

Where Are Real Estate Prices Going in Orange County? by Hendricks & Partners

2004 REVIEW

Orange County apartments recorded a banner year in 2004 despite the region's mixed economic performance. Non-farm employment recorded a minor 0.8% growth rate for the 12 months ended December (*a 50% slowdown from the year prior*), hindered by declines in professional/business services and government employment, while the construction and tourism industries continued their expansion. Bolstering apartment demand in the face of minimal job growth was the region's unrelenting rise in housing prices, which left many of the year's newly created households with little alternative to rental housing. Orange County's median-priced home stood at over \$625,000 in December of 2004, a roughly 17% increase from its year-ago value that depressed the local affordability figure from 18% to just 13% at last measure.

- Amid active apartment development, apartment absorption measured a robust 2,954 units for the year, double the volume of net move-ins recorded in 2003.
- A total of 2,758 new apartment units reached lease-up for the year – concentrated in the cities of Fullerton (*North Submarket*) and Irvine (*South Submarket*) – a 50% increase from 2003's completions.
- Developer interest drove multi-family permitting activity higher for the year as well, from roughly 2,900 multi-family units in 2003 to nearly 4,000 units last year.
- With demand slightly ahead of supply, the market's overall vacancy rate edged slightly lower for the year from 4.4% in December 2003 to 4.1% at the close of 2004.
- Aided by the skyrocketing cost of condominium and detached housing units, as well as the introduction of newer, more upscale rental product, Orange County's overall average apartment rent advanced 4.5% to an average of \$1,327 over the 12 months ended in December 2004.

FORECAST 2005

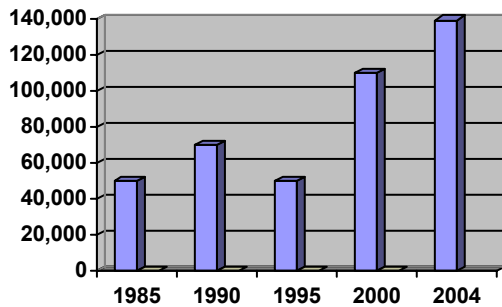
While job growth will strengthen at just a measured pace, Orange County's beneficial demographic trends, prohibitively expensive housing market, and apartment supply constraints have and will continue to favor strong performance by local rental properties in the years ahead. Apartment demand will hold near the areas roughly 2,100-unit average seen since the mid-1990's over the near-term, with any slowdown in demand attributable more to the rate of apartment development than fluctuations in employment growth.

Apartment construction, following the uptick in activity last year, will fall back to historical norms as well, with overall residential construction permit volume expected to fall more than 10% this year. The ever-growing scarcity of available land will necessitate an increase in high-density, infill, and live-work type multifamily development. The city of Anaheim's Platinum Triangle neighborhood surrounding Angel Stadium, for example, is being transformed into several thousand condo and apartment units along with several million square feet of retail and office space. Larger scale apartment development does remain an option in parts of Irvine and Tustin, especially in and around the former Tustin and El Toro marine bases and along the Jamboree

Road Corridor east of the John Wayne-Orange County Airport. As well, the area's skyrocketing housing costs are contributing to a rising apartment-to-condominium conversion trend, further constricting the area's supply of available rental units.

The net result of these trends will be a further gradual lightening of apartment vacancies and improved rent growth. For the first time since mid-2001, vacancy will recede below 4.0% in 2005, and hold in the upper-3.0% range the following year. Apartment units, meanwhile, in light of their comparative affordability to for-sale housing, will command higher rents, approaching growth of 5.0% per year.

SALES PRICE / UNIT



HISTORICAL REVIEW

In response to the rapid build-out of Los Angeles in the early 20th century, Orange County emerged as an attractive alternative for business and housing. The area experienced rapid growth fueled largely by migration averaging roughly 15% annually between 1950 and 1970. Over the following three decades, growth eased substantially (*averaging less than 2% annually*) as available land increased in scarcity. Today, Orange County ranks as the second most densely populated county in the state (*behind San Francisco*) and is home to nearly 3,000,000 residents. Household size is among the highest in the state, a dynamic emerging in response to the region's limited supply of land and skyrocketing housing costs. As such, the local apartment market has historically enjoyed a stable renter pool with ample room for rental growth, a fact that has attracted real estate investors in droves.

Further contributing to its stability, the area also enjoys an extremely diverse economic base, with no single sector contributing greater than one-third of total local employment. As well, testifying to the area's rich entrepreneurial climate, less than one-fifth of Orange County's residents are employed in companies of more than 500 people, compared to nearly one-quarter for the state as a whole.

EMPLOYMENT FORECAST

Strong growth within several East Asian economies coupled with the decline in the dollar's trade-weighted value spurred a 20% increase in Orange County exports last year. Economists predict continued growth on the scale of 10% this year, with total exports reaching a record \$12 billion. Also forecasted to break its 2000 record performance this year is the region's tourism trade, which will benefit from increased international travelers, a rebound in domestic business travel, and a major stimulus from the 50th anniversary of local giant Disneyland.

Manufacturing activity, which returned to positive, albeit minimal growth last year, will see continued gradual improvement through the near-term on increased hiring by defense contractors Boeing and Ceradyne, as well as a favorable high-tech export environment. Illustrating the

improved health of local manufacturers, Orange County's industrial real estate market recorded its fourth consecutive quarter of positive absorption in December – the first time since 2000.

One potential hurdle exists for the local construction and finance/real estate industries, which face a likely damping by impending interest rates hikes. Following four years of greater than 10% appreciation, single-family housing prices face a possible 5% correction in 2005 according to several local universities, which may potentially impact the local economy if it coincides with weak job growth.

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