

**Orange County Real Estate  
2005 Economic Report  
By Gary Watts**

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**January 18, 2005**

## About the Author, Gary Watts

This year marks the 31st year of Gary bringing to the real estate industry his *Economic Outlook for Orange County*.

Gary is a consultant to some of the largest real estate companies in Orange County. He was an accredited instructor for the California Department of Real Estate and sometimes guest lectures at Saddleback College where he once taught. Gary's specialties are economic forecasting, financing and real estate trends. He holds a degree in Economics with advanced studies in Psychology. The Register quotes Gary Watts more than any other forecaster, especially when it comes to the issue of housing and his economic predictions for Orange County.

### **The 3 Most Commonly Asked Questions About Real Estate:**

- I. **“Won't there be a lot of foreclosures when the interest rates go up on all those *interest-only* and *low adjustable rate* loans?”**
  - A. Equity
  - B. Delinquencies
  - C. Foreclosures
  
- II. **“At our high housing prices, how can people *qualify for a loan*?”**
  - A. Incomes
  - B. Debts
  - C. Lender Qualifications/ Loan Programs

### III. “Isn’t the *housing bubble* finally going to *burst* because Chapman University says real estate is going down this year by 7.4%?”

- A. Make-up of a Bubble
- B. Demand versus Supply
- C. Forecasts: For the Record on Housing Appreciation

#### **Their Record:**

Once again the economic gurus of our higher educational institutions have touted their forecasts for housing appreciation (or lack thereof) for 2005 . . . and once again, they will be wrong! Cal State Fullerton has housing prices dropping 20% over the next two years while UCLA sees downward pressure on housing prices but not as severe as the early '90's. Our own Orange County's Chapman University revised their forecast of -2.7% downward to -7.4% for housing in 2005!

My forecast: **Housing prices will appreciate 15% over the next 12 months!** This is not just a number pulled out of thin air, the following will tell you why - as well as comparing my record this century with reality!

	<u>Year</u>	<u>Chapman</u>	<u>Gary</u>	<u>Actual</u>
1.	2000	8.0%	12.5%	<b>13%</b>
2.	2001	7.7%	12.0%	<b>10.1%</b>
3.	2002	2.8%	10.0%	<b>16.8%</b>
4.	2003	2.0%	15.0%	<b>19.1%</b>
5.	2004	-2.7%	25.0%	<b>24.8%</b>
6.	2005	-7.4%	15.0%	<u>?</u>

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## **The Economic Forces Effecting Housing**

### **I. Demographics**

- A. Baby Boomers Demand for Housing
  - 1. 1<sup>st</sup> Wave – they are now in their mid to late 50’s

- a. reeked havoc on every industry
  - b. building homes became a major industry
2. 2<sup>nd</sup> Wave – 2<sup>nd</sup> largest group of the baby boomers
    - a. 36 is median age for 1<sup>st</sup> time home buyers
    - b. 45 is median age for upscale purchasing
    - c. this decade – 1.17 million new households per year
  3. 3<sup>rd</sup> Wave – the largest group
    - a. presently 23 to 33 years of age
    - b. next decade 1.2 million new households per year
- B. Housing Needs
1. Next 8 years we need 10 million new homes built
    - a. an average of 1.25 million per year
    - b. our record for building is 1.2 million
  2. From 2013 to 2023 we need to build 2 million units per year
    - a. new players putting pressure on the housing market
      - (1) 30% growth among women owning homes
      - (2) 27% growth from minorities – who own 15.2 million homes
      - (3) single/unmarried homeowners remaining in their home longer!
- C. Changes in Zoning . . . to Add Housing

1. How communities are built
  - a. 1<sup>st</sup> phase: they begin horizontal until built out
  - b. 2<sup>nd</sup> phase: to “infill” and then build vertically
    - (1) allows for more building
    - (2) cities change their code restrictions
2. Cycle of home remodeling
  - a. usually occurs in the first 12 to 15 years
  - b. must remodel by the 30<sup>th</sup> year
3. Demand/Supply Crisis
  - a. developmental land is gone yet demand remains strong
  - b. fewer and fewer new homes and condos are being built
  - c. forcing buyers into the resale market and appreciation to rise

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## II. The National Economy

- A. Business Expansion – All Regions are Growing!
1. Gross Domestic Product grew last year at a rate of 3.9%
  2. Consumer spending is up – retail sales are up
  3. Business capital spending is exploding as corp. cash is at a 30 year high

4. Non-manufacturing index rose for the 21<sup>st</sup> consecutive month
5. Manufacturing index rose for the 19<sup>th</sup> consecutive month

B. Jobs

1. Since November of '03, payroll employment is up by 2.2 million
  - a. biggest increase since 1999
  - b. add another million (+) for self-employed
2. Productivity (output per worker) is at historical highs
  - a. manufacturing is boosting average weekly hours/overtime
  - b. U.S. office vacancies decline to 14.5% - lowest since 2002
3. Unemployment rate is 5.4%

C. Interest Rates – Fed Funds Rate is at 2.25%

1. Consumer Price Index (as of Nov.) is 3.7%
2. Core index (minus food/energy) is 1.9%
3. Inflation to remain low: globalization/high tech/productivity
4. Mortgage rates are as low as they were a year ago
  - a. in housing, every ½% rise in rates creates 5% less demand

D. Housing – 69% of our population (73.8 million) now owns a home

1. 1.2 million new housing units built in 2004 – a new record
2. 6.94 million resale homes sold in 2004 – a new record
3. No state in the U.S. is has recorded a decline in housing prices
  - a. U.S. housing prices are up 10.4%
4. Low household debt – due to low interest rates and paid-off bills
  - a. refinances paid off 23% of debt and 24% went into remodeling
  - b. household payment ratio to income stands at only 17.5%
    - (1) early '80's: 30%
      - (a) to get back to this ratio, interest rates must rise to 8.5%
    - (2) late '80's: 22%
  - c. revolving credit, credit card debt is falling at an 11% annual rate
  - d. consumer credit declined \$8.7 billion in November – largest ever
5. Ownership is up 1.6 million in the past 12 months

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### III. California's Economy

A. Power State – we rank 5<sup>th</sup> in the world!

1. California represents 12-15% of the total GDP of the U.S.
2. 11% of all employed workers in the U.S. are in California
3. Receive 40% of the total share of venture capital in the U.S.

- a. last year, Southern California received 1.5 billion dollars
  - (1) high productivity – tops in the nation
  - (2) entrepreneurial environment

#### B. Diversified Economy

1. Trade – up 12% -14%
  - a. LA/LB is the 3<sup>rd</sup> largest seaport complex in the world
  - b. 15% of the nation's international cargo travels our freeways
  - c. longshoremen have agreed to 3 shifts-hiring 3,000 workers
  - d. rails added 500 locomotives/1,700 conductors and 4,200 workers
2. Service Sector is growing and retail sales are up
3. Electronics – largest single component of manufacturing
4. Manufacturing – Southern California is #1 in employment
5. High tech / bio-tech – both future growth areas
6. Agriculture – 5 central counties produce 15 billion worth of crops
7. Government is the weak spot – technology is replacing the workers
  - a. 1 out of every 6 jobs in the State but lost 44,300 jobs last year

#### C. Employment

1. 300,000 new jobs in the past 12 months – now over 14.5 million workers
2. 7 million work in Orange, LA and Riverside counties
3. Job growth and income are strengthening in Southern California
4. Corporate tax revenues are running 30% above forecast
5. Unemployment is at a 3 year low – 5.8%

#### D. Population – up 600,000 in the State in the past 12 months

1. Southern California's grew by 1 million in the past 3 years

#### E. Housing – 4 consecutive years of 10% or more appreciation!

1. 2001 to 2010 – we need 250,000 units per year
  - a. 1<sup>st</sup> 9 mos. Of '04: 156,788 permits – up 7.4%
  - b. still produces a shortage of 50,000
2. Median price in Southern California was up 23.1%
  - a. single detached home sales at 601,800 – a record
  - b. median sales price is \$450,000 – up 23.5%
3. Marin has the highest median price at \$753,000
  - a. the South Coast of Santa Barbara's median price is at \$1,053,750

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## IV. Orange County – “Economic Powerhouse”

#### A. Gross County Product “GCP” is: \$142 Billion

1. Orange County (as a nation) would rank 34<sup>th</sup> (out of 183) in the world!
2. has been growing at 2% for the past 2 years

3. 43.6 million visitors spend 7.3 billion yearly!
  4. ranks in the top 20 metro areas of the country for manufacturing
- B. Employment – # 1 in the nation for employment in large metro areas
1. lowest unemployment in So. Ca. and 2<sup>nd</sup> lowest in the State – 2.9%
  2. OC ranks # 1 in the nation in job growth to housing starts - 1.73%
  3. OC has 7 of Business Week's "100 Hot Growth Companies – ranking #1
  4. OC ranks #1 (in the nation) with the creation of jobs
  5. *Triple Endowment*
    - a. entrepreneurial culture
    - b. access to venture capital – ranks # 3 in the State
    - c. pool of talent not easily replicated anywhere in the world!
  6. employment numbers:
    - a. 2004 – employment rose 9,800
    - b. 2005 – forecasted to be 21,000 to 27,000
      - (1) vacancy rate for commercial buildings is at 4 year low
    - c. present employment is at 1,590,900
- C. Population – since 2000: ranks # 8 in growth in the nation @ 3.9%
1. OC has over 3,020,000 residents = 1% of the nation's population
    - a. 3,600 (+) per square mile
    - b. 3<sup>rd</sup> highest density in the United States
  2. Numerically #1 in the nation in population growth
    - a. since 2000 census: 350,000
    - b. dynamic economy / desirable location
    - c. immigration influx / strict zoning guidelines
- D. Housing
1. Need 15,132 units a year to meet demand – avg. 8,500
  2. OC builders had 18% to 21% of the total yearly sales – today 10% to 14%
  3. With half the homes needed being built, appreciation is permanent
  4. Current housing supply is at 8 weeks
    - a. quotes of 5 to 7 month supply of housing is flawed

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## The Real Estate Year

### I. The Cycles

#### A. The *Top Dollar* Season – February thru May

1. buyers enter the market in record numbers: 16,000 to 19,000
  - a. 8 year average: 4,328 per month

- b. 3 year average: 4,709 per month
  - 2. the least amount of listings are available
    - a. as of January 13<sup>th</sup> – 6,850 in (SOCALMLS)
  - 3. increase demand hits limited supply and prices rise rapidly
- B. The *Ugly* Season – June thru September
  - 1. sales volume drops 11%
    - a. 8 year average: 3,878
    - b. 3 year average: 4,269
  - 2. highest number of listings come onto the market (SOCALMLS)
    - a. May – 2,231 existing inventory
    - b. June – 7,078
    - c. July - 9,861
    - d. Aug. – 10,985
    - e. Sept. - 11,426
  - 3. seller's list their homes for more than the *top comps*
  - 4. 60 to 90 days later, price reductions
- C. The *Good Buy* Season – October thru January
  - 1. sales volume drops another 17% - 19%
    - a. 8 year average: 3,157
    - b. 3 year average: 3,636
  - 2. listings inventory begins a steady decrease
    - a. October - 10,924 existing inventory
    - b. Nov. - 9,678
    - c. Dec. - 8,611
    - d. Jan. - 6,345 (usually low due to holiday “holds”)
  - 3. motivated sellers reduce prices to the lowest levels of the year
  - 4. buyers acquire at least 13,000 homes during this time period

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## II. The Forecast & Year End Numbers

A. Ending Year's Housing Supply Ratios		vs.	Next Year's Appreciation	
1. 2001	10.7 weeks		2002	16.8%
2. 2002	6.2 weeks		2003	19.1%

3. 2003	2.9 weeks	2004	24.8%
4. 2004	8.1 weeks	2005	15% (f)

## B. 2004 - By the Numbers

### 1. Housing Overview

	<u>% of sales</u>	<u>median price</u>	<u>appreciation rate</u>
a. single family homes:	61.7%	\$ 575,000	22.2%
b. condos / townhomes:	27.0%	\$ 385,000	24.6%
c. new home:	11.3%	\$ 716,250	27.7%

### 2. Overall Numbers

a. median sales price:	\$541,000
b. appreciation rate:	24.8% in November
c. total number of sales:	47,876 vs. 53,791 - down 11%

### 3. Financing

a. adjustable rates:	72.3%
b. fixed rates:	27.7%
c. average down payment:	22.5%
d. monthly payment:	\$ 2,394.38 vs. \$2,127.83 – up 12.5%