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THE SAN FRANCISCO BAY AREA HOUSING MARKET: A BUYERS MARKET

By

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The San Francisco Bay Area Housing Market: A Buyer's Market

Introduction

During the technology boom of the last four years, Bay Area housing prices skyrocketed. Buyers, many of whom had made their fortunes during the Internet frenzy, waged fierce bidding wars for homes. To meet increasing demand for homes, homebuilders launched new subdivisions.

But the Bay Area economic landscape has altered dramatically over the last year. The area is in the midst of an economic recession that began in March 2001, with 117,000 more unemployed in the Bay Area than in December 2000. Fortunes made during the Nasdaq skyward climb of 1999 and 2000 have now been lost in its more recent plunge.

For years a seller's market, the Bay Area is now a buyer's market. Based on November 2001 numbers, Bay Area prices for all categories of homes have dropped 6.3 percent from their March 2001 peak and 1.9 percent from December 2000. The number of home sales has dropped by 25 percent since December 2000 and 29 percent since sales peaked in August 2001.

Due to the recent increase in unemployment and drops in home prices and home sales, we believe the prevailing opinion that the Bay Area economy, along with the housing market, will rebound in 2002 is overly optimistic. The Bay Area economy, currently in a deep recession, will not reverse course until late 2002 or 2003. Job loss is likely to continue as technology companies and others that fed off the technology sector's growth retrench. Homeowners who find themselves out of a job or with worthless stock options may sell their houses in order to rid themselves of mortgages they no longer can afford. Although many prospective buyers will take advantage of low interest rates to purchase homes, others will waver in their decisions until the economic outlook improves.

Even if the worst part of the current recession is behind us, the effects on the housing market will lag about a year. Home prices adjust slowly to economic downturns because homeowners trim other expenses before resorting to selling their homes. Likewise, the real estate market recoveries also lag by one to two years behind economy-wide improvements.

We believe the Bay Area home market is fundamentally sound but will continue to be a buyer's market for another year. In the coming year, we expect the number of homes for sale to increase and existing home prices to weaken further.

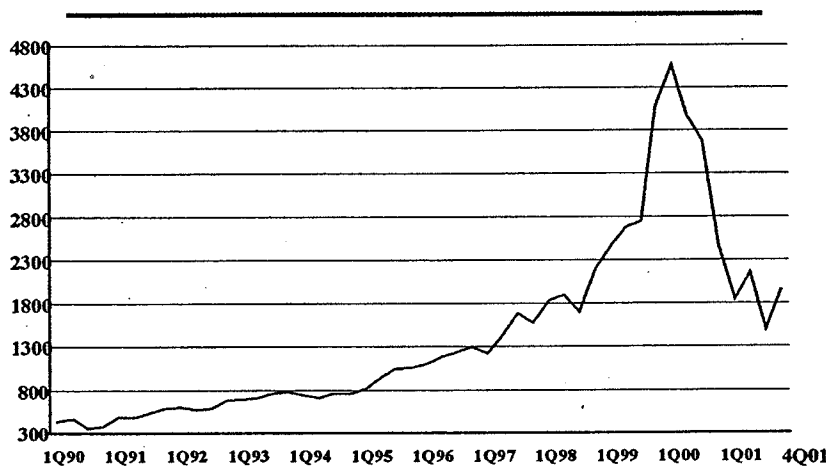
We expect employment numbers to further decline and unemployment numbers to rise during the first part of 2002 when companies that delayed firings until after the holidays, further trim their staffs.

The Bay Area is in the midst of a prolonged recession and is unlikely to recover until 2003 due to the area's tech heavy focus. We expect the Bay Area labor force to contract a further 1 percent to 1.5 percent in 2002.

Wealth effect and home prices

In addition to the employment explosion in the late 1990s, the wealth effect pushed home prices dramatically upward. During the stock market euphoria that ended in March 2000, many young

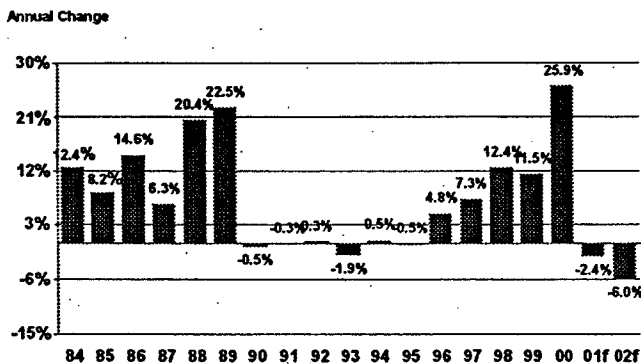
NASDAQ Composite Index



Source: Bloomberg

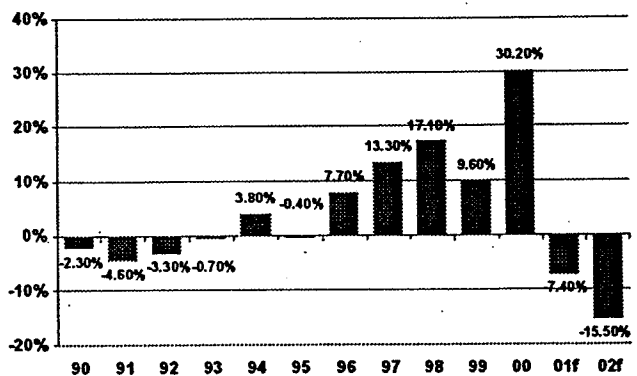
entrepreneurs became millionaires seemingly overnight, as ordinary Americans invested in record numbers in the stock market. The new rich flooded the housing market in the 1998 – 2000 period. During the height of the market frenzy, interested buyers often competed in bidding wars for homes. Clearly the spillover of the high-tech boom was dramatically felt in the housing market.

**Single Family Median Home Price Growth
San Francisco**



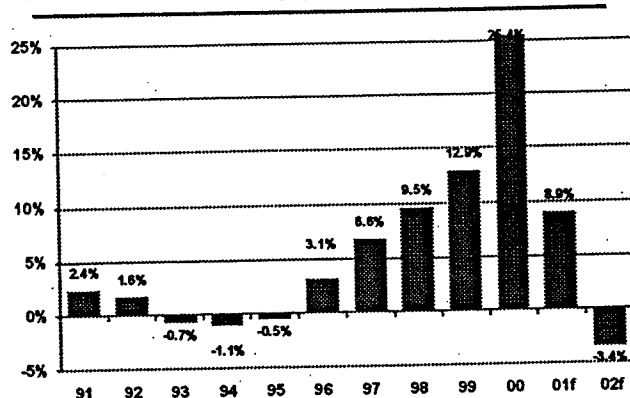
Source: CAR, RCG

**Single Family Median Home Price Growth
San Jose**



Source: CAR, RCG

Single Family Median Home Price Growth Oakland



Source: CAR, RCG

Price escalation in the 1980s was followed by a recession in the early 1990s, which saw year-over-year housing price declines. Then in the mid-90s the cycle started again with huge run-ups in prices. For example, home prices in the San Jose area declined every year from 1990 to 1994 before soaring 110 percent from 1994 to 2000. In 2000 alone San Jose home values rose 30 percent.

The San Francisco and Oakland areas experienced similar housing booms, with home values rising 77 percent in San Francisco and 59 percent in Oakland from 1994 to 2000.

But the loss of wealth due to company closings, the stock market decline and job losses have begun to chip away at housing value. Home prices began to weaken at the end of 2000 and have slid downward in 2001.

Median Bay Area single family home prices are down 0.7 percent from year's end and 6 percent

Median Bay Area Single Family Home Prices

Date	Alameda	Contra Costa	Marin County	San Francisco	San Mateo	Santa Clara
Dec-00	350,000	270,000	549,500	525,000	523,500	485,000
Jan-01	335,000	279,000	612,250	499,000	575,000	505,000
Feb-01	345,000	285,000	636,250	523,500	600,000	496,500
Mar-01	356,500	296,000	599,500	543,250	554,000	500,000
Apr-01	367,000	297,000	669,000	550,000	532,000	500,000
May-01	358,250	300,000	625,000	544,000	536,500	473,000
Jun-01	372,000	308,500	595,000	534,000	535,000	472,750
Jul-01	370,000	310,000	600,000	525,000	545,000	490,000
Aug-01	360,000	315,000	595,000	510,000	535,000	455,000
Sep-01	351,500	315,250	560,000	509,000	525,000	460,000
Oct-01	360,000	299,500	535,000	495,000	530,000	438,000
Nov-01	350,000	293,500	571,500	500,000	530,000	435,000
% Decline						
From Dec-00	0.00%	8.70%	4.00%	-4.76%	1.24%	-10.31%
From Peak	-5.91%	-6.90%	-14.57%	-9.09%	-11.67%	-13.86%

Source: DataQuick Information Systems

from their July 2001 peak. Santa Clara County has seen the largest drop in home values with November 2001 median prices at \$435,000, down 10.3 percent from December 2000 and 13.9 percent from their January 2001 peak. Median home prices in San Francisco have also dropped 4.8 percent from December and 9.1 percent from their April 2001 peak to \$500,000 in November 2001.

Marin County, often characterized as the Bay Area's tightest home market, and the East Bay, which did not have as large an influx of technology companies as other parts of the Bay Area, have also dropped from their peak levels, with prices down 15 and 6 percent respectively from their peaks.

The most dramatic impact of the boom can be witnessed in the luxury housing market.

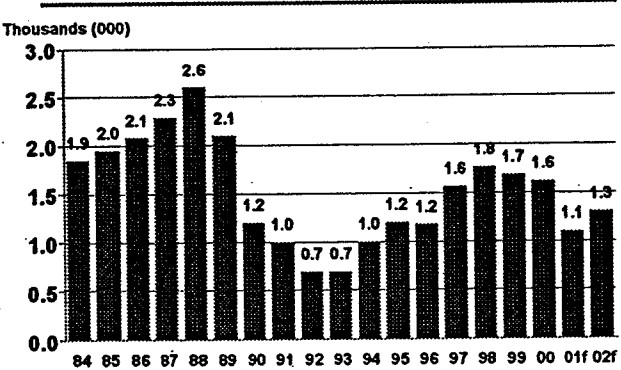
Average luxury home values in San Francisco shot up from \$1.6 million at third quarter 1999 to \$2.2 million at third quarter 2000, an eye-popping 37.5 percent increase, according to First Republic Bank's housing price index.

But the technology correction and a weak economy may force some people to sell pricey homes they can no longer afford. Luxury home values have already started to slip. San Francisco area average luxury home values fell 7.5 percent to \$2.21 million in September 2001 from \$2.39 million in June 2001. High-end homes are now selling at just under September 2000 levels. This is the first time since mid-1997 that luxury home values have not risen each quarter.

Bay Area luxury home sales are responsible for the state-wide decline in luxury home values, according to DataQuick Information Services.

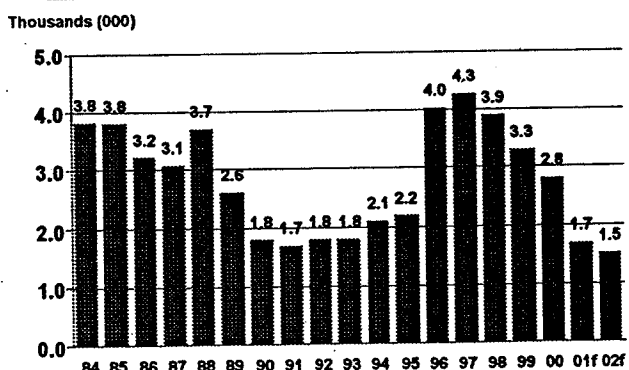
In third quarter 2001, the number of million-dollar home sales in California fell to 2,682 units,

Single Family Permits
San Francisco



Source: Census Bureau, RCG

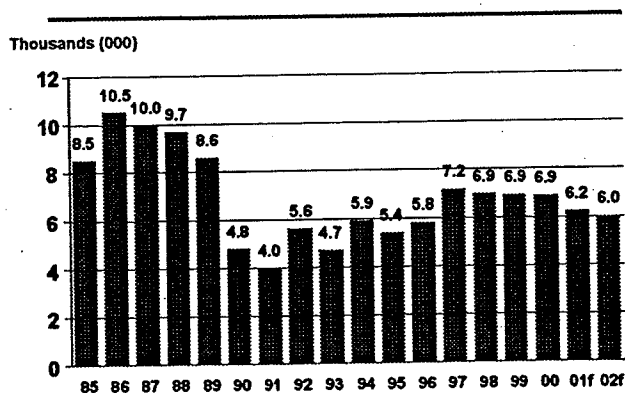
Single Family Permits
San Jose



Source: Census Bureau, RCG

down from 2,976 in the third quarter 2000. Southern California actually experienced an

Single Family Permits Oakland



Source: Census Bureau, RCG

increase in sales, but this was offset by Bay Area declines. Indeed, homebuilders report that Southern and Northern California area almost like "two different states," with healthy sales activity in the south and particularly slow sales in the north.

The number of Bay Area new home sales is down between 15 to 25 percent from their peak and is showing particular weakness in South San Jose, South Livermore and East Dublin.

Real estate agents and homebuilders view the Bay area market as bifurcated. Homes priced below \$400,000 are selling quite well, and even those priced up to \$800,000 are moving fairly quickly. But the market for homes priced above \$800,000 is viewed as "very weak," with prices down as much as 25 percent from their peak. There are far fewer buyers for luxury properties and many sellers are still pricing their homes above market. For that reason, luxury prices are likely to drop further in the first part of 2002 before stabilizing sometime in late 2002 or in 2003.

Sale volume

The drop in Bay Area home prices was accompanied by a drop in home sales. In November 2001, 5,252 new and resale homes were sold in the six-county region. That marks a 24.5 percent drop from year's end and a 29 percent drop from the market's August 2001 peak.

In areas close to Silicon Valley and the far East Bay, homebuilders went from pre-selling homes to having them sit on the market for up to 60 days after completion. Homeowners trying to sell received far fewer offers at prices closer to asking than in 2000. New home sales have dropped by almost a half since December 2000, the market peak.

Comparing the number of single family homes sold in at the end of 2000 and November 2001, Santa Clara County experienced the sharpest drop with 306 fewer sales, a decline of 24.8 percent. Contra Costa saw a 22 percent dip, followed by Alameda and San Mateo counties with 15.8 percent and 11.4 percent declines respectively. Marin, where housing supply is severely limited, actually saw a 22.9 percent increase in sales.

