

Real Estate Outlook

2006/2007

October - 2006

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Gary Watts' forecast for 2006/2007 marks the 34th year of bringing to the real estate industry his outlook for the resale housing market. Since Gary speaks only to the real estate industry, his information is presented in a format that real estate agents can use to inform their clients. His forecasting analysis includes both the current marketplace and where housing demand and pricing will likely to be heading. In the 1970's he forecasted trends, in the 1980's he began forecasting the direction of home prices which included his now famous 1989 talk *The Party is Over*. In the mid 1990's, he gave the signal to the real estate industry that the *bad times* were over and in this new millennium, Gary began forecasting home price appreciation rates. His forecast versus the actual appreciation numbers are listed below. Even though we are enduring the "hang-over" from the last *two* "wild party years", Gary still does not see any economic signs that will cause any major problems for housing or a decline in their prices.

For the record, here are his numbers compared to actual numbers for our new millennium:

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>Totals:</u>
Gary's Forecast:	12.5%	12.0%	10.0%	15.0%	25.0%	15.0%	15.0%	104.5%
Actual:	13.0%	10.1%	16.8%	19.1%	24.8%	16.5%	7.7% *	106.3%

- through August of 2006

Last Year's Forecast

What Went Right!

1. Interest rate increases will be no more than ¼ to ½ percent on the upside, with it all being given back in the fall.
2. The Federal Reserve will stop raising rates by summer and may even begin to reduce the Fed rate by fall.
3. U.S. Economy will continue to grow and budget deficits will decline.
4. Employment will continue to increase as business activity remains strong.
5. Home price appreciation will continue upward with no “Bubble” in site.

What Went Wrong . . . (besides all the world problems)!

1. Inventory of both homes and condos *exploded* upward when seasonally, they should have begun to decline.
2. By April, resale condo prices began to decline (from previous month) but corrected by August and are still positive year to date.
3. By June, resale home prices began to decline (from previous month) but corrected in September and are still positive year to date.

How Will This Year End?

1. As mortgage rates continue to decline, buyers will get off the fence and purchase homes as soon as they believe housing prices have stabilize.
2. Sales of homes should start to rise by the fall, while inventory goes into its seasonal decline.
3. Appreciation should continue to rise in the fall, compared to last year when prices actually dropped.
4. We will end the year with positive appreciation in homes while condo prices produce a very small gain.

Resale Numbers:

December 2005	<u>Homes</u>	<u>Condos</u>	<u>Inventory</u>	<u>Appreciation Rate</u>	
	\$660,000	\$459,000	8,105	% change (YTD) vs. '05	
	<u>Homes</u>	<u>Condos</u>			
January 2006	668,250	455,000	6,910	16.2%	15.8%
February	690,000	462,000	8,195	15.5%	14.2%
March	695,000	469,000	9,140	14.7%	13.2%
April	705,000	460,000	10,404	13.8%	9.5%
May	705,000	460,000	11,135	12.6%	8.8%
June	700,000	456,000	13,489	11.5%	3.8%
July	699,000	450,000	14,982	10.5%	9.6%
August	685,000	460,000	15,698	9.2%	8.4%
September			15,863		
October			15,462		
November					
December					

Projected Appreciation- 2007
6%-7% 4%

Current Housing Supply as of October 2006: 21.76 weeks

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

The Media: *Factual vs. Accurate*

Their Problem

Newspapers are losing subscribers and television is losing viewers. Consultants have advised them that if they want to *hold* their viewers' or readers' attention, they have no alternative but to portray *fearful* impending events and instill anxiety in their audiences!

This raw emotion will help to keep people *tuning in*, thus possibly preserving precious advertising dollars. The media's portrayal of a few past events will help make this point clear:

- ◆ What did they put us through with **Y2K**?
- ◆ How about the **Killer Bees** of South America, the **West Nile Virus** and **Mad Cow** disease?
- ◆ What happened with last year's "serious" **lack of vaccines** for one of the "worst" anticipated flu seasons?
- ◆ Where did **Scars** and the **Bird Flu** . . . fly to?

Their Solution

Present information in a way as to create 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:

- ◆ **Housing Prices Continue to Decline!**
Only the rate of appreciation is declining but home prices are still rising!
- ◆ **Supply of Unsold Homes Rises to 6 Months!**
In the U.S., the average supply has historically been around 6 months.
- ◆ **Home Sales Decline By X %!**
Again, historically our home sales are still about a ½ million units *higher* than any other time except for the period between mid June of 2003 and mid June of 2005.
- ◆ **Foreclosure Activity Rises!**
Note that they use the word "*activity*". This means "**Notices of Default**", but less than 10% of those ever go to foreclosure! Also, foreclosures have to naturally rise after hitting all time record low! The truth is that **99%** of all loans in the U.S. are not in foreclosure and the remaining **1%** that were foreclosed upon had the following breakdown:
 - * 80% are classified by federal lenders as *Professional Thieves* and have been turned over to the FBI.
 - * 20% are classified by lenders as *Fraud for Property* which resulted in unethical lending practices.

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

- ◆ **Affordability Index at Record Low – So Few Can Afford to Buy!**
This index does not account for a world that changed dramatically in 1979. With homeownership at a record high of 70%, yes, that does leave so few to buy – only the 30% who do not own a home!

Why The World Changed in 1979!

Baby Boomers Impact

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 with skills for the *changing* world. With both spouses working, these dual incomes would have a tremendous effect upon future wealth.

From 1945 to 1979, incomes increased at the same rate for all tax brackets. Since 1979, a larger percentage of the population is become more and more affluent! From 1980 to 2004, the median income rose by 18% but . . .

- ◆ the top **20%** of incomes grew by **59%**
- ◆ the bottom **20%** of incomes grew by only **7%**
- ◆ the top **1%** on incomes grew by **200%!**

1. Today top **10%** of wage earners receive **45%** of all household cash income.
2. The top **85%** of the nation's wealth resides in the richest **15%** of Americans while the bottom **50%** hold only **2.5%** of the nation's wealth.
3. 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! This age group is spending **\$1.7 trillion** annually!
4. This helps to explain why, last year, **27.7%** of all sales (2.3 million) were for *investment* purchases while **12.2%** of all sales (1.0 million) were for *2nd homes*!
5. The Federal Reserve reports that consumers have **\$5 trillion dollars** in liquid cash sitting in banks and savings and loans. By mid-year, they had **\$53.83 trillion dollars** of household net worth!
6. Other assets held by individuals includes: **\$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, **\$2.5 trillion** in 4019k)s and there is over **\$10 billion** in loose change American homes and cars!
7. There are now **2.9 million millionaires** in North America holding **\$10.2 trillion in assets!** California is home to **90 billionaires!**.

Orange County Wealth

- ◆ Today, **30%** of Orange County households earn in excess of **\$100,000!**
- ◆ Since 1999, households earning in excess of **\$200,000** is up **50.2%** and now totals **67,729** households!
- ◆ OC has one of the highest median incomes in the U.S. at **\$65,953**. Newport Beach #1 in U.S. **\$97,428** with Mission Viejo being #2 with **\$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 the home to **5 billionaires!**

Source: 2004 Census, Federal Reserve, Internal Revenue Service

Why We Will Continue To Do Well In 2007?

The National Economy

If we take a look back over the past 5 years, we have seen a whole 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 *country*, 2 geo-political *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 over 5 million new salaried jobs. Add to that another couple of million self-employed jobs the government can't accurately gage, the existing 10 million self-employed, 25 million part-time workers plus the 24 million small businesses where 75% are sole proprietors and you can see we are generating a whole lot of tax revenue.
2. As of August, we have employed 1.7 million new workers over the past 12 months. The unemployment rate of 4.7% is near 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 only \$240 billion. Our tax revenues are up 13% over last and while the federal debt has been reduced by 20.8%. There is a chance that a surplus *may* occur next year, and all but 4 states are running state budget surpluses!
National Association of State Budget Offices says the 4 states are: Indiana, Louisiana, New Jersey and Rhode Island.

4. Corporate profits have doubled in the past 4 years and this year, corporate (after-tax) profits are averaging **20.3%** - the highest in 4 decades. This makes 16 straight quarters of double digit earnings! Corporate cash is at a historical high of **\$2 trillion** dollars after paying their quarterly tax to the IRS on Sept. 15th which set a one day record of **\$85.5 billion** dollars - beating last year's record of **\$71 billion!**
5. Since 1980, the Gross Domestic Product has risen **66%** and is now at **\$12.6 trillion**, helping to shrink our federal deficit. For the first half of the year, the GDP has averaged **4.25%** and that makes 12 out of the last 14 quarters in which it has exceeded 3%. Today, debt is only **2.7%** of the GDP compared with **6.0%** in '83 and **4.7%** in '92. From Sept. 11th 2001 to Sept. 11th 2005, our GDP is up **\$3 trillion!**
6. Personal income is growing a twice the rate predicted by economists. With business spending growing and the consumer making up 70% of the economy, these forces are propelling the economy upward with a "one-two punch". Our economy should continue to grow between 2.5% and 3.0% for the rest of 2006.

Orange County

- ◆ has the lowest unemployment rate in California (3.7%) and the second lowest in the nation.
- ◆ ranks #10 in the U.S. in creating jobs and #5 in the number of jobs (1.5 million).
- ◆ ranks #5 in the nation in rental rate increases at 6.0% 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 Statistics, California Employment Development Department (EDD)

We Live and Work . . . Where?

Southern California

Around the 1850's, people began to arrive to California. Last year, the State population grew by 600,000 domestic and 200,000 legal immigrants. It took **155 years** to grow from almost no one to over 36 million people who now call this State their home. 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 States' *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-employment is growing in excess of 11%! Southern California is home to over **60%** of the States' 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 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.

- ◆ southern California is adding **200,000** to **300,000** residents each year!
- ◆ August unemployment rate for southern California was only **4.55%** with Riverside being the highest at 5.2% and Orange County being the lowest at 3.6%. Ventura was 4.6%, while San Bernardino came in at 4.7% and Los Angeles showed 5.1%, with San Diego posting a 4.1% unemployment rate.
- ◆ Los Angeles created only **40,264** new jobs (with 10 times the population of OC) vs. Orange County creating **38,175** new jobs! OC has one of the lowest commercial vacancy rates in the nation at **7%**!
- ◆ High employment numbers have helped the State post a \$7.5 billion dollar surplus!
- ◆ statewide listings are on par with the average number of listings over the past 25 years!
- ◆ million dollars(+) home sales accounted for **1** out of every **13** sales in California with Los Angeles selling over **10,700** while Orange County sold **7,342** million dollar (+) homes!

Sales Stats for Southern California

Year-to-year percent increases:	2000	2001	2002	2003	2004	2005	2006 mid-year
Homes:	13.9%	16.8%	20.9%	24.4%	18.9%	4.6%	6.6%
Condos:	16.1%	20.0%	22.2%	28.4%	16.8%	2.0%	4.0%

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

Housing Supplement

The Facts About Housing:

A. Demand for Housing

1. This demand is coming in *waves*, the first *Ist wave* being the baby boomers who are now in their early 40's to early 60's. They found a way to mix leisure with work and are not ready to fully retire – they have *money and income* and are still investing in real estate.

2. 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 29) and those purchasing upscale homes (median age 45).
3. 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! They are purchasing at a median age of 26. Those purchasing under 25 years of age now represent 14% of the *first time* buyers market.
4. Last year we added **1.7 million** new homeowners. There are now **74.8 million** homeowners, who make up **69.9%** of our population – a new high!
5. In the past 12 months, the U.S. population grew by **2.8 million persons**. By **2030**, there will be **80 million** more people living in the U.S.!
6. Between 2000 and 2005, only 4 counties in the U.S. drew more immigrants than **Orange County!**

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 and represent 28.4% of all households.
 - ◆ Presently, Latinos are the fastest growing segment of the U.S. housing market.
 - ◆ The Asians will become the fastest growing segment of the U.S housing market over the next decade, largely concentrating on the West Coast.
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.

3. 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.
4. In 2004, more “single” or “unmarried” persons bought real estate than those “married with children!”.

C. 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 this cycle, whereby it breaks into two parts: those that 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 the national rental rate are at **5.3%** annually. Since 2001, the rise in rental rates has outpaced inflation.
2. 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%**!
3. Last year, investment purchases in Orange County represented **14.1%** of all sales. Rental rates increased **6.0%** ranking it **# 5** in the U.S. in rental rate increases.

Source: Census Bureau, National Association of Realtors, National Association of Homebuilders, DataQuick Information Systems