand. We are currently three-years into sub-average price appreciation.
- Double-digit price increases anticipated.** The current downturn, while severe and unprecedented, will be able to recover faster given historically low mortgage rates, more modest job losses, and increased FHA limits appropriate for our local housing markets. While painful, the current steep decline should lead to a shorter recovery period where the market inventory can be absorbed more quickly. It is difficult to predict when it will take place, but we can predict with a high degree of confidence that double-digit price appreciation will occur again within the next six years.

