Weekly Real Estate Statistical Update

Up-to-date data on crucial California real estate trends from first tuesday

June 2, 2014 • Vol. 3 • Issue 22 • ***Purchasing power drives home prices***

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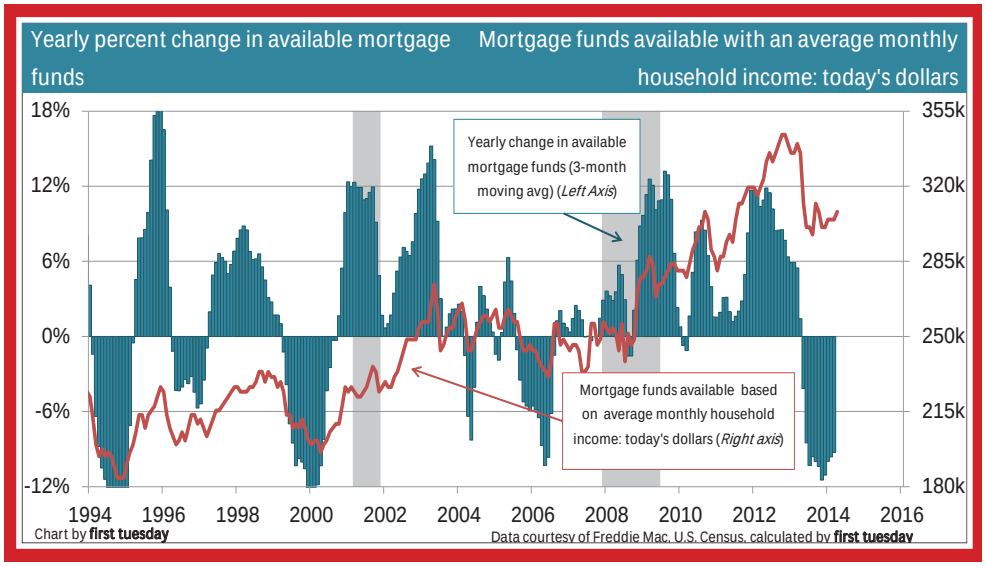
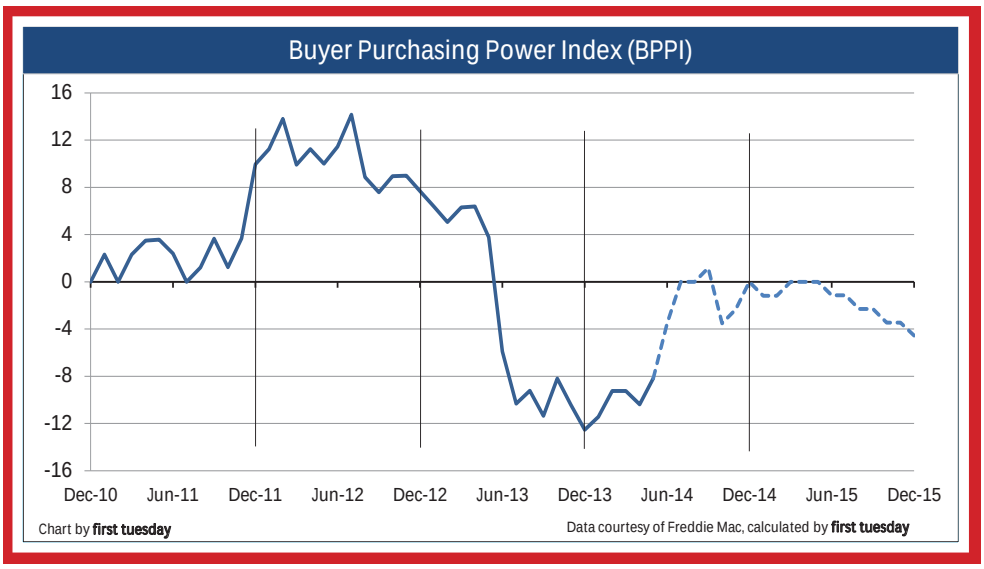
Mortgage money is limited and costly

This chart measures the year-over-year change in the amount of mortgage money available to a homebuyer, known as the **buyer purchasing power index (BPPI)**.

30-year **fixed rate mortgage (FRM) rates** in California averaged 4.15% in May 2014. One year earlier, the rate was 3.51%. As a result, the BPPI figure rose slightly to negative 8.17 in May. This translates to 8.17% less **mortgage funds available** to today's buyers compared to funds available to the same buyers one year earlier. In turn, the price buyers are able to pay for a home is reduced by an equal percentage.

Today's negative BPPI figure will return to zero mid-year if mortgage rates remain the same. Unless rates drop or income rises dramatically, downward pressure on future home pricing will be inevitable. Reports for March 2014 show home prices topping out after last year's steep, **unsustainable price growth**.





Buyer purchasing power in the red

This chart tracks the **BPPI**. The BPPI is based on the **30-year FRM rate** and California's **median income**.

As the BPPI rose to negative 8.17 in May from negative 10.38 in April, it was down from a positive 3.77 one year ago. The BPPI dropped sharply during the second half of 2013 due to the steep rise in mortgage rates which lingers today. In effect, **homebuyers** are able to borrow 8.17% less today than one year ago without an increase in their income to offset the rise in rates. Any increase in prices today over last year further aggravates the ability to buy a home.

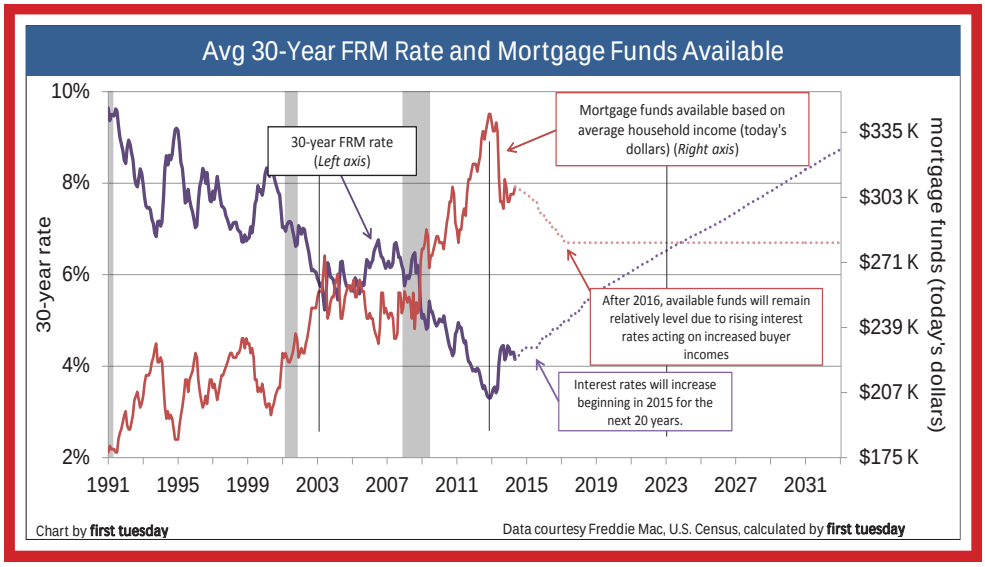
The BPPI will likely return to zero around mid-2014 due to level mortgage rates over the past 12 months. In 2015, the BPPI will continue a decades' long descent as mortgage rates rise with renewed growth in our economy. Sellers can expect **downward pressure on home prices**, as buyers will be able to borrow less over the coming decades with the same income.

Reduced ability to borrow will suppress home prices

This chart contrasts the average **30-year FRM rate** with the corresponding availability of total mortgage funds, stated in today's dollars.

Falling interest rates over the 30 years prior to 2013 artificially increased the mortgage funds available to buyers, driving up prices to the delight of sellers. As interest rates rise over the next 20-plus years, this principle will work in reverse. Downward pressure on prices will develop, flattening prices into the future.

Looking forward, FRM rates will remain at today's levels through 2015, then rise as the bond market leads the Federal Reserve's increase in short-term rates. This will usher in the attractiveness of **seller financing** and **adjustable rate mortgages (ARMs)** if sellers hold on to their sticky price delusions.



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