

Where Are Real Estate Prices Going In Northern California? by Hendricks & Partners

2004 REVIEW

While the East Bay apartment market remained sluggish in 2004, encouraging signs emerged, including the area's first positive yearly absorption total since 2000 and a leveling off of the consistently climbing vacancy rates that began in early 2001. Responsible for the turn in apartment demand was an up tick in hiring over the second half of 2004. By year's end, local employers added 12,200 jobs (1.2%) from their December 2003 employment figures. Meanwhile, housing prices in the East Bay continued their rapid ascension in 2004 despite the region's only recently concluded two-year decline in employment. For the year ended December, the region's median-priced single-family home rose 22.1% (to \$470,000) in Contra Costa County and 18.8% (to \$505,000) in Alameda County. Accompanying this was a sharp slide in their housing affordability indexes from 12 to 10 and 20 to 14, respectively.

- Amid the year's strengthening employment trends and ever dwindling housing affordability, positive apartment demand was recorded in the fourth quarter of 2004, bringing the year's overall total to 189 units.
- While new apartment development fell roughly 50% in 2004 from the previous year, a still substantial (*in light of depressed demand*) 767 apartment units reached lease-up for the year. The previous six years recorded deliveries averaging 1,600 units annually.
- Likely influenced by the abundance of condominium projects planned for the area, multifamily permits reached nearly 4,000 units last year; this was up from a robust 3,500 units permitted the year prior.
- The market's average apartment vacancy rate held relatively steady for the year, measuring 5.4% in December 2004.
- In concert with elevated vacancy rates, the market's average apartment rent retreated 1.2% over the past 12 months. Of note, however, the rate of decline slowed from 2.6% the previous 12 months.

FORECAST 2005

Anchored by a further rebound in demand, the Oakland/East Bay apartment market is set for stabilization this year before a period of steady improvement commences in 2006. A favorable employment outlook (*within the backdrop of ever-decreasing entry-level housing affordability*) will secure Oakland's strongest year for apartment leasing activity since the year 2000. Look for absorption to reach nearly 1,000 units this year and roughly double that the subsequent year.

While apartment demand will improve markedly in 2005, still relatively aggressive apartment construction will delay a fall in vacancy until at least the following year. Illustrating the strong degree of developer interest in the region, multifamily permits hit nearly 4,000 units last year, a level not reached since the late 1980s. While somewhat inflated by aggressive condominium development, a sizable 900 apartment units are slated for completion by the close of 2005 and a still greater figure upwards of 1,200 units is likely to be delivered in 2006. Aside from a handful of projects within the Oakland area, ongoing development will be concentrated within less-developed areas, particularly in and around the cities of Dublin (*East Alameda County*) and San Ramon (*South Contra Costa County*).

With supply mirroring demand, the East Bay's average vacancy rate will edge only minimally lower in 2005. A shift to stronger demand in 2006 (*in excess of supply*) will promote tighter lease-up conditions, with vacancy reaching the mid-to-upper-4.0% range by the close of next year. The market's 4-year decline in rental rates will conclude by the end of 2005, with 2006 ushering in a return to growth of around 2.0%.

SALES PRICE / UNIT

HISTORICAL REVIEW

The East Bay region has historically been blessed with greater economic stability and more favorable demographic trends than its Bay Area neighbors to the south and west. Originally a shipping/transportation stronghold, the Port of Oakland was the 1st major port on the West Coast; the East Bay has evolved into a center of state government, professional/business services, and retail trade. It is this economic diversity (*i.e. divergence from the IT industry*) that has cushioned the region from the more severe slowdown seen elsewhere during the recent tech crash. Whereas office vacancies rose to over 20% immediately following the crash of 2001 in the South Bay and San Francisco markets, Oakland's comparatively diverse tenant base allowed its buildings to retain vacancies of just 15%.

The area's comparatively affordable housing market has led it to become a sizable bedroom community to job centers elsewhere in the Bay Area. At latest measurement, a median priced home in Alameda County cost only 75% of the greater Bay Area average, while Contra Costa County was even more affordable at just over 70%. Comparative affordability allowed the region to record robust population growth in the 1990's of nearly 14% - compared to 11.6% in the South Bay and 7.3% in San Francisco – as well as escape the widespread out-migration of residents plaguing more costly regions of the Bay Area following the recent tech crash.

EMPLOYMENT FORECAST

A gradual recovery is expected for the greater by Area this year and next, led not by a turnaround in tech employment, but rather in the construction, business services, leisure/hospitality, and health care sectors. This mix of industries will heavily favor the East Bay region. Of the 12,000 jobs added in the East Bay last year, roughly 6,000 were created in the construction industry, with a large portion of these in the booming residential market. With mortgage interest rates holding close to their historic lows, and not expected to rise substantially through the close of 2005, expect a similarly impressive performance by the construction industry this year. While a risk of slower construction activity the following year in the East Bay looms over the sustainability of job creation, even contraction within this sector will be offset by larger gains in the local healthcare, professional/business services and finance industries.

A widely noted caveat to the health of Oakland's sizable public sector lies in the state's budget crisis. However, this potential dark cloud should be tempered by news of renewed job growth (*greater than 2.0% last year*) in the San Francisco economy, which employs a large portion of East Bay residents.

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