Mid-Year Economic Outlook
for
Real Estate

presented by:

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I. Welcome To . . . The "Real" World of Real Estate!

A. The "Dream" Years Are Over!

1. Unlike the past 5 years of being *order-takers*, we are back to the real world of real estate. For many of you who entered into real estate during those years, you now have to deal with a new market and learn how real estate *really* functions. For those of us who have known markets like this, we just have to ***think back*** to how we use to sell homes!

a. Properly priced listings will take approximately 60 to 90 days to sell!
b. It is not uncommon for buyers to spend a month (or more) looking for a home!

2. Everything is really "OK" and the message you have to convey to your clients is to be patient, while everyone readjusts to this changing marketplace.

a. Sellers must be more realistic about the pricing of their home or stay out of this market until it improves – which it will!

b. Buyers need your help in understanding the *difference* between what is really happening in our marketplace versus what the various media sources are conveying.

B. Understanding the Difference Between Factual and Accurate!

1. The media will tell you that in southern California, sales last month were down 28% from last year. That is ***factual*** but it is not ***accurate!*** Our April sales of 24,898 homes actually exceeded are average for the last 2 decades!

2. The media will tell you that the median sales price was only 8.7%! Although ***factual,*** it is not ***accurate!*** Apartment conversions are pulling down the new home median sales price and thus lowering the overall median price. The resale market is doing well.

3. By the Numbers:

		2005			2006	
		Sales	**Price**	**Appreciation**	**1st Qtr.**	**April**
a.	**Los Angeles**					
	Homes:	**84,191**	**$495,000**	**20.1%**	**17.8%**	**15.2%**
	Condos:	**23,032**	**$385,000**	**18.5%**	**15.3%**	**11.2%**
b.	**Orange County**					
	Homes:	**30,386**	**$650,000**	**14.0%**	**14.7%**	**11.1%**
	Condos:	**14,146**	**$435,000**	**14.5%**	**14.4%**	**9.5%**

C. A Very Strong National Economy

1. May marks the Federal Reserve's 16th straight rate increase and yet they still can not slow this economy down! This *should* be the end of rate hikes for the rest of the year.

2. Despite higher gas prices, consumers are still feeling fairly confident and with no job losses, our housing market remains surprisingly strong. Since most sellers have no financial pressures to sell, there is little need to drastically reduce their prices.

3. Business spending is growing at its fastest pace in six years, which helps explain how the GDP for the 1st quarter expanded at an amazing **5.3%**! That makes 12 out of the last 13 quarters (last quarter was 1.7% due to the hurricanes) in which the GDP has exceeded 3%!

4. Personal income has been growing at twice the rate predicted by economists. So with the consumers making up 70% of the economy and business spending growing, these are hitting the economy with a "one-two punch". The economy should continue to grow at a rate between 3.0% to 3.5% for the rest of the year.

5. A Gross Domestic Income of **$12,600,000,000,000** is helping to shrink the federal deficits. Today, they are only **2.7%** of the GDP, compared with **6.0%** in 1983 and **4.7%** in 1992!

6. Increased tax revenues, have the Budget Office reducing the deficit by $320 billion this year. In April, the U.S. Government had a budget surplus of $119 billion!

7. As of April, we have employed 1.9 million new workers over the past year. We have averaged over 2 million for the last two years – all adding tax receipts to the Treasury.
If you add in the self-employed, we added another 1 million workers last year!

8. April's unemployment rate of 4.7% is the lowest since 2001, <u>and</u> since 3% of the population won't work even if you give them a job, we are at nearly full employment.

9. This explains why, in the U.S:

a. Incomes exceeding $100,000 (+) are growing 6 times faster than the population.

b. For the first time, there are over 1 million people living in $1 million dollar homes.

c. 2.5 million people had net financial assets exceeding $1 million dollars, which is up 10.3% from the previous year.

D. A Strong California Economy

1. California produces 15% of the nation’s GDP. One out of every eleven workers in the U.S. is employed in this State - 16.874 million workers!

2. Our employment growth is at 1.5% adding 223,000 jobs last year. However our self-employment growth rate is 11.1%, which added another 214,000 jobs.

3. California has one of the most diversified economies in the world, serving the *Pacific Rim* through **trade,** a growing **service sector**, and expanding **electronics** and **manufacturing.** Add **high-tech**, the **financial sector**, **bio-tech**, **tourism**, **agriculture** and **government**, and it is easy to see why California is one powerful state!

4. In southern California, there are over 10 million people employed, plus another 1.5 million that are self employed. April’s unemployment rate for southern California’s six counties was only **4.15%!**

   a. Los Angeles has the highest at 4.8% while the “OC” has the lowest at 3.4%.

   b. San Diego was 3.9%, Ventura was 4% and both Riverside and San Bernardino counties posted a 4.4% unemployment rate.

5. High employment numbers have allowed the state to post record surpluses! In April, the State had a $5 billion dollar surplus, and there were additional surpluses at the end of last year.

6. In southern California, 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.

7. This helps to explain the following:

a. 48,666 million dollar homes were sold in California last year, which was a 47% increase over last year! That’s 1 out of every 13 sales in the State!

b. There are over 450,000 million dollar homes in California! Last year in Orange County, there were 7,342 homes sold, which represented 15% of the real estate market. In Los Angeles, just over 10,700 million dollar homes sold!

c. Think of the cities of Inglewood, Compton and Watts. Now think of housing prices appreciating 38% to 46% yearly in those cities!

II. “But What About . . .”

A. The Housing Bubble?

1. It was suppose to occur in 2002. Forecasters have been telling you for 5 years that it is about to happen!
   a. It can’t happen when your creating jobs!
   b. It can’t happen when your population/housing needs are growing
   c. It can’t happen when you are out (or almost out) of land to develop.

2. When you see ***massive job losses***, then you can begin to talk about a bubble!

B. The Affordability Index?

1. When 67% to 70% of your county residents already own a home, then the index effects only 3 out of every 10 people – so who cares?

2. This 40 year (+) index is no longer relevant due to the seriously flawed assumptions it contains:
   a. Assumes everyone must put 20% down and must have fixed rate financing.
   b. Assumes the buyer’s income is the median income in the area when purchasing a median priced home.

C. At These Prices, Who Can Afford Them?

1. Obviously a lot of people. Last year in the U.S., a record **1.21 million** *new homes* and a record **7.1 million** *resale homes* were sold- California set a record selling **635,000** homes.

2. A larger percentage of the population is continuing to become more affluent!
   a. From 1945 to 1979, incomes increased at the same rate for all tax brackets.
   b. Since 1980, after-tax per capita incomes are up 61%.
   c. From 1979 to 1997, the top **1%** tax bracket increased **157%**!

3. Last year, **12.2%** of all sales were for *second homes*! Another **27.7%** of all sales were for *investment purchases*! In “The OC”, **4.1%** are 2nd homes while **10.1%** are investors.

4. Today, mortgage costs average **17.5%** of household income vs. **30%** in the ‘80’s. In OC, **43.2%** pay 30% or more, but that is due to the *upper ranks* of OC jobs increasing by 50%!

Over the next decade, there will be a 25% increase in the population who are over 50 years of age. They have more money than any preceding generation, due to having dual incomes, equity growth, and record inheritances!

D. Interest Rates Rising . . .Creating Foreclosures & Buying Opportunities!

1. Look what we have been through in the past year:

    a. Gas prices almost doubled.
    b. Hurricanes hitting the South.
    c. A protracted war in Iraq with a militant running Iran.
    d. Nigerians working in the oil fields have gone on strike.
    e. Venezuela's congress is voting on nationalizing the oil industry.
    f. Bolivia nationalized their oil industry.
    g. Ecuador nationalized Occidental Petroleum's holdings.

2. Interest rates on conforming loans have risen <u>only</u> **.68%** since last September. The 10-Year Treasury has risen from 4.4% to 5.07% since January. So few are effected:

    a. 35% of owners own their home outright
    b. 50% have a fixed rate loan
    c. 15% have adjustable/interest only – but 8% of those being of *high wealth!*
    d. Therefore, only **7%** of all mortgages are interest rate sensitive.

3. This may help to explain the very low foreclosure rate in both the U.S. and California. Buyers have enough income to move from rising adjustable rates to fixed rate financing. Presently, 78% of all new loans are fixed rate loans.

4. The Federal Reserve reports that consumers have ***$5 trillion dollars*** in liquid cash sitting in banks or savings and loans.

5. Keep waiting! Last year Orange County sold **48,883** homes and only **142** were foreclosure sales! Today, OC is averaging 22 foreclosure sales a month. Most are due to combination of stupidity, fraud and 100% financing.

6. Buyers wanting foreclosures should also know that when they go to bid on these properties, they will have to compete with the "Group of Seven". They acquire approximately 98% of all foreclosures in southern California!

7. One last thought on foreclosures: The Mortgage Bankers Association says that the equity position in the U.S. stands at **57%** - a fairly safe buffer against price declines!

The Federal Reserve estimates that American households' <u>net worth</u> at the end of the year was **$51 trillion dollars!**

8. The rates should start to come down and will most likely settle around the 5.875% to 6.25% range for fixed rate loans. Since 2003, we have had four prior upward moves bigger than that, each of which later largely or completely reversed itself.

III. Just the Facts

A. Demand for Housing

1. The State population grew by approximately 608,000 last year. We now have over 36 million people and in southern California, 1.39 million joining us over the past 4 years.

2. In the next 10 to 15 years, **3.5 million** more people will reside in southern California.

3. This demand is coming in *waves,* the first ***1st wave*** being the baby boomers who are now in their early 40's and late 50's. They found a way to mix leisure with work and are not ready to fully retire – they have *money and income* and are <u>still investing</u> in real estate.

4. The ***2nd wave*** of home buyers are predicted to grow at a rate of **1.17 million** per year for the next 7 years. They include *1st time* home buyers (median age 36) and those purchasing upscale properties (median age of 45).

5. The ***3rd wave*** of home buyers is the largest group. They are presently 23 to 33 years of age and will total **1.2 million** new households per year for the next decade!

6. Last year we added **1.7 million** new homeowners. There are now **74.8 million** homeowners, who make up **69%** of our population – a new high!

B. More Demand – Here Come the Immigrants!

1. 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 with California being the #1 destination – receiving 22.4% of all immigrants!

   ♦ Since 2000, 1.1 million more foreign immigrants have moved to California.
   ♦ Los Angeles ranks #1 in the U.S., receiving 400,000. OC ranks #11 with 83,000!
   ♦ Latinos are the fastest growing segment of the housing market in the U.S.

2. From 1980 to 2000, over 6.2 million minority households joined the ranks of middle-income earners and are purchasing housing.

   ♦ The children who arrived with their parents in the '80's and '90's, are buying homes.
   ♦ These ***2nd generation*** Americans, if history repeats itself, will out-earn their parents.
   ♦ As 1st time buyers, they acquire homes at 26 – a full decade before non immigrants.
   ♦ Today, they represent ***35% of the 1st time*** resale market.

Adding more pressure to the *already strained* housing market are the new players in homeownership. There has been a 30% growth among women owning homes, 27% increase in minorities owning homes (15.7 million). Single or unmarried homeowners are remaining single longer, adding pressure to the housing supply.

IV. Today and Tomorrow

A. Planning for More Growth

1. Demand for housing is staying strong, but land available for development is diminishing. Environmental issues restrict or reduce the size of developments, while political or regulatory-driven supply constraints continue to hamper development of new housing.

2. Last year, California built 207,200 units, breaking a 15-year record! Demand called for 250,000 units. In 2006, the State hopes to build between 185,000 to 195,000 units.

3. For Los Angeles, the land is almost gone. That leaves development of the "in-fill" lots with almost all development being vertical to meet the needs of the County.

4. In the past 20 years, Orange County developers built 260,000 homes, condos, and apartments. In the next 20 years, they will build 56,000 units and then all the land will be gone!

   - ♦ There are currently 36 high-rise condominium towers under construction or in various stages of pre-development in Orange County.

B. The "OC"

1. There is a great demand for living and working in Orange County.

   - ♦ "The OC" added 31,600 jobs in the past 12 months and ranks as the **9th** most productive job growth county in the nation. OC ranks **#5** in the number of jobs (1.5 million), in addition, approximately 300,000 are self employed.

   - ♦ Ranks # 1 in the state, #2 in the U.S., with an unemployment rate of 3.4% because of the ***Triple Endowment* –** entrepreneurial culture ♦ access to capital ♦ educated talent.

   - ♦ Since 2000, it is the 8th fastest growing county in the nation. It ranks #7 as the most dense county in the U.S. and 2nd with the most population (1% of the U.S.)

   - ♦ Ranks # 8 in the nation in manufacturing, with 184,800 jobs. With all the new commercial construction, the vacancy rate is at a 5-year low!

2. OC has a *dynamic economy* in one of the most *desirable locations* in the world. Most of the County was developed under *strict zoning guidelines,* and our *population growth* should continue to keep upward pressure on the housing market!

- ♦ 43 miles of beautiful shoreline and 51% dedicated open space.
- ♦ 14th largest market in the U.S. and ranks #3 (per household) in retail sales.
- ♦ A magnet for tourists, attracting 44.7 million visitors spending $7.7 billion dollars.
- ♦ The median age is 34.2 and has one of the highest household incomes in the U.S.
- ♦ OC ranks #3 in the U.S. with 113,299 millionaires and there are 5 billionaires!