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Monthly condensed analyses of crucial real estate and economic issues offered by the UCLA Anderson Forecast and UCLA Ziman Center for Real Estate. Here, UCLA Anderson Forecast Economist Jerry Nickelsburg looks behind the latest housing data to gauge the depth of the real estate rebound.

How Real Is California's Housing Recovery?

Coastal and Inland Areas Tell Two Different Stories

By Jerry Nickelsburg, Adjunct Professor of Economics, Anderson School of Management, and Senior Economist, UCLA Anderson Forecast

Recent news suggests a nascent recovery in California's housing might be near[1]. But, the aggregate data ought not to be read to say, "California housing is back!" The reason is that looking behind the data one finds a very mixed picture. There is solid evidence of a return of residential construction in California and at the same time solid evidence of considerable stress and stagnation in real estate markets over large swaths of the state. It all depends on where you look.

The aggregate California home price statistics are encouraging. Prices as measured by the FHFA Purchase Only index have risen the last 3 quarters and are now higher than any time since the 3rd quarter of 2010. The S&P Case-Shiller Index for San Diego, San Francisco and Los Angeles is the highest it has been since June 2011 and the median sales price is now the highest since 2008.

This appreciation can occur one of three ways: an increase in demand, a reduction in supply, or a change in the composition of what is being measured. If it is the first, then we should see an increase in home sales corresponding to the increase in demand. If it is the second, we should see a decrease in home sales as supply shrinks relative to demand. And if neither of those occurs, it is time to look at the composition of home sales.

In fact home sales are basically flat. Volumes moved up from January to May of this year, but that was just the normal seasonal increase. Since May volumes have been basically stagnant at about 40,000 units per month. One might argue that inventories are low and demand is increasing with the result that two are cancelling out in the sales figures, but it is hard to make that case over a 9-month period. The latest numbers for the Bay Area are indicative of a near-term reduction of offerings, however, the expectation is that the higher prices in September will induce an increase in inventory in the fall.

The remaining possibility is that the data do not fairly represent true market conditions. The same house sold as an REO, a short sale, or an owner-occupied sale will bring different prices due only to the fact that each represents the

1 Alejandro Lazo describes these signs in "Housing Market May Be On Rebound At Last," Los Angeles Times, April 25, 2012, and quotes California economists and real estate professionals as interpreting them as hopeful signs of a recovery with some associated risk.

house as a home in a different way. An REO is an empty house with foreclosure karma. The buyer has to imagine how it would work as a home as well. The short sale shows the house as a home, but is still tainted with foreclosure karma. In each of these cases buyers are willing to pay less and buyers are aware that the seller is a lien holder who will be more flexible in price on average than an owner/seller.

From January 2011 to August 2012 foreclosures as a fraction of the number of homes sold fell from 40% to 20%. The fraction of short sales also fell and in April of this year the median home sale ceased to be a distressed sale. Add to this a dash of normal springtime price appreciation and the price numbers are well explained.

For all of California these new lower levels of foreclosures are still high, near the peaks of the 1990s housing market slump. Significantly, that stress is much more concentrated in inland markets. Where there has been substantial job growth, for example in San Francisco, Santa Clara and San Diego counties, foreclosures are approaching more normal levels. A low level of distressed offerings admits more normal appreciation and presages the end of the slump in housing.

Moreover, demographic factors are also working in favor of a recovery in these coastal regions. During the Great Recession household formation dried up as the kids stayed home and out of work Californians doubled up. With two years of job growth, the kids are finally moving out, and are demanding multi-family housing. Rents in urban communities along the coast have risen steadily and apartment vacancies have fallen.

The pressure in the apartment market then explains the building data. Over the last nine months, multi-family housing permits, primarily for rental units, have increased to about 40% of the previous peak. Apartments are not reflected in home sales data, but robust apartment rent increases are a precursor to a return of condominium and single-family detached home sales and ultimately growth in residential construction.

Inland California, where home construction is traditionally a more important component of economic growth, has not experienced the same improvement. High unemployment, high foreclosures and considerable housing stress remain inland, and while tincture of time will be the curative, it is not as yet.

So looking behind the aggregate statistics that combine very different market data, one finds a mixed picture. California housing markets are both recovering and that recovery should accelerate, and they are still in the doldrums at the same time. The expectation is that the aggregate data should begin to reflect much stronger housing growth in the coming years, but as we look at the data we need to keep in mind that some local markets will not yet have come to the party.

Residential Housing Permits by Type

6 mo. monthly average, no. of permits