Public Policy Institute *of* California

California Counts

POPULATION TRENDS AND PROFILES

Hans P. Johnson, editor

Volume 7 Number 1 • August 2005

California's Newest Homeowners

Affording the Unaffordable

By Hans P. Johnson and Amanda Bailey

Summary

How can so many Californians afford to spend so much on home purchases? Each year seems to bring more astounding price increases and record sales volumes in California's housing markets, even as the state experienced an economic downturn in the early part of the decade. Income growth has certainly not kept pace with housing price appreciation. In this edition of *California Counts*, we examine the latest trends in home-ownership and the characteristics of homebuyers. How are recent homebuyers able to afford such high prices? How do they compare with other Californians? Is there a growing gap between those who can afford to buy and those who rent?

We find that California's recent homebuyers are younger and more ethnically diverse than long-term homeowners in the state but older and less diverse than renters in the state. Their incomes are somewhat higher than those in the rest of the nation, but sizable numbers of recent homebuyers in California have moderate or even modest incomes.

How can so many Californians afford to buy homes? One way is by financially extending themselves. The share of income spent on housing is higher for homeowners in California than in any other state. Alternative forms of financing also play a role, with large numbers of new purchasers using interest-only and variable rate loans. Declines in interest rates in the early part of this decade have kept monthly payments from rising as fast as home prices. For many buyers, the sale of a previously owned home has provided much of the money needed to purchase a home. Another route to homeownership in California is to move to a less expensive

The share of income spent on housing is higher for homeowners in California than in any other state.

region. California's regional housing markets have all experienced sharp increases in prices, but inland areas of the state have lower prices than coastal areas. In Southern California, the fastest-growing region is the Inland Empire, and the primary source of population growth there is domestic migration. Many of those migrants are moving from Los Angeles, Orange, and San Diego Counties. In Northern California, much of the growth in the northern San Joaquin Valley and in the Sacramento metropolitan area is fueled by migration from the San Francisco Bay Area.

Finally, although many Californians have been able to find a way to buy a home, many have not. Even with record sales volumes, homeownership rates in California are much lower than those in the rest of the nation: California ranks 48th of the 50 states in terms of homeownership rates. The vast majority of renters in California want to buy a home, but only a small share are confident that they will be able to do so.

Hans P. Johnson is a research fellow and Amanda Bailey is a research associate at the Public Policy Institute of California. Views expressed here do not necessarily reflect those of PPIC. *The authors acknowledge the helpful comments of Gary Bjork, John Karevoll, Robert A. Kleinhenz, Dowell Myers, Karthick Ramakrishnan, Joyce Peterson, and Deborah Reed.*

Introduction

Throughout the state, California's housing markets consistently make headlines. Prices are at record levels, and annual percentage increases in prices have been in double digits for several years. The California Association of Realtors (CAR) placed the state's median single-family home price at $522,590 in May 2005. Defying the economic downturn of the early part of this decade, Bay Area housing prices have seemingly reached the stratosphere, with a median sales price of $765,000 in San Francisco in May 2005 and even higher prices in Marin County (DataQuick Information Systems, 2005).[1] However, prices have risen dramatically in all regions of the state (Table 1). Among the 378 metropolitan areas in the United States, the ten with the greatest percentage increase in housing price appreciation since 2000 are all in California; among the 19 metropolitan areas in the United States with the greatest appreciation rates, 18 are in California.[2] Over the last five years, California has led all states in housing price appreciation, with housing values doubling: California now has the most expensive housing of any state in the nation, having recently surpassed Hawaii.[3]

Affordability, of course, has also fallen. Affordability rates are hypothetical estimates of the percentage of households that can afford the median-priced home. Increasing prices make homes less affordable; increases in incomes and declines in interest rates make homes more affordable. Incomes have not kept pace with the rapid escalation of prices, although declining interest rates have prevented affordability from falling even further than it already has. CAR estimated that only 16 percent of California households could afford the median-priced home in May 2005.[4] Coastal regions of the state have been at the epicenter of the state's affordability crisis, with only about one in ten households able to afford the median-priced home in San Diego, Orange County, Santa Barbara, and the San Francisco Bay Area. Affordability rates are higher in inland areas of the state but, according to CAR, even in the state's most affordable large county—San Bernardino—only about one in four households could afford the median-priced home in the county.[5] Affordability rates nationwide are three times higher than in California. The National Association of Home Builders reports that 17 of the 19 least affordable housing markets in the country in the first quarter of 2005 were in California, with the only exceptions being the metropolitan areas of New York City and Nassau-Suffolk (Long Island).

Despite the tremendous increase in prices, sales volumes are at record levels.

According to a 2004 survey conducted by PPIC, Californians are aware of these trends and are concerned about the state's high-priced housing (Baldassare, 2004). Over half of Californians (55%) regard the lack of affordable housing as a "big problem." Many renters in the state want to be homeowners but are pessimistic about their chances of buying a home in California: 86 percent of renters in California hope to be homeowners someday, but only 18 percent believe it is very likely (and 49% somewhat likely) that they will find a home they can afford. Over one-third of renters in California (37%) respond that the high cost of housing has made them "seriously consider" moving to another part of California or even out of the state.

Despite the tremendous increase in prices, sales volumes are at record levels (Figure 1). That is, at the same time that affordability is at or near an all-time low and prices are at an all-time high, the number of people purchasing homes is at an all-time

Homeownership rates in California are among the lowest in the nation.

high. The volume of sales, as measured by CAR, reached 624,740 units in 2004. DataQuick reports that the volume of sales for each of the first three months of 2005 was at record levels—January sales in 2005 were higher than in any January since DataQuick began keeping records (1988), as were February and March sales. In the first three months of 2005, 141,000 homes were sold in California, an increase of 3.3 percent over the first three months of 2004 (see the home sales reports at http://www.dqnews.com/RRMain.shtm).

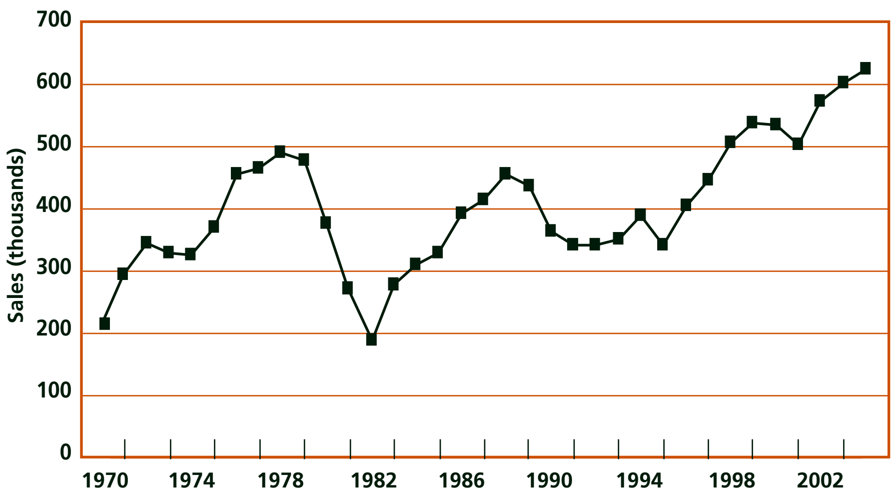
The large volume of sales at such high prices is no small conundrum. How can so many afford so much? In this edition of *California Counts*, we seek to answer that question. First, we profile California's newest homeowners and then we identify strategies they use to purchase a home. We use numerous datasets, none of them perfect, to understand

Table 1. Percentage Change in Home Prices for California Metropolitan Areas

Metropolitan Area	One Year Increase (1st Quarter 2004 to 1st Quarter 2005), %	Five Year Increase (1st Quarter 2000 to 1st Quarter 2005), %	National Rank for Five Year Increase
Yuba City	26	122	1
Santa Barbara–Santa Maria–Goleta	27	122	2
Merced	27	118	3
San Diego–Carlsbad–San Marcos	25	118	4
Modesto	26	118	5
Salinas	31	117	6
Riverside–San Bernardino–Ontario	29	116	7
Sacramento–Arden–Arcade–Roseville	26	113	8
Fresno	27	111	9
Stockton	28	111	10
Vallejo–Fairfield	22	108	12
San Luis Obispo–Paso Robles	22	107	13
Santa Ana–Anaheim–Irvine	24	107	14
Madera	28	107	15
Chico	21	107	16
Los Angeles–Long Beach–Glendale	26	106	17
Oxnard–Thousand Oaks–Ventura	24	105	18
Napa	21	105	19
Redding	21	103	21
Bakersfield	34	102	24
Santa Rosa–Petaluma	21	86	39
Oakland–Fremont–Hayward	21	86	40
Hanford–Corcoran	29	84	45
Visalia–Porterville	32	77	49
El Centro	31	76	55
Santa Cruz–Watsonville	18	72	61
San Francisco–San Mateo–Redwood City	18	63	77
San Jose–Sunnyvale–Santa Clara	17	52	99

Source: Authors' calculations of Office of Federal Housing Enterprise Oversight (OFHEO) 2005 data.
Note: Figures are based on resales of homes with mortgages of less than $337,000 in 2005.

Figure 1. Annual Home Sales Volume in California, 1970–2004



Source: California Association of Realtors.

California's newest homebuyers. See the text box, "Identifying California's Most Recent Homebuyers" for details.

A Profile of Recent Homebuyers

With nearly 7 million owner-occupied residences in California and about 600,000 home sales annually, only about 9 percent of homes are sold in a given year. Thus, the vast majority of the homeowning population, even in a dynamic state such as California, will change only slowly. As of 2004, 41 percent of all households in California were renter-occupied and 59 percent were owner-occupied.

We define *recent* homebuyers as those who have purchased a house within the last two years. In 2003, approximately 11 percent of owners (786,869 households) had lived in their homes for less than two years. Forty percent of owners (2,780,373 households) had lived in their homes for two to ten years and nearly half (48% or 3,314,972 households) had lived in their homes for more than ten years.[6]

Homeownership rates in California are among the lowest in the nation. Overall, only 59 percent of California householders own their own homes, compared to 70 percent in the rest of the nation.[7] The only states with lower homeownership rates than California are New York (54%) and Hawaii (57%).[8] California's relatively low homeownership rates are not a recent phenomenon—they have been substantially below those in the rest of the nation for decades, with no appreciable change in the relative standing of California and the rest of the United States over those years. However, as in the rest of the nation, California's homeownership rates have risen slightly since the late 1990s (Figure 2) and now appear to be at the highest level in decades. These increases occur in an environment where income growth is not keeping pace with housing price appreciation and is thus all the more remarkable. Indeed, the state's homeownership rates may now be at their highest levels ever. At the previous peak in 1960, 58 percent of California householders were homeowners (Fannie Mae, 2001).

The largest differences in rates of homeownership between California and the rest of the nation are among young adults; for example, in California only about one-quarter of 25- to 29-year-old householders own a home, compared to almost 40 percent of 25- to 29-year-olds in the rest of the country (Figure 3). This gap narrows at older ages but is never closed completely. The age pattern reflects the high cost of ownership in California, which forces young adults to save longer and wait until their incomes are higher before they are able to purchase a home.

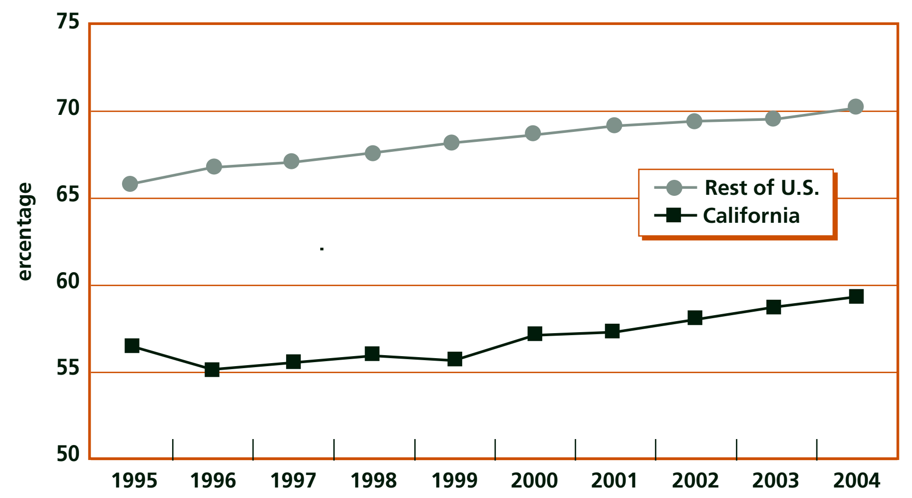
However, many of California's most recent homebuyers are young

Identifying California's Most Recent Homebuyers

We rely on several datasets to describe California's most recent homebuyers. Because California's housing markets are changing so rapidly, we use the most current publicly available data. To identify the latest homeownership rates, we use the U.S. Census Bureau's annual March supplement of the *Current Population Survey* (CPS). The CPS provides information on owning or renting through 2004, but the sample is not large and it contains no other housing information. In contrast, the 2003 American Community Survey (ACS) is a large survey conducted by the U.S. Census Bureau that contains quite a lot of housing information. In California, 43,000 households responded to the survey in 2003. The survey provides information on tenure (owning or renting), year that the respondent moved into the present residence, owner costs, housing unit value, and numerous socioeconomic and demographic characteristics. We define recent homebuyers as those who bought their homes within the last two years, but we are unable to distinguish between first-time homebuyers and previous homeowners. Unfortunately, the ACS does not provide information on the housing purchase price or financing. It provides a self-reported measure of home *value*; all other data series that we reference (the U.S. Census Bureau's Residential Finance Survey (RFS), DataQuick, CAR, the National Association of Home Builders, and OFHEO) estimate home *prices* based on sales activity. We use the RFS to identify financial aspects of recent home purchases. Unfortunately, the 2001 survey is somewhat dated. We rely on published reports by independent companies and organizations (such as DataQuick, CAR, and the National Association of Home Builders) to identify some of the latest trends in sales prices, sales volumes, and financing. OFHEO provides an index of home appreciation based on repeat sales that we also use to highlight changes in California prices. The advantage of the OFHEO method is that it accounts for most changes in quality (because it is based on changes of sales prices of homes at two points in time). However, only single-family detached homes with mortgages of less than $337,000 in 2004 are included in the OFHEO index. The OFHEO index is derived from Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal National Mortgage Association (Fannie Mae) conforming mortgage transactions. We compare price changes from two sources—the National Association of Realtors and OFHEO—and find that changes in prices in metropolitan areas generally maintain the same rank order within both datasets. Metropolitan areas in both datasets show rapid price increases, but the exact level of growth varies across the datasets.

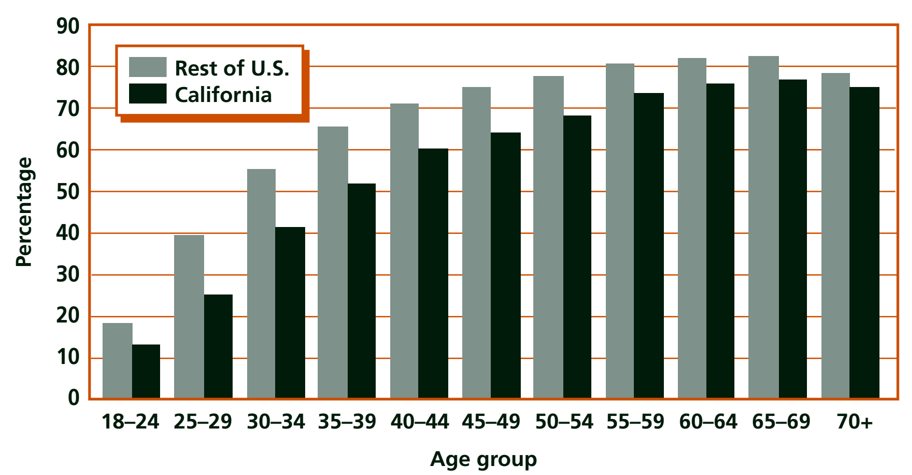
In all the datasets, we calculate homeownership rates as the share of occupied households that are owned (versus rented). Seasonal and vacant housing units are not considered.[9] The homeownership rates we report are based on standard definitions used by the Census Bureau and others. We also use the term "householder" throughout the report. The householder is the person in whose name the housing unit is owned or rented. The number of householders equals the number of occupied housing units. We compare homeownership rates for California from several different sources. We find that the 2000 CPS, 2000 ACS, and the 2000 decennial census are all in close agreement. Moreover, increases in homeownership rates between 2000 and 2003 as measured by the ACS are nearly identical to increases as measured by the CPS.[10]

Figure 2. Homeownership Rates, 1995–2004



Source: Authors' tabulations of the March *Current Population Surveys*.

Figure 3. Homeownership Rates, by Age

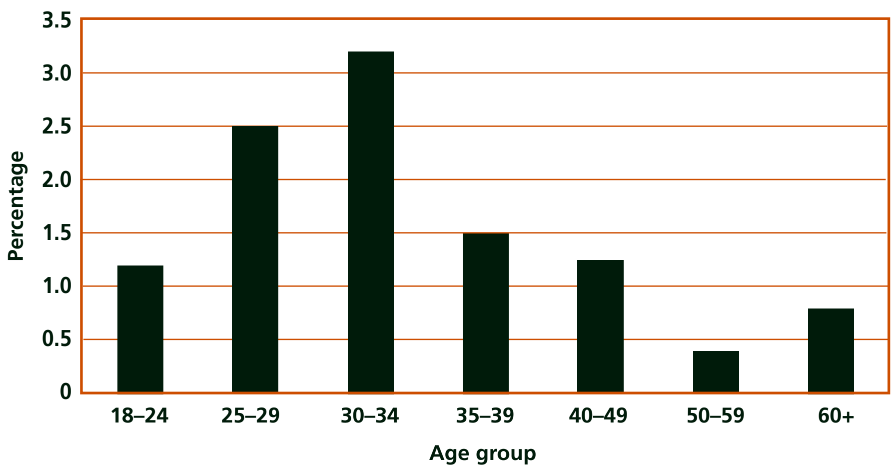


Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).

adults. Between 2000 and 2003 in California, homeownership rates increased more for young adults than for older adults (Figure 4).[11] The largest increase was for householders in their early thirties. In 2003, 41 percent of householders ages 30–34 owned their homes (59% were renters), compared to 38 percent in 2000. Given the rapid escalation in housing prices during this period, the increase in homeownership among young adults—an age group that is not associated with high incomes—seems all the more remarkable. A sizable share of young adults are finding a way to purchase a home in California, even with the state's high prices.[12] By 2003, the difference in homeownership rates between young adults in California and their counterparts in the rest of the country had narrowed slightly. However, the vast majority of young adults in California remain renters, and homeownership rates for this group remain far below those in the rest of the United States.

We find a consistent picture of the relative youthfulness of California's most recent homebuyers when we examine householders by whether they rent or own and by the amount of time they have lived in their owned homes. California's most recent homebuyers—those who have lived in their currently owned home for less than two years—are much younger than other homeowners

Figure 4. Change in Homeownership Rates Between 2000 and 2003, by Age



Source: Authors' calculations based on the 2000 and 2003 ACS (U.S. Census Bureau, 2003).

and only slightly older than renters (Table 2). The sharpest age differences are not between renters and recent homeowners but between long-term owners and all other householders. A substantial number of young adults (those age 34 or younger) have been able to purchase homes in California fairly recently. Among all 30- to 34-year-olds in California, one in nine has purchased a home in the last two years, and two in five have purchased a home within the past nine years. Thus, we do not see evidence that California's high housing prices over the past few years have pushed young adults out of the market. We see similar age patterns among recent homebuyers in comparable markets outside California. In New York, for example, 36 percent of recent homebuyers are under age 35, compared to 33 percent of recent homebuyers in California.[13] California's young age structure accounts for some of the youthfulness of the state's recent homebuyers. Nevertheless, the probability of a young adult purchasing a home within the last two years is similar in California and the rest of the nation (among 30- to 34-year-old householders, one in nine in California and one in eight in the rest of the nation are recent homebuyers).

Homeownership rates in California, as in the rest of the nation, are lower for African Americans and Latinos than for whites and Asians. California's recent homebuyers are more ethnically diverse than long-term homeowners in the state but less diverse than renters (Table 3).[14] In California, non-Hispanic whites and Asians are disproportionately represented among recent homeowners, making up almost three of every four recent homebuyers compared to two of every three householders. African Americans are particularly unlikely to be recent homebuyers—a reflection of lower household incomes and concentration in some of the state's most expensive housing markets. Latinos, although underrepresented compared to their share of all householders, make up a sizable share of recent homeowners. Our data from 2003 suggest that almost one of every four recent homebuyers in California is Latino.[15] Homeownership rates among Latinos increased from 43 percent in 2000 to 46 percent in 2003, representing the biggest gain among large ethnic groups in California.[16] This relatively strong rate of new homeownership among Latinos is perhaps surprising given the generally lower incomes of Latino households. Part of the explanation could be the geography of the state's Latino population. Latinos are less likely to live in the Bay Area—the state's most expensive housing market. Moreover, the pool of potential new homeowners is sizable among Latinos given their generally low homeownership rates.

Marriage and having children are key life cycle events that

Table 2. Percentage Distribution of California Householders, by Age and Whether Owning or Renting

Age Group	Owned <2 Years	Owned 2–9 Years	Owned 10+ Years	Renting	All Householders
18–24	4.7	1.2	0.3	10.8	5.2
25–29	10.6	4.9	0.4	13.9	7.8
30–34	17.4	12.2	1.0	14.6	10.4
35–39	16.4	16.4	3.0	12.8	11.1
40–44	14.7	17.3	7.5	11.3	11.9
45–49	10.0	14.8	11.5	9.9	11.5
50–69	20.2	26.6	47.4	18.7	28.7
70+	5.8	6.5	28.8	7.9	13.3
Total	100.0	100.0	100.0	100.0	100.0

Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).
Notes: Classification as owner or renter is based on current place of residence. Columns may not sum to 100 percent because of rounding.

Table 3. Percentage Distribution of California Householders, by Ethnicity and Whether Owning or Renting

Ethnicity	Owned <2 Years	Owned 2–9 Years	Owned 10+ Years	Renting	All Householders
White	58.5	59.5	68.1	45.0	55.8
Latino	22.5	22.7	16.1	31.9	24.7
Asian, Pacific Islander	13.2	11.1	9.4	11.4	10.9
African American	3.6	4.6	4.8	9.2	6.5
American Indian	0.3	0.7	0.5	0.7	0.6
Other	0.1	0.3	0.2	0.2	0.2
Multiracial	1.7	1.2	1.0	1.5	1.3
Total	100.0	100.0	100.0	100.0	100.0

Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).
Note: Columns may not sum to 100 percent because of rounding.

Homeownership rates in California, as in the rest of the nation, are lower for African Americans and Latinos than for whites and Asians.

prompt couples to buy a house. Most recent homeowners are married (Table 4). Householders who have purchased their home within the last ten years are almost twice as likely as renters to be married. Single individuals living alone or with roommates and single parents are much less likely to own a house. Recent homebuyers are more likely to be married with children than married without children, whereas those who have lived in their homes for at least ten years are much more likely to be married without children. Many of those long-term homeowners are empty nesters—older adults whose children have grown and moved away from home.

Given the remarkable increases in home prices over the past decade, it is not surprising that recent homebuyers have substantially higher incomes than those who have lived in their homes for many years. The primary economic differences in incomes are between homeowners and renters (Table 5).

For example, almost 40 percent of renters have household incomes of less than $25,000, whereas only 13 percent of recent homebuyers and 19 percent of long-term homeowners have incomes that low. Median household incomes are higher for recent homebuyers than for those who have owned their homes for many years. Nonetheless, a substantial share of recent homebuyers have incomes that are moderate or even modest, with 44 percent having household incomes of less than $60,000.

Migrants from other states and from abroad do not generally immediately buy a home: They constitute less than 10 percent of all recent homebuyers. The vast majority of recent migrants to California rent rather than own their homes. Among all people moving to California between 2002 and 2003, only 27 percent bought rather than rented their homes. Among all *householders* who moved to California in the past year, only 20 percent purchased a home.[17]

How Do People Find Ways to Buy Homes in California?

Californians are resourceful when it comes to finding ways to buy a house. Some have sufficient financial resources, others pool their resources, some use

Table 4. Percentage Distribution of California Householders, by Family Type and Whether Owning or Renting

Family Type	Owned <2 Years	Owned 2–9 Years	Owned 10+ Years	Renting	All Householders
Married, no children	23.6	25.7	43.0	13.0	25.1
Married with children	36.9	40.1	16.3	20.4	25.0
Single or roommates	31.0	26.6	36.9	50.3	39.7
Single parent with children	8.5	7.6	3.8	16.3	10.2
Total	100.0	100.0	100.0	100.0	100.0

Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).

Table 5. Percentage Distribution of California Householders, by Household Income and Whether Owning or Renting

Household Income	Owned <2 Years	Owned 2–9 Years	Owned 10+ Years	Renting	All Householders
<$10,000	2.8	2.8	4.8	12.6	7.5
$10,000–$25,000	9.7	8.4	14.4	26.4	17.7
$25,001–$40,000	12.7	12.0	14.7	20.3	16.3
$40,001–$60,000	18.5	17.8	17.0	17.8	17.6
$60,001–$80,000	15.9	16.0	14.0	10.5	13.1
$80,001–$100,000	11.5	12.9	10.4	5.0	8.8
$100,001–$125,000	10.2	10.3	8.8	3.2	6.9
>$125,000	18.7	19.6	15.9	4.2	12.0
Total	100.0	100.0	100.0	100.0	100.0
Median household income, $	68,000	71,000	60,000	33,000	50,000

Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).

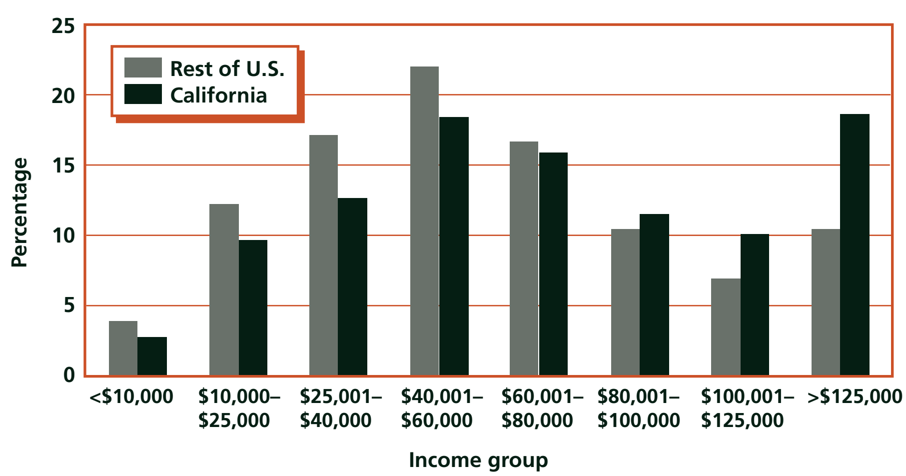
alternative forms of financing, and many are financially extended or even financially stressed. Finally, some Californians move to less expensive areas to find housing that is more affordable. However, for every renter who succeeds in purchasing a house, many more who desire to do so are not able to.

One way to buy a home in California, of course, is to have a sizable income. The median household income of recent homebuyers in California is about 20 percent higher than the median for recent buyers in the rest of the country ($68,000 versus $56,000 in 2003). Moreover, California has a high share of homebuyers with very high incomes: In 2003, almost one of every five recent homebuyers had a household income of more than $125,000, compared to one of every ten in the rest of the nation (Figure 5). Partly, this simply reflects higher incomes in California overall; in a state with a relatively high share of high income households, we would expect a higher share of recent buyers to have high incomes. To a certain extent, however, California's high household incomes are a consequence of the state's high housing prices, with some lower income households either leaving the state or not moving to the state because of the state's high housing prices.

Californians can also buy a home by becoming "house poor"—paying an inordinate share of their income on housing. The U.S. Department of Housing and Urban Development (HUD) guidelines recommend that a household pay no more than 30 percent of its income on housing costs (U.S. Department of Housing and Urban Development, 2005). In California, 40 percent of all households with mortgages exceed this recommended threshold, a higher share than in any other state (Table 6). The state's newest homebuyers are even more likely to exceed this threshold. About half of recent homebuyers (52%) pay more than 30 percent of their income on housing costs (Table 7). Perhaps even more remarkable, 20 percent of recent homebuyers in California spend more than half of their income on housing costs. When we examine affordability by income, we see that lower- and moderate-income households ($60,000 and below) who recently purchased a home devote a large share of their income to housing. Three-quarters of low- and moderate-income recent buyers spend more than 30 percent of their income on

. . . 20 percent of recent homebuyers in California spend more than half of their income on housing costs.

Figure 5. Percentage Distribution of Recent Homebuyers, by Household Income



Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).

Table 6. States with the Highest Housing Cost Burdens

Rank		% of Homeowners Spending >30% of Their Income on Housing	% of Homeowners Spending >50% of Their Income on Housing
1	California	39.6	15.4
2	Hawaii	36.4	11.2
3	Washington	33.5	10.6
4	Florida	33.2	13.2
5	Nevada	33.0	11.6
6	New York	32.9	13.7
7	Massachusetts	32.6	12.5
8	New Jersey	32.5	12.1
9	Oregon	32.4	11.6
10	Colorado	31.8	10.9
	United States	29.1	10.6

Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).
Notes: Income is pretax household income. Calculations include only homeowners with a mortgage. Housing costs include mortgage, real estate taxes, various insurances, utilities, fuels, mobile home costs, and condominium fees.

housing and one-third spend more than 50 percent. Recent homebuyers, at all income levels, in the rest of the nation spend far lower (Table 7, left column).

These data suggest that large numbers of homeowners in California have relatively low levels of disposable income after paying for their housing. However, the effect on disposable income is undoubtedly tempered by income tax benefits[18] and the wealth effect.[19] Those who have purchased their homes in California even a couple years ago have experienced strong appreciation in value and therefore large gains in home equity. These gains in wealth are, of course, less liquid than income, but some Californians have converted their equity to cash by taking out home equity loans, refinancing their mortgages, or adding additional mortgages. We found that 10 percent of recent homebuyers and 15 percent of all other homeowners in the state have a home equity loan.[20] Such practices may or may not be financially sound, but they could alleviate the house-poor effect that many homeowners in California would otherwise experience.

A large share of recent homebuyers in California are able to afford the high price of a recently purchased home because most were previous homeowners in California. The number varies according to the data source and year, with the RFS of 2001 suggesting that 58 percent of those buying within the last two years were previous homeowners and the California Association of Realtors reporting that seven in ten homes sold in 2003 and three in four homes sold in 2004 were sold to people who had previously owned a home (Kleinhenz, 2004; Sutachan, 2004). It is noteworthy that the share of previous owners among recent buyers in California, according to the 2001 RFS, was essentially the same as the share in the rest of the United States (58% and 59%, respectively).

Although a majority of recent homebuyers are previous owners, it is not necessarily the case that most of those previous owners are financing their recent home purchase with the sale of their previous home. According to the RFS, less than half (41%) of the recent homebuyers who previously owned a home sold that home to make a down payment on a new home.[21] However, the California Association of Realtors reports that repeat buyers "typically financed" the new purchase out of proceeds from a previous sale (Kleinhenz, 2004).

Declining interest rates have enabled many Californians to purchase high-priced homes. Because the vast majority of Californians

Table 7. Housing Cost Burden, by Income and Whether Owning or Renting

Income	Owned <2 Years (Rest of U.S.)	Owned <2 Years (California)	Owned 2–9 Years (California)	Owned 10+ Years (California)	Renting (California)
Percentage of households paying more than 30 percent of their income on housing					
< $30,000	79.4	89.1	90.7	84.0	77.4
$30,000–$60,000	38.5	76.4	63.7	54.2	32.4
$60,001–$100,000	14.3	49.3	33.2	21.4	7.6
> $100,000	5.0	18.8	12.9	6.7	0.8
All income levels	30.9	51.8	40.8	34.3	46.4
Percentage of households paying more than 50 percent of their income on housing					
< $30,000	46.7	72.4	71.9	60.5	48.7
$30,000–$60,000	6.6	30.7	20.9	17.1	4.9
$60,001–$100,000	1.4	6.8	4.4	3.4	0.4
> $100,000	0.4	1.8	1.4	0.7	0.0
All income levels	9.9	19.5	15.1	14.4	23.5

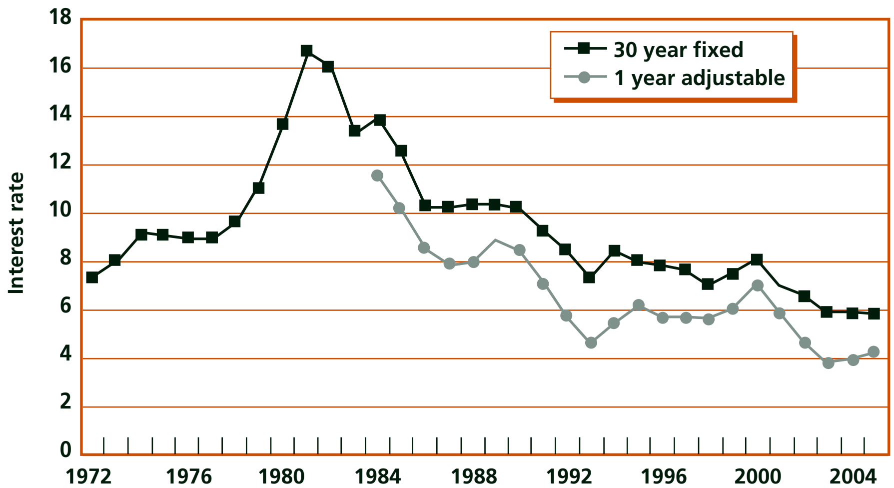
Source: Authors' calculations based on the 2003 ACS (U.S. Census Bureau, 2003).
Notes: Income is for pretax household income. Calculations include only homeowners with a mortgage. Housing costs include mortgage, real estate taxes, various insurances, utilities, fuels, mobile home costs, and condominium fees.

finance their home purchase through a mortgage, the fall in interest rates has allowed new homeowners to borrow more money without commensurate increases in monthly payments. According to Freddie Mac, interest rates on 30 year fixed rate mortgages fell from 8 percent in 2000 to 6 percent in 2003. Rates have remained at around 6 percent since that time (Figure 6). Thus, a loan of $367,000 in 2003 could be had for the same payment ($2,200) as a loan of $300,000 in 2000. In other words, a 22 percent increase in prices from 2000 to 2003 would not lead to a change in monthly mortgage payments (assuming no jumbo premiums).

At the same time that interest rates have fallen, there is evidence that nontraditional mortgages have become more commonplace in California. Many Californians are relying on adjustable rate mortgages and interest-only mortgages instead of 30 year fixed rate mortgages. These nontraditional mortgages allow homebuyers to borrow more money than they could with traditional mortgages. The interest rate for one year adjustable rate mortgages is substantially below that of 30 year fixed rate mortgages (Figure 6). The same initial $2,200 monthly payment that supports a fixed rate loan of $367,000 at 6 percent interest could support a loan of $461,000 with a one year adjustable rate loan at 4 percent. Adjustable rate loans now dominate the California mortgage market, and many of these loans are interest-only loans.[22] Interest-only loans are a new and increasingly popular form of financing a home purchase, increasing from less than 2 percent of mortgages for homes bought in California in 2001 to almost half of mortgages for homes bought in 2004. These loans are much more common in California than nationally, constituting about one-third of all mortgages nationwide (Streitfeld, 2005). Finally, lenders appear to be allowing higher debt-to-income ratios. According to the California Association of Realtors, rather than limiting housing costs to no more than 30 percent of income, lenders are commonly qualifying homebuyers for loans that lead to housing costs of 40 percent of income and in some cases even 50 percent of income (Sutachan, 2004).

Another way in which Californians can afford to buy a house is by having two or more incomes.

Figure 6. Mortage Interest Rates, 1972–2005



Source: Freddie Mac (2004).

Recent homebuyers in California are more likely than renters in the state to rely on the incomes of two or more workers (44% versus 31% in 2003, according to the ACS). However, recent homebuyers in California are not any more likely to rely on more workers per household than are recent homebuyers in the rest of the nation (where an identical 44% are home to two or more workers). Thus, California's housing market includes many multiple-income households, but high housing prices in the state have not disproportionately prevented many single-worker households from purchasing a home.

Some Californians have been able to buy a home recently by buying a smaller home. Almost one of every three (32%) recent homebuyers in California in 2003 bought a housing unit with two or fewer bedrooms, compared to one of every four long-term (ten or more years) homeowners. Many of these smaller houses are condominiums (or other attached housing units), or, less commonly, mobile homes. Whereas only 15 percent of long-term homeowners in California live in a housing unit that is not a single-family house, 26 percent of recent buyers do so.[23]

Finally, many Californians have been able to buy a home by moving to a less expensive region of the state. In many cases, they commute back to their original jobs; but in some cases, they find jobs in the new, lower-priced housing region. Throughout the state, the exodus is from expensive coastal areas to less expensive inland areas. In Southern California, the Inland Empire (San Bernardino and Riverside Counties) has long been and continues to be the primary destination of migrants from Los Angeles, Orange, and San Diego Counties. In Northern California, flows of migrants from the Bay Area to the Central Valley have increased substantially over the past decade. Average annual net flows of migrants to the Sacramento metropolitan area from the rest of California reached 26,000 per year between 2000 and 2003—more than doubling the average annual flow of the late 1990s. Similarly, annual net flows from the rest of California to the northern San Joaquin Valley almost tripled, reaching 24,000 per year between 2000 and 2003 (Johnson and Hayes, 2004). Over half of intercounty migrants to the northern San Joaquin Valley listed housing as the primary reason for their move. Many of those moving to the northern San Joaquin Valley continue to work in the Bay Area, whereas most of those moving to the Sacramento metropolitan area find jobs in that region.

Regional Patterns

Although all of the state's metropolitan areas have experienced dramatic increases in housing prices over the past four years (Table 1), prices are much lower in inland areas than in coastal areas. Median home values in 2003 ranged from $116,000 in Kern County to $664,000 in San Mateo County (Table 8). As prices have risen faster than incomes, the share of homeowners who pay a large share of their income on housing costs has also risen. Coastal areas have higher incomes than inland areas, but prices are higher still, so that the percentage of households paying 30 percent or more of their income on housing exceeds 40 percent in every major coastal area (Table 8).[24] Homeownership rates also vary widely across the state, ranging from only 39 percent in the city and county of San Francisco to around 70 percent in several suburban counties (including Contra Costa, Riverside, and Placer). As in the state as a whole, homeownership rates increased in almost every region of the state between 2000 and 2003 (Table 8, right columns).

Conclusion

Homeownership is often seen by policymakers and by community leaders as desirable. It promotes people's connections with their communities and may lead to greater civic participation. It has financial benefits for many homeowners and can enhance neighborhood stability. Californians are concerned about the lack

Table 8. Median Home Values, Owner Costs as Share of Household Income, and Homeownership Rates

	Median Home Value, $	Owner Costs Are 30% or More of Household Income (with Mortgage), %		Homeownership Rates, %	
County	2003	2003	2000	2003	2000
Bay Area	501,500	44.0	36.8	59.6	57.3
Alameda	457,000	44.6	38.0	57.5	54.8
Contra Costa	430,000	41.9	34.0	70.2	68.9
San Francisco	597,000	48.2	41.1	38.7	34.9
San Mateo	664,000	44.8	42.1	61.4	60.4
Santa Clara	587,000	42.8	37.6	62.7	58.4
Solano	314,000	43.0	34.5	67.2	65.0
Sonoma	429,000	45.1	31.6	64.2	65.8
Los Angeles region	318,800	42.9	39.2	55.7	53.5
Los Angeles	323,000	44.7	41.9	49.0	46.9
Riverside	224,000	42.1	35.8	69.4	68.4
San Bernardino	188,000	38.2	33.4	65.2	60.8
Orange	419,000	42.5	38.9	61.0	58.8
Sacramento region	269,000	38.8	31.9	64.7	59.6
Sacramento	245,000	39.7	29.7	62.1	55.9
Placer	337,000	39.1	NA	72.3	NA
San Joaquin Valley					
Fresno	154,000	30.6	38.1	58.4	51.6
Kern	116,000	30.7	32.5	68.2	61.0
San Joaquin	242,000	36.5	38.0	63.8	62.7
Stanislaus	220,000	35.3	36.0	62.6	62.2
Tulare	116,000	33.5	35.1	60.2	59.6
Coastal area					
Monterey	426,000	51.6	37.9	56.8	50.1
San Luis Obispo	420,000	46.9	NA	56.5	NA
Santa Barbara	462,000	46.2	45.9	53.5	57.6
Santa Cruz	575,000	51.7	NA	59.7	NA
Ventura	394,000	40.6	35.0	67.8	69.0
San Diego region					
San Diego	386,000	43.2	40.7	56.6	52.4

Sources: U.S. Census Bureau, *American Community Survey, Multi-Year Profiles 2003* and *American Community Survey, Data Profiles 2000*.

Notes: All data in the table refer to specified owner-occupied units in 2000 and 2003. Specified owner-occupied units are defined by the Census Bureau as "total number of owner occupied housing units described as either a one-family home detached from any other house or a one-family house attached to one or more houses on less than 10 acres with no business on the property." NA indicates that data are not available for comparison. Regional totals are not available when the MSA does not correspond to the geographic area of the region. Owner costs represent "selected monthly owner costs" and are calculated from the sum of payments for mortgage, real estate taxes, various insurances, utilities, fuels, mobile home costs, and condominium fees.

However, despite the rise in homeownership rates recently, California continues to have one of the lowest rates of homeownership in the country.

of affordable housing in the state. In 2002, voters passed Proposition 46, a $2.1 billion bond, to increase the amount of affordable rental housing in the state and to provide funds to encourage homeownership. About 20 percent of the state's Proposition 46 funds have been directed to local public agencies for homeownership programs (California Department of Housing and Community Development, 2004). These programs include down payment assistance to low- and moderate-income first-time homebuyers.

Perhaps surprisingly, we do not find that California's latest run-up in housing prices has led to erosion of homeownership rates in the state. To the contrary, homeownership rates have risen as the increases in prices have been accompanied by record or near record sales volumes.[25] Young adults—those most likely to be shut out of owning a home in California—have experienced the greatest gains in homeownership over the past few years. Nor do we find a growing divide between homeowners and renters. The gap between renters and homeowners, at least with respect to income, is no wider in California than in the rest of the nation; in both cases, recent homeowners have just over double the household income of renters.

However, despite the rise in homeownership rates recently, California continues to have one of the lowest rates of homeownership in the country. The vast majority of renters in California aspire to homeownership, yet these Californians are not optimistic about their chances of finding a home they can afford. Moreover, they are pessimistic about the ability of government to find solutions to their housing needs (Baldassare, 2004).

What is new in the latest run-up of California housing prices appears to be the financial degree to which Californians are willing to go to buy a house and the willingness of financial institutions to accommodate that desire. Alternative mortgages, including interest-only adjustable rate mortgages, have allowed many to enter the market. High loan-to-income ratios have led to a greater financial burden with respect to housing in California than in any other state; that burden is particularly acute among recent homebuyers. Many have suggested that these practices place recent homebuyers in a vulnerable financial position. Some groups, such as limited-English speakers or isolated racial minorities, may be particularly at risk because they have less access to accurate information about key issues in the homebuying process (Fannie Mae, 2003). This lack of information best explains barriers to entry into the homeownership market, but it may also suggest that these groups may be unknowingly affected by fluctuations in the broader economy (e.g., increasing interest rates) and unprepared for sizable increases in future monthly payments for adjustable rate or interest-only mortgages.

Large numbers of new housing units provide more opportunities for homeownership. Developers have responded to the incentives of California's housing market by building more new housing units in the state from 2000 to 2004 than in any other five year period since the late 1980s. Still, the strong desire for homeownership among the state's relatively large number of renters suggests that California has a long way to go to meet the demand for a home of one's own. ◆

Notes

[1] The median sales price is reported by DataQuick Information Systems, a firm that collects information on residential real estate sales.

[2] The only non-California metropolitan area in the top 19 is Port St. Lucie–Fort Pierce, Florida. It is ranked 11th nationally for its appreciation increase from 2000 to 2005. These findings are based on authors' calculations of Office of Federal Housing Enterprise Oversight (OFHEO) House Price Index for Metropolitan Statistical Areas, comparing 1st quarter 2000 with 1st quarter 2005.

[3] These results are based on self-reported values of owner-occupied units. In the 2003 American Community Survey (ACS), a large survey conducted by the U.S. Census Bureau, median values in California were 334,000 and 325,000 in Hawaii.

[4] CAR (2005) reported that California's Housing Affordability Index fell to 16 percent in May 2005, a three point decline from May 2004. In its calculations, CAR assumes a 20 percent down payment, a 30 percent qualifying ratio, the median price for an existing home, and an "effective" mortgage interest rate of 5.71 percent. Thus, the affordability index may overstate the crisis in California's housing market today because it is based on historic lending practices. Historically, mortgage lenders assume a 30 percent qualifying ratio; that is, lenders will allow buyers to borrow an amount equal to 30 percent of their income. Evidence from California's market today suggests that lenders are willing to lend more money than the 30 percent qualifying ratio.

[5] The National Association of Home Builders and Wells Fargo (May 24, 2005) also estimate affordability rates for metropolitan areas in California and the United States. Because they use family income instead of household income, assume a 10 percent down payment, and assume that a family can spend no more than 28 percent of its income on housing costs (including mortgage, property taxes, and insurance), they generally find lower affordability rates than those reported by the California Association of Realtors. The regions of the state covered also differ in the two measures. The NAHB-Wells Fargo index for the 1st quarter of 2005 named the Bakersfield metropolitan area as the state's most affordable, with 39 percent of families there able to purchase the median-priced home (Kern County).

[6] Authors' calculations based on the 2003 ACS and the 2004 CPS.

[7] A householder is the person in whose name the housing unit is owned or rented. Each occupied housing unit has only one householder. If two or more people share ownership, only one is considered the householder. Results are based on authors' estimates derived from the 2004 March Current Population Survey. See the text box, "Identifying California's Most Recent Homebuyers."

[8] Authors' calculations based on the 2003 ACS. California's homeownership rate in 2003 according to the ACS was 58 percent.

[9] In California, seasonal or vacation homes account for a relatively small share of the housing market.

[10] Homeownership rates could give a false impression of the likelihood of owning a home, because the rate considers only householders (the person in whose name the housing unit is owned or rented) and not other residents of housing units. For example, if young adult renters move in with their parents, homeownership rates would increase for young adults, but the actual probability of owning a home for a young adult would not have changed. To ensure that the trends we observe toward higher homeownership rates are not due to such increases in household size, we estimate the probability that an adult owns a home. To calculate these probabilities, we consider the householder of each owned housing unit to be the owner. If the owner is married or has a domestic partner, the spouse or partner is also considered an owner. All other residents of the housing unit are considered nonowners. All occupants of rented housing units are considered renters. Calculations relating to estimation of these probabilities are available from the authors. They show that the probability of being a homeowner has increased just as homeownership rates have increased.

[11] Similarly, the probability of being a homeowner rose more for younger Californians than for older Californians.

[12] Myers (2001) found that increasing house prices in the 1980s and 1990s in the United States were associated with increased homeownership among young people.

[13] Authors' calculations based on the 2003 ACS.

[14] Recent homebuyers in California are much more diverse than in the rest of the nation, where 80 percent of recent homebuyers are non-Hispanic white.

[15] DataQuick Information Systems reports that almost one-third of California homebuyers had Hispanic surnames in June 2004, an increase from less than one-fifth of buyers in June 2002 (El Nasser, 2005).

[16] Authors' calculations based on the 2000 and 2003 ACS.

[17] Authors' calculations based on the 2003 CPS.

[18] Mortgage interest payments, loan points, and real estate taxes can be deducted from income taxes.

[19] Case, Shiller, and Quigley (2001) report that increases in housing market wealth have important effects on consumption. See also McCarthy and Peach (2004).

[20] Authors' calculations based on the 2003 ACS.

[21] The RFS probably understates the share of previous homeowners who used their previous home to help finance their more recent purchase. If the previous home sold more than a year before the survey, proceeds from that sale are considered cash.

[22] According to data compiled by LoanPerformance and reported by the *Los Angeles Times*, adjustable rate mortgages constituted more than 80 percent of all loans in the metropolitan areas of Santa Rosa, Oakland, San Diego, and Santa Cruz, and 74 percent in Los Angeles. About two-thirds of the loans were also interest-only (Streitfeld, 2005). Some of these interest-only loans will allow borrowers to pay principal as well.

[23] Among recent buyers in housing units that are not single-family detached dwellings, 37 percent purchased single-family attached dwellings, 34 percent purchased housing units in multiunit buildings, and 28 percent purchased mobile homes (authors' calculations based on the 2003 ACS).

[24] Unfortunately, the public use files of the ACS do not provide substate identifiers. Thus, we cannot develop our own tabulations for regions within the state. Here, we depend on tables prepared by the U.S. Census Bureau.

[25] Myers (2001) finds a similar pattern across the country in areas where housing prices have increased. He attributes this pattern to the investment incentive associated with expectations of continued strong housing price increases.

References

Baldassare, Mark, *Special Survey on Californians and Their Housing*, PPIC Statewide Survey, Public Policy Institute of California, San Francisco, California, November 2004.

California Association of Realtors, "C.A.R. Reports California's Housing Affordability Index Falls Six Points to 19 Percent in February," *Newsstand*, April 7, 2005, available at http://www.car.org/index.php?id=MzQ4MzE=.%20CAR.

California Department of Housing and Community Development, "Proposition 46 Housing Programs List," Sacramento, California, February 2004, available at http://www.hcd.ca.gov/index.html.

Case, Karl E., Robert J. Shiller, and John M. Quigley, "Comparing Wealth Effects: The Stock Market Versus the Housing Market," NBER Working Paper No. 8606, November 2001.

DataQuick Information Systems, "Bay Area Home Sales: Record Prices, Near-Record Sales," *DataQuick Real Estate News*, April 14, 2005, available at http://www.dqnews.com/RRBay0405.shtm.

DataQuick Information Systems, home sales reports, available at http://www.dqnews.com/RRMain.shtm.

El Nasser, Haya, "'New Urbanism' Embraces Latinos," *USA Today*, February 15, 2005.

Fannie Mae, Homeownership Database, compiled from decennial census data by Patrick Simmons, 2001, available at http://www.usc.edu/schools/sppd/futures/chfindex.htm.

Fannie Mae, "Understanding America's Homeownership Gaps: 2003 Fannie Mae National Housing Survey," available at http://www.fanniemae.com/global/pdf/media/survey/survey2003.pdf.

Freddie Mac, "Primary Mortgage Market Survey, Historical Monthly PMMS Data Tables," available at http://www.freddiemac.com/dlink/html/PMMS/display/PMMSOutputYr.jsp?year=2004.

Johnson, Hans P., and Joseph M. Hayes, *The Central Valley at a Crossroads: Migration and Its Implications*, Public Policy Institute of California, San Francisco, California, 2004.

Kleinhenz, R., "Repeat Homebuyers Dominate 2003 Market; Sellers Reap Record Gains," *Market Trends*, California Association of Realtors, January 2004.

McCarthy, Jonathan, and Richard W. Peach, "Are Home Prices the Next 'Bubble'?" *Federal Reserve Bank of New York Economic Policy Review*, December 2004.

Myers, Dowell, "Advances in Homeownership Across the States and Generations: Continued Gains for the Elderly and Stagnation Among the Young," Census Note 08, October 2001, available at http://www.fanniemaefoundation.org/programs/census_notes_8.shtml.

National Association of Home Builders and Wells Fargo, "NAHB-Wells Fargo Housing Opportunity Index (HOI)," May 24, 2005, available at http://www.nahb.org/page.aspx/category/sectionID=135.

National Association of Realtors, available at http://www.realtor.org/Research.nsf/Pages/MetroPrice.

Ruggles, Steven, Matthew Sobek, Trent Alexander, Catherine A. Fitch, Ronald Goeken, Patricia Kelly Hall, Miriam King, and Chad Ronnander, Integrated Public Use Microdata Series: Version 3.0 (Machine-readable database), Minnesota Population Center, Minneapolis, Minnesota, 2004, available at http://www.ipums.org.

Streitfeld, David, "They're In—But Not Home Free; Many Californians Have 'Interest-Only' Loans," *Los Angeles Times*, April 3, 2005.

Sutachan, Sara Chaloen, "Housing Market Paradox: Record Sales vs. Low Affordability," *Market Trends*, California Association of Realtors, December 2004.

U.S. Census Bureau, *Current Population Survey*, Washington, D.C., annual.

U.S. Census Bureau, *American Community Survey, Data Profiles 2000 for California*, available at http://www.census.gov/acs/www/Products/Profiles/Single/2000/ACS/CA.htm.

U.S. Census Bureau, *American Community Survey, Multi-Year Profiles 2003 for California*, available at http://www.census.gov/acs/www/Products/Profiles/Chg/2003/ACS/CA.htm.

U.S. Department of Housing and Urban Development, "Affordable Housing," May 2005, available at http://www.hud.gov/offices/cpd/affordablehousing/index.cfm.

ISSN #1554-401X

The Public Policy Institute of California is a private, nonprofit research organization established in 1994 with an endowment from William R. Hewlett. The Institute conducts independent, objective, nonpartisan research on the economic, social, and political issues affecting Californians. The Institute's goal is to raise public awareness of these issues and give elected representatives and other public officials in California a more informed basis for developing policies and programs. PPIC does not take or support positions on any ballot measure or on any local, state, or federal legislation, nor does it endorse, support, or oppose any political parties or candidates for public office.

PUBLIC POLICY INSTITUTE OF CALIFORNIA
500 Washington Street, Suite 800 • San Francisco, California 94111
Telephone: (415) 291-4400 • Fax: (415) 291-4401 • www.ppic.org

PUBLIC POLICY INSTITUTE OF CALIFORNIA
500 Washington Street, Suite 800
San Francisco, California 94111

In This Issue

Buying into the California Housing Market