A money pit? Maybe it's more like a pendulum

As housing affordability keeps shrinking, communities can change dramatically

By Craig Venezia
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Take a look at today's Bay Area housing market. Prices are flat, more houses are for sale, and interest rates are near 25-year lows. It's a buyer's market.

So why then, according to a research report prepared last year by the California Association of Realtors, can only 12 percent of Bay Area households afford to buy the median-priced home? The answer lies in the growing disparity between home prices and household incomes.

"Over the decades, Bay Area home appreciation has consistently outpaced increases in incomes," points out Scott Anderson, senior economist at Wells Fargo & Co. "That means a larger share of a person's budget must go toward paying for his or her home."

U.S. Census Bureau data show that in 1979 the Bay Area median home price of $99,600 was almost five times the median household income. In 2005, the median home price of $645,300 was almost 10 times the median income. Not only does this wider gap make it more challenging to buy a home, it has altered the social dynamics of towns.

Clark Rosen has certainly noticed a change in Petaluma since he settled there with his wife and four children in 1978.

"When we first came to Petaluma it was mostly an agricultural town. The houses ranged from modest to average, both in price and style, and the residents were primarily a mix of agricultural workers, teachers, small-business owners and other middle-class individuals," said Rosen, a broker with Coldwell Banker who has been selling real estate in the area.

This is the first of two stories exploring the costs of Bay Area housing.

Today: Appreciation has far outstripped income. That's why only 12 percent of the Bay Area can afford a median-priced house.

Next week: Share and share alike — how first-time buyers can get their foot in the door.
Kroll, who has been studying the California economy and real estate market for more than 20 years. "With such a wide gap between home prices and incomes, there's a natural migration away from economic centers like San Francisco as people search for more affordable housing. The trade-off is usually a longer commute."

Kroll goes on to say that for those who don't want to deal with the longer commute, it usually means working harder to afford the house they want.

Kathleen Herrmann and Peter Vasilev of Moraga have witnessed such a change in their community over the past 18 years. When the couple bought their 1,500-square-foot tract home for $330,000 in 1988, they had a 5-year-old daughter and another on the way. Still, they managed to swing it on Vasilev's income alone, which he describes as being more or less average for the time.

"When we moved here, many of our neighbors were like us. Usually, the moms were homemakers and the dads worked to support their families," said Herrmann, who was a stay-at-home mom for more than two decades. "It was very 'Leave It to Beaver.'"

The problem is the Cleavers can't afford to live in Moraga anymore. Walk the neighborhood today and you'll spot more nannies than moms, a telltale sign of a place inhabited by working couples.

It's no wonder Moraga's stay-at-home moms are on the road to extinction. Last year, a neighboring house comparable to Herrmann and Vasilev's sold for about $1.1 million, more than three times what the couple had paid.

"I was amazed. There's no way we could afford to pay that today," said Vasilev, who owns iSOLD It, an eBay drop off franchise in Pleasant Hill. "But I suppose that's the price you pay to live within an acceptable commute to the city."

When it comes to buying a house in the Bay Area, more than just the social dynamics of towns have changed over the decades. The number of financing options has experienced a metamorphosis as well.

Before the early 1980s, the 30-year fixed-rate mortgage was too banks what the Model T was to Henry Ford. Home buyers scraped up a 20 percent down payment and took out a 30-year fixed-rate loan for the balance of the price. That's more or less how it worked for everyone. Those who couldn't come up with the full 20 percent had private mortgage insurance automatically tacked onto their
Financing options let more afford homes

HISTORY
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loan payments, which protected the lender in case of default.

Today, the plethora of mortgage products available allow individuals to buy homes with little or no money down while avoiding PMI. Karen Toms-Brown, a mortgage broker with Adamarc Financial Co. Inc. in Menlo Park, offers this example: “Today, loans can be structured with less than 20 percent down and no PMI. That’s because lenders have developed second-mortgage products to go behind a maximum 80 percent first mortgage. By breaking the loan into two, the requirement for PMI is nullified.”

Toms-Brown is referring to the piggyback or combo loan, which is really two loans — a first mortgage (usually for 80 percent of the house value) with a second mortgage (usually for 10 to 15 percent of the house value). That means a buyer can put 5 or 10 percent down on a home and still avoid PMI. This has allowed many first-time buyers break into a market that would have otherwise shut them out.

The evolution of the adjustable rate mortgage, born about 25 years ago, has also helped many buyers enter a market where increases in incomes severely lag home appreciation.

The appeal of an ARM has always been the initial lower monthly payment compared with a fixed-rate mortgage. However, an ARM involves higher risk because the interest rate fluctuates over the life of the loan. In general, when overall interest rates are low an ARM is attractive. However, if interest rates rise, an ARM can wind up costing just that and a leg as well. Suddenly, a once low payment exceeds the borrower’s affordability range.

The traditional ARM has spawned variations that offer borrowers even lower payments, at least initially. Examples of these unconventional or exotic loans, as they are called, include the interest-only loan, which, as its name implies, allows borrowers to make monthly payments that cover only the interest portion of the loan. There’s also the option ARM, in which borrowers can choose to pay no principal and very little interest. Lenders add this unpaid interest to the balance of the loan (this is known as negative amortization).

“The power of choice is biggest change that has occurred in home financing over the last couple of decades,” said Joe Rogers, executive vice president of product development for Wells Fargo Home Mortgage. “Today, there are multiple types of mortgage products available and a variety of features within them, all of which are meant to support the individual needs and risk levels of varying home buyers. That didn’t exist when all you could get was a fixed-rate loan.”

While home prices and loan
2005: $645,300

Median House Price

Median Household Income

$66,657