CALIFORNIA ASSOCIATION OF REALTORS®

S.H.I.F.T.

2018
State of the Housing Market

Study of Housing:
Insight, Forecast, Trends

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FOREW0RD

The tight supply issue that has been lingering on for years has finally turned into a demand issue. With the economy growing at a solid pace and new households continuing to form at the fastest pace in the last 10 years, home sales in 2018 were projected to increase from the prior year, despite an anticipation of interest rate hikes. The Tax Reform and Jobs Act passed at the end of last year was expected to have a negative impact on the supply and the demand of housing, but overall sales were still forecast to inch up from 2017. Up until April, the market performed in line with our prediction for the most part, and California was on track to have another year of gain in both sales and price.

Then something happened in May. Housing demand began to shrink as buyers became more cautious with their buying decision. Sales dropped on a year-over-year basis for four consecutive months and at a pace that warrants many to be concerned. Home prices continued to increase but at a decelerated pace. Housing supply, which had been declining consecutively for almost three years, bounced back, registering double-digit growth. All signs seem to suggest that the market is losing momentum, and that California is experiencing a sustainable slowdown.

A softening of the market is undeniably underway. The questions are how big of an impact the transition is going to have on the market and how long will it last. This report uses monthly transactional data and results from the Annual Housing Market Survey collected by the California Association of REALTORS® (C.A.R.) to get a better understanding of the current market conditions and to shed some light on how the ongoing transition might have affected home buying and home selling behavior. This analysis provides insights on how the market will adjust and where this **S.H.I.F.T** will take us.

KEY HIGHLIGHTS

- Home sales in California have hit some rough patches in recent months, and the latest fallout could be a sign of a sustained market shift. As of August, the market was down 2.1 percent compared to sales in the first eight months of 2017.

- Several factors contributed to the softening of the market: interest rate volatility, sales being pulled forward in anticipation of higher rates in the future, and the continuous constraints on housing supply. The erosion of affordability, however, is really what's driving the market.

- With housing affordability expected to deteriorate further, the lackluster performance in home sales will continue into 2019. While the economy will remain solid, the increase in housing demand will go unmet, as the erosion of affordability continues to leave potential buyers either unwilling or unable to buy.

- Home prices in California reached a new high. The statewide median price surpassed its prior peak set in May 2007 for the first time in May 2018 only to exceed it a month later with a new record high of $602,760. Despite setting a new high, the strong growth trend in prices may have already peaked. With inventory growing, the appreciation in home prices is softening and should continue to decelerate in the upcoming year.

- Results from the latest annual housing market survey indicate that housing affordability was the primary reason for 28 percent of homebuyers to move out of the county where they previously resided, an increase from 21 percent in 2017. The outmigration trend was worse in both the Bay Area and the Southern California region, with 35 percent of homebuyers moving out of the county in which they previously lived because of the housing affordability issue. Housing affordability was an even bigger problem for first-time buyers, as nearly half of them cited the issue as the main reason for their outmigration move.

- Despite tough market conditions, more first-time buyers continued to enter the housing market, and pushed the share of first-time buyers to 34.8 percent, which is the highest level since 2012. A stronger economy, more robust household growth, and an urge to get into the market before interest rates climbed further were some of the primary factors that contributed to a higher share of first-time buyers

- The first-time buyer market was more competitive when compared to the repeat buyer market, with 62 percent of all first-time buyer transactions receiving multiple offers, 40 percent having a sold price above the asking price, and properties typically staying on the market for 12 days.

- With fewer bargain properties being available on the market, investors' interest in the residential market dropped in the first half of 2018. In fact, the share of sales to investors declined to the lowest level since 2009. The declining trend of investor buyers will likely remain on course in the upcoming year as rent growth flattens and

KEY HIGHLIGHTS

(continued)

the uncertainty in rent control policy continues to mount.

- Market competitiveness varied between price segments. Properties in the upper mid-priced range — homes sold with a price between $750,000 and $1M — were the most sought after, as they were the most likely to receive multiple offers, the most likely to receive an offer with a price above the asking price, and sold the fastest.

- While tight supply in the housing market costs more on the buyers' side, sellers have been benefiting from the strong price appreciation resulting from the supply constraint. The median net cash gain to a typical seller resulting from a home sale in California remained unchanged from 2017 at $200,000, the highest level since 2006.

- Sellers have not been moving as often as in previous years, with a typical seller owning his/her home for 11.5 years before selling, the highest level in at least the last 38 years. The trend was especially obvious for older generations, as baby boomers typically owned their property for 15 years before selling, while the Silent Generation held on to their properties for 30 years before selling.

- The share of sellers who expressed interest in buying another property has been steady in the last four years and remained near the highest level since 2006. Millennials and Gen X sellers were the most interested in buying again, as nearly two-thirds of both generations said they planned to buy after selling their previous property.

- Nearly three of ten sellers who planned to purchase a new home decided to buy in a state outside of California, an increase from 28 percent in 2017. Declining housing affordability in recent years is one of the factors that resulted in the surge in sellers wanting to move to another state.

- Current conditions for the housing market and for real estate financing are healthier than the environment that we observed in the mid-2000s before the housing market started deteriorating. In general, more buyers in Q2 2018 were putting a bigger down payment on their home purchase, and there were fewer buyers with zero down payment. The share of buyers who used a second lien to finance their property also shrank significantly from the peak of the current housing cycle.

- C.A.R. projects that existing home sales in California will decline 3.2 percent in 2018 and drop 3.3 percent in 2019. Home prices will continue to rise this year, growing by a projected 7.0 percent in 2018, and a more moderate 3.2 percent in 2019.

HOUSING MARKET UPDATE

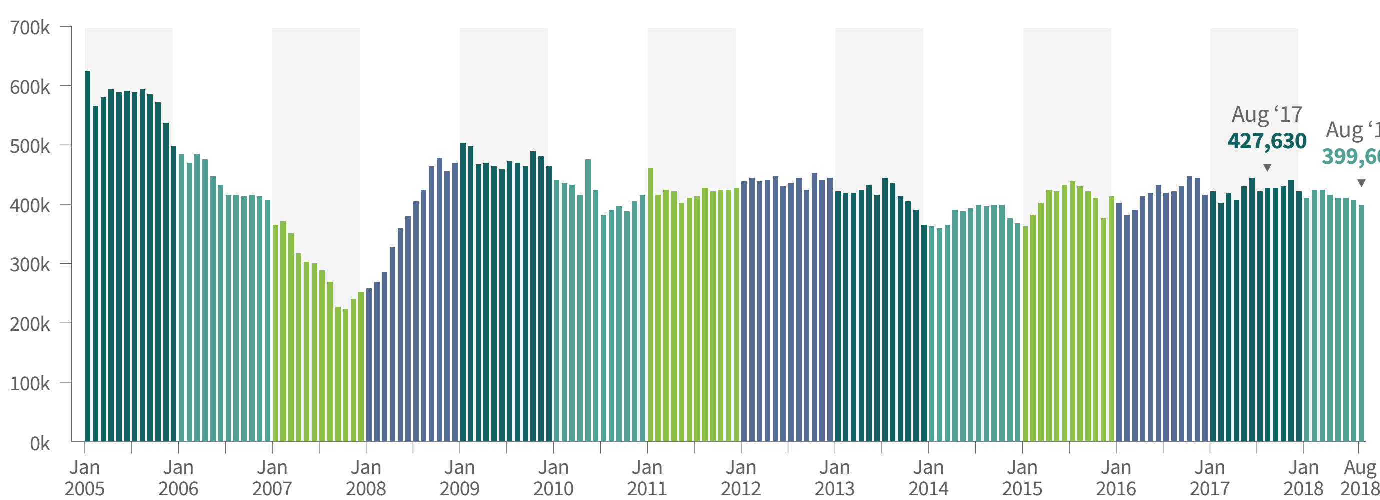
California home sales began to show some softening in recent months as sales of existing single-family homes declined year-over-year for the fourth consecutive month. August home sales dropped to the lowest level since March 2016, and sales at the state level declined 2.1 percent from 2017 after the first eight months of the year. Several factors contributed to the softening of the market: interest rate volatility, sales being pulled forward in anticipation of higher rates in the future, and the continuous constraint in housing supply. The erosion of affordability and market uncertainty, however, are really what's driving the market.

Home prices in California continued to rise in 2018. In May 2018, the statewide median price surpassed its prior peak set in May 2017 and followed up the next month with a new record high of $602,760. Strong price growth reflects the imbalance between supply and demand. With the economy growing at 3.2 percent in the first half of 2018, the number of new household formations in California continued to increase at the fastest pace since 2008. On top of that, many buyers rushed into the market to take advantage of low interest rates before they disappeared. Meanwhile, despite an increase in active listings, supply remained tight as new construction continued to fall behind the demand for housing. Consequently, prices remained elevated and continued to experience strong growth.

With the statewide median home price averaging an annual increase of 8.1 percent, the housing affordability index (HAI) — an indicator that measures the share of households that can afford to buy a median-priced home — continued its down-

Sales of Existing Single-Family Homes in California

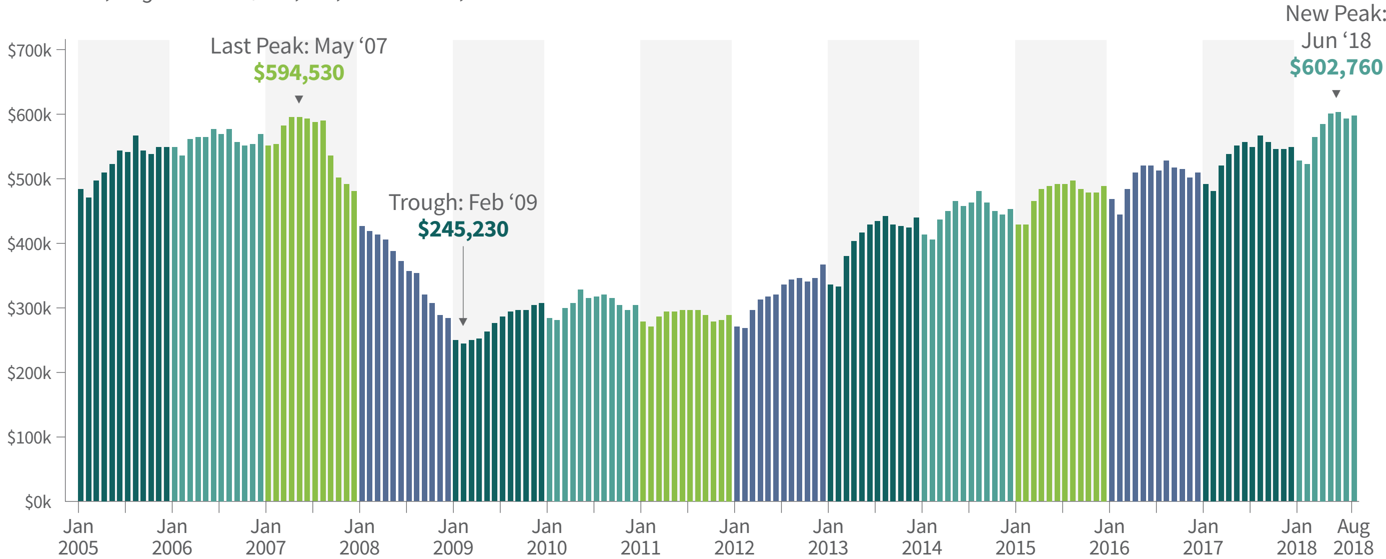
California, August 2018 Sales: 399,600 Units, -2.1% YTD, -6.6% YTY



HOUSING MARKET UPDATE

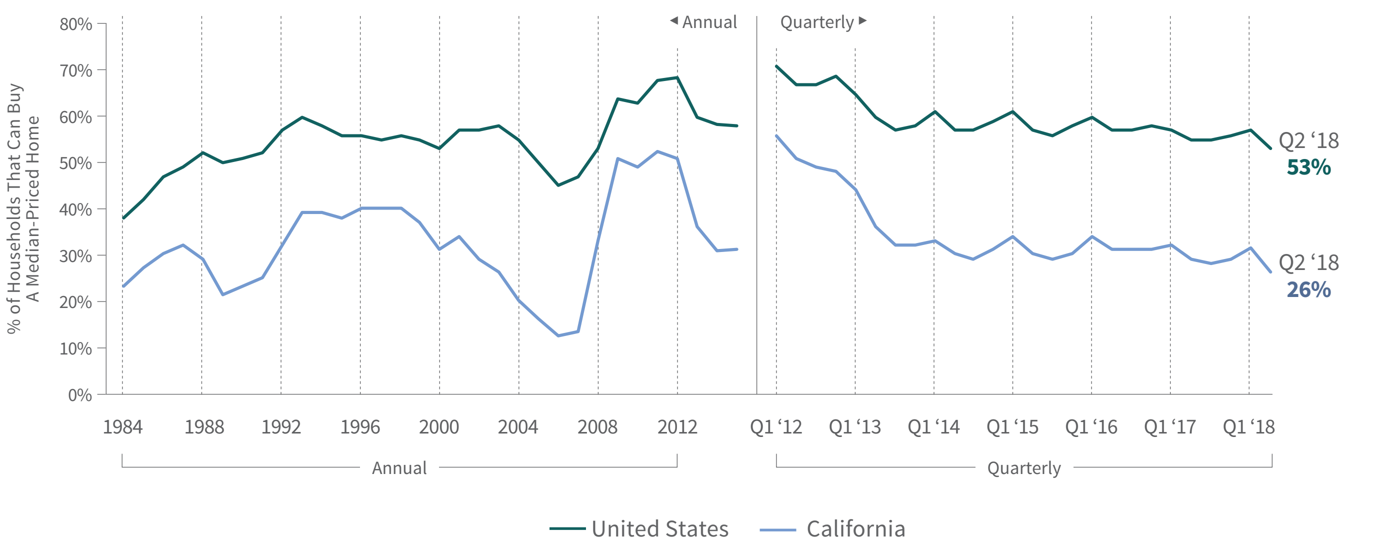
Median Price of Existing Single-Family Homes in California

California, August 2018: $596,410, +0.8% MTM, +5.5% YTY



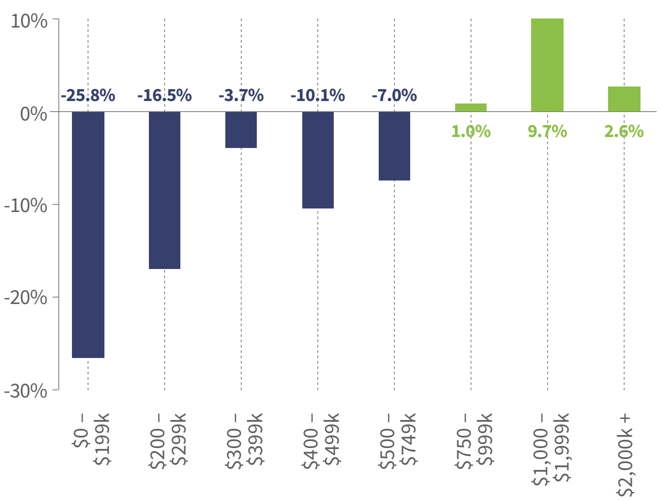
Housing Affordability Index

California vs United States, 1984-2018



Sales Took the Hardest Hit in the Lower to Mid-Tier Price Segments

August 2018 (Year-to-Year)



ward trend in the latest quarter. The state HAI, in fact, dipped to the lowest point since Q1 2008, dropping to 26 percent from 31 percent in Q1 2018, and from 29 percent in Q2 2017. Looking at it from the consumer perspective, the monthly mortgage payment (including taxes and insurance) for a median-priced home jumped 13.4 percent to $3,160 in Q2 2018 from $2,770 a year ago. The minimum income required to buy such a home also surged to $126,490 from $110,890.

While wage growth has made some decent progress this year, price appreciation combined with interest rate hikes continued to outpace gains in income. As such, housing affordability continued to erode and many potential buyers who could not keep up with price growth simply put their American Dream on hold, hoping that prices will come down eventually. Sales declined as a result, and the slowdown was especially obvious in the lower- to mid-tier price segments where affordability took the hardest hit.

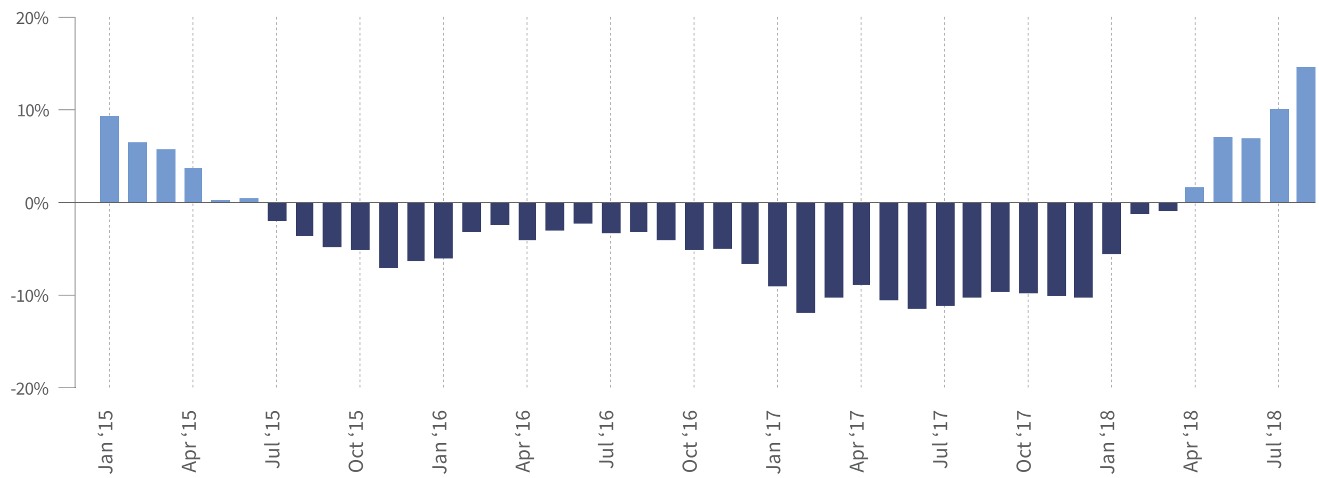
The softening of the market in recent months also reflects the mismatch in price expectations between buyers and sellers. Housing affordability may not be the primary reason that prevents all potential buyers from making the leap to buy, but some are unwilling to do so as they believe list prices in general are well above their market values. Buyers are being more cautious and reluctant to make a commitment as they are concerned that home prices may have peaked and may go down from this point on. This psychological effect is affecting homebuying decisions and putting buyers on the sideline. Instead of buying, they are waiting until there is more clarity in the market. Sellers, meanwhile, aren't voluntarily adjusting their list price as long as the market remains competitive. As home prices continue to climb while interest rates rise, the gap in price expectation between buyers and sellers widens. This mismatch is another reason for the sales decline as buyers and sellers are unwilling to come to the table to discuss the price difference. If prolonged, this could hold back housing demand further, and the weakening in home sales could linger on for a while longer.

Constrained supply has been an issue for California for years, but improvement finally came earlier this year. The state housing market reversed its 33-month long declining trend in active listings

HOUSING MARKET UPDATE

Active Listings

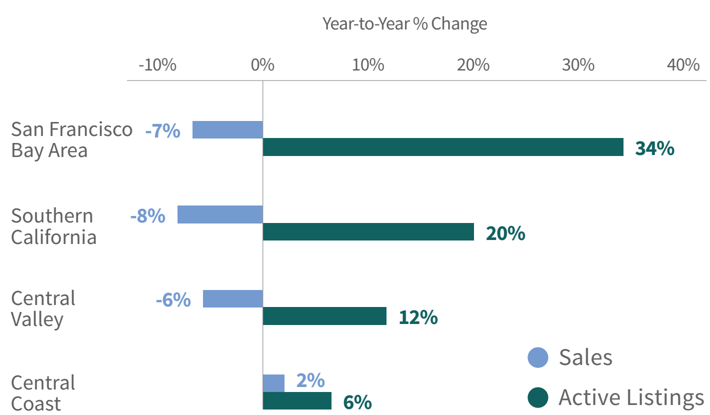
Year-over-Year % Chg



and has been rising since April 2018. The statewide active listings have been showing positive year-over-year gains for five consecutive months, increasing by more than double-digits in both July and August. With the overall supply condition improving at the fastest pace in nearly four years, all price categories above $200,000 had more inventory than a year ago as of August 2018. At the regional level, unsold inventory was up across the board, with the largest increase in the Bay Area, but the Southern California and Central Valley regions also surged when compared to last year.

Change in Active Listings by Region

August 2018

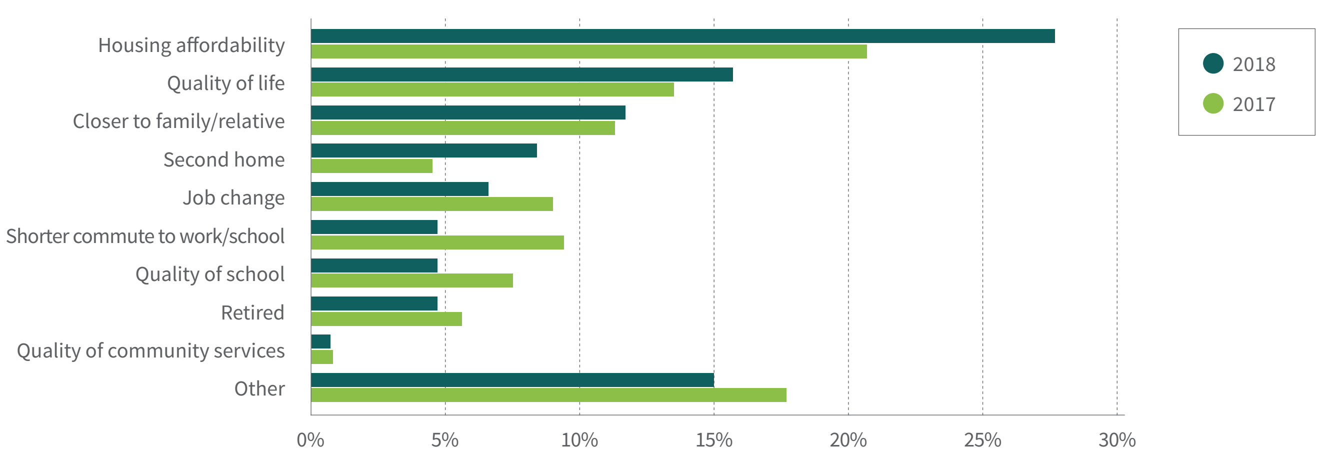


HOUSING AFFORDABILITY AND OUTMIGRATION

Housing affordability will remain a primary concern for the California housing market as home prices are expected to increase modestly in 2019. With interest rates expected to rise further in the upcoming year, housing affordability will likely decline in 2019. Housing affordability has been declining since it reached its peak in the first quarter of 2012, and has reached a level last seen in early 2008. While it is still higher than what we observed in 2007 when only 11 percent of households could afford to buy a median-priced home, the problem will only exacerbate further when home prices and interest rates continue to rise.

Many will move out of their current county or even the state if they cannot afford to live there. In fact, outmigration is already taking place and has been an ongoing movement for quite some time. Results from the latest annual housing market survey indicate that housing affordability was the primary reason for 28 percent of homebuyers moving out of the county where they previously resided, an increase from 21 percent in 2017. The outmigration trend was worse in the Bay Area where housing was the least affordable, with 35 percent of homebuyers moving out because of constrained affordability. Southern California did not fare much better, as the same percentage of buyers in the region moved out of their county for the same reason, a significant increase from 21 percent in 2017. This surge in the number of buyers who left their counties is a reflection of the slowdown in housing demand in the region. Sales activity in Southern California, indeed, declined nearly 5 percent from last year for the first eight months of 2018, and has been decreasing more severely than other major regions in the state. The problem is not going to get better any time soon as home prices and interest rates will likely remain on an upward trend in the upcoming year.

Primary Reasons for Changing County (All Buyers)

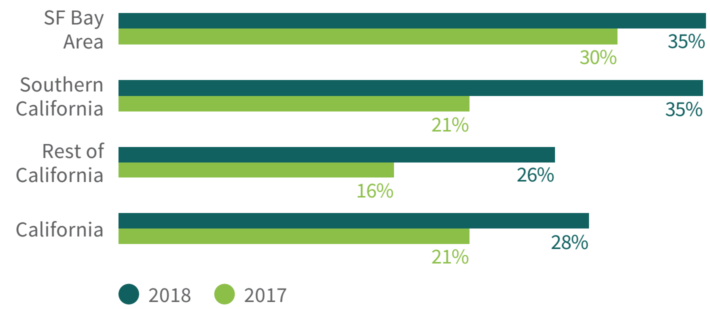


HOUSING AFFORDABILITY AND OUTMIGRATION

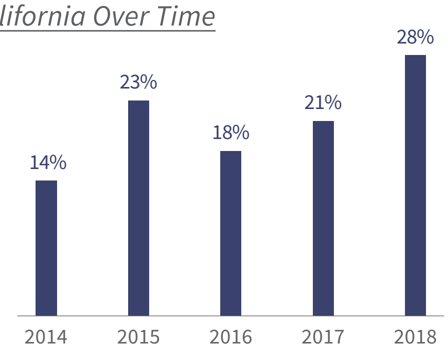
Housing affordability is an even bigger problem for first-time buyers as nearly half of them cited the issue as the main reason for their outmigration move. They were more likely to feel the "pain," partly because most of them purchased in price segments where housing supply was the most constrained. Sixty-one percent of all first-time buyers purchased a home in the price segments $300,000 - $500,000 and $500,000 - $750,000, which were the markets with some of the lowest inventory levels in Q2 2018. As such, these price segments were also the most competitive across all price ranges. The first-time buyer/entry-level market, indeed, was more competitive when compared to the repeat buyer market:

- 62 percent of all first-time buyer transactions received multiple offers, as compared to 53 percent of all repeat buyer transactions
- 40 percent of all first-time buyer transactions had a sale price above the asking price, as compared to 30 percent for all repeat buyer transactions
- Properties purchased by first-time buyers typically stayed on the market for 12 days, as compared to 14 days for properties purchased by repeat buyers

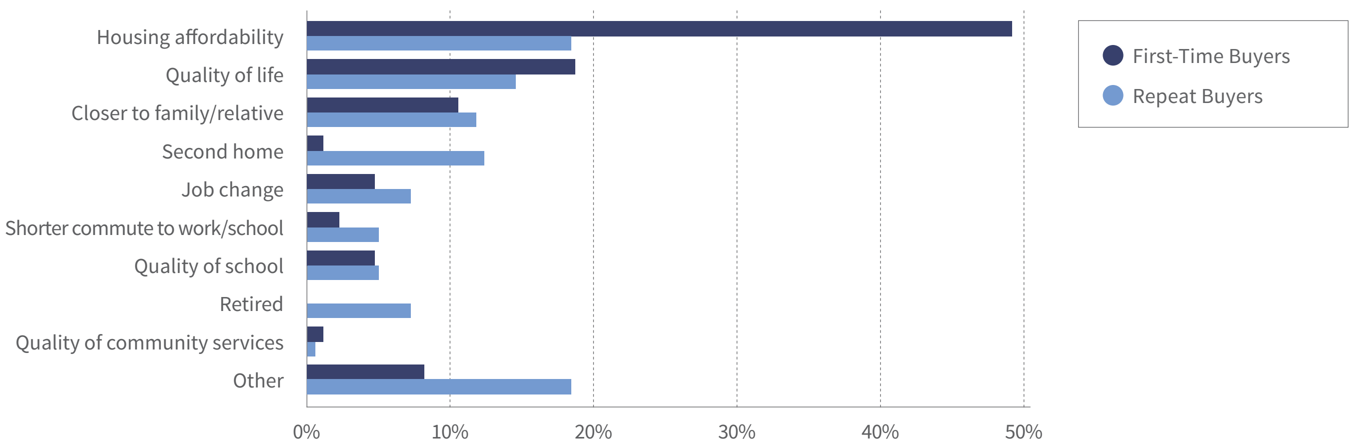
% of Buyers who Changed County Because of Housing Affordability – By Region



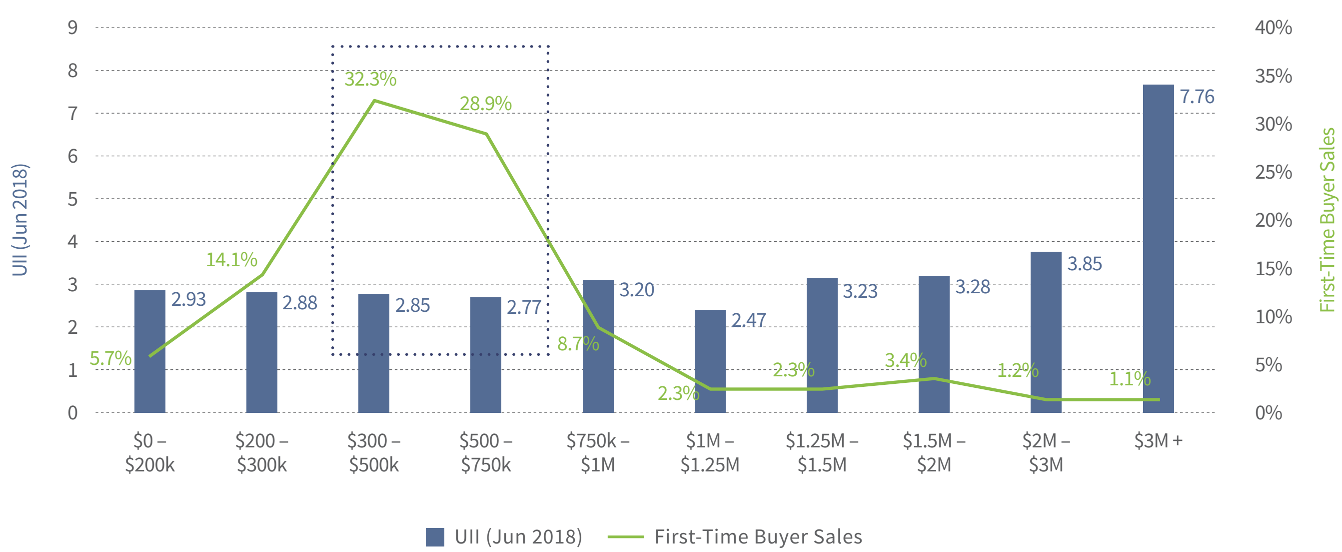
% of Buyers who Changed County Because of Housing Affordability – California Over Time



Housing Affordability Is a Bigger Problem for First-Time Buyers – Reasons for Changing County



First-Time Buyers Purchasing in Supply Constraint Price Segments



HOW DID FIRST-TIME BUYERS DO IT?

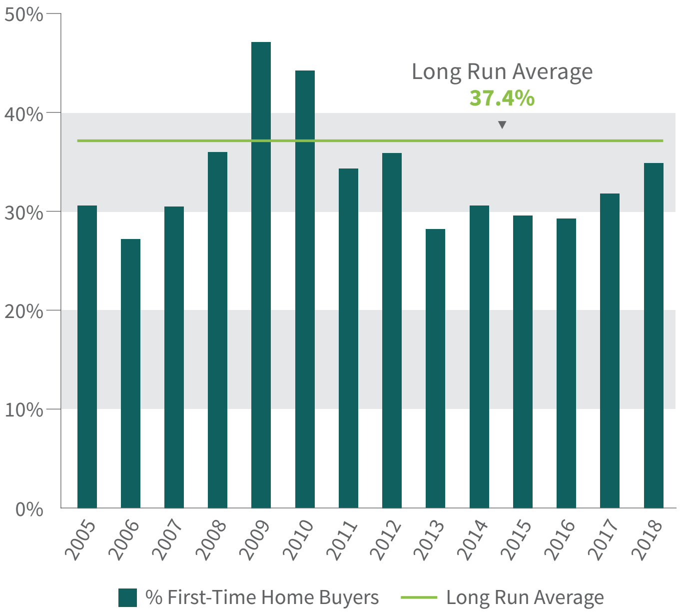
Despite tough market conditions, more first-time buyers continued to enter the housing market, pushing the share of first-time buyers to 34.8 percent, the highest level since 2012. A stronger economy, more robust household growth, and concerns over interest rates rising further were some of the primary factors that contributed to an increasing number of buyers entering the housing market for the very first time.

While home prices continued to increase, first-time buyers were able to get into the market by borrowing more. With only a small down payment available for their home purchase, many first-time buyers opted to finance with an FHA loan, which often requires a smaller down payment than a conventional loan. The number of first-time buyers who financed with an FHA loan was much higher than that of repeat buyers. In fact, it was more than triple the share of repeat buyers in 2018. First-time buyers were also more likely to finance their home purchase with a second mortgage than repeat buyers.

To cope with their affordability constraints, first-time buyers also had to make compromises on the size and the type of their new home. They typically purchased a house that was 363 sq. ft. smaller than what repeat buyers purchased. With low housing affordability a large factor, the size of a typical entry-level home was smaller, dropping from 1,541 sq. ft. in 2015 to 1,458 sq. ft. in 2018. More first-time buyers also opted to purchase a condo or a town home in recent years, as they are generally more affordable when compared to a single-family home.

While first-time buyers continued to take on more risks than repeat buyers to finance their home purchases, their exposure to financial risks has been reduced substantially since the last cyclical peak in 2006. Many first-time buyers overleveraged back then by putting zero down payment, taking on more debt with a second loan, and financing with risky mortgage instruments that they might not have fully understood. The landscape for mortgage finance is different today when compared to a decade ago, and while loan standards in recent years are considered too tight by many, first-time buyers under the current lending environment are exerting more discipline on themselves and managing their financial risks more wisely than before.

Share of First-Time Buyers



First-Time Buyers and Repeat Buyers' Financial Profile I

	First-Time Buyers	Repeat Buyers	All Buyers
Median Household Income	$100,000	$150,000	$120,000
Median Monthly Mortgage Payment	$2,265	$1,644	$2,000
Median Downpayment (in $$)	$36,500	$120,000	$78,000
Median Downpayment (in % to Price)	9.2%	20.0%	18.0%

First-Time Buyers and Repeat Buyers' Financial Profile II

	First-Time Buyers	Repeat Buyers	All Buyers
% of Buyers with Zero Down Payment	9.2%	5.7%	7.3%
% of Cash Buyers	7.1%	32.2%	22.9%
% of Home Buyers with a Second Mortgage	6.6%	2.7%	4.2%
% with FHA Loan	23.7%	6.3%	13.4%

Characteristics of Homes: First-Time Buyers and Repeat Buyers

	First-Time Buyers	Repeat Buyers	All Buyers
Median Sales Price	$475,000	$649,000	$570,000
Median Square Footage	1,458	1,821	1,690
% of Detached Single-Family	72.2%	78.8%	76.4%
% of Condo/ Townhome	22.0%	13.5%	16.4%

First-Time Buyers Reduced Their Exposure to Financial Risks Since 2006

	2006	2017	2018
% of Buyers with 20% or More Down Payment	23.9%	26.2%	27.2%
Median Downpayment (% To Price)	2.4%	7.4%	9.2%
% of Buyers with Zero Down Payment	40.9%	10.2%	9.2%
% of Cash Buyers	3.3%	6.7%	7.0%
% of Home Buyers with a Second Mortgage	62.8%	5.9%	6.6%
% of Buyers with ARM	38.1%	4.4%	4.0%

INVESTORS ARE STALLING

First-time buyers often have to compete with investor buyers, who purchase properties with similar size, location, and price point. With a higher household income and the capability of putting a bigger downpayment, investor buyers have the financial advantage over first-time buyers, making it very difficult for first-time buyers to win in a bidding war.

A typical investor buyer in Q2 2018 went after properties in the 1,400s sq. foot range and a price tag between $400,000-$500,000. They preferred to purchase in a major metropolitan area, which is where many first-time buyers choose to buy as well. Investors were less likely to purchase a condo or a townhome than first-time buyers, due partly to the additional cost incurred and the complexities of dealing with homeowners' associations. They might also prefer to buy a single-family home to avoid any mortgage finance complications.

With home prices rising high and surpassing the previous record this year, fewer bargain properties are available on the market. As such, it is not a surprise to see a slight drop in investor interest in the residential market in 2018. In fact, the share of

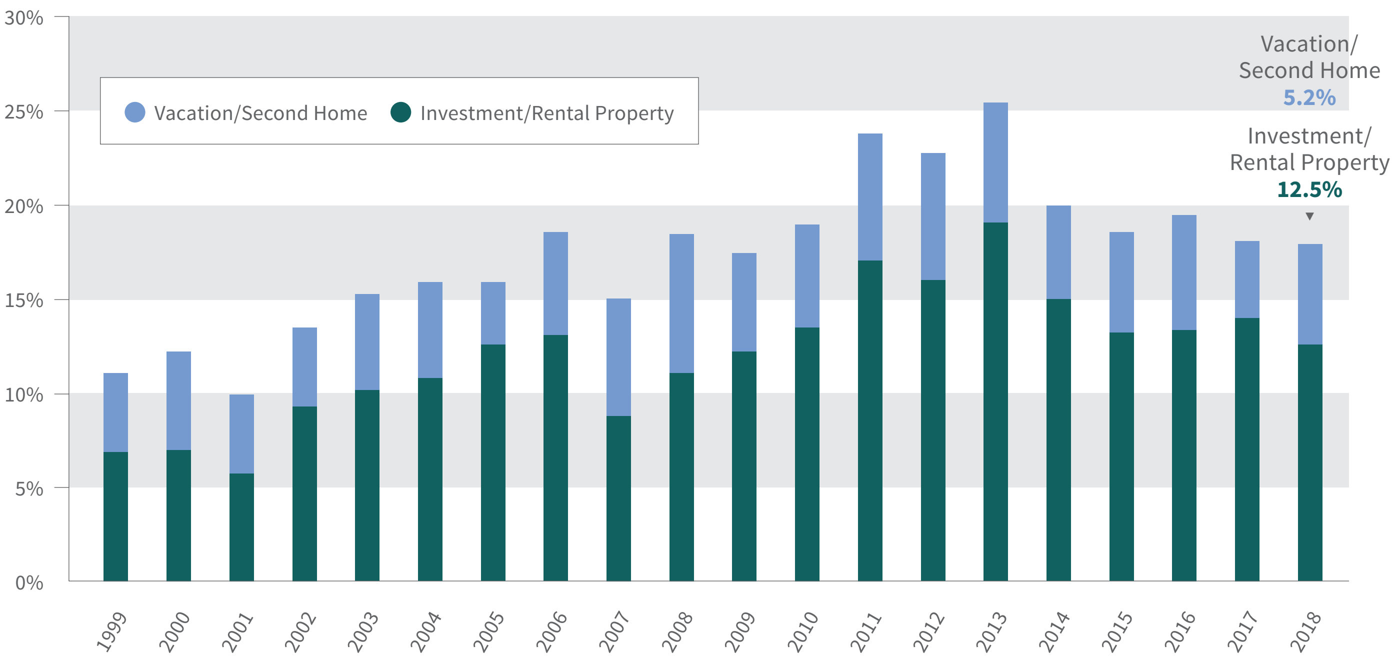
First-Time Buyers and Investor Buyers' Financial Profile

	First-Time Buyers	Investor Buyers
Median Household Income	$100,000	$150,000
Median Downpayment (in $$)	$36,500	$113,000
% Paid All-Cash	7.1%	56.3%

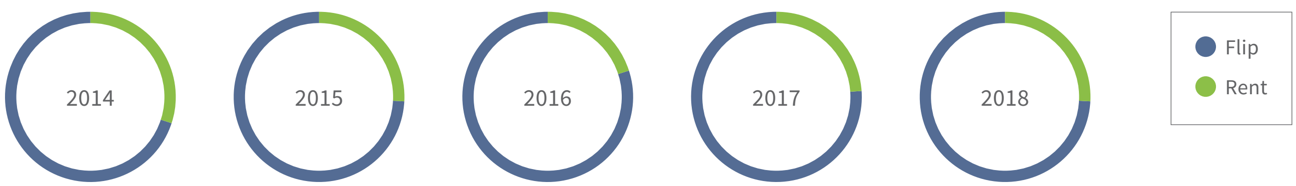
Characteristics of Homes: First-Time Buyers vs. Investor Buyers

	First-Time Buyers	Investor Buyers
Median Sales Price	$475,000	$442,000
Median Square Footage	1,458	1,400
% of Condo/Townhomes	22%	12.2%

Investor Share of Total Sales



Investors Buying as Rental vs. Flip



sales to investors has dropped to the lowest level since 2009. While the number of investors in California is still a tad higher than the long-run average of 12 percent going back to 1999, it is below the average of 14.5 percent of the last 10 years.

Investors purchased a property to either rent out for a long-term gain or flip for a quick profit. Nearly three quarters of those who purchased a property as an investment planned to use it as a rental unit. With the economy steadily growing in the past few years, there has been an increase in renters as more new households have been formed. Rental rates have been increasing as a result and have generated more investor interest in rental properties since the beginning of this decade. But as home prices continued to rise in the last couple years, the profit margin for investors has been squeezed, and might have prompted a slowdown in the purchase of investment properties in recent years.

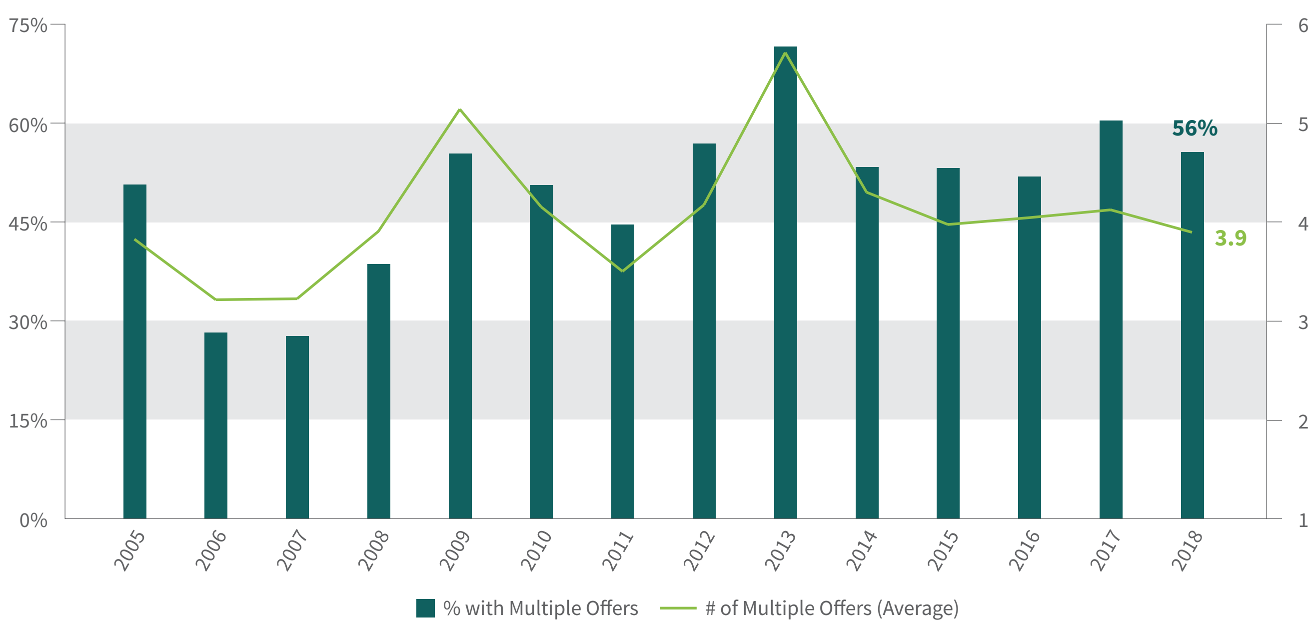
In addition, while rents are still increasing, the growth rate has been slowing down in the past couple of years. This may explain why there have been fewer investors purchasing properties as rentals since the share peaked in 2016. Going forward, the declining trend of homebuyers purchasing their property as a rental unit will likely continue, as rent growth flattens and the uncertainty in rent control policy continues to mount.

MARKET REMAINS COMPETITIVE DESPITE SUPPLY IMPROVEMENT

Despite the improvement in supply in recent months, housing inventory remains tight and below the long-run average. The market has cooled off from last year and is expected to soften further in the upcoming year. It was, however, still competitive in the first half of 2018, even though it was not as fierce as before. One way to measure the level of competitiveness is to look at the share of homes sold with multiple offers. Results from the latest C.A.R. Annual Housing Market Survey (AHMS) indicate that 56 percent of all home sales in Q2 2018 received multiple offers. While it was a decline from 2017, it was still the second highest in the last five years. On average, a California home sale received 3.9 offers in the second quarter, a decline from 4.1 in the same quarter in 2017. It is consistent with the 20-year long run average of 3.9, but is the lowest level observed since 2011.

Home prices continued to show robust growth in the first half of 2018 because of strong market competition. A desirable property often leads to a bidding war between buyers, and many properties end up selling at a price higher than their asking price when the housing supply is tight. As our survey results indicate, one-third of all home sales

% of Sales with Multiple Offers & Average # of Offers



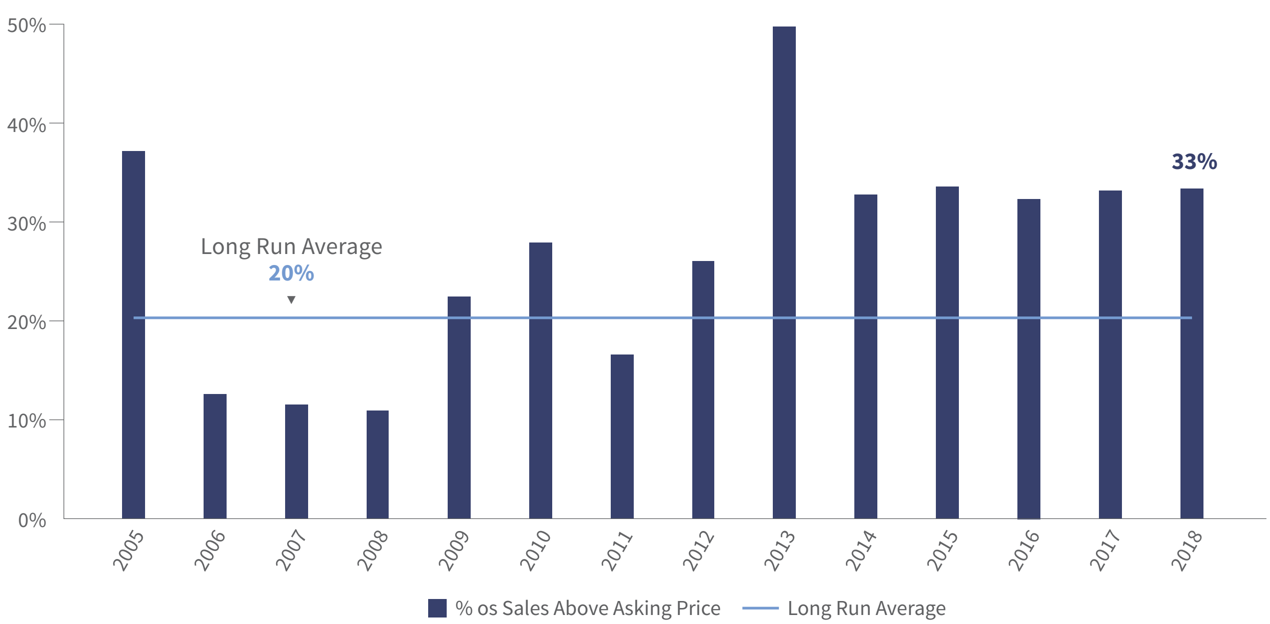
were sold above their asking price, a much higher percentage than the long-run average recorded since the early 1980s. Meanwhile, properties typically stayed on the market for two weeks, a slight increase from last year, but still the second shortest time on market in the last five years. In fact, over a quarter (29%) remained on the market for only one week or less.

While the tightness in housing supply differs by price range, market competitiveness also varies between price segments. Properties sold in the upper- mid-priced range —between $750,000 -$1M - were the most sought after, as they were the most likely to receive multiple offers, most likely to receive an offer above the asking price, and sold the fastest. Overall though, the market competitiveness has clearly cooled down from a year ago, as reflected by fewer homes getting multiple offers in 2018. This is another sign that the California housing market is softening, and the slowdown is expected to continue in the upcoming year.

Market Competitiveness Differ by Price Range

	% with Multiple Offer	% of Sales Above Asking Price	Days on Market
Lower Priced Range ($0 -$300k)	45.3%	16.7%	15
Lower Mid-Priced Range ($301k - $500k)	56.8%	25.4%	11.5
Mid-Priced Range ($501k - $750k)	57%	35.6%	15
Upper Mid-Priced Range ($751k - $1000k)	74.3%	50.5%	10
Upper Price Range ($1001k and up)	62.2%	43.5%	12
All Prices	55.6%	33.2%	14

% of Sales with Sold Price Above Asking Price

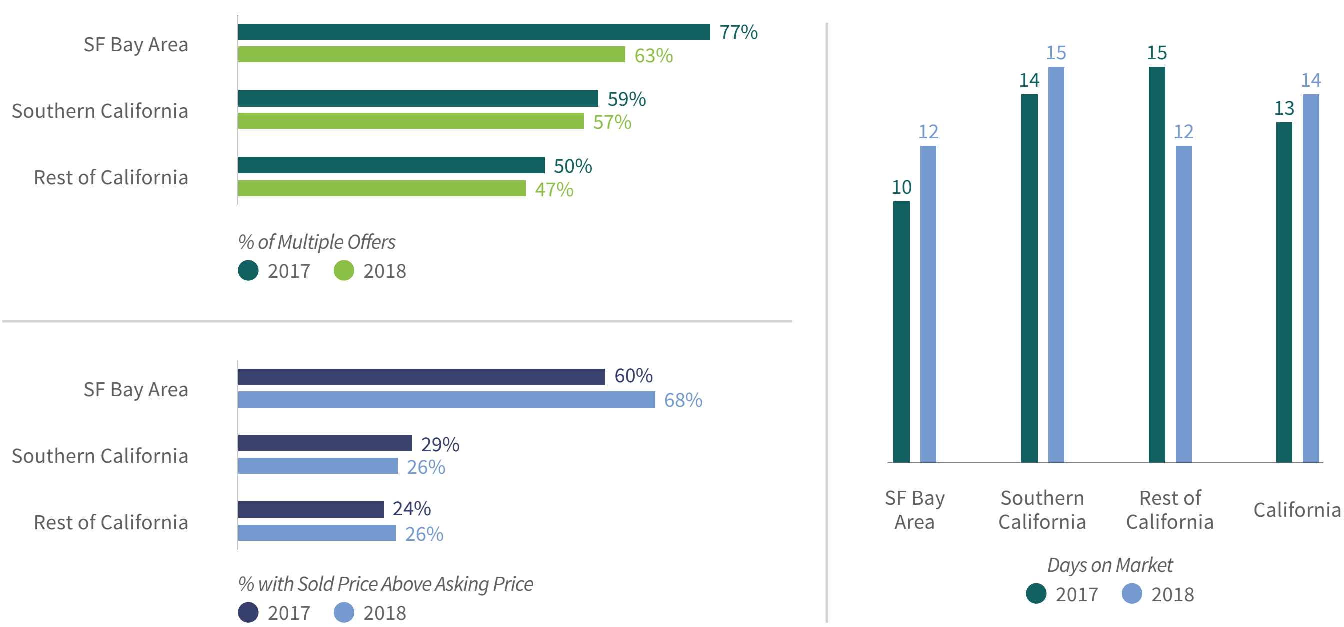


MARKET REMAINS COMPETITIVE DESPITE SUPPLY IMPROVEMENT

One would have thought the lowest price segment, where inventory had the steepest drop in the last couple of years, would be the most competitive market. According to the survey results, however, this price segment had the fewest multiple offers amongst all price ranges, stayed on the market the longest, and had the smallest share of sales above the asking price. A closer examination of the results indicates that many of the properties in the lowest price range were in areas further away from major metropolitan areas. In other words, they were in areas where the housing supply was not as tight and the housing demand was not as strong. As such, the level of market competition in this price range may not be as bad as previously thought.

So, how competitive are the housing markets in those major metropolitan areas? With the lowest unemployment level in the state, the San Francisco Bay Area has the fastest growing economy among the three major regions in California. It is, however, also the area with the fewest number of housing units for sale. While active listings in the region has improved and increased 34 percent year-over-year in the late summer of 2018, unsold inventory was only at 2.3 months, which was well below the state's long-run average of 5.7 months.

Market Competitiveness Differ by Region



Seven of the nine counties in the region, in fact, have inventory below 3 months as of August 2018. Because of its lack of inventory, the Bay Area was also the most competitive market in the state with:

- 63 percent of homes sold in the region receiving multiple offers, as compared to 57 percent in Southern California and 47 percent in the rest of the state
- 68 percent of the sold properties receiving a final sale price higher than the asking price, as compared to 26 percent in Southern California and 26 percent in the rest of the state
- A median number of days on market for a property listed in the region at 12 days, as compared to 15 days in Southern California and 12 days in the rest of the state

While not as severe as the Bay Area, Los Angeles, Orange, San Diego counties — Southern California counties where housing supply is the most constrained — were the most competitive in the region. Collectively, they had a higher share of sales with multiple offers than the Inland Empire. Properties in Los Angeles, Orange, and San Diego counties also stayed on the market for fewer days on average when compared to those in the Inland Empire. Fewer days on market and more homes receiving multiple offers suggest that there is not only a difference in market competitiveness between the North and the South, but there is also a difference between the coastal counties and the inland counties.

Market Competitiveness Differ Even Within Southern California

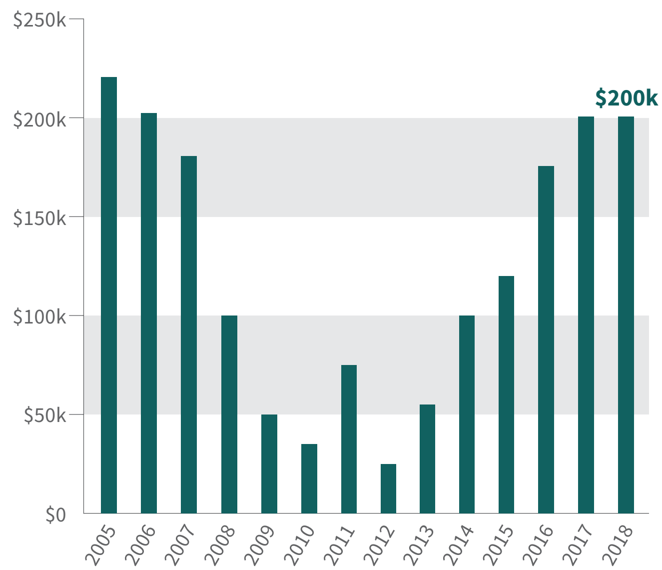
	% with Multiple Offer	% of Sales Above Asking Price	Days on Market
Inland Empire	44.1%	14.4%	17
LA / OC / SD	62%	31.3%	14
Southern California	56.5%	26%	14
California	55.6%	33.2%	13

SELLERS GAINED FROM PRICE GROWTH, BUT MANY STAYED PUT

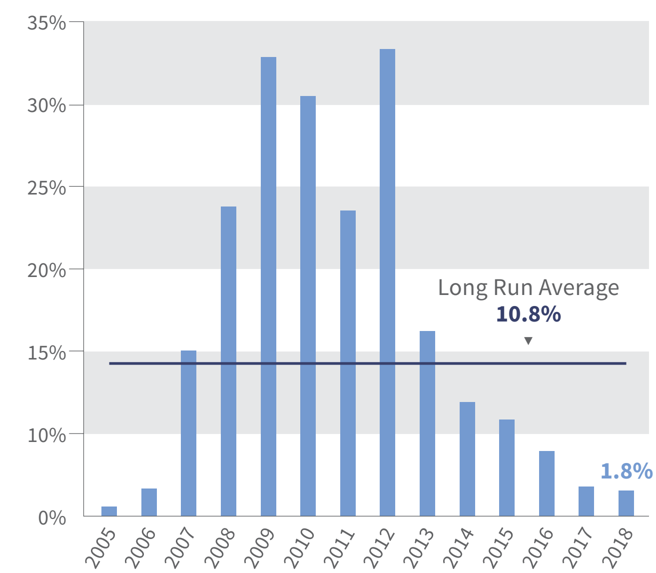
While the imbalance between supply and demand in the market means buyers are paying higher prices, sellers have been benefiting from the strong price appreciation resulting from the supply constraint. The median net cash gain to a typical seller remained unchanged from 2017 at $200,000 and continued to stay at the highest level since 2006. At the regional level, sellers who lived in the Bay Area had the highest net cash gain of $380,000, followed by Southern California with $200,000, and the rest of California with $110,000. Meanwhile, sellers who sold with a net cash loss dropped for the sixth consecutive year from 2.1 percent in 2017 to 1.8 percent in 2018, the lowest level in the last 12 years. It has been below the long-run average of 10.8 percent for the fifth year in a row.

While homeowners may have gained some equity due to the run-up in home prices in recent years, many of them are staying put and are not selling their properties. Recent statistics from the Census American Community Survey and C.A.R. research show that the turnover rate has been downward trending for years, with the turnover rate reaching 4.6 percent in 2016, significantly below the level of 9 percent observed in the late 70s. Results from our Annual Housing Market Survey also show that sellers have not been moving as often as in previous years, with a typical seller owning his/her home for 11.5 years before selling, the highest level in at least the last 38 years. The trend is especially obvious for older generations as Baby Boomers typical-

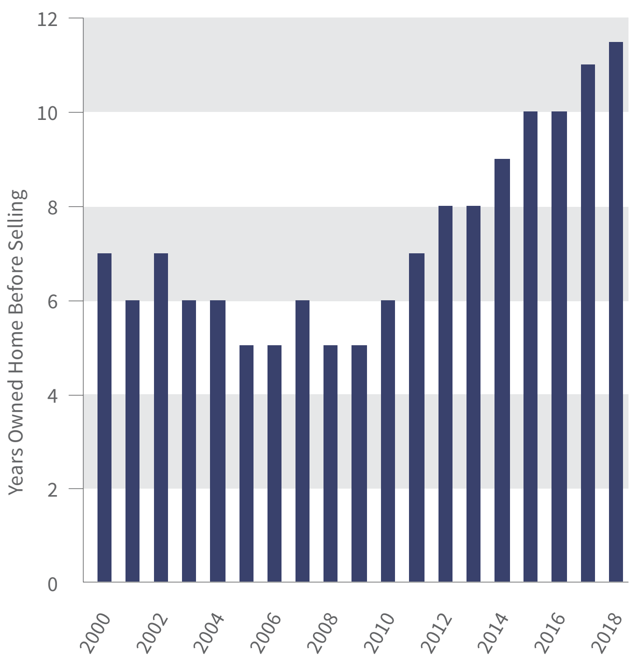
Net Cash Gain for Sellers



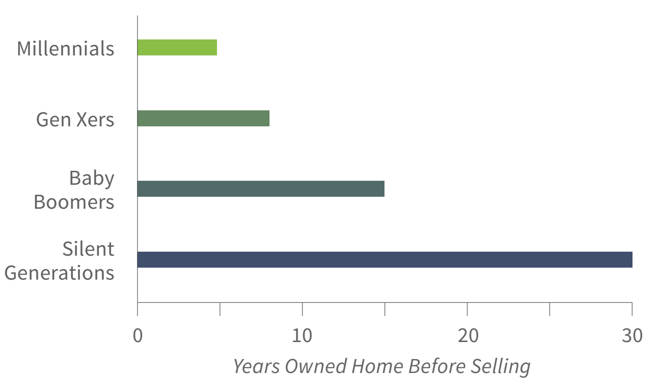
% of Sellers with a Net Cash Loss



Sellers Not Moving as Often



Older Generations Don't Move as Often



ly owned their property for 15 years before selling, while the Silent Generation held on to their properties for 30 years before selling.

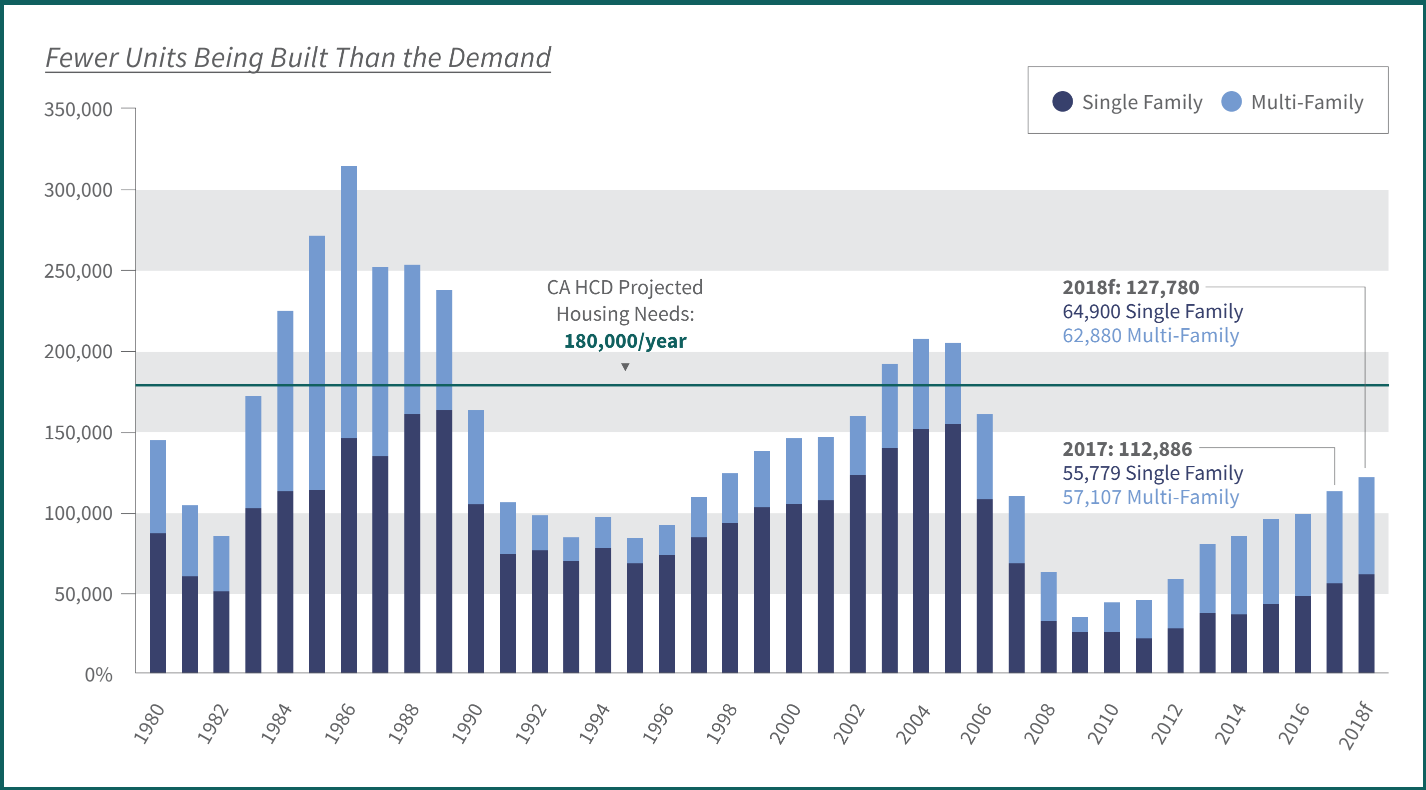
Fewer housing units being turned over in recent years is one of the primary reasons for the housing supply shortage. Homeowners are no longer moving as often as they were in the past, and there are several factors at play behind this current trend:

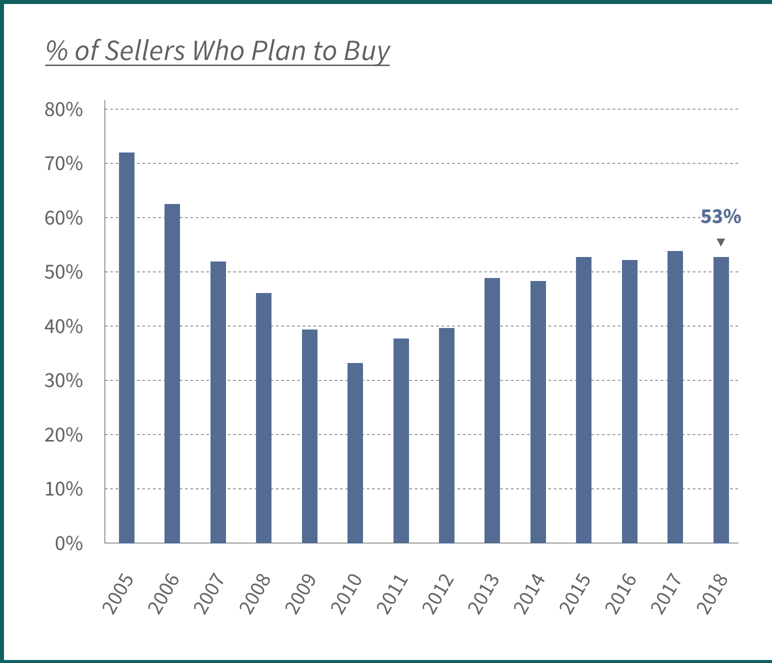
- **Demographic shift.** Baby Boomers, the largest homeowning cohort, are aging into the years of 55+, which is an age group that typically does not move as much as those who are in their 20s, 30s, and 40s. With an increasing number of Boomers not selling their home, fewer housing units are being turned over, resulting in a constant shortage of supply in the last few years.

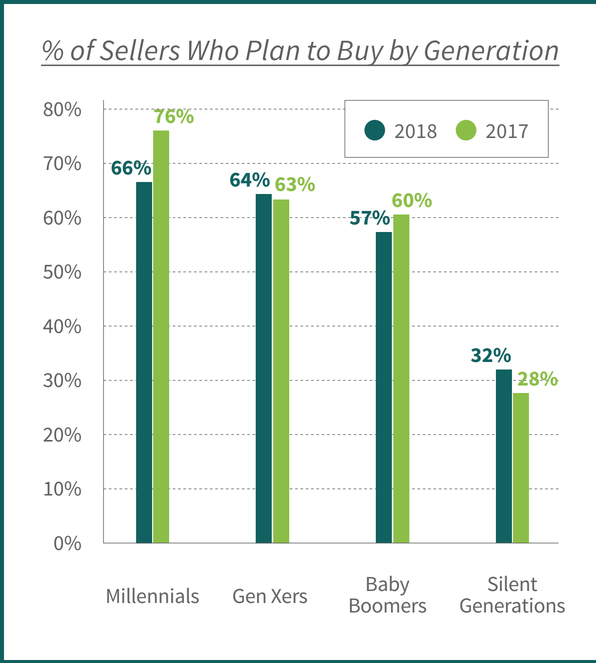
- **Lock in effect.** Many homeowners locked in their fixed-rate mortgages at a low level when rates hit bottom in 2013 and do not want to sell now because they would have to pay a higher rate if they were to buy another property.

- **Financial reasons.** Homeowners do not want to sell as they likely would end up paying a higher property tax if they were to move to a higher-priced home, and the capital gains tax for the home sold could be substantial for some.

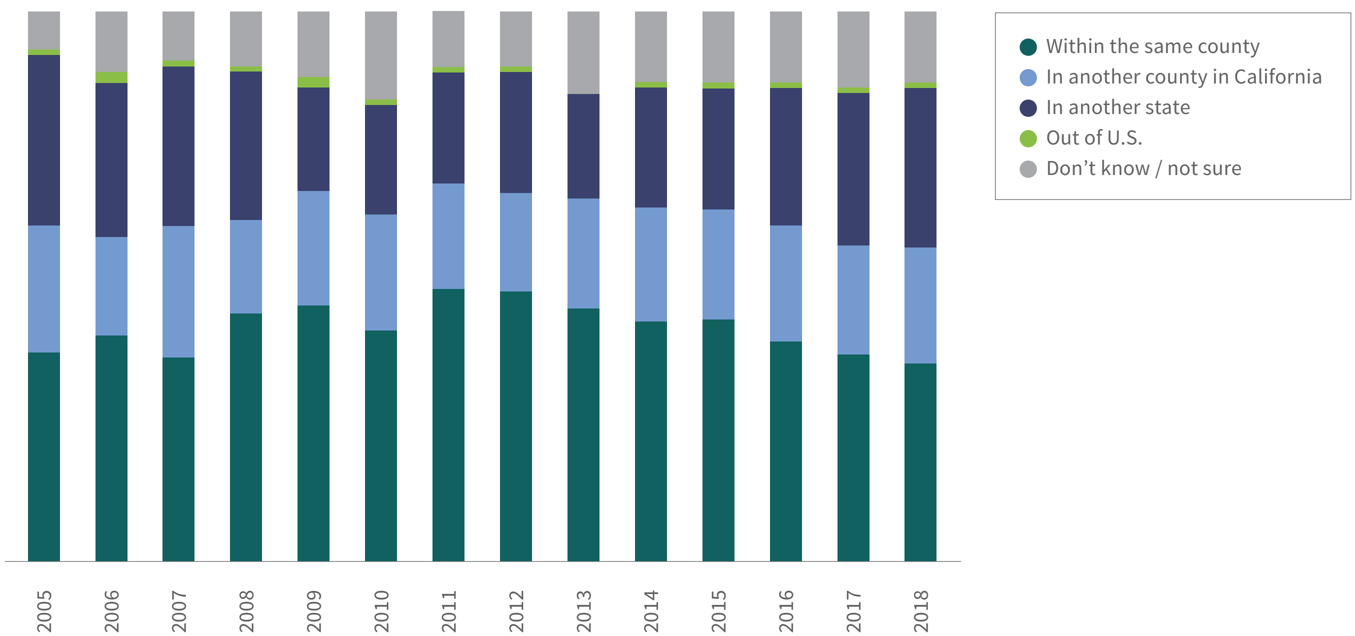
SELLERS GAINED FROM PRICE GROWTH, BUT MANY STAYED PUT







Location of Sellers New Home

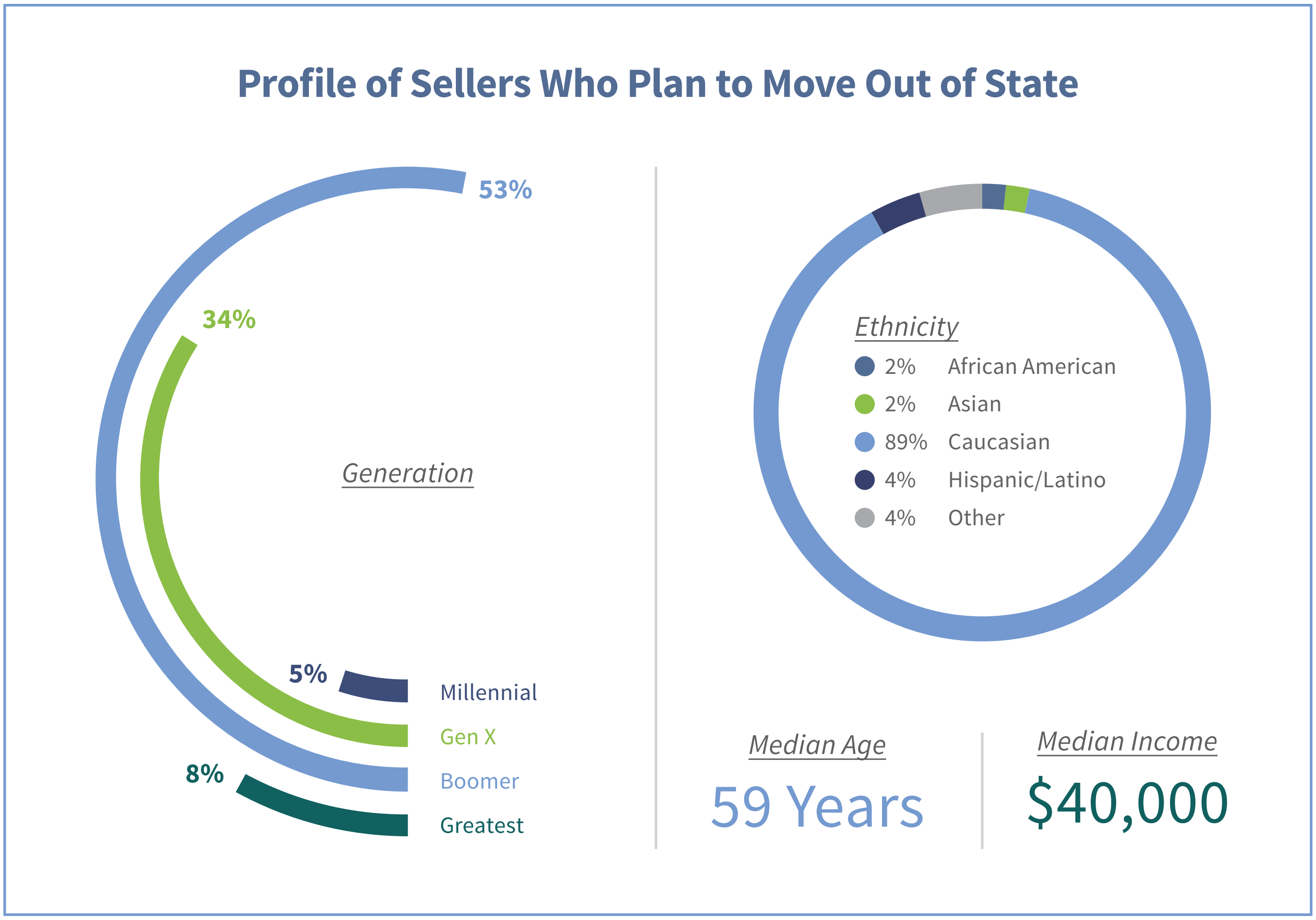


Coupled with the fact that fewer affordable housing units are being built than household growth requires to keep pace with demand, tight housing supply remains an issue in the long run despite a surge in inventory in recent months.

Many sellers remained confident about the housing market as the economy continued to grow and home prices continued to rise. The share of sellers who expressed interest in buying another property remained near recent highs, with over half planning on purchasing a home again. Millennial and Gen X sellers were the most interested, as nearly two-thirds of each generation said they planned to buy a property again.

Less than two-fifths of those sellers who planned to repurchase said that their new home would be located within the same county, a continuous decline from the last few years and dropping below the previous record low of 37 percent set in 2007. Meanwhile, more than a quarter of sellers who planned to purchase a new home decided to buy in another state outside of California, a slight increase from 28 percent in 2017, and the highest level since 2007, when the state median price hit its last cyclical peak. Older generations were more likely to buy outside of California as over two-thirds of baby boomers and the Silent Generation planned on repurchasing in another state. Only 18 percent of the millennial sellers would do the same thing. In fact, over 60 percent

SELLERS GAINED FROM PRICE GROWTH, BUT MANY STAYED PUT

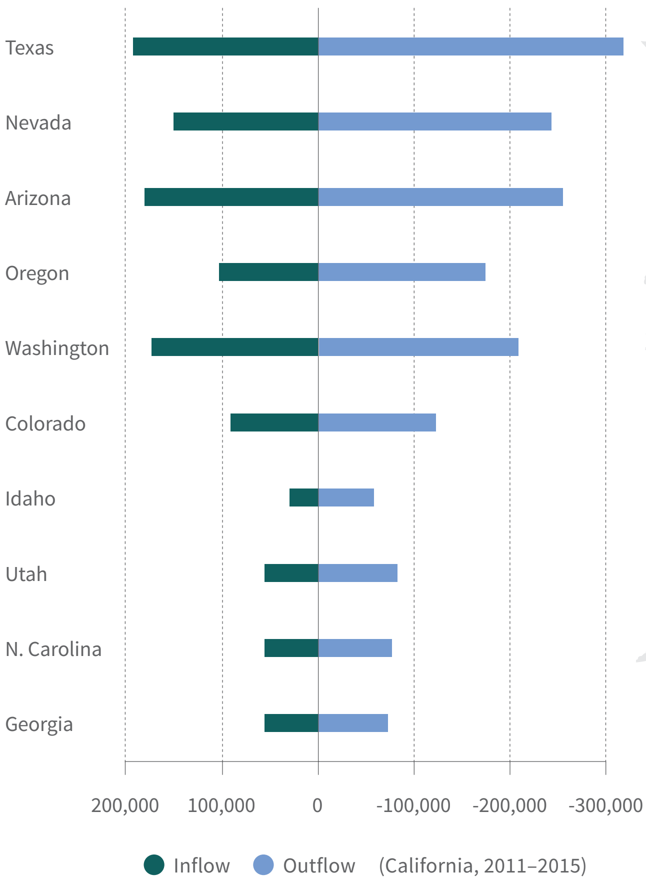


of sellers who planned to buy outside of California were Baby Boomers and Silent Generations.

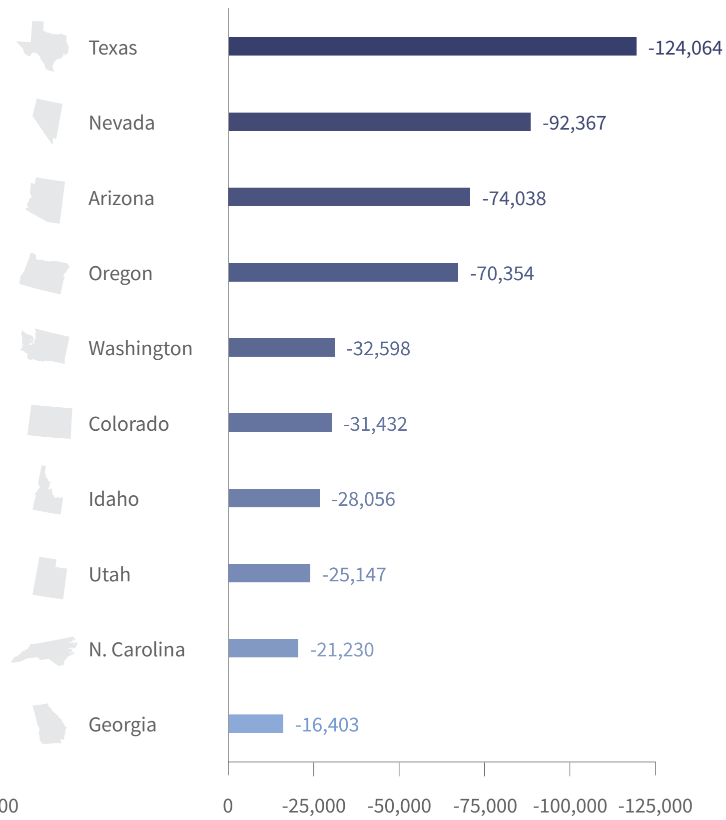
Declining housing affordability in recent years is one of the factors that resulted in the drop in sellers wanting to stay within the same county and the surge in sellers wanting to move to another state. Since 2012 when the housing affordability index (HAI) reached its peak, the statewide median price has increased 82 percent from $319,310 to $575,800(p) in 2018. While mortgage rates have remained low in recent years, they are expected to rise further in 2019 as inflation continues to heat up. HAI is expected to decline further as home prices continue to increase modestly in the upcoming year, making sellers more inclined to buy out of their current county if affordability is perceived to be an issue.

The high cost of living, higher state income tax rates, and a lack of affordable housing continued to drive many to leave California, which resulted in

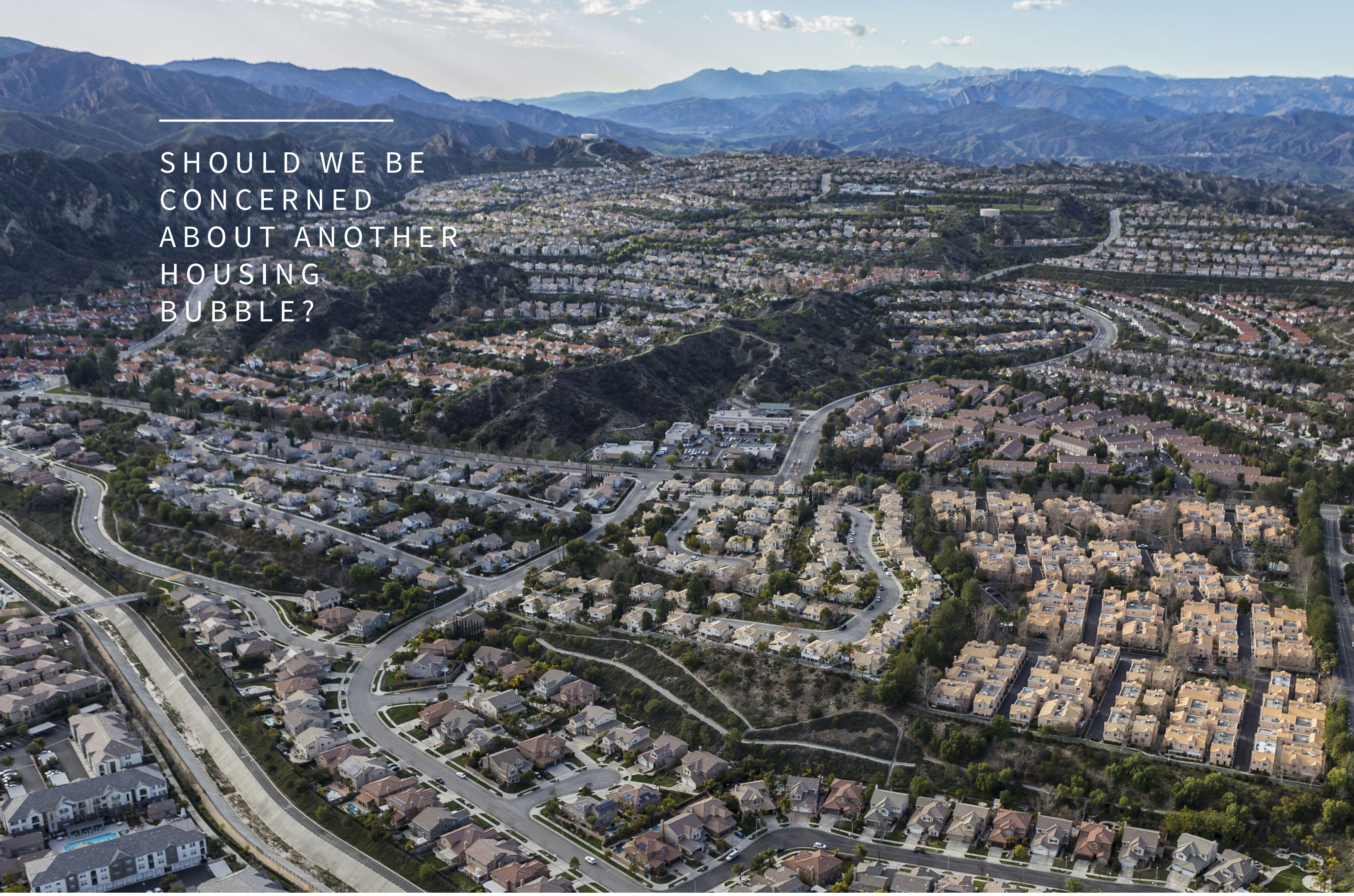
Outmigration to Other States



Net Migration (California, 2011–2015)



a net loss of 1 million residents in the state population due to domestic migration. The outmigration trend has consequences far reaching than just a shrinking population count. Companies and jobs are also leaving the state and expanding elsewhere because they have difficulty finding qualified workers in California. Additionally, the cost of hiring is higher because of the higher cost of living in the state. Toyota and Jamba Juice both left California for Texas, while Nestle moved to Virginia, and Northrop Grumman is now in Washington D.C. Outmigration will also lead to an increase in income inequality since there will be a reduction in less-skilled workers' access to high-wage labor markets, a slowdown in economic growth, and of course, a gradual decline in housing demand.



SHOULD WE BE CONCERNED ABOUT ANOTHER HOUSING BUBBLE?

With the statewide median price surpassing its previous record high and continuing to increase at a modest level, there are concerns that the market is in the bubble territory. Price increases are particularly obvious in the Bay Area with the region continuing rising by 10 percent in August 2018, despite the recent slowdown in price appreciation at the state level. Discussions on whether the housing market in California is vulnerable to record home prices and whether recent price increases are justifiable come up from time to time, and the debate will continue. While home price appreciation is one variable to account for when considering whether the housing market is in "bubble" territory, there are other factors to take into consideration as well. The level of risk that homeowners/homebuyers are exposed to, for example, is another element to examine when assessing whether the market is in imminent danger of a bubble bursting. According to results from C.A.R.'s 2018 Annual Housing Market Survey, current conditions for the housing market and for real estate financing are healthier than the environment that we observed in the mid-2000s before the housing market started deteriorating.

Buyers Have More Skin in the Game				
	2006	2012	2017	2018
% of buyers with 20% or more down payment	43.2%	54.4%	42.9%	44.2%
Median Downpayment (% to Price)	11.8%	20.0%	17.6%	18.0%
% of buyers with zero down payment	21.1%	4.6%	6.0%	7.3%
% of cash buyers	11.0%	29.6%	21.5%	22.9%
% of home buyers with a second mortgage	43.4%	1.8%	3.9%	4.2%
% of buyers with ARM	32.6%	3.5%	5.1%	4.0%

The environment for housing finance in 2018 required home buyers to be more responsible financially than they were in 2006. Recent home buyers had more "skin in the game" than many of those who purchased twelve years ago when the housing market was at its peak. In general, more buyers in 2018 put a bigger down payment on their home purchase, while fewer buyers purchased with zero down payment. The share of buyers who used a second lien to finance their property also shrank significantly from the peak of the current housing cycle, and those who opted for an Adjusted Rate Mortgage (ARM) took a dive from the mid-2000s. There were also more buyers offering all cash to pay for their house in 2018, as cash buyers in the current market made up nearly twice of what it was in 2006. The likelihood of default has also been reduced as the cost of borrowing remained at low levels, while the typical homebuyer's household income increased from $100,000 in 2006 to $120,000 in 2018.

2019 HOUSING MARKET OUTLOOK

Economic and Housing Market Risks

The outlook for the economy and the housing market is a mixed bag for the next 18 months. With the labor market operating at full employment and business optimism remaining near a cyclical peak, the U.S. economy will remain solid over the near term. On the other hand, high home prices and rising interest rates will lower housing affordability and create demand issues in the housing market that could put a drag on home sales going forward. In addition, there are other wildcards over the forecast period that could derail the economy and the housing market. Here are some that we should keep in mind:

International Trade: The likelihood of an economic downturn in the U.S. will increase if the Trump Administration continues to move in the protectionist direction in international trade and other countries retaliate by raising their own barriers to trade. While a trade war alone might not directly cause a recession in the U.S., a trade war that causes a global economic slowdown, a market sell-off, and an evaporation of business confidence certainly could have a significant adverse impact on the U.S. economy. Regional housing markets such as the Inland Empire, where businesses rely heavily on import/export, could also see a decline in housing activity as increases in tariffs hinder the region's economic growth. The inflationary effect resulting from the increase in overall price level of imported goods could lead to upward movement in interest rates, which could lead to higher costs of borrowing for home buyers and homeowners in general.

GSE Reform: Treasury Secretary Steve Mnuchin mentioned in the past that "getting Fannie and Freddie out of government ownership" is one of the Trump Administration's top 10 priorities. While it has been confirmed that the reform of GSE will not happen this year, reform could be a big focus in 2019. What are some of the implications for the housing market? There are a few serious proposals to reform the mortgage finance system that have been discussed in the past, and the effect the reform has on the housing market would

US Economic Outlook							
	2013	**2014**	**2015**	**2016**	**2017**	**2018p**	**2019f**
US GDP	1.70%	2.40%	2.60%	1.60%	2.30%	3.00%	2.40%
Nonfarm Job Growth	1.70%	1.90%	2.10%	1.80%	1.40%	1.60%	1.30%
Unemployment	7.40%	6.20%	5.30%	4.90%	4.40%	3.90%	3.70%
CPI	1.50%	1.60%	0.10%	1.40%	2.00%	2.50%	2.40%
Real Disposable Income, % Change	-1.40%	2.70%	3.40%	2.70%	2.10%	2.80%	2.60%
30-Yr FRM	4.00%	4.20%	3.90%	3.60%	4.00%	4.70%	5.20%

depend on the proposal adopted. Regardless of which proposal will be considered, a few key elements that REALTORS® support will certainly be discussed during the process. These include 1) government guarantee, 2) mortgage liquidity in all market conditions, 3) equal access to capital for high-cost areas, and 4) the 30-year fixed rate mortgage. Any change to one or more of these elements would have an impact on real estate finance and, hence, an impact on the housing market.

Monetary Policy: Monetary policy may tighten too fast or too late, prompting adjustments and risk repricing from the markets that may shorten the life of the current economic expansion. The Federal Reserve is expected to tighten at a measured pace, but a bit faster than what is currently priced in by the market. The federal funds rate is expected to increase at least one more time this year and two to three times next year. The risks for policy mistakes, however, have certainly risen as the economy enters its late stages of expansion.

Forecast

Prices have now increased on a year-over-year basis for 78 consecutive months since 2012. To put this number into perspective, the previous cycle enjoyed 126 months of consecutive price growth between 1997 and 2007. This suggests that a price correction is not imminent, but given the softness in sales and the increase in price reductions, home price appreciation could be leveling off. With inventory rising, the growth in home prices should decelerate in the next 18 months, especially since further rate increases are expected to hamper homebuyers' affordability and put a cap on how much they are willing to pay for their new home.

As housing affordability is expected to deteriorate further, the weak performance in home sales will continue into 2019. While the economy will remain strong, the increase in housing demand will go unmet, as the erosion of affordability continues to leave potential buyers either unwilling or unable to buy. Despite an improvement in supply conditions, there is currently a high level of market uncertainty, especially from the standpoint

California Economic Outlook							
	2013	2014	2015	2016	2017	2018p	2019f
Nonfarm Job Growth	3.00%	2.20%	2.70%	2.30%	1.60%	2.00%	1.40%
Unemployment	8.90%	7.50%	6.20%	5.50%	4.80%	4.30%	4.30%
CA Population (Million)	38.4	38.7	39.1	39.4	39.6	39.9	40.2
Population Growth	0.90%	1.00%	0.80%	0.60%	0.80%	0.70%	0.70%
Real Disposable Income, % Change	-2.10%	5.60%	3.90%	1.60%	1.60%	2.40%	3.00%

California Housing Market Outlook							
	2013	2014	2015	2016	2017	2018p	2019f
SFH Resales (000s)	414.9	382.7	409.4	417.7	424.1	410.5	396.8
% Change	-5.90%	-7.80%	7.00%	2.00%	1.50%	-3.20%	-3.30%
Median Price ($000s)	$407.20	$446.90	$476.30	$502.30	$538.00	$575.80	$593.40
% Change	27.50%	9.80%	6.60%	5.40%	7.20%	7.00%	3.10%
Housing Affordability Index	36%	30%	31%	31%	29%	28%	25%
30-Yr FRM	4.00%	4.20%	3.90%	3.60%	4.00%	4.70%	5.20%

of consumers. This lack of clarity creates a mismatch in price expectations between buyers and sellers, which, if prolonged, could exacerbate the slowdown in home sales. The acceleration of migration out of California also does not bode well for the future of our state. As such, existing home sales in California are projected to decrease 3.2 percent in 2018 and will drop further by 3.3 percent in 2019.

METHODOLOGY – 2018 ANNUAL HOUSING MARKET SURVEY

C.A.R. has conducted the Annual Housing Market Survey since 1981. The questions and methodology have stayed essentially the same throughout that time. The survey was sent via email to a random sample of 30,355 REALTORS® throughout California. The sample represented the geographical distribution of C.A.R. membership across the state. The survey asked REALTORS® to provide information from their most recent sales transaction that closed escrow in the second quarter of 2018. The survey instrument was a questionnaire with both multiple choice and open-ended questions. There were 1,492 valid survey responses, equivalent to a response rate of 4.9 percent. The margin of error for this survey was +/- 2.5 percent at a 95 percent confidence level.

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