

# U.S. Regional Flash

## Higher Mortgage Rates Fail to Slow State Home Price Appreciation

Regional home price indexes surged in 4Q13, capping the second consecutive year of national home price appreciation. Low inventory combined with higher consumer confidence related to strong equity gains, a renewed willingness of households to take on leverage and historically low mortgage rates led to an increase of home prices from one year-ago in 49 of 50 states and 280 of 382 MSAs. Despite an uptick in interest rates in 2H13, which led to a reduction in housing affordability, home prices also increased in 231 MSAs and 39 states from 3Q13. The favorable outlook for home prices and limited housing supply underpin stronger construction activity in 2014. Our baseline forecasts project above-average regional home price growth in 2014 and 2015, and even more so in the areas acutely impacted by the housing bubble.

- West Coast Home Prices Recover, Still Well Below Pre-Crisis Peak**

The housing crisis decimated Arizona's, California's, Florida's and Nevada's housing markets— 50.3% average home price declines from peak. However, in 2013, these states experienced a remarkable recovery and ranked as the top 4 states for home price gains. In fact, prices increased 15.2%YoY in Arizona, 19.5%YoY in California, 12.6%YoY in Florida and 24.3%YoY in Nevada. Eleven of the 28 MSAs in California and Nevada also grew above 20% from one year-ago. Although reminiscent of unsustainable pre-crisis growth, market fundamentals have changed. Residential lending has declined since the crisis, and given that prices in the fastest growth states and MSAs remain well-below pre-crisis peaks, current home price trends suggest that regional housing markets are not overheating. Moreover, in spite of double-digit home price growth in 2013 and 2014, and above-average growth thereafter, these states will remain below pre-crisis peaks through 2017.

- Employment & Income Gains Only Partially Explain 2013 Home Price Growth**

In 2013, job and income growth only explained a small share of home price growth across states, which suggests that other factors such as housing inventory will likely determine price appreciation over the medium-run. In fact, income growth explained less than 2% of state home price growth whereas employment growth explained over 25%. Despite the larger contribution to home price growth, the impact of job creation was not uniform across industries. For example, job gains in the healthcare services sector (28%) were more highly correlated with home price growth than professional services (6.3%). Ultimately, our baseline forecast assumes higher GDP and employment growth, and as more and more people become employed it is likely that job growth will become a larger contributor to home price appreciation.

- Declining Affordability Will Counteract Home Price Appreciation**

Rising interest rates and continued increases in home prices will erode housing affordability going forward. In terms of interest rates, we still expect a gradual exit by the Fed from QE3 (tapering) in 2014 and policy normalization to begin in 2015. Thus, mortgage rates will begin to rise steadily throughout 2014 and 2015 for all states. As a result, homebuyers will face higher borrowing costs, and overall mortgage lending will remain tepid. In addition, increases in household income have lagged home price growth, and because home prices will continue to appreciate faster than income in most areas, our forecasts suggest that demand will weaken in the West Coast and Northeast regions relative to the rest of the U.S.

Table 1  
**State Snapshot: Top 10\* States for Home Price Growth**

BBVA Compass	Index	Growth (%)		Forecast**	
		YoY	QoQa	2014	2015
<i>Nevada</i>	162.9	24.3	17.6	26.4	17.7
<i>California</i>	204.8	19.5	10.4	17.0	10.5
<i>Arizona</i>	232.4	15.2	15.9	11.9	10.0
<i>Oregon</i>	299.2	12.9	11.0	9.1	9.0
<i>Florida</i>	210.5	12.6	11.8	10.7	8.2
<i>Georgia</i>	178.8	11.4	10.1	6.6	5.3
<i>Michigan</i>	168.9	9.4	2.5	8.3	6.8
<i>Utah</i>	291.4	9.3	4.1	6.9	5.2
<i>Colorado</i>	309.4	9.1	7.4	7.5	6.6
<i>Hawaii</i>	208.3	7.9	13.1	7.2	7.4

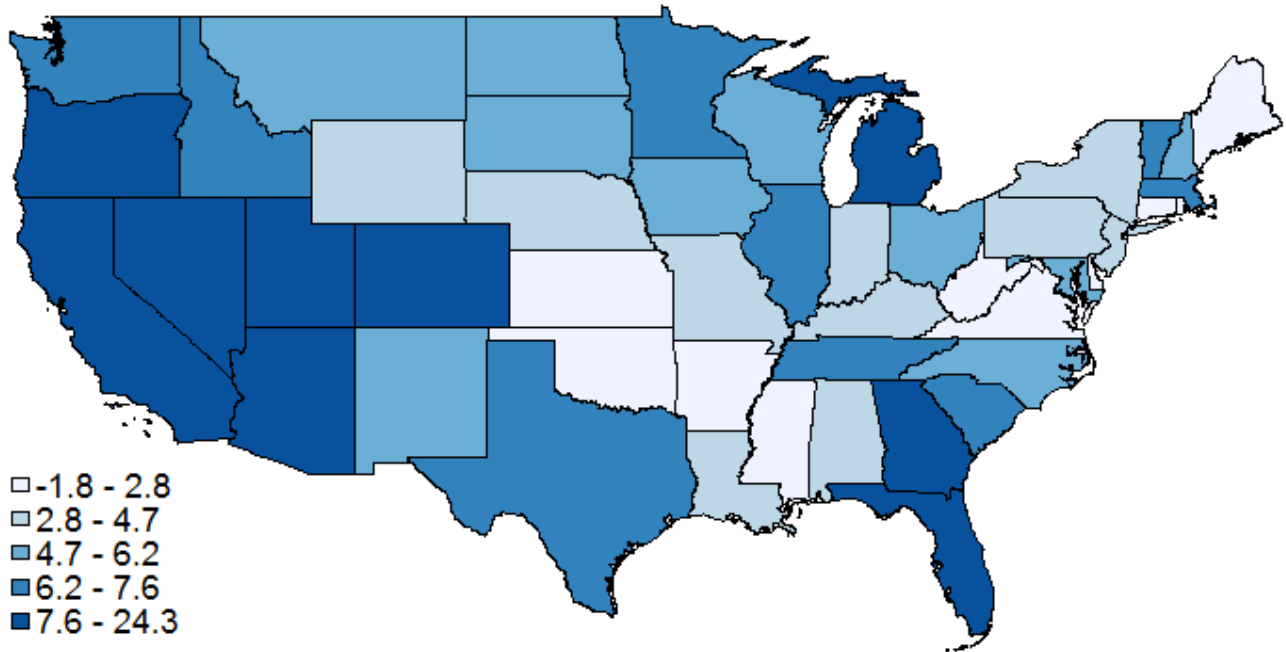
Table 2  
**MSA Snapshot: Top 10\* MSAs for Home Price Growth**

BBVA Compass	Index	Growth (%)		Forecast**	
		YoY	QoQa	2014	2015
<i>Modesto, CA</i>	166.2	28.5	33.0	16.2	6.6
<i>Stockton-Lodi, CA</i>	166.0	26.8	21.0	14.4	6.7
<i>Vallejo-Fairfield, CA</i>	179.4	25.0	24.8	14.0	6.8
<i>Merced, CA</i>	148.5	24.9	20.1	17.0	5.9
<i>Las Vegas, NV</i>	133.6	24.7	22.2	16.0	9.3
<i>Riverside, CA</i>	211.2	23.3	25.0	14.6	8.0
<i>Napa, CA</i>	236.3	22.5	21.6	14.9	8.9
<i>Sacramento, CA</i>	196.2	22.2	17.8	13.4	7.8
<i>Santa Rosa, CA</i>	226.3	21.7	22.3	14.7	8.6
<i>Bend-Redmond, OR</i>	207.9	21.0	18.3	9.4	5.6

Source: BBVA Research, FHFA & Haver Analytics  
\*Ranking based on current YoY% growth  
\*\*Average YoY%

Chart 1

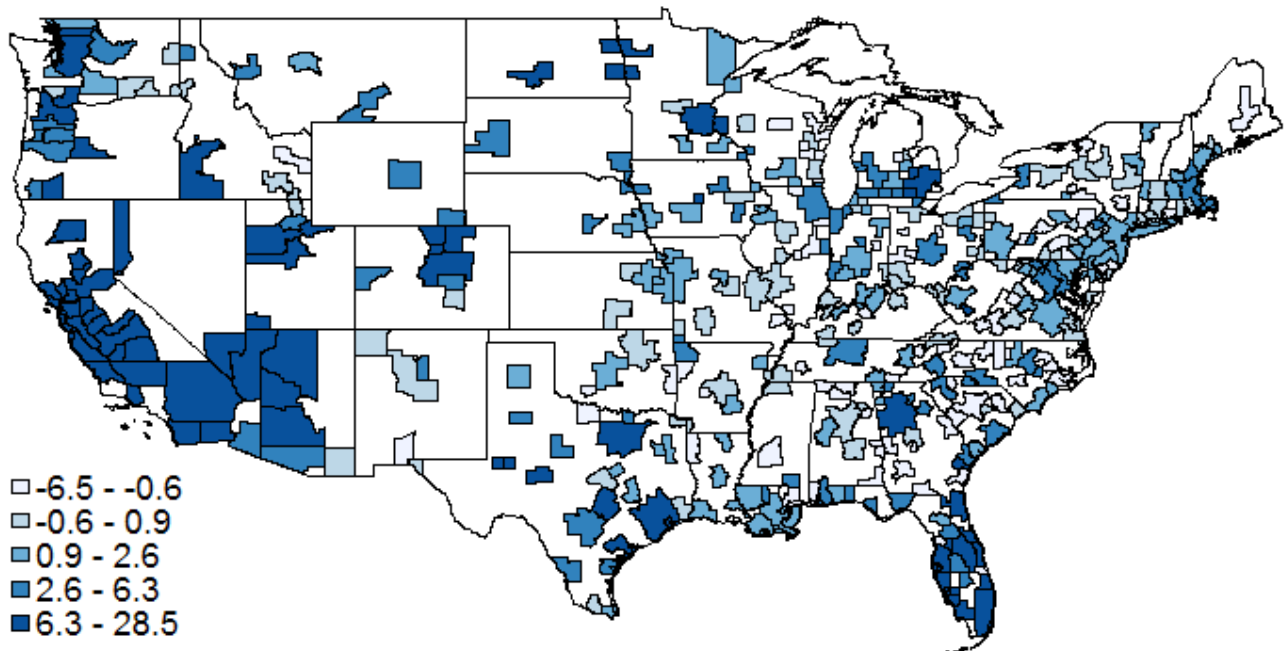
### FHFA State Purchase-Only Home Price Index (YoY% Change)



Source: BBVA Research, FHFA & Haver Analytics

Chart 2

### FHFA MSA Home Price Index (YoY% Change)



Source: BBVA Research, FHFA & Haver Analytics

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