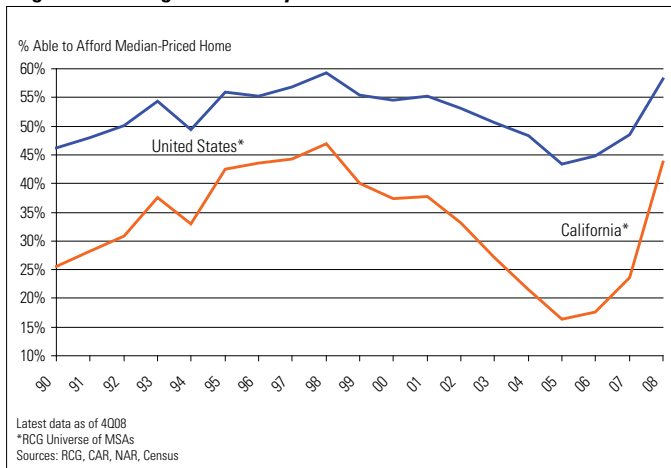


The California housing market has been in a great recession for the past three years, with house price declines of 57%, single family building permits off 89% from peak levels, and resales off 21% from the 2005 peak. Foreclosures mushroomed to 822,000 in 2008, with another one million likely in 2009. This great housing recession followed the boom years of 2002-2005, and is characteristic of the boom/bust nature of the California housing market that has happened every ten years or so since World War II. The current housing recession now looks as if it will be the deepest since the 1930's.

Figure I. Housing Affordability - United States and California



Despite bleak recent activity levels there are signs that the California housing market is in a "bottoming process." The plunge in housing prices and decade-low mortgage rates, combined with tax incentive programs, have created the most "affordable" home purchase environment in decades. Figure I shows the affordability index for California and the United States. If one has a secure job and good credit, and can put down 20% on a home purchase, it is a

Figure II. California Existing Home Sales

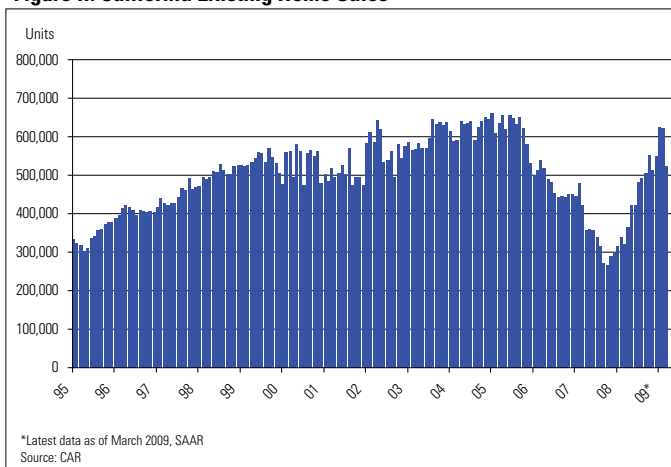
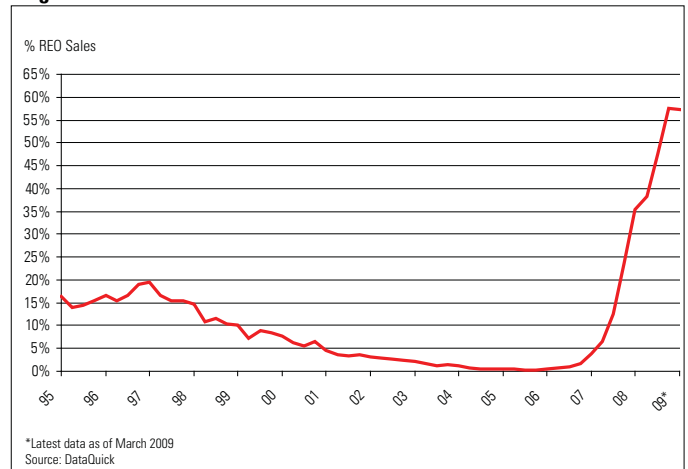


Figure III. REO Sales in California



good time to buy. The recently passed \$8,000 Federal tax credit for first-time homebuyers and the \$10,000 state credit for "new home" buyers has helped ignite demand. Figure II shows that the monthly resale activity was up by 97% in March from the bottom in October 2007. The significant increase in sales is somewhat deceptive as it also includes many foreclosure sales to investors. Figure III shows that more than 57% of sales in March 2009 were foreclosure sales. This large number of foreclosure sales also "pushes" downward the reported median prices by CAR and others. Figure IV purports to show house prices are down 57% from the May 2007 peak. If foreclosures are removed from the series, prices are down only 20% from the peak level. Of course, low-priced foreclosures represent opportunities for first-time home buyers and investors with substantial risk appetites.

This activity in the existing resale market has translated into more sales at the low and middle segments of the new housing market. Figure V on the subsequent page shows that building permits for single family houses are at very low levels. Through March 2009,

Figure IV. California Existing Median Home Price

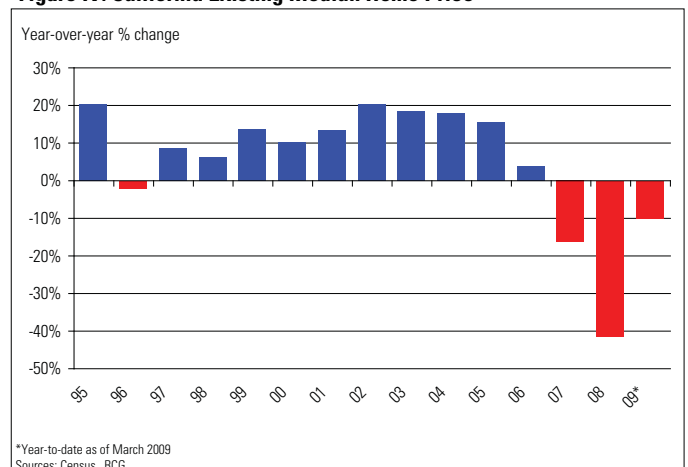
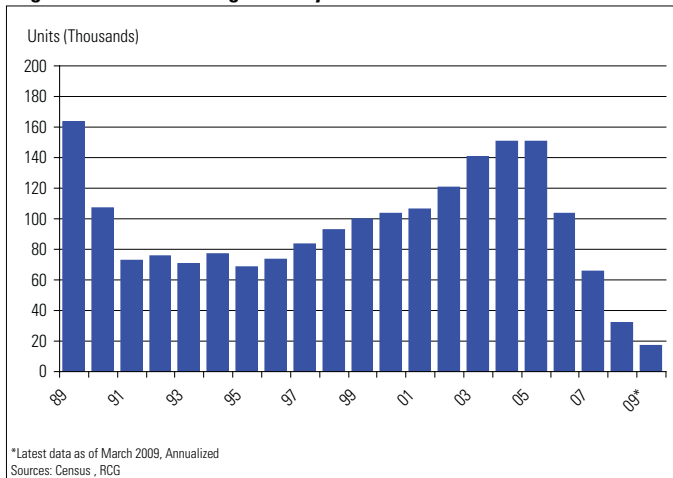


Figure V. California Single Family Permits



single family permits were issued at a seasonally adjusted annual rate of 16,800, as opposed to 32,000 permits issued in 2008.

While the California housing market is showing some “green shoots” because of lower prices, low mortgage rates, and the Federal and state tax credits, this optimism must be tempered by the reality of the “great economic recession.” Figure VI shows that California has lost nearly 728,000 jobs since employment peaked in mid-2007. Figure VII shows that the California unemployment rate is at 11.2%, and is likely to rise to nearly 13% in the next year. This bleak employment situation, along with the continued “foreclosure tsunami,” means that the recovery in housing is likely to be anemic for the next year, with increased sales volume, but little pricing power for builders and sellers of homes. There is also a risk that the huge Federal budget deficit will make it difficult for the Fed to keep long-term mortgage rates below 5%. A surge in mortgage interest rates could snuff out this embryonic housing recovery.

Figure VII. California Unemployment Rate

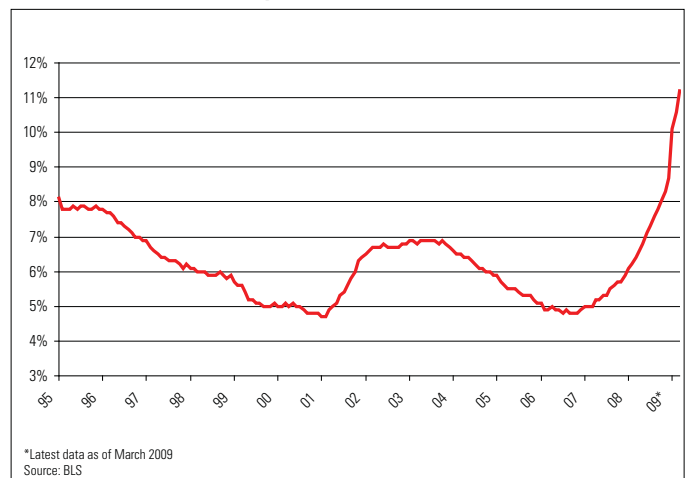


Figure VI. California Employment Growth

