FORECAST HIGHLIGHTS

Sales of new and existing homes will remain strong throughout 2004, but will decrease slightly compared to the record levels of 2003. Job losses in the Sacramento region and the prospect of increasing interest rates will act together to slow somewhat the pace of home sales in the six county region, including Sacramento, Placer, El Dorado, Yolo, Sutter, and Yuba Counties.

Cooling demand coupled with continued high levels of production from builders and the prospect of increasing interest rates will act together to significantly slow the rapid pace of price appreciation for both new and existing homes over the coming year.

2004 is expected to be a good year for the housing sector, but it will not match the record levels of 2003.

SACRAMENTO REGION HOUSING OUTLOOK

We expect sales for the fourth quarter of 2003 to be approximately 4,400 new homes and 10,000 existing homes, sales totals slightly down from the third quarter’s record levels. We expect the number of new homes sold to gradually trend down to a seasonally adjusted level of approximately 4,000 sales by the fourth quarter of 2004. Sales of existing homes will also moderate somewhat in 2004, but will nevertheless remain at historically very high levels.

The median home price for new homes surpassed $300,000 this summer, and is expected to remain at approximately this level throughout 2004. We expect median prices to increase to an average of just over $300,000 for 2003, reaching an average of $307,000 for 2004.

The median price of existing homes reached a new high this summer, surpassing $200,000. Prices for existing homes are projected to increase for the rest of 2003, the median price averaging to $208,000 for the year. For 2004, we expect median prices to increase modestly to an annual average of $220,000.

Several factors conspired to create the record level of home sales during 2003. Employment continued to grow in the region through most of the first half of the year, adding to the pool of pent-up demand for housing that has developed since the late 1990’s, as job growth outstripped growth in new housing units. Mortgage rates hit record lows and remained low throughout most of the year increasing the buying power of consumers.

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

These trends will moderate in the coming months, resulting in slight declines in demand relative to 2003. Consequently, the number of sales for both new and existing homes will decline slightly from the high levels observed in recent months. In turn, the decreasing demand for houses, combined with the recent boom in new housing construction, will stall the growth in housing prices.
Poor job growth will be the dominant factor influencing demand for new houses. As the state struggles to bring its budget into balance, continuing reductions in government spending and employment are anticipated for the Sacramento region. This weak employment outlook occurs at a time when a significant number of new housing units have come on the market. As a result, the pool of pent-up demand for housing in the region has steadily been lessening.

Recent improvements in the Bay Area economy coupled with a decline in the price differential between the Bay Area and the Sacramento region may indicate the decreasing importance of this group of buyers in the Sacramento region’s housing market.

**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 1.5:1. This means that for every 1.5 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 actually 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 1.5 new jobs for each housing unit; at first this increased demand was compensated for by the earlier over-supply. 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 ratios of new jobs to new housing starts in the state during the 1990s, and thus 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 slumped 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 Sacramento region began losing jobs early this past summer, and is projected to continue to lose jobs for the next three quarters. By next spring this new housing surplus will translate into decreased housing demand and fewer home sales.
BAY AREA HOUSING MARKET

Over the past 12 months the employment market in the Bay Area has stabilized, resulting in an improving real estate market for that region.

The median price of an existing home in the Bay Area is approximately $396,000, up nearly $30,000 from October 2002. After a slump in 2001, housing prices have generally remained strong in the Bay Area. Nevertheless, the price appreciation in the Bay Area has not matched the rapid pace of price increases in the Sacramento region. As the price of homes in the Sacramento region increases, the price difference from Bay Area homes is decreasing. A narrowing price difference, coupled with a stabilizing Bay Area economy, may attract fewer Bay Area homebuyers to the Sacramento region.

HOME PRICES AND INTEREST RATES

Home prices across California rose over the course of 2003, resulting in a 15% increase in new home prices over 2002, and a 18% increase in existing home prices (based on CICG projected figures for the remainder of 2003). Housing prices in the Sacramento region remain lower than median statewide prices, although by a smaller margin than that between the Sacramento Region and the Bay Area.

Housing prices in the Sacramento region over the last few years have been rapidly increasing. While housing prices are not expected to fall, we anticipate the pace of price increases to slow significantly in 2004. After reaching the $300,000 mark just this year, the median sales price of a new home in the Sacramento region is projected to increase only modestly to an average of about $307,000 for 2004. The median sales price of an existing home in the Sacramento region is forecasted to continue increasing above $200,000 for the remainder of 2003, finishing the year with an average price of $208,000. For 2003 we expect the median price to average $220,000.

Interest rates have recently begun increasing from 40-year lows, decreasing the buying power of consumers even as housing prices continue to rise. (See graph on following page.) The recent boom in housing may have been partly due to buyers entering the market now to take advantage of lower interest rates. Even though housing prices will remain steady or grow slightly, increasing interest rates will raise mortgage costs.

HOUSING PERMITS

There is approximately a nine-month lag between the issuance of a housing permit and the construction
of a new housing unit. Recent increases in the number of permits issued in the Sacramento region have several consequences for the future of the housing market: the leveling off of new home prices projected for the coming year may be explained by the expected increase in homes coming on the market, coinciding with decreasing demand resulting from the decline in overall employment levels. The expectation that the Sacramento region will continue to lose jobs as it builds near record numbers of new homes also indicates we may be entering a period of housing surplus.

**CONCLUSION**

Declining employment levels in the Sacramento region combined with large numbers of new home sales and increases in permit activity suggest that the pent-up demand for houses finally may be being met. While housing demand will remain strong in the Sacramento Region for the next few months, the overall trend of home sales for the next four quarters is one of moderate decline.

Median home prices in the Sacramento region are projected to remain steady or increase slightly. This is a significant change in the trend of housing prices, which have been increasing significantly over the last few years.

The projected leveling off of both housing sales and housing prices are mostly explained by the abatement of housing demand, resulting from lower employment and higher interest rates. Demand for homes in the Sacramento region by Bay Area homebuyers may decrease, further lowering overall housing demand.

**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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