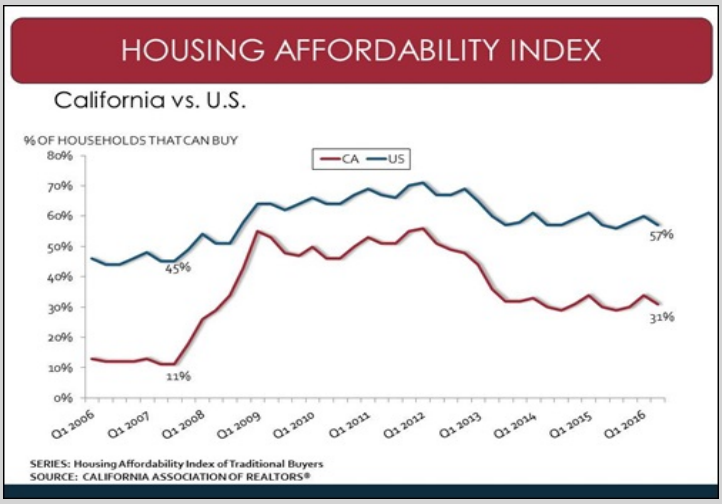
Interest Rate – A Solution and a Problem for Housing Affordability

Housing affordability remains a challenge for many potential homebuyers in 2016, despite favorable lending environment in recent years. According to the latest housing affordability index (HAI) reported by the California Association of REALTORS® (C.A.R), the percentage of homebuyers who could afford to purchase a median-priced home in California in the second quarter of 2016 fell to 31 percent from the 34 percent recorded in the first quarter of 2016, and was up from 30 percent in second quarter of 2015. This was the 13th consecutive quarter that the index has been below 40 percent and was near the mid-2008 low level of 29 percent.

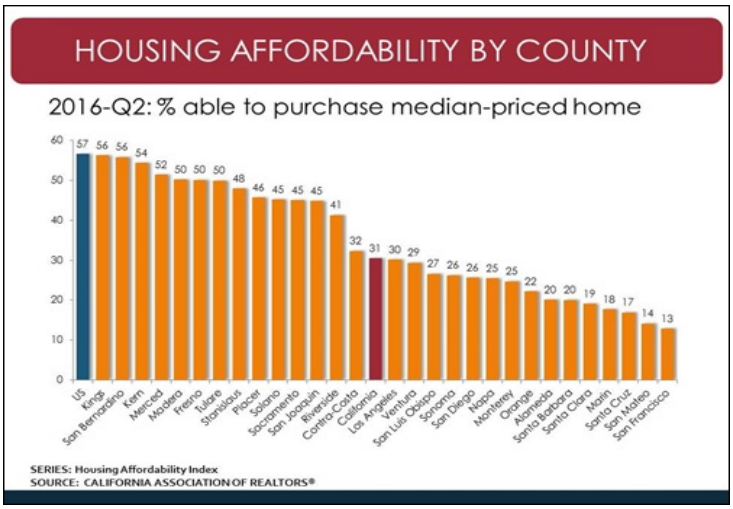


At the state level, the recent quarterly HAI is only slightly below the long-run average of 32 percent, and is nowhere near the historic low of 11 percent recorded in the second and third quarters of 2007. Keep in mind, however, that interest rates differ considerably between 2007 and 2016.

The monthly average commitment rate for 30-Year fixed rate mortgages reported by Freddie Mac, for example, was at 6.70 percent in July 2007, as compared to 3.44 percent in July 2016. The difference in monthly mortgage payment between those rates at the statewide median price is $824, which is substantial for most Californian households.

Higher home prices across the state and regions account for most of the decline in affordability, as the minimum annual income required to buy a median-priced home in California grew to $101,220 in the second quarter. That's an increase of $8,000 from the first quarter of 2016 and was $4,500 from the same quarter last year.

The California median price continued to increase at a steady but moderate pace since the mid of 2014, averaging a 5.9 percent annual growth rate in the last 25 months. With mortgage rates dropping back to record low levels at the end of June, housing affordability was being kept from declining further in the first half of the year. But when interest rates start moving higher in the upcoming year, housing affordability will become more and more of an issue until we figure out how to resolve the housing supply problem.



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