

Real Estate Outlook 2007 Orange County

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The Year in Review

Last year, was the year for real estate to *catch* its breath - especially after two very “wild party” years of 2004 and 2005! With the aftermath of the hurricanes, oil prices rising, continued credit tightening by the Federal Reserve, increased fighting throughout the Middle East and the media’s *factual* but *not accurate* appraisal of the real estate market, it was remarkable that prices actually rose throughout most the year! Here is a look at quarter by quarter:

First Quarter:

1. Employment numbers stayed strong and the economy grew at a 5.6% pace.
2. The Federal Reserve continued to raise the discount rate, putting upward pressure on mortgage rates.
3. Inventory of homes and condos began the year just under 7,000.
4. Number of sales (compared to last year) declined 13.5% yet . . .
5. Orange County resale home prices continued to rise 14.7% while resale condo prices rose 14.4%!

Second Quarter:

1. The Federal Reserve raised the discount rate to 5.25% causing mortgage rates to rise over 6.5%.
2. It was clear that the buyers were pulling back as the sales volume declined 19.4%.
3. The inventory of homes (which usually declines) rose dramatically to 14,982 by end of June.
4. Sellers placing their homes on the market based their price upon the 1st quarter appreciation numbers.
5. Home prices rose 8.5% (from the previous year) while condo prices rose 7.3%.

Third Quarter:

1. The Federal Reserve decided to put a *pause* on interest rate hikes.
2. The normal *explosion* of summer listings did not take place but inventory continued to increase.
3. Sales volume declined 34% vs. last year and almost half of the listed homes were unmotivated sellers.
4. With fewer buyers and unrealistic sellers, the housing market began to react poorly.
5. By September, our listing inventory had peaked at 15,863 while sales continued to decline.
6. Orange County resale home prices rose 2.9% from 2005 and resale condos rose only 1.1%.

Fourth Quarter:

1. With the Federal Reserve still on *pause* from the summer, mortgage rates began to decline.
2. As mortgage rates fell below 6%, buyers began to return to the market place.
3. Although sales declined 27.7%, this was a much lower number than expected.
4. By the end of December, the housing inventory had dropped to 11,942.
5. Resale home prices ended the quarter at **-.96%** while the resale condo market finished at a **-.73%**.
6. For the year, the median price in Orange County went up **3.2%** with the median price being **\$639,000**.

Source: Sales data from DataQuick and inventory numbers from SoCalMLS.

So What Were The Final Numbers?

Well, it depends upon what type of report your clients are reading! There are *month to month* reports, *same month vs. last year*, *cumulative*, and *actual sales*. So what type of statistics are your clients seeing? Here is a look at the four most common sources that report on housing appreciation.

DataQuick Informational Systems:

This number is used the most by the media in southern California. They track the sales of all properties on a monthly basis and report the median price changes. They also report the cumulative difference year to date. The numbers on the previous page all come from this source on a month to month basis. If you use their *cumulative report*, the numbers are as follows: (through November):

Orange County	San Bernardino	Riverside	San Diego	LA
6.2%	14.8%	8.6%	.04%	8.7%

Case-Shiller:

This is one of the newer indices used by the commodity markets. Referred to as the Case-Shiller Indexes (CSI), it forecasts single-family and condo home prices and identifies long-term influences on prices, such as income trends and demographics, and cyclical factors such as joblessness and changes in mortgage rates.

Orange County	San Bernardino	Riverside	San Diego	LA
7.1%	N/A	N/A	- 1.0%	7.1%

Office of Federal Housing Enterprise Oversight:

This is a quarterly report from the government that tracks gains and losses on single family homes and condos sold or refinanced in a county. It involves only government-sponsored mortgage buyers it oversees, which are the Fannie Mae and Freddie Mac loans with a limit of \$417,000. These are for the 3rd quarter.

Orange County	San Bernardino	Riverside	San Diego	LA
11.3%	14.2%	14.2%	3.21%	15.98%

First American Real Estate Solutions:

This is the newest of the indices; it measures sales of both single family homes and condos against the amount sellers paid when they bought the property. The yearly percentages are based upon length of ownership.

Orange County	San Bernardino	Riverside	San Diego	LA
15.2% / 4.33 yrs.	21.6% / 4.0 yrs.	16.8% / 3.3 yrs.	12.1% / 5.15 yrs.	17.2% / 4.5 yrs.

Since 2000: 104.1%	107.9%	83.3%	98.70	113.8%
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Forecasting Record for "OC" This Decade: Gary: +102.5% vs. Actual: +104.1%

So Why Do You Feel So Bad? . . . Could It Be The Media?

Newspapers are losing subscribers and television is losing viewers. Viewers' reactions to media presentations of past events have shown the media that if they want to *hold* their viewers' or readers' attention, they can do so by portraying *fearful* "impending events" and instilling anxiety in their audiences!

They present information in a way that creates this anxiety or fearfulness. In so doing, it is important to be *factual* but not necessarily *accurate!* They use *bold headlines* to grab the viewers' attention, but the content often misleads or tells another story. Here are some very good examples:

- ◆ Remember all the fuss over **Y2K**?
- ◆ How about **Killer Bees, West Nile Virus and the Mad Cow** disease?
- ◆ What happened with 2005's "serious" **lack of vaccines** for one of the "worst" flu seasons?
- ◆ Where did **SARS** and the **Bird Flu**. . . fly to?

What They Do With Real Estate:

◆ **Housing Prices Continue to Decline!**

Only the rate of appreciation is declining; home prices are still rising. The median profit earned for **Orange County** was **\$291,000** for 4 years of ownership!

◆ **Supply of Unsold Homes Rises to 6 Months!**

In the U.S., the average supply has historically been around 6 months. For southern California, the average has been 3 to 4 months and today's present inventory, is a 4.2 month supply..

◆ **Home Sales Decline By 30 %!**

They are measuring against 2005's almost record year. Since 1996, the yearly average of all sales in Orange County has been 42,716. Last year our sales decline will be only 15% off our 10 year average.

◆ **Foreclosure Activity Rises!**

They have to be up after hitting a record low! The truth is that **99%** of all loans in the U.S. are not in foreclosure. The remaining **1%** that were foreclosed upon had the following breakdown:

- * 80% were classified by federal lenders as *Professional Thieves* and were turned over to the FBI.
- * 20% were classified by lenders as *Fraud for Property* that resulted in unethical lending practices.

- * Ca. Defaults: **Historical** 32,762 - **Low:** 12,145- 3Q'04 **High:** 59,987 – 1Q'96 **Current: 37,273**
- * For all of '06, foreclosures accounted for only 1.81% of all Orange County sales, with lenders reselling those homes at an average discount of only 3.8%!

◆ **Affordability Index at Record Low – So Few Can Afford to Buy!**

Home ownership is at a record high of 70%, while the baby boomers ownership percentage is 80%! This index is archaic and does not account for how dramatically the world changed in 1979.

Source: American Bankers Association, Mortgage Bankers Association, Freddie Mac, Fannie Mae

Why The World Changed in 1979!

Baby Boomers Impact

From 1945 to 1979, incomes increased at the same rate for all tax brackets. By 1979, the early *baby boomers* had been in the workplace for over 10 years. They were the most educated generation to enter the work force, and they had the skills for our *changing* world. With both spouses working, dual incomes would have a tremendous effect upon future wealth. Since 1979, a larger percentage of our population is becoming more and more affluent! From 1980 to 2004, the median income rose by 18% but . . .

- ◆ the top **20%** of incomes grew by **59%**, while the bottom **20%** of incomes grew by a measly **7%**!
- ◆ the top **1%** of incomes grew by **200%** - earning more than the entire bottom **50%** of wage earners!
- ◆ today, the top **10%** of wage earners receives **45%** of all household income.
- ◆ the top **85%** of the nation's wealth resides with the richest **15%** of Americans; the bottom **50%** holds only **2.5%** of the nation's wealth. Just **1%** of investors hold **53%** of all shares in the stock market!

Over the next decade, there will be a **25%** increase in the population over 50 years of age. They have more money than any preceding generation, due to having dual incomes, equity growth, and record inheritances (**60%** goes to the top **40%**)! This age group is spending **\$2 trillion** dollars annually! Last year, 2.1 million boomers turned **60**, with **25%** planning on not retiring. They found a way to mix leisure with work and are not ready to fully retire – they have *money and income* and they are still investing in real estate.

They are part of a major buying wave, as **75%** plan on moving to either the west or the south for warmth. Already, **80%** own their own home with **25%** of those owning additional property. This helps to explain why, in 2005, **27.7%** of all sales were for *investment* purchases and **12.2%** of all sales were for *2nd homes*!

They or their parents are also in the process of *transferring their wealth* to their children and grandchildren. These *newest* home buyers make up the largest group of the 3 buying waves. They are presently 23 to 33 years of age, and will total **1.2 million** new households per year for the next decade! They are purchasing at a median age of 26, yet those purchasing under 25 years of age now represent 14% of the *first time* home buyers market.

And let us not forget the wave of buyers that represent the *normal* buying market. This group is projected to grow at a rate of **1.17 million** per year for the next 7 years. They include *1st time* home buyers (median age 29) and those purchasing upscale homes (median age 45).

Add to this the immigrants purchasing real estate and you can see that the U.S. home buying market will remain strong. In the past 12 months, the U.S. population grew by **2.9 million persons**. By **2030**, there will be **80 million** more people living in the U.S.! From 1980 to 2000, over 6.2 million minority households joined the ranks of middle-income earners, and they are purchasing housing.

- ◆ Immigrant children who arrived with their parents in the '80's and '90's, are now buying homes.
- ◆ These **2nd generation** Americans, if history repeats itself, will out-earn their parents.
- ◆ As *1st time* buyers, they represent **35% of the 1st time** resale market.

Source: 2004/2005 Census, Federal Reserve, Internal Revenue Service, NAR

Impact (continued)

Immigration of new buyers is largely due to a U.S. policy of *family reunification*. Today, there are **34** million immigrants, making up **12%** of our total U.S. population and representing **28.4%** of all households.

- ◆ Presently, Latinos are the fastest growing segment of the U.S. housing market.
- ◆ Asians will become the fastest growing segment of the U.S housing market over the next decade, largely concentrated on the West Coast.
- ◆ Between 2000 and 2005, only 7 counties in the U.S. drew more immigrants than Orange County! Los Angeles is always #1.

Adding more pressure to the *already strained* housing market are the “single” players in home-ownership. Single or unmarried homeowners are remaining single longer. Divorced parents are also maintaining larger homes for their “floating children”. Single female buyers represent **21%** of the market, while single men make up **9%** of the market.

More on Wealth

There are now **2.9 million millionaires** in North America holding **\$10.2 trillion in assets**. There are **371 billionaires** holding **\$1.1 trillion** and California is home to **90 billionaires!**

The Federal Reserve reports that consumers have **\$5 trillion dollars** in liquid cash sitting in banks and savings and loans. Through June of last year, homeowners had **\$53.83 trillion dollars** of household net worth! Other assets held by individuals include: **\$3.2 trillion** in bonds and credit instruments, **\$1.1 trillion** in insurance reserves, **\$6.7 trillion** of equity in non-corporate businesses, **\$11.1 trillion** in pension funds and **\$2.5 trillion** in 401K's – plus **\$10 billion** in loose change in homes and cars!

Orange County Wealth

- ◆ Today, **30%** of Orange County households earn in excess of \$100,000 – up 32% since 1999!
- ◆ Since 1999, households earning in excess of **\$200,000** are up **50.2%** and now total **67,729** households!
- ◆ OC has one of the highest median incomes in the U.S. at **\$65,953**, which has tripled since 1980!
- ◆ Newport Beach ranks **# 1** in median income in the U.S. with **\$97,428!** Mission Viejo is **#2** at **\$90,855!**
- ◆ **11%** of households in OC have a net worth exceeding **\$1,000,000**.
- ◆ OC ranks **#3** in the U.S. with **113,299 millionaires** and is home to **5 of the 90 billionaires!**
- ◆ In OC, **14%** of our market is 2nd homes or income properties, and **22%** of our homes have no loans!
- ◆ OC had **89** properties sell for over **\$5 million** – up from 50 sales in 2005!
- ◆ OC poverty rates have fallen since 2000, reversing a 20 year trend!

Source: 2004/2005 Census, Federal Reserve, Internal Revenue Service

Why We Will Continue To Do Well In 2007!

The National Economy

If we take a look back at this decade, we have seen a lot of really bad things happen to both individuals and businesses. Our nation has seen the *crash* in the *Dot.Com* business world, an *attack* on our own *soil*, 2 geopolitical *wars* with serious consequences, *major* stock scandals, record corporate *bankruptcies*, the *doubling* of the price of oil, and as if all this were not enough . . . 17 consecutive rate increases by the Fed!

So let us look at what is happening now in our economy . . .

1. Since 2003, the U.S. has created **3.9 million** new businesses and approximately **7.5 million** new salaried jobs. Add the existing **16 million** self-employed, the **25 million** part-time workers and the **25.8 million** small businesses (where 75% are sole proprietorships) and you can see we are generating a whole lot of tax revenue.
2. As of December, we have employed **2 million** new workers over the past 12 months. The rate of **4.6%** for unemployment is a 5-year record low, and since **3%** of the population won't work even if you give them a job, we are near *full employment*.
3. These increased tax revenues have helped to reduce the originally projected deficit of \$325 billion down to around \$248 billion. Our tax revenues are up **14.1%** over last year, and the federal debt has been reduced by **20.8%**. The 1st Quarter deficit was **\$80 billion**, the smallest in 5 years and all but 4 states are running state budget surpluses!
4. Corporate profits have doubled in the past 4 years, and this year their after-tax profits averaged **20.3%** - the highest in 4 decades. This makes 18 straight quarters of double digit earnings! Corporations posted earnings of **\$1.42 trillion** in the 3rd quarter, and after paying quarterly taxes on Sept. 15th (setting a single *one day record* of **\$85.5 billion**), corporate cash is still at a historical high of **\$2 trillion**.
5. Since 1980, the Gross Domestic Product has risen **70%** and is now at **\$13.3 trillion**, helping to shrink our federal deficit. Today, debt is only **1.8%** of the GDP, compared with **6.0%** in '83 and **4.7%** in '92.
6. With both business and consumer spending growing, these forces are propelling the economy upward with a "one-two punch". Our economy should continue to grow between **2.5%** and **3.0%**!

Orange County...

- ◆ has the lowest unemployment rate in California (3.2%) and usually the second lowest in the nation.
- ◆ ranks #7 in the U.S. in creating jobs (32,175) and #5 in the U.S. in total number of jobs (1.6 million).
- ◆ job creation has been twice the national average since 1996 (due to the creation of 317,000 new jobs)!
- ◆ has the lowest housing ratio (to jobs) in the nation!
- ◆ ranks #5 in the nation in rental rate increases at 6.4%, plus has a 96.8% occupancy rate.
- ◆ ranks #3 in the U.S. in Asian businesses and #3 in Asian population in California.

Source: Federal Reserve, IRS, U.S. Bureau of Labor, California Employment Development Department (EDD), Forbes

We Live and Work . . . Where?

Southern California

It took California nearly **155 years** to grow from its low indigenous population to over 36.5 million people who now call this State home. In 2005, the state population grew by 600,000 domestic and 200,000 legal immigrants. In the next **20 years**, the population is projected to *double* - reaching almost **60 million!** In half that time, more than **3.5 million** people will move into southern California. It appears the State's *allure* has remained strong!

It is no wonder that with all these people, we employ 1 out of every 11 workers in the U.S. and produce **15%** of the nation's GDP. Our employment is growing at approximately 1.5% while our self-employed have grown to exceed **2.2 million!** Southern California is home to over **60%** of the state's entire diversified workforce, serving the *Pacific Rim* through **trade**, a growing **service sector**, and expanding **electronics** and **manufacturing**. Add **high-tech**, the **financial sector**, **bio-tech**, **construction**, **tourism**, **agriculture** and **government**, and it is easy to see why southern California is a magnet for highly productive jobs.

In southern Calif., **95%** of companies employ fewer than **50** people! Today's technologies enable companies to become highly productive with fewer people, ending the *boom-bust* cycle and its massive lay-offs.

- ◆ Southern California is adding **200,000** to **300,000** residents each year and ranks **#6** in the U.S. for metro areas in job creation, with 59,500 in the past 12 months. (Los Angeles/Long Beach/Santa Ana)
- ◆ December's unemployment rate for southern California was just **4.03%**, with Riverside being the highest at 4.6% and Orange County being the lowest at **3.2%**. Both Los Angeles and San Bernardino came in at 4.2%; Ventura showed 4.3%, and San Diego is at 3.7%.
- ◆ This year, venture capitalists have invested **\$2.25 billion** in southern California start-up companies!

Final Note on Housing: Those Who Own and Those Who Don't

1. We are the youngest of the home-building nations. History does repeat itself! Every country has gone through a cycle whereby it breaks into two parts: those who own a home and those who don't.
2. When this happens, rental rates begin to soar. We are in the beginning cycle of this event, as evidenced by the fact that the national rental rate increased **5.3%** in the last 12 months. Since 2001, the rise in rental rates has outpaced inflation.
3. Obviously this becomes a great benefit to those who own homes and rental properties – especially when the U.S. occupancy rate is now at **96.2%!**
4. Last year, investment purchases in Orange County represented **14.1%** of all sales. Rental rates increased **6.4%**, ranking OC # **5** in the U.S. in rental rate increases. Today, OC homeowners (on average) devote **25.4%** of their income to housing while renters devote **32.5%** of their income to landlords!

Source: DataQuick, State EED, Southern California Governments, 2004 Census, U.S. Bureau of Labor Statistics, CAR.

So What May Happen This Year?

Within the last quarter, we have had Alan Greenspan tell us “most of the negatives in housing are behind us,” the Dallas Fed Governor tell us that inflation appears to be under control, stock brokers upgrading building stocks to a hold or buy position, NAR reporting existing home sales rising, and the backlog of new unsold homes falling for a 5th straight month. In the U.S., the new median home price rose 2% for the entire year. In California, home sales have held steady at 450,000 since last year. CAR has revised their forecast upward, estimating an appreciation rate of 6.5% to 7% - which comes close to my forecast from last October.

First Quarter:

1. The economy will continue to show positive growth while the Fed continues to stay in the *pause mode*.
2. The interest rates will continue to remain around 5.78% to 6.25%, with some downward pressure.
3. Number of home sales may actually rise when compared to last year’s decline of 13.4%!
4. The media will have to compare last year’s numbers to this year and things will begin to look good!
5. However, resale appreciation may not rise when compared to the big increase in 2006’s 1st quarter!

Second Quarter:

1. The Federal Reserve should begin reducing the Fed rate, and mortgage rates should decline further.
2. Inventory should begin to rise, but at a moderate rate.
3. The media will have to report dramatically increasing home sales when compared to last year.
4. Home prices should continue to rise, and condo prices should begin to appreciate once again.

Third Quarter:

1. The Federal Reserve should see that inflation is moderating and continue to reduce the Fed rate.
2. Home buyers may see 5.5% interest rates by summer, and the sales volume will continue to rise.
3. The media will once again become our friend as they report these new positive numbers.
4. The inventory of homes should once again peak in September.

Fourth Quarter:

1. The Federal Reserve may *pause* once again, awaiting final year end numbers.
2. Home sales, although declining, should still be above 2006 numbers.
3. Home prices will be up for the year but will be moving slowly in this quarter.
4. Resale homes should rise about 7% while resale condos increase 4% for the entire year.

And this is why I’m predicting that you will have “ <i>a little bit of heaven in 2007!</i> ”
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What to Watch:

1. If the Fed sees things it does not like and raises interest rates.
2. If increases in our housing inventory push the supply past 5.5 months.
3. Un-motivated sellers still entering the market in large numbers.

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