THE Orange County HOUSING REPORT

REPORTS ON HOUSING

Orange County Housing Report:
A 2021 Forecast

December 28, 2020

HAPPY NEW YEAR!!! Now, what does that mean for Orange County real estate?

First, let us look back at what happened in 2020 in terms of the inventory, demand, luxury properties, and the Expected Market Time.

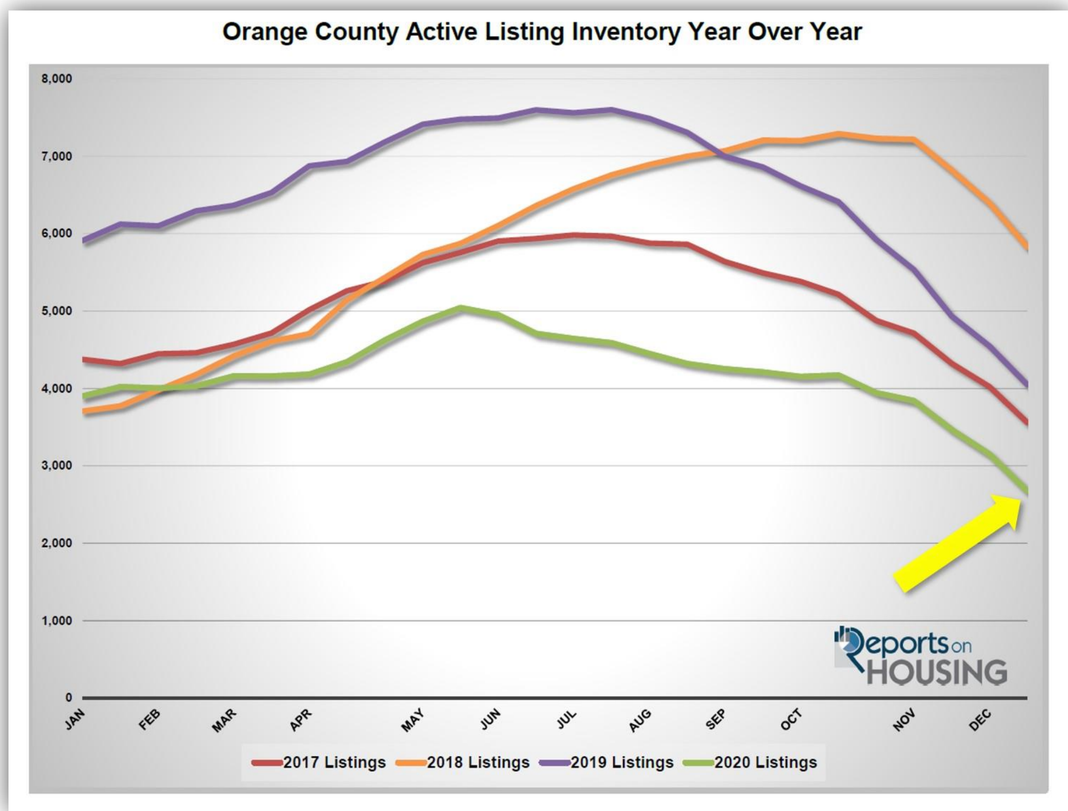
Active Inventory

After starting the year with very few available homes to purchase, the inventory only grew slightly, plunging to unbelievably low levels during the second half of the year.

The year started with an active inventory of 3,692 homes, only the third time it dropped below the 4,000-home threshold to start a year since 2004. Typically, the inventory continuously climbs until peaking between July and August, but not this year. After adding only 1,352 homes, it peaked at the end of May at 5,044 homes, its lowest peak since reporting began in 2004. The average peak since 2004 is 7,241.

COVID-19 suppressed the inventory in Orange County. Many homeowners simply did not want to place their homes on the market amid a pandemic. From March through June, there were 4,655 fewer home placed on the market compared to the five-year average, 29% less. The Coronavirus lost its grip on preventing homes from coming on the market from July through November. In those five months, there were 1,694 additional homes that came on the market compared to the five-year average, an extra 11%. Nonetheless, from January through November, there were still 3,150 overall missing FOR-SALE signs, 8% fewer than the five-year average.

With fewer homes coming on the market during the first half of the year and soaring demand (prior 30-days of new escrows), the active listing inventory dropped from the end of May through year's end, shedding 2,369 homes, or 47%. It dropped below 4,000 homes in October for the first time since February 2018, and then dropped below 3,161, the lowest level since tracking began in 2004, which occurred on January 1, 2013. But it did not stop there. In the past two-weeks, the inventory plunged an additional 477 homes, or 15%, its largest drop of the year. Today it sits at 2,675 homes, an unprecedented, low level of homes to start 2021. There were 51% more homes on the market last year at this time, an additional 1,374 homes.



The "supply problem" that everybody talks about is actually due to heightened demand fueled by historically low mortgage rates. The number of available homes to purchase is at record low levels because demand is at its highest level since 2012. Just about everything that comes on the market has made its way into escrow, eating away at the active inventory. That will be the continued storyline for 2021.

Demand

Initially, COVID-19 impacted demand substantially, but record low mortgage rates saved the day and demand soared.

At the beginning of the year, demand for Orange County homes (the number of pending sales over the prior month) followed a normal strong housing pattern. It looked as if the 2020 housing market was poised to be one of the hottest in years. That all changed in March when the Coronavirus pandemic slammed the entire economy and buyer activity slipped to levels last seen at the beginning of the Great Recession. The shock factor of the virus stopped the Spring Market momentum in its tracks. Open houses were halted. Homes were pulled off the market. Life was turned upside down and a stay-at-home order confined everyone to their homes except for "essential workers."

The impact on demand was catastrophic, dropping to 1,080 by mid-April. That was a 60% drop, or 1,630 fewer pending sales, compared to mid-April 2019. It was the lowest level since January 2008. Initially during the lockdown there were no showings or open houses allowed. That changed at the end of March when real estate was reclassified as an "essential service". Yet, even with low a low mortgage rate environment, there was not a lot of appetite for buyers to purchase in April.

That all changed by the start of May, just as mortgage rates dipped to another record low level at 3.23%. Buyers reemerged and demand climbed from 1,172 to 2,035 pending sales in only four weeks, a 74% rise. By the end of June demand was at its strongest level in five years. Typically, demand peaks in the middle of the Spring Market between April and May, but after dropping to lows in April that were last recorded during the Great Recession, the market continued to improve. Instead, demand peaked at the beginning of September at 3,340 pending sales, its highest peak since 2012.

Headlines promoted the record low mortgage rates throughout the year. On December 24th, Freddie Mac's weekly Primary Mortgage Market Survey® revealed that the 30-year fixed rate mortgage hit a 16th record low of the year at 2.66%. They were at 3.74% one year ago. Despite COVID-19, the record low mortgage rate environment was the rocket fuel that rocketed the Orange County housing market to its hottest levels in years. For proper perspective, at the end of 2018, just two years ago, mortgage rates reached 5%. A $700,000 mortgage at 5% has a monthly payment of $3,758. Today's 2.66% rate has a monthly payment of $2,824, a $934 per month savings. It is no wonder buyers are still flocking to purchase even with home values rising to record levels. Low interest rates are facilitating affordability and propping up demand.

Within the past two weeks, demand dropped by 354 pending sales, or 14%, and now sits at 2,195 pending sales, the lowest reading since May, but the highest level for an end to December since 2012. Last year at this time, demand was at 1,590, or 28% fewer pending sales.

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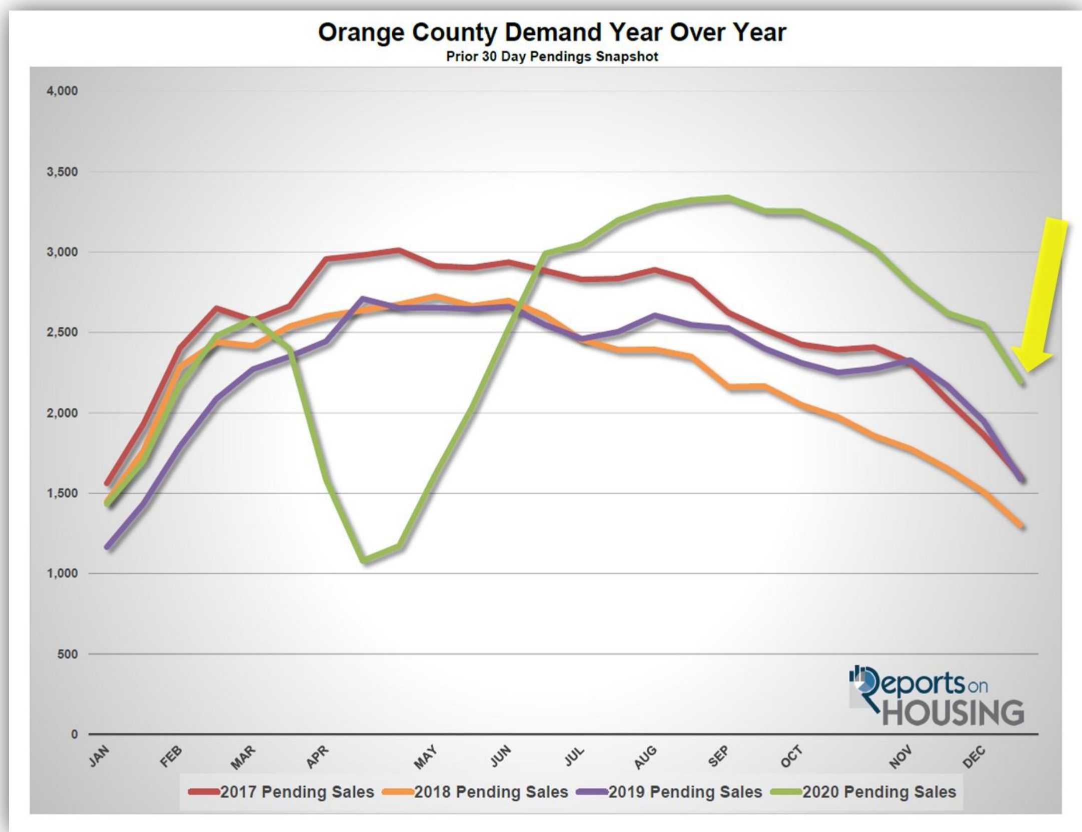


Luxury End

The luxury home market reached record levels this year.

2019 was a record-setting year for the most sales ever above $1.25 million, 1% more than 2018 and that year was a record-setting year as well. In 2020, Orange County reached for the stars and was up by 26% compared to 2019, shattering the prior record by over 1,000 closed sales. There were 5,100 closed luxury sales compared to 4,021 in 2019. This record was achieved despite COVID-19 taking a major bite out of closings from April through June.

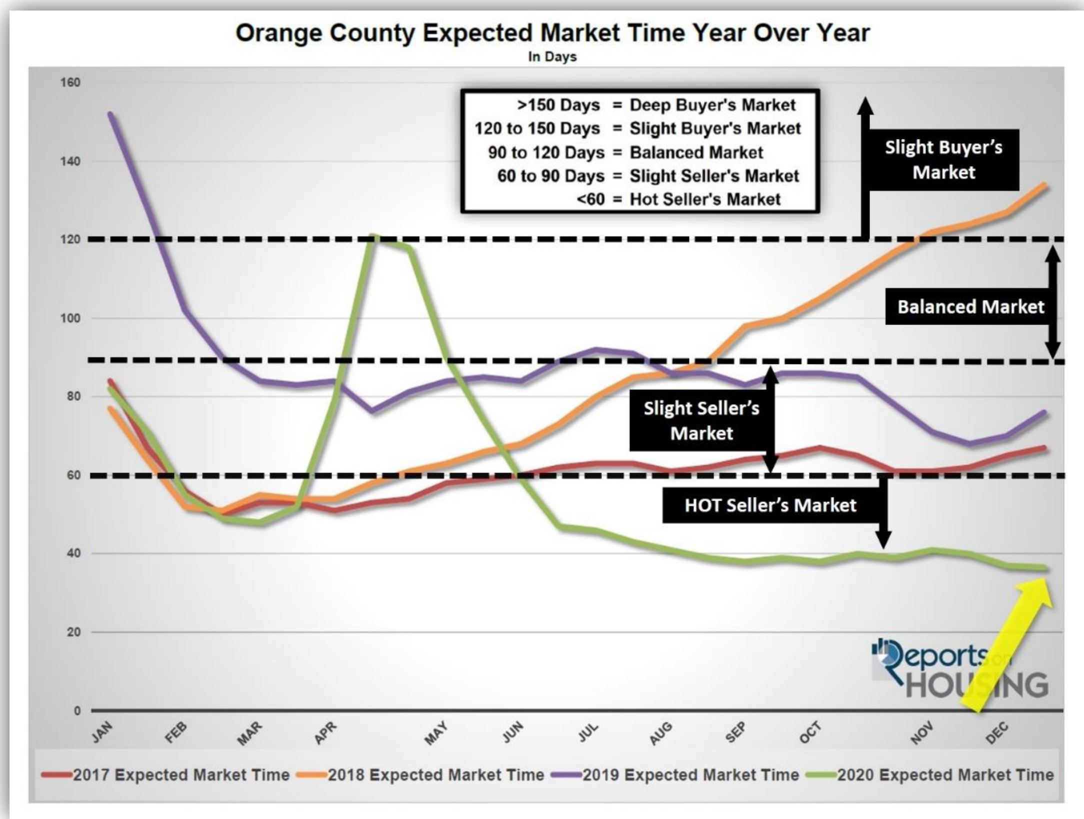
The luxury home market started off extremely strong. In the first quarter of 2020, there were 50% more luxury sales year over year. Due to the pandemic, they were off by 35% in the second quarter of 2020. Yet, the luxury market surged back to life in the second half of the year as mortgage rates plummeted and Wall Street returned to record levels. They were up by 46% during the third quarter, and up by 70% during the fourth quarter.

Like the rest of the housing market, the luxury market was heavily impacted by the Coronavirus, but then rocketed upward as the economy improved, rates dropped, and the equity markets climbed. In mid-April, the luxury inventory was down by 64% year over year, and demand was off by 67%. By July, the inventory was down by 30% and demand was 61% **higher**. At the end of 2020, the inventory was down by 25% and demand was 72% **higher** year over year. The lower supply and massive demand at the end of the year translates to an unbelievable start to the luxury market in 2021.

Expected Market Time

COVID-19 may have initially impacted the amount of time it took to sell a home, but that rapidly changed as the inventory dropped and demand soared.

The Expected Market Time, the amount of time it would take to place a home listed today into escrow down the road (based upon current supply and demand) started the year at 82 days, a Slight Seller's Market (between 60 to 90 days). In February, Orange County housing evolved to a Hot Seller's Market (less than 60 days) and remained there until the stay-at-home orders where it eclipsed 121 days by mid-April, a Slight Buyer's Market (between 120 to 150 days). Yet, by mid-May, as demand surged, the Expected Market Time dropped like a rock. In June, the market descended below 60-days, a Hot Seller's Market and was hotter than 2019. It remained there for the remainder of the year. As the inventory continued to fall and demand climbed through August, the Expected Market Time continuously improved. It dropped to 38 days by the start of September.



Buyers have felt the heat in the housing market. With very few available homes to purchase and plenty of buyer competition fueled by record low mortgage rates, buyers have been bumping into each other and competing to purchase. Multiple offers and surging values are the current trends. Surprisingly, it has not let up at all during the Holiday Market, foreshadowing an incredible start to 2021 and a sizzling hot Spring Market.

In the past two weeks, the Expected Market Time for all of Orange County remained at 37 days, its lowest level of the year and its lowest level for an end to a year since tracking began in 2004.

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The 2021 Forecast

A hot year for housing

The year 2020 was going to be one of the hottest years on record for the U.S. economy. That all came to an abrupt halt in March due to the Coronavirus Pandemic. With a national emergency and stay-at-home orders across the country, the U.S. was thrown into a recession. Yet, this was not like any other recession. Recessions are typically caused by one sector of the economy dramatically turning negative, which pulls down the entire country to negative territory. This time it was a forced shutdown of the economy to save lives from a once-in-a-lifetime pandemic. Every economic chart was impacted, from consumption to unemployment to equities, nothing was spared. The Federal Reserve did everything in their power to mitigate the damage to the economy, and Washington D.C. provided major relief packages to aid the unemployed and small business owners. The GDP had its worst quarter over quarter reading in the history of the U.S. during the second quarter, followed by the best quarter over quarter reading during the third quarter. The economy has dramatically improved, but there is still a long way to go. It will take a bit more time due to the slow rollout of the recently approved vaccines. The low interest rate environment will continue and will be a tailwind that will not only aid the recovery to the economy, but it will also continue to fuel the incredible run on housing in 2021. As a result, the local housing market is going to be HOT in 2021. Here is the forecast:

- **Active Inventory** – the year will begin with around 2,500 homes, the lowest start by far since tracking began in 2004. It will be 21% less than the 3,161 start to 2013. With very few available homes to purchase, housing will be extremely hot on January 1. The theme for 2021 will be not enough homes for buyers to purchase. Instead, they will all be in escrow. Expect the active inventory to peak around August between 5,000 to 5,500 homes.
- **Demand** – with an anemic inventory and record low mortgage rates, buyer demand will be extremely strong from the start of the year through the Summer Market. With tremendous buyer competition, buyers will be willing to stretch slightly in price compared to the most recent sale; so, expect appreciation around 6 to 8% for the year. Demand will be at its strongest, and most appreciation will occur from January through July, and then will downshift during the Autumn and Holiday Markets.
- **Housing Cycle** - the housing market will follow a normal housing cycle. The strongest demand coupled with plenty of fresh inventory will occur during the Spring Market. This will be followed by slightly less demand and a continued new supply of homes in the Summer Market. From there, demand will drop further along with fewer homes entering the fray in the Autumn Market. Finally, all the distractions of the Holiday Market will be punctuated with the lowest demand of the year and few homeowners opting to sell.
- **Closed Sales** - the number of successful, closed sales will increase 4 to 8% compared to 2020 with around 31,500 (2020 was up 3% compared to 2019).
- **Luxury Market** – luxury sales will continue to improve year over year and surpass 2020's unbelievable record level by nearly 5%. The Spring Market will be the strongest for luxury and will become a bit more sluggish from about August on.
- **Interest Rates** – look for mortgage rates to continue to remain at record low levels until the current Coronavirus wave diminishes. Expect rates to rise from the record low levels with positive vaccine and COVID-19 news, congressional relief and stimulus packages, and positive job reports and economic news. Long term rates are driven by economic fundamentals and headline risks. Negative economic headlines drive rates lower and positive economic headlines drive them higher. The year 2020 was filled with more than its fair share of negative news. Mortgage rates will rise in 2021, climbing from their current low of 2.66% to 3.5% by year's end.
- **Distressed Inventory** – in 2020, distressed sales, foreclosures and short sales combined, only accounted for 0.6% of all closed sales, 170 total. There will be more distressed sales in 2021 due to the pandemic and forbearance. Yet, 90% of all homeowners in forbearance have more than 10% equity, enough equity to sell and avert going the distressed route. There are 2.7 million homeowners who are currently in in Forbearance across the U.S. Since 90% have enough equity to sell, that leaves 270,000 (10%) vulnerable to becoming either a foreclosure or short sale. Yet, many will still be able to make their monthly payment after coming out of Forbearance. The bottom line: while there will be an increase in the distressed inventory, it will not be a wave. It will be more of a ripple, rising to levels last seen in 2017 when there were 614 distressed sales. That pales in comparison to the Great Recession where in 2009 there were 13,403.