FORECAST HIGHLIGHTS

Our forecast calls for continued strength in the Sacramento region’s housing sector for the remainder of 2004 and continuing through 2005. We project continued increases in prices for both new and existing homes, although the pace of price appreciation will moderate over the coming 18 months. Sales of new and existing homes will continue at record levels in 2004. For 2005 new home sales will continue to climb as the economy improves, while sales of existing homes will moderate at near 2004 levels.

SACRAMENTO REGION HOUSING OUTLOOK

We expect home sales for 2004 to be approximately 17,700 new homes and 41,000 existing homes, both totals up from 2003. We expect the number of new homes sold to trend up over 2005 to a total of approximately 19,500 for the year. Sales of existing homes will moderate somewhat in 2005, but will nevertheless remain at the historically very high level of approximately 40,000 homes sold over the course of the year.

The median price of existing homes also reached a new high last summer, surpassing $200,000. Prices for existing homes are projected to increase to a median price of over $225,000 for 2004. For 2005, we expect existing home prices to increase modestly to an annual median of $235,000.

An improving employment outlook both across the state and in the Sacramento region will serve to maintain the pace of home sales in the six county region, including Sacramento, Placer, El Dorado, Yolo, Sutter, and Yuba Counties.

Prices will also continue to rise over the coming 18 months, although at reduced rates. Continued high levels of production from builders, coupled with a slight upward trend in interest rates will act together to slow price appreciation for both new and existing homes over the coming six quarters.

The median home price for new homes surpassed $300,000 last summer, and is expected to reach a median price of about $335,000 for 2004. The median price of a new home is expected to increase to around $350,000 for 2005.

Several factors conspired to create the record level of home sales during 2004. The region has continued to add jobs, defying state and national trends. This continuing employment growth has acted to stimulate demand for new homes. Low mortgage rates have also acted to increase sales, encouraging existing home owners to move up and bringing new buyers into the market. Finally, an influx of new buyers, largely from the Bay Area, has further stimulated demand.

Each of these factors acted not only to increase the number of sales, but also to push prices to record levels, with double digit percent increases for most categories of homes throughout the region over the past few years.

These trends are likely to continue in the coming months, bolstered by the recovering statewide and Bay Area economies and an expected acceleration in employment growth.
in the Sacramento region (please see the separate report, CSUS Forecast of the Sacramento Region for more information about the region’s employment outlook).

Nevertheless, as the national economy improves interest rates likely will continue to rise. Additionally, as builders continue to add to the supply of housing units at a time of relatively moderate job growth, supply and demand will come into closer balance, leading to moderation in price appreciation.

JOBS AND POPULATION

Employment growth is an important factor in housing demand, yet employment growth and housing growth are rarely matched at any given point in time. It is frequently suggested that the recommended ratio for new jobs to new housing units is 1.3:1. This means that for every 1.3 new jobs created in a region, one new housing unit should be built to keep demand and supply in balance. As the graph on the following page shows, the housing market in the Sacramento region cycles through periods of housing surplus and housing shortage.

In the early 1990s the labor force declined but the supply of houses did not. In fact, new houses continued to be built in large numbers. This resulted in a surplus of housing and a drop in home prices.

In contrast, between 1995 and 2002, the Sacramento region created well in excess of 1.3 new jobs for each new housing unit; at first this increased demand simply acted to counter the earlier over-supply of housing units. By the late 1990s, however, this employment-driven housing demand resulted in record levels of home sales and ultimately a supply shortage that produced double digit price increases.

The influx of homebuyers from the Bay Area, which had the highest ratio of new jobs to new housing starts in the state during the 1990s, and thus is one of the most expensive housing markets, also contributed to the housing shortage in Sacramento.

The recent boom in housing sales suggests that demand for housing in the region remains strong. However, as employment has steadied in recent months and new homes continue to be built at a record pace, the number of new homes being built is outpacing the number of new jobs created. The continuing strength of the housing market suggests that the backlog of housing demand has not yet been completely met. However, if employment growth continues to be outpaced by the growth in the supply of new homes, we would expect an eventual return to a more balanced jobs-housing picture, characterized by more stable prices.
BAY AREA HOUSING MARKET

The strength of the Sacramento region’s economy and housing sector are closely tied to the performance of the Bay Area’s economy. During the late 1990s, Sacramento gained jobs and experienced home price appreciation as businesses, unable to afford Bay Area rents or hire enough local workers, moved to the Sacramento region. Then, as the Bay Area economy faltered, Bay Area refugees continued to move the area, seeking the region’s relatively more abundant jobs and much lower housing prices. Today, the large differential between Bay Area home prices and prices in the Sacramento region continues to attract new buyers.

Over the past two years the employment market in the Bay Area has been steadily improving, resulting in increasing housing sales and prices. After a slump in 2001, housing prices have been steadily increasing in the Bay Area. The seasonally adjusted median price of an existing home in the Bay Area in April 2004 was approximately $446,000, up 18 percent from April 2003.

Recent rapid price appreciation in the Bay Area has outpaced the rate of appreciation in the Sacramento region, thereby increasing the price differential between the two regions. Such an increasing price differential contributes to the relative attractiveness of the Sacramento housing market, thereby fueling demand for homes. With an improving employment outlook in the Bay Area, we expect this trend to continue.

HOME PRICES

Home prices across California have increased substantially during the past year. In April of 2004 the median new home price was up 16 percent from April 2003 levels while existing home prices were nearly 27 percent higher.

Housing prices in the Sacramento region over the last few years have been rapidly increasing, although we expect the pace of price appreciation to moderate. For 2004, we project a 9 to 11 percent increase in the median price of new and existing homes (2005 over 2004).

Moderation in prices is primarily a result of expected increased in interest rates and continuing strong supply of new homes at a time of moderate job growth.

HOUSING PERMITS

Housing permit applications provide a good indicator of the future supply of new homes. After pausing
briefly during 2003, housing permit activity has once again accelerated. As a result, we expect an increase in supply and ultimately sales of new homes through 2005.

As the Sacramento region continues to build near record numbers of new homes, there are indications that we may be close to filling the backlog of housing demand and entering a period of more balanced supply and demand, partially explaining the slowing of price increases.

**CONCLUSION**

The outlook for the Sacramento region’s housing sector remains strong. Accelerating employment growth in the region will act to stimulate demand. Builders are expected to respond with continued high levels of production, resulting in high level of new home sales.

High production levels combined with moderate job growth and likely increases in interest rates will act to slow price appreciation somewhat over the forecast period.

Risks to the forecast include the potential for higher than anticipated interest rate increases, which would act to cool demand and price appreciation. In addition, faltering local employment growth, though not anticipated, could also act to stall growth in the sector.

**HOUSING SECTOR NOTES**

The CSUS Forecast of the Sacramento Region: Housing Sector Outlook was developed by the California Institute for County Government (www.cicg.org).

Support was provided by the CSU, Sacramento. The forecast report was prepared by Hilary Haycock under the direction of Matthew Newman.

The forecast contains the results of an econometric model of the six county Sacramento region’s economy (including the counties of El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba).

For more information about the forecast methodology, please contact Matthew Newman, Director of CICG, at 916.324.0796 or via email at mnewman@cicg.org.

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