Home Price Analysis for San Francisco-Oakland-Fremont

By the Research Division of the National Association of REALTORS®

Executive Summary

With home prices rising strongly in most parts of the country, there has been widespread media coverage on the possibility of a housing market bust. A thorough analysis of the San Francisco-Oakland-Fremont metro market, as detailed below, reveals that there is little danger of this. In fact, the local housing market is in excellent shape with a potential for significant housing equity gains, particularly for homebuyers who plan to remain in their house for the long run.

Because prices have risen faster than income, the ratio of price-to-income is currently above the historical norm. This measure is frequently cited to imply that there is a housing market bubble. But this ratio is a misleading measure in assessing bubble prospects. A more relevant measure is the mortgage servicing cost relative to income. This ratio is at a very manageable level. It implies no widespread financial overstretching to purchase a home in the region.

	San Francisco	Top 20 Metros	National Average	Comment
Price Activity				
Current Appreciation	12%	25%	13%	Strong
3-year Appreciation	40%	79%	32%	Strong
Affordability				
Home Price to Income Ratio*	5.2	3.8	2.3	Unfavorable
Mortgage Debt Servicing Cost to Income Ratio **	37%	30%	16%	Neutral
Local Fundamentals				
3-year Job Growth	-7.1%	7.2%	2.4%	Unfavorable
Housing Starts to Total Employment	0.8%	1.0%	1.5%	Very Favorable
Net Migration	-67,300	19,100	0	Unfavorable
Risk Factor	A high usage of interest only loans (45%) and ARMS (67%) places a greater exposure risk to interest rate changes. But the risks are mitigated from recent job additions of more than 24,000 in the past 12 months. Also only 5% of recent loans had a loan-to-value ratio greater than 90%, which implies minimal foreclosure risk.			

** Income is per capita income times average number of person per household*
*** Servicing cost is the mortgage obligation relative to income at the prevailing mortgage rate*

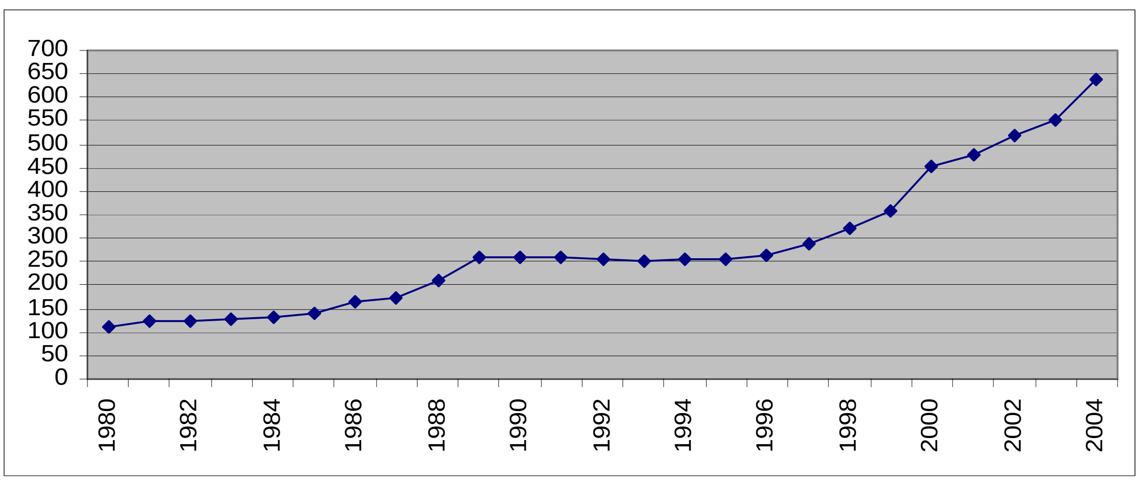
Price Activity

- The current price of $726,900 is more than three times the national average.
- The median home price rose 15% in 2004 and 40% in the past three years.
- Home price growth has been weak throughout the 1990s. So part of the recent increase is attributable to the "catch-up" effect.

Annual Data	**2005***	**2004**	**2003**	**2002**	**2001**	**2000**
Existing Home Price (in $thousand)	726.9	637.7	552.6	517.5	476.4	451.6
% change	14.0%	15.4%	6.8%	8.6%	5.5%	25.9%
Quick Glance	**3-year Price Appreciation**	**Home Price-to-Income Ratio**	**Mortgage Servicing Cost to Income**	**Historic Local Average on Mortgage Servicing Cost**	**12-month job gain**	**Local price vs national**
	40%	5.2	37%	33%	24,100	3.5

* 2005 price is as of second quarter and is usually a good estimate of the annual average price.

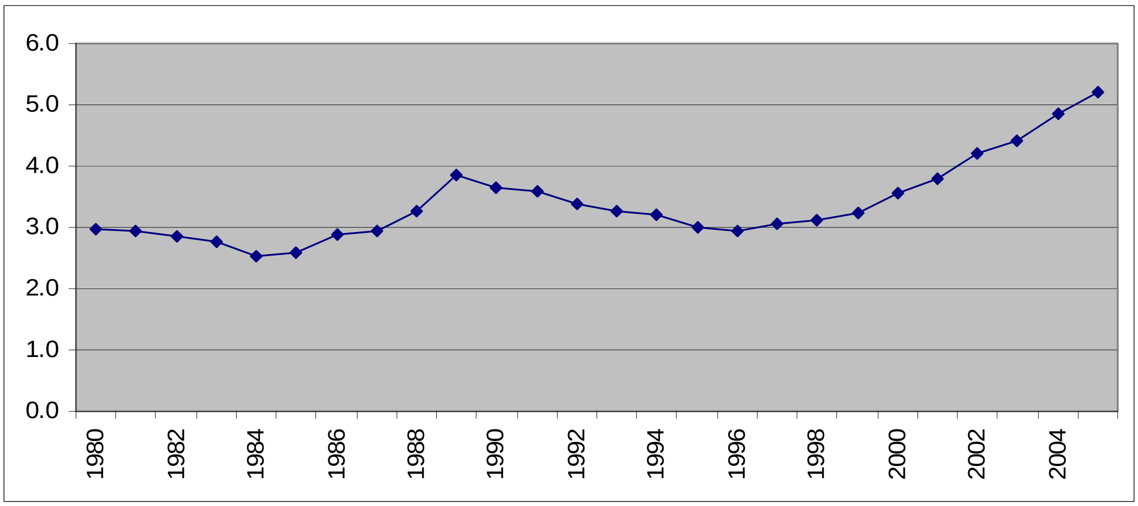
Home Price (in $thousand)



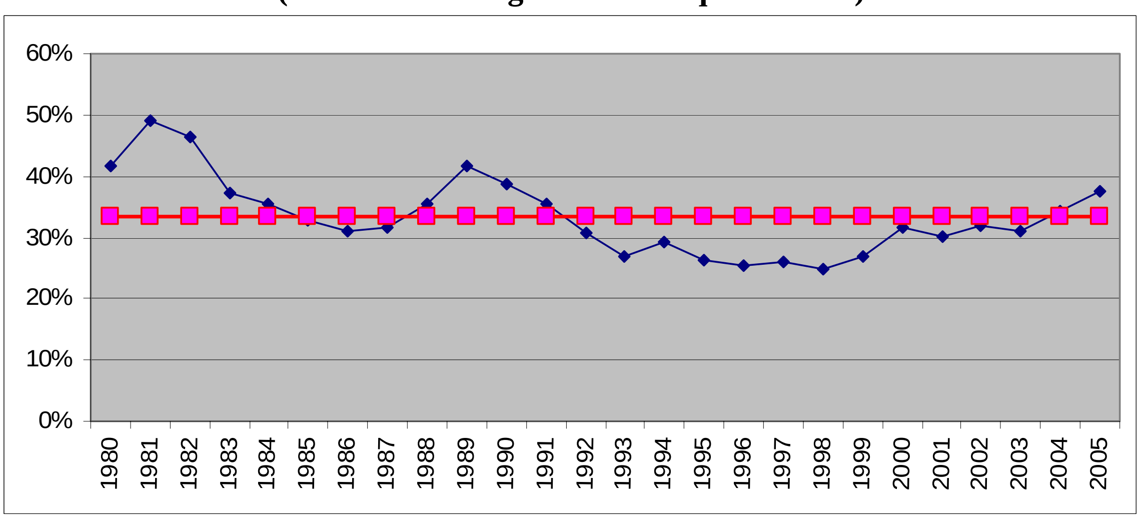
Affordability

- Because the prices have risen faster than income in recent years, the ratio of price-to-income has been rising strongly. This measure is frequently cited to imply that there is a housing market bubble.
- Mortgage rates declining to 45-year lows have been a major force in boosting home prices in recent years. Lower rates allow homebuyers obtain a larger loan without necessarily increasing monthly mortgage payments.
- A more relevant measure for assessing the risk of a home price bubble is the median mortgage servicing cost relative to the median income. This ratio is currently above the local historical average, but not to the worrisome levels of the early 1980s. It implies limited financial overstretching to purchase a home in the region.

Price to Income Ratio



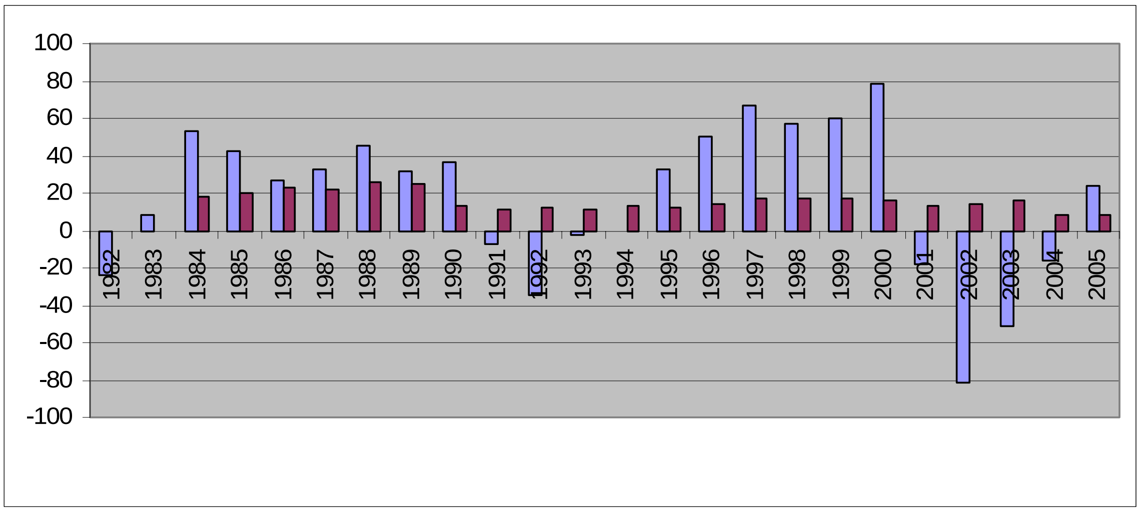
Mortgage Servicing Cost to Income Ratio
(Historical average shown as square boxes)



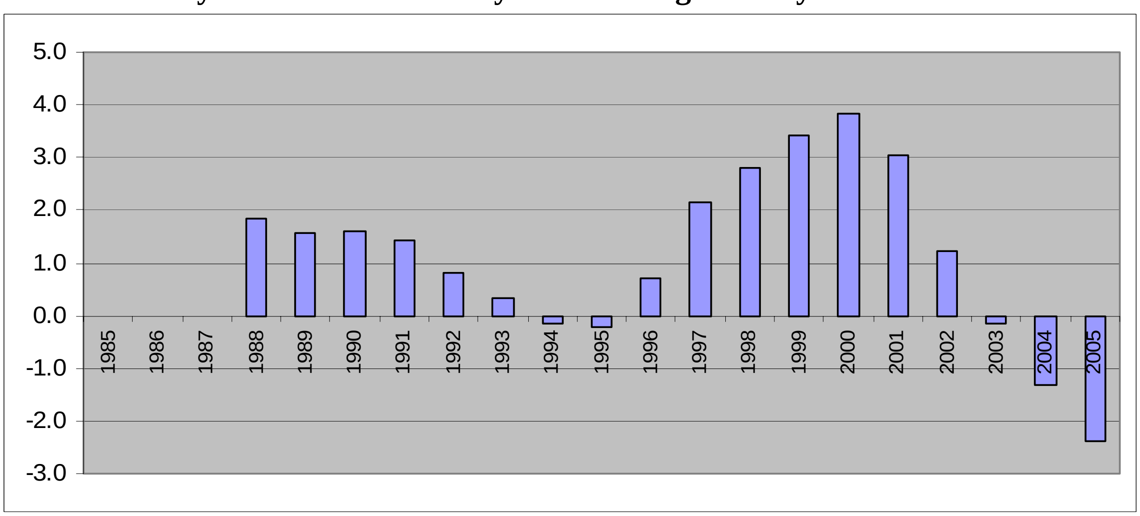
Local Fundamentals

- The job market has turned the corner after taking a large hit from the fallout of the technology bubble. There have been 24,100 payroll job additions in the past 12 months to July. Many new job holders seek their own housing units.
- The region added in the past five years an estimated 103,000 new housing units of which about 60% were single-family units.
- The ratio of five-year job gains to five-year new home construction shows the "hangover" impact of the housing shortage, or housing surplus. In our case, the local market is suffering from a housing surplus as the ratio is below zero. However, with recent job gains and the expected continued economic expansion, the jobs-to-new home ratio could further increase. Furthermore, the number of new home construction in relation to the overall population size is one of the lowest in the country, implying fundamental long-term undersupply of homes in the region.

Job Gains (light/blue) versus New Single-family Housing Starts (dark/red)

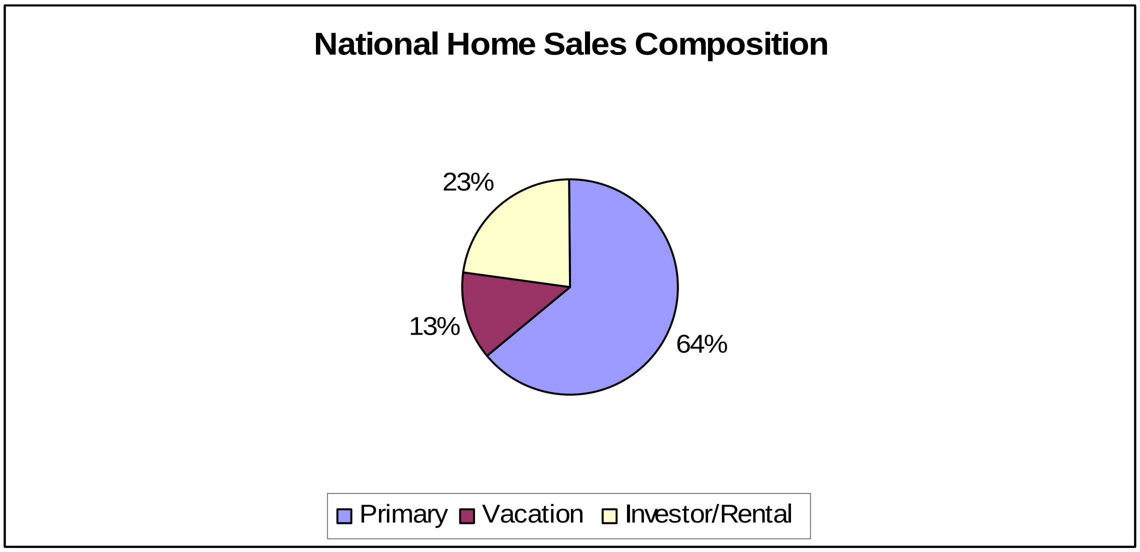


Ratio of 5-year Job Gains -to- 5-year New Single-family Home Construction



Other Factors

- ARMS accounted for 67% in 2004 across the region, one of the highest rates in the country. Furthermore, the interest-only loans accounted for nearly half of all loans in 2004. Therefore, some homeowners will feel the pinch of higher rates over time.
- However, only 5% of the loans have loan-to-value ratios above 90%, so the foreclosure risk is rather minimal. (That is, prices would have to decline by more than 10% to have a measurable impact on foreclosure rates.)
- The baby boomers in their peak earning years and have been active in purchasing second homes, which many consider their future retirement homes. The baby boomer impact could continue for another decade.
- The region is a highly sought after region with mild weather and being right next to the Pacific Ocean. The local market will benefit from second-home purchases by U.S. baby boomers as well by wealthy foreigners in the outer-edges of the region.



Stress Test

- Price declines in the local market are unlikely according to our stress test.
- The local housing market will experience a price decline of 5% only under unlikely scenarios of much higher mortgage rates. For example, mortgage rates rising to 7.8% (even with job gains of 125,000) could lead to a price decline.
- Over scenarios that could lead to a price decline of 5% are shown below.

Mortgage Rate	Job Gains/Losses
6.8%	26,000
7.8%	125,000
8.3%	175,000

- Such scenarios are unlikely. Most credible forecasts predict the region will create, given the tech rebound, 80,000 to 120,000 jobs over the next 24 months and mortgage rates will hover around 7% by the end of 2006, which bodes well for future price gains.
- Even in the unlikely event of prices declining by 5%, most homeowners will maintain sizable equity build-up in their homes. The table below shows the home equity gains if prices were to fall by 5% by homebuyers at various years of purchase.

Year of Purchase	Housing Equity after 5% price decline (home price appreciation + principal payments on mortgage)
1980	$634,917
1985	$588,103
1990	$485,068
1995	$467,972
2000	$260,608
2001	$235,593
2002	$190,108
2003	$152,851
2004	$61,145
2005	-$36,345

- Housing equity will most likely continue to accumulate to local homeowners. The equity gains under three price growth scenarios are presented below. One scenario assumes a historical conservative price appreciation of 1.5% above consumer price index inflation. With most credible inflation forecasts pegged at 2.5%, home prices can expect to rise by 4% per year under normal circumstances. The two other scenarios assume slightly below (1.5%) and slightly above (6.5%) the normal rate of appreciation.

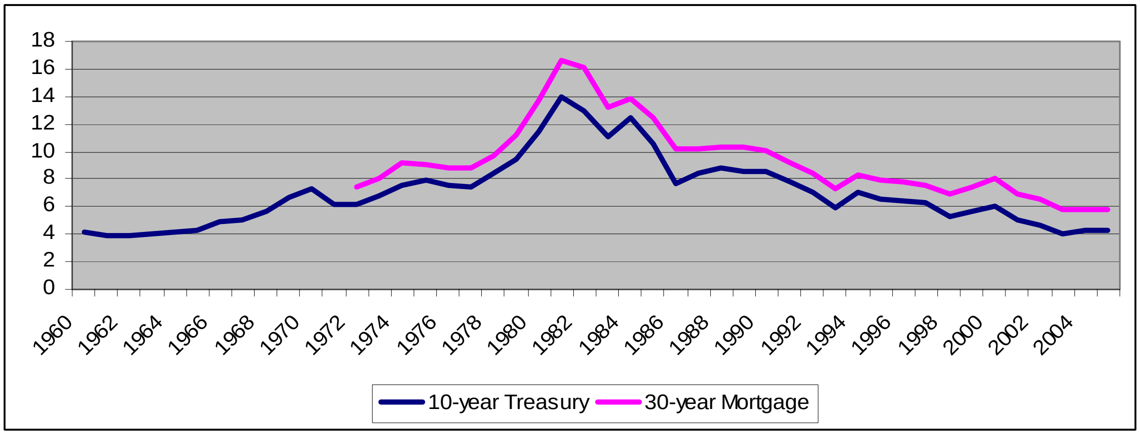
Housing Equity Gain			
Appreciation Rate	***1.5%***	***4.0%***	***6.5%***
2010	$120,145	$221,452	$332,983
2015	$235,182	$467,574	$756,076
2020	$392,695	$793,007	$1,353,372
2030	$829,353	$1,712,457	$3,283,915
2040	$1,224,013	$2,868,412	$6,587,353

Additional Discussion Points

- Home price declines are very rare. In fact, the national median home price has not declined since the Great Depression of the 1930s. Stock market collapses, the OPEC oil crunch, economic recessions, and even wars have not negatively impacted national home prices since the 1930s.
- There have been few times when local prices declined. In nearly all these cases, the price declines were accompanied by sharp prolonged job losses. It is difficult to foresee a price decline in a job creating economy.
- Homes trade far less frequently than financial assets (about one home sale every 7 to 10 years for most homeowners). There are also larger transaction costs associated with selling a home due to the lengthy careful examination demanded by home buyers and sellers. Therefore, home prices are not prone to fluctuations as in the stock market. There are neither panic sells nor margin calls associated with homes.
- Many non-quantifiable factors could be important for this metro market in determining home prices. Access to cultural life, the quality of museums, nearby local and national parks, water views, exclusive neighborhoods, weather, the international airport, city vibrancy, restaurants, and a host of other non-quantifiable factors could have an important influence on the overall pricing.
- There are immense tax benefits to owning a home. These tax considerations were not considered in the analysis. For example, the 1998 law permitting primary owner occupants to trade down without having tax consequences. Also most home sales results in no capital gains tax. In addition, long-term capital gains tax rates were reduced in 2003, thereby providing higher return for home investors. These positive benefits, if accounted for in the analysis, would have shown an even stronger case for housing fundamentals in supporting home prices.

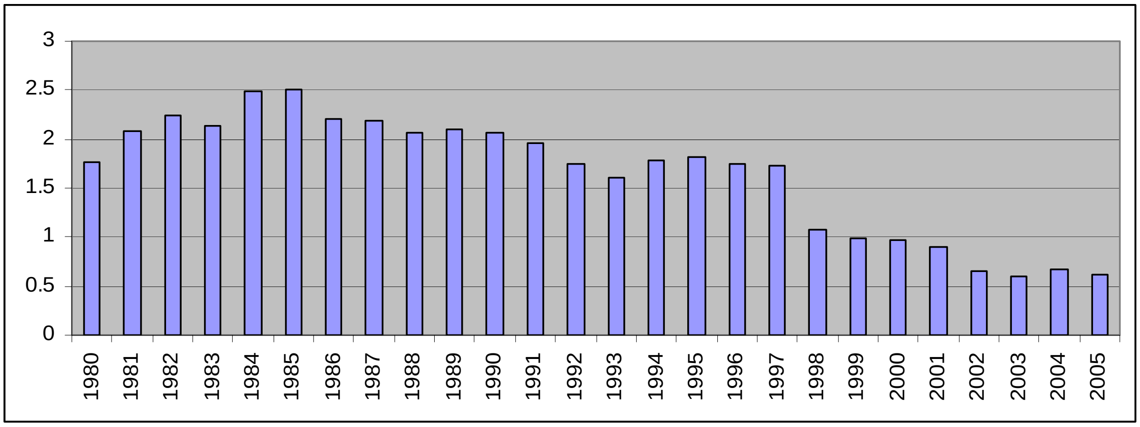
Additional Informative Charts

45-year Low Mortgage Rates



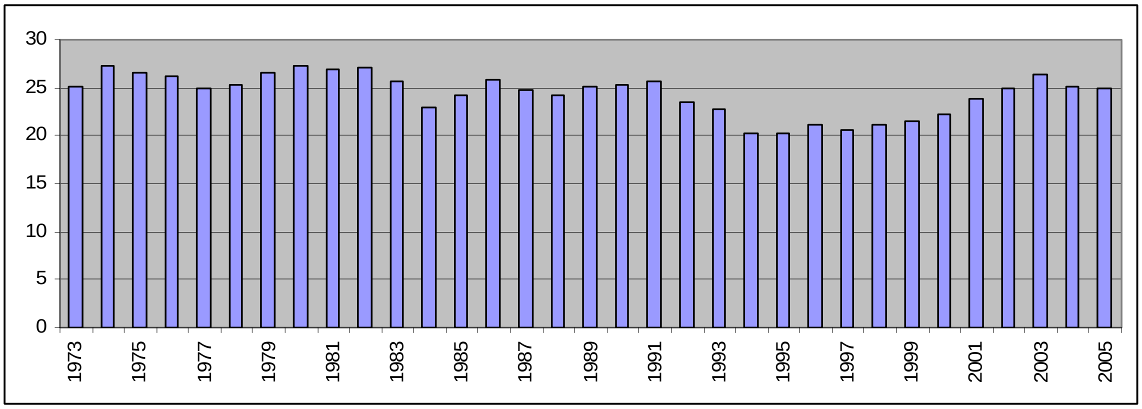
Source: Freddie Mac, Federal Reserve

Historic Low Fees and Points for Mortgage Origination



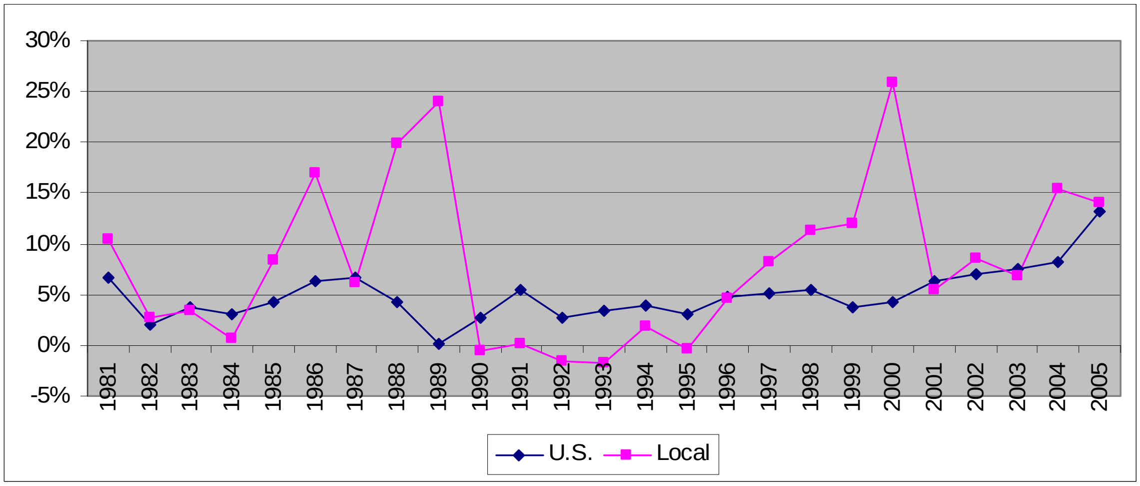
Source: Freddie Mac

Typical Down-payment Percentage Returning to Historic Norms



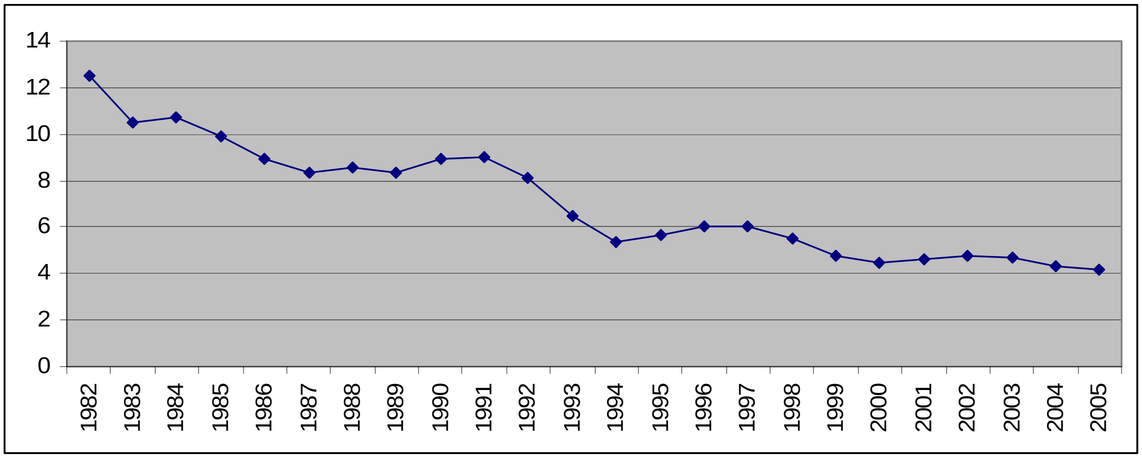
Source: Federal Housing Finance Board

Home Price Growth

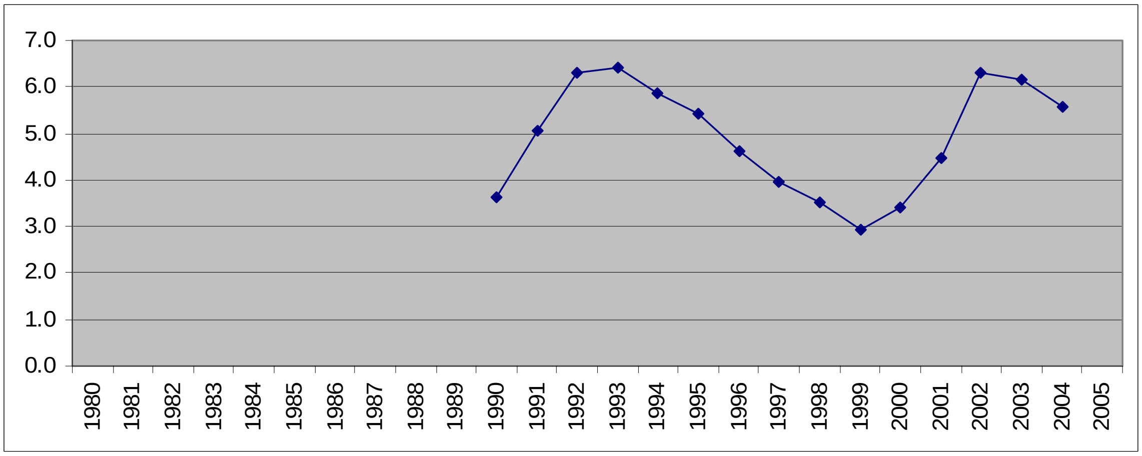


Historic Low National Months Supply of Homes on the Market

(The number of months it would take to sell all current homes on the market at the current sales pace)



Local Unemployment Rate



Source: BLS

NAR Research

NAR Research produces the premier measurement of residential real estate activity – the existing-home sales series – and analyzes how changes in the U.S. and international economies can impact the real estate business. It also examines trends in real estate practices, and how NAR members are adapting technology in their business operations. NAR Research looks at regulatory and legislative policy proposals and how those policies could affect REALTORS® and their clients, America's property owners.

To find out about other products from NAR's Research Division, visit our web site at www.REALTOR.org/research.

National Association of REALTORS®
Research Division
500 New Jersey Avenue, NW
Washington, DC 20001
www.REALTOR.org/research
202-383-7518