

North Bay Branch Chapter of the Appraisal Institute

# North Bay Real Estate & Economy: "Riddles, Bubbles & Recovery"

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School of Business  
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# Agenda

- Macroeconomic situation and real estate
  - Indicators and things to watch: global issues
  - Labor, financial markets a big issue for real estate
  - 2012 an election year again!
  - North Bay economic evolution interconnected
- Theme: regionalism and global markets
  - International and domestic issues affect local real estate
  - Demand will come both locally and internationally
- Bottom line: still in a slow-moving, recession like economy with a lot of activity

# Agenda (cont.)

- North Bay political economy issues
  - What will be the new, local companies?
  - What effect a public sector contraction have on real estate?
  - How important is the labor market and economic development to the North Bay real estate markets?
  - What are regional factors that come into play for these market?
- Wrap up: what to watch for and takeaways

# Macro/Intl Issues

# International Issues

- Middle East
  - Refocus on oil and political instability
  - Contagion effect is tricky to predict and to see ending
- Europe
  - Greece issues now over 18 months old: still here
  - ECB now raising rates of interest
  - PIIGS economies all somewhat related and same creditors
- South America
  - Brazil's economy now showing signs of slowing, inflation
  - A wild card regardless of market size and current political stability otherwise

# International Issues

- Asia
  - China now spearheading world economy
  - Japan is forced recovery: emerging well, but for how long?
  - SE Asia now waiting to absorb Chinese businesses
  - Australia and New Zealand booming through natural resources
- So what?
  - World economic center shifting westward from eastern US
  - Financial markets have become very integrated

# Int'l Connections: Local real estate

- ECB rate hike likely a sign of US rate hikes
  - 10 year Treasuries and Federal Funds Rate target highly linked
  - If FED begins to increase rates, mortgage rates forced up through 10-year Treasuries (more in a minute on this)
- China and Asian wealth a driver for land, homes, commercial demand in North Bay
  - Already starting: location, location, ... you know.
  - A relatively good deal for now

# Domestic Issues

- Continued slow movement at national level
  - New industries have not shown their face as leaders
  - Mid-west and MS-MO River Valleys doing well
- **Biggest challenge is job matching: can we avoid another jobless recovery nationally?**
- Recent job data not helping at national level
  - This has implications for CA and local jobs
  - Importance of job permanence in terms of real estate market demand more evident in wake of crisis
  - Regulations on home and property purchases have forced more evidence (good thing overall)

# Domestic Issues (cont.)

- Election year coming in 2012 may slow down residential and commercial investment
  - Potential presidential change makes 2012 look like 2008
  - Will senate seats, assembly seats, etc. force more change?
  - Will fiscal austerity come to the US?
  - Is the federal government at threat of debt default?
- How the national picture affects North Bay
  - Tourism, wine industry in recovery and cannot be outsourced
  - Gas prices microcosm of inflation to come: rates rising
  - Federal fiscal debates means less money locally in gov't

# Financial Markets

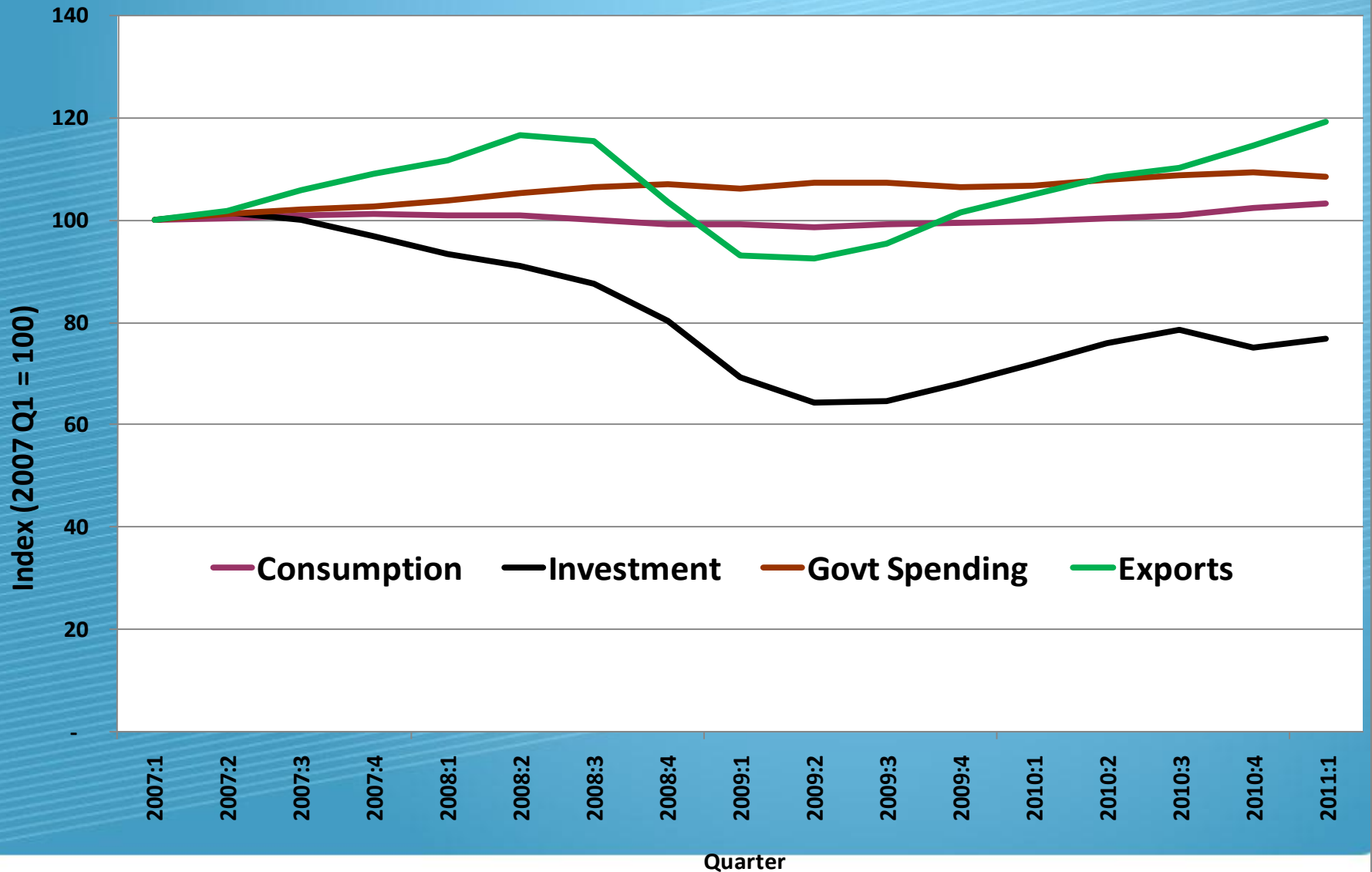
- Remember: 10 year treasury rate the floor for long-term debt
- Remember: stocks and bonds are complements and substitutes
  - Complements when things go right (bonds to stock to bonds)
  - Substitutes when things go wrong (stocks to bonds)
- QE2, QE3 a cruise to inflation, at some point
- Lending markets a function of labor and goods markets

# Takeaways from Int'l and Domestic

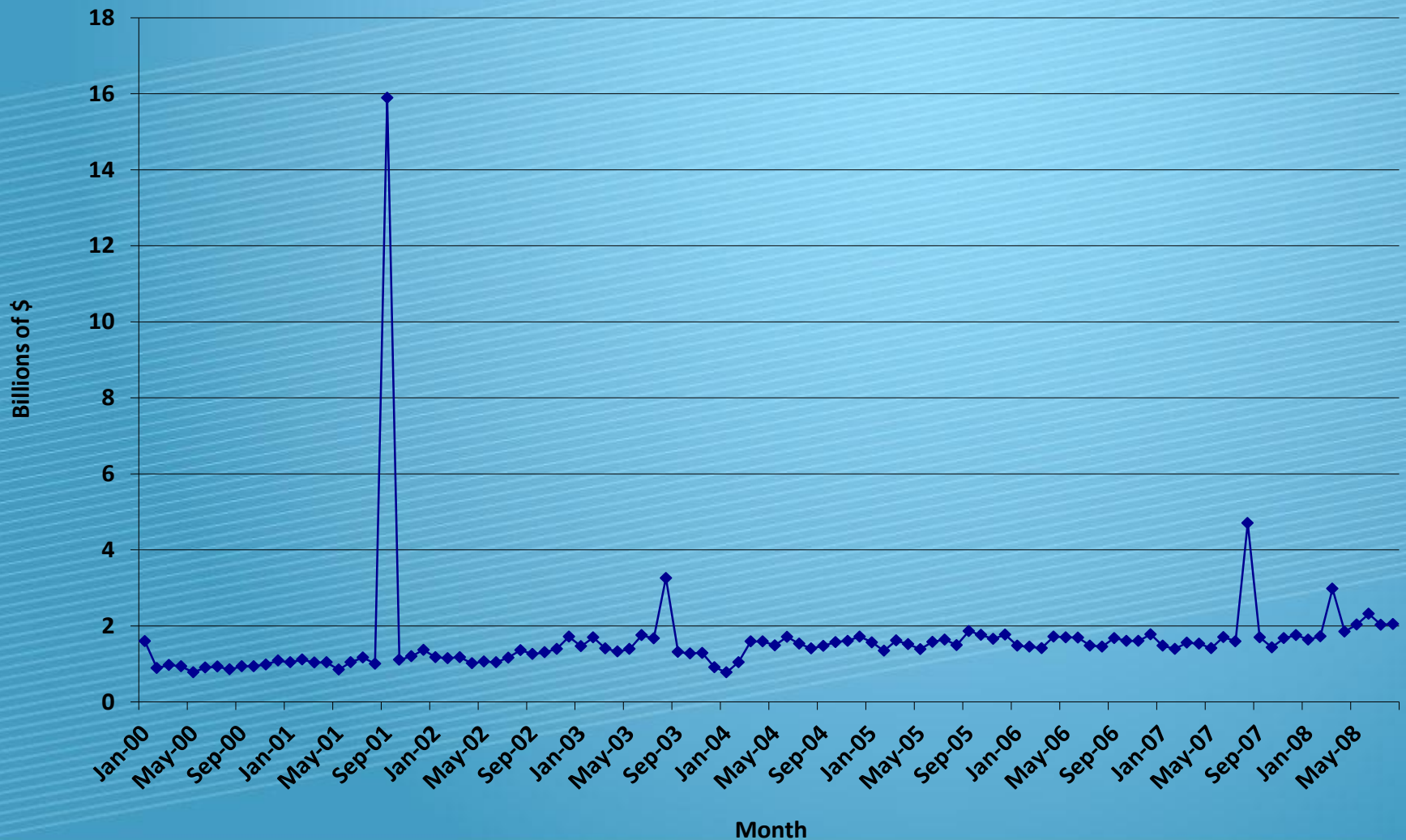
- Interest rates will rise
  - Just a matter of when, at what speed and why
  - Effects on real estate market somewhat mixed on this
  - Financial markets otherwise watching multiple vectors
  - **Key: financial and real estate market now global**
- Macroeconomics affects local economies
  - North Bay has mix of industries that both represent and depend on global flows
  - Can current vacancies in commercial be filled?
  - Need labor market recovery and sustained

# Macro Stats to Watch

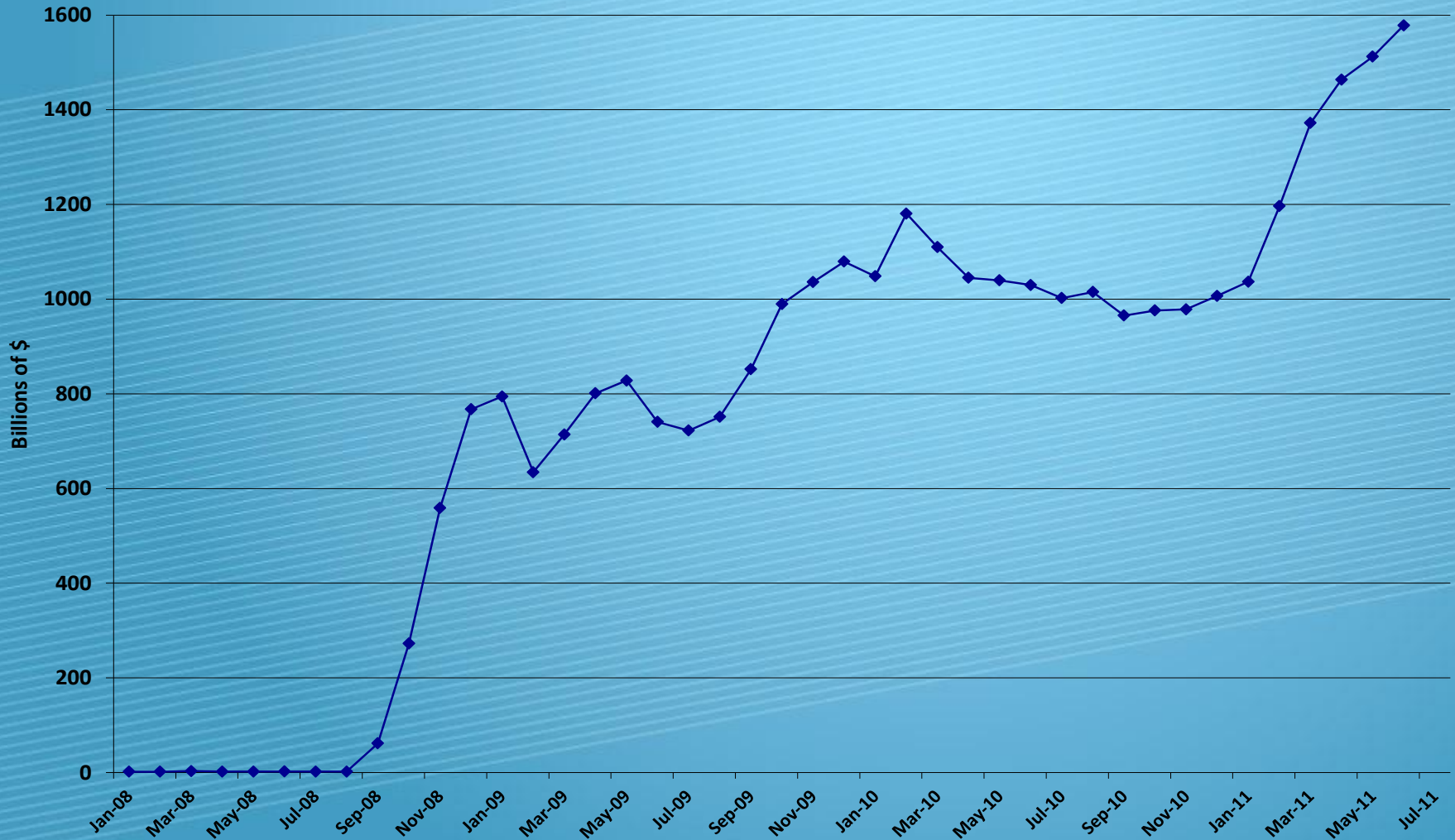
## Comparison of GDP Components, US, 2005\$, 2007 - Present



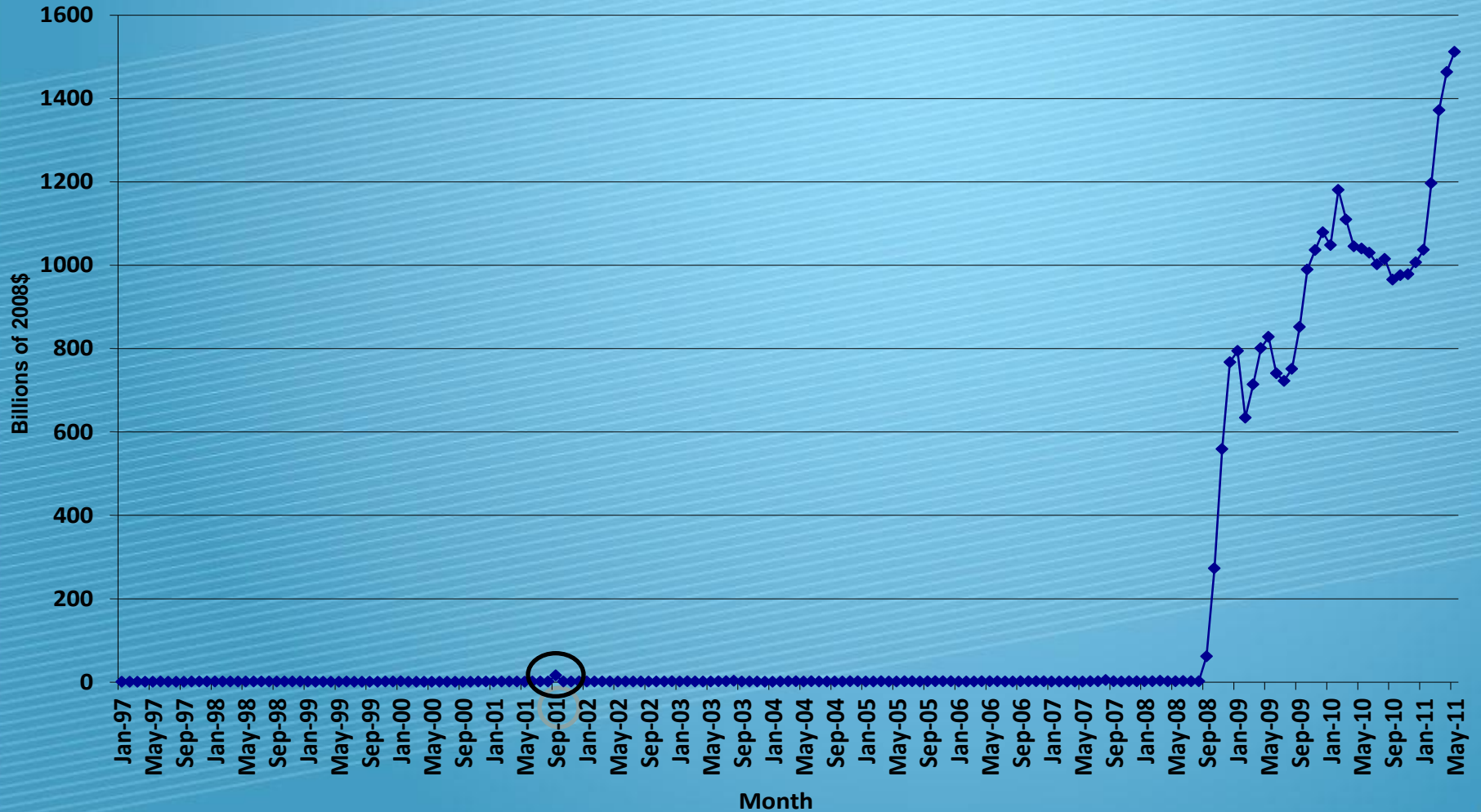
## Excess Reserves at U.S. Depository Institutions (Loanable Funds Not Lent), 2008\$, Jan 2000 - Aug 2008



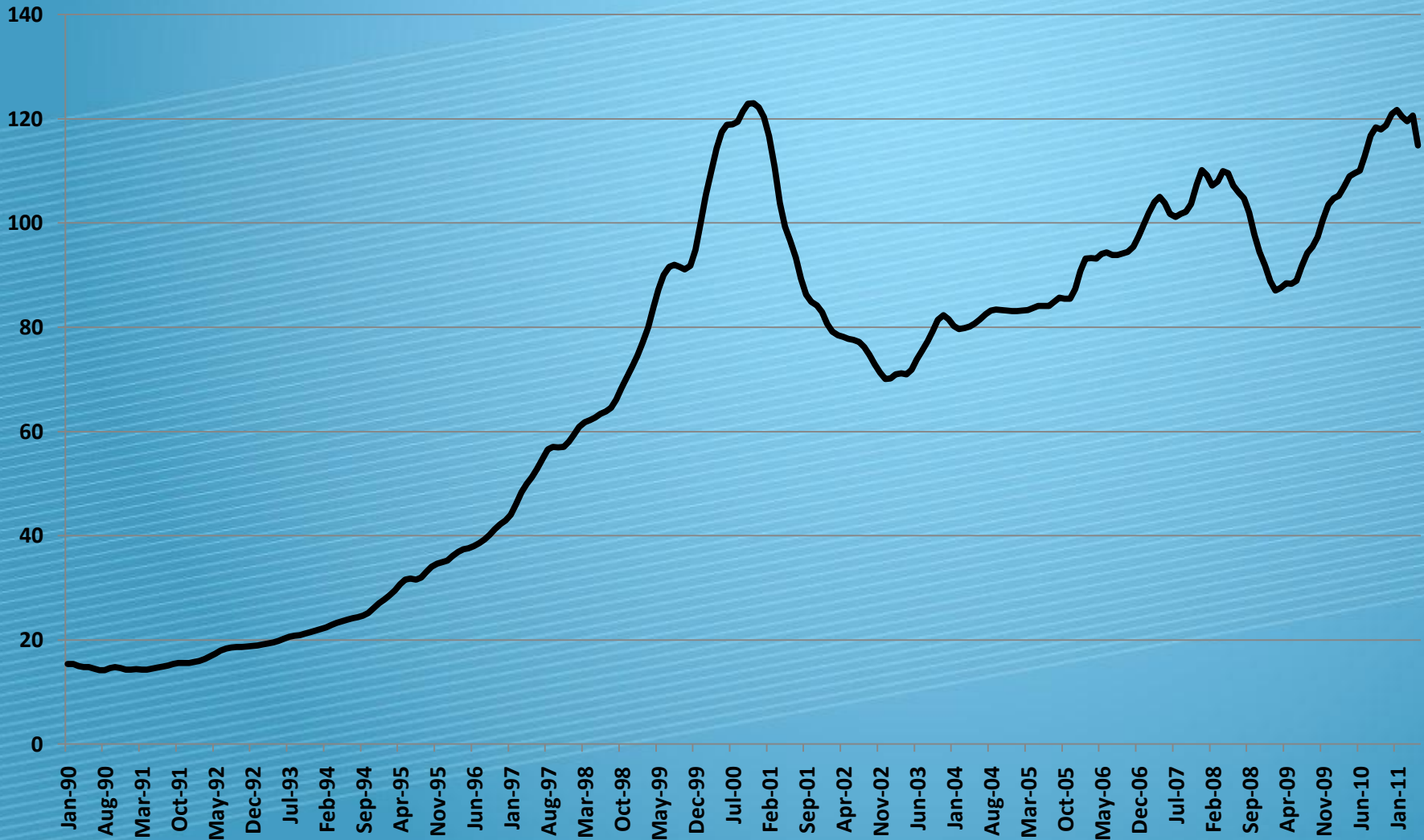
## Excess Reserves at U.S. Depository Institutions (Loanable Funds Not Lent) 2008\$, Jan 2008 - Present



## Excess Reserves at U.S. Depository Institutions (Loanable Funds Not Lent) 2008\$, Jan 1997 - Present



# High Tech Activity (Tech Pulse), Index, Jan 2001 = 100



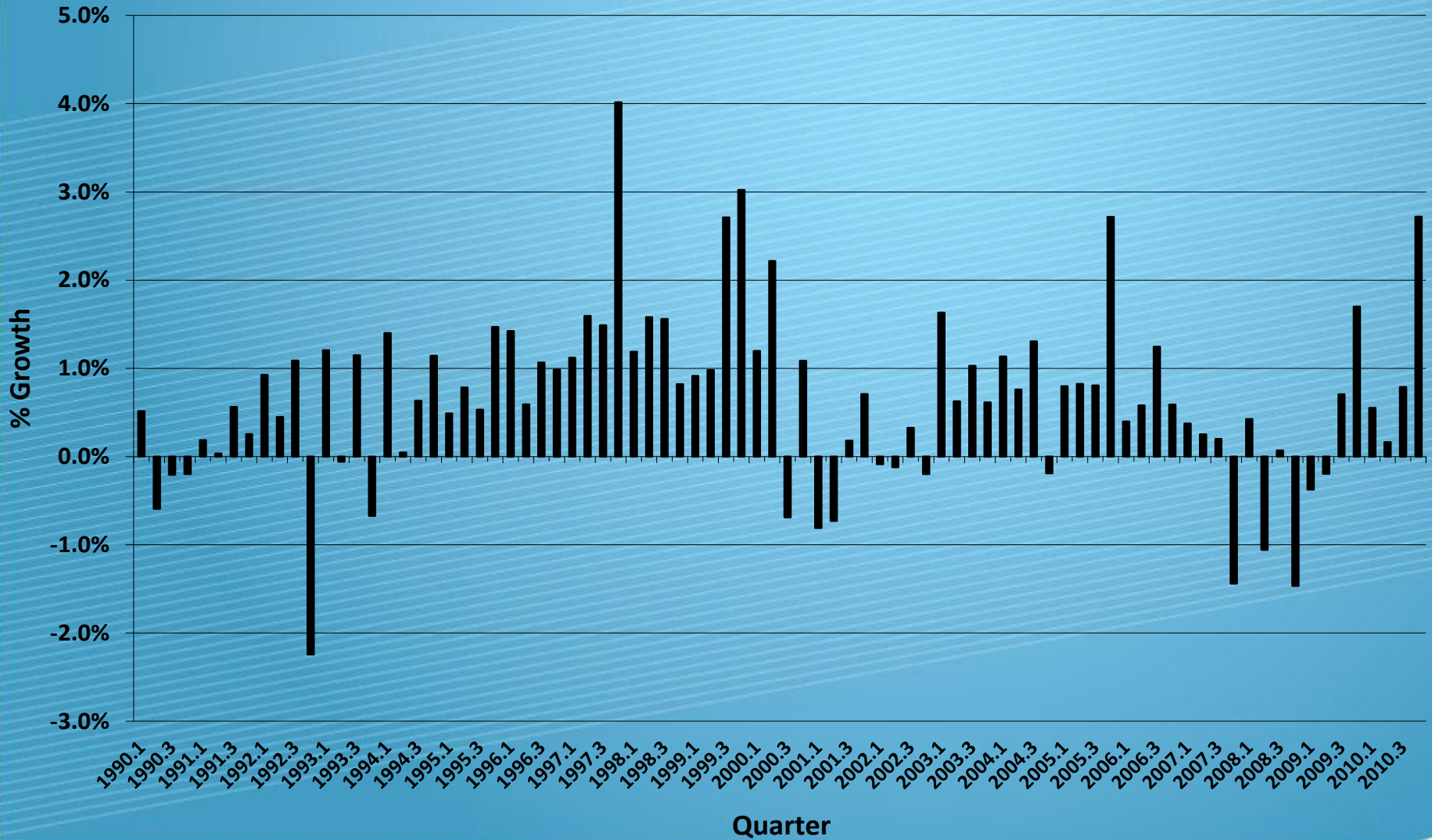
# California

- A wild paradox: innovation and inaction
  - Still the world leader in frontier technology
- Two major issues with California labor force
  - Retiree bubble coming: private and public
  - Government staffing for state, county and city workers likely to change: where will these folks find work
- Real estate and California
  - Still in demand
    - Valleys are looking at Japan-like recovery: 10 years + (in year 4)
    - What about coastal areas?
    - What about commercial?
  - Macro situation in CA will affect external demand (taxes)

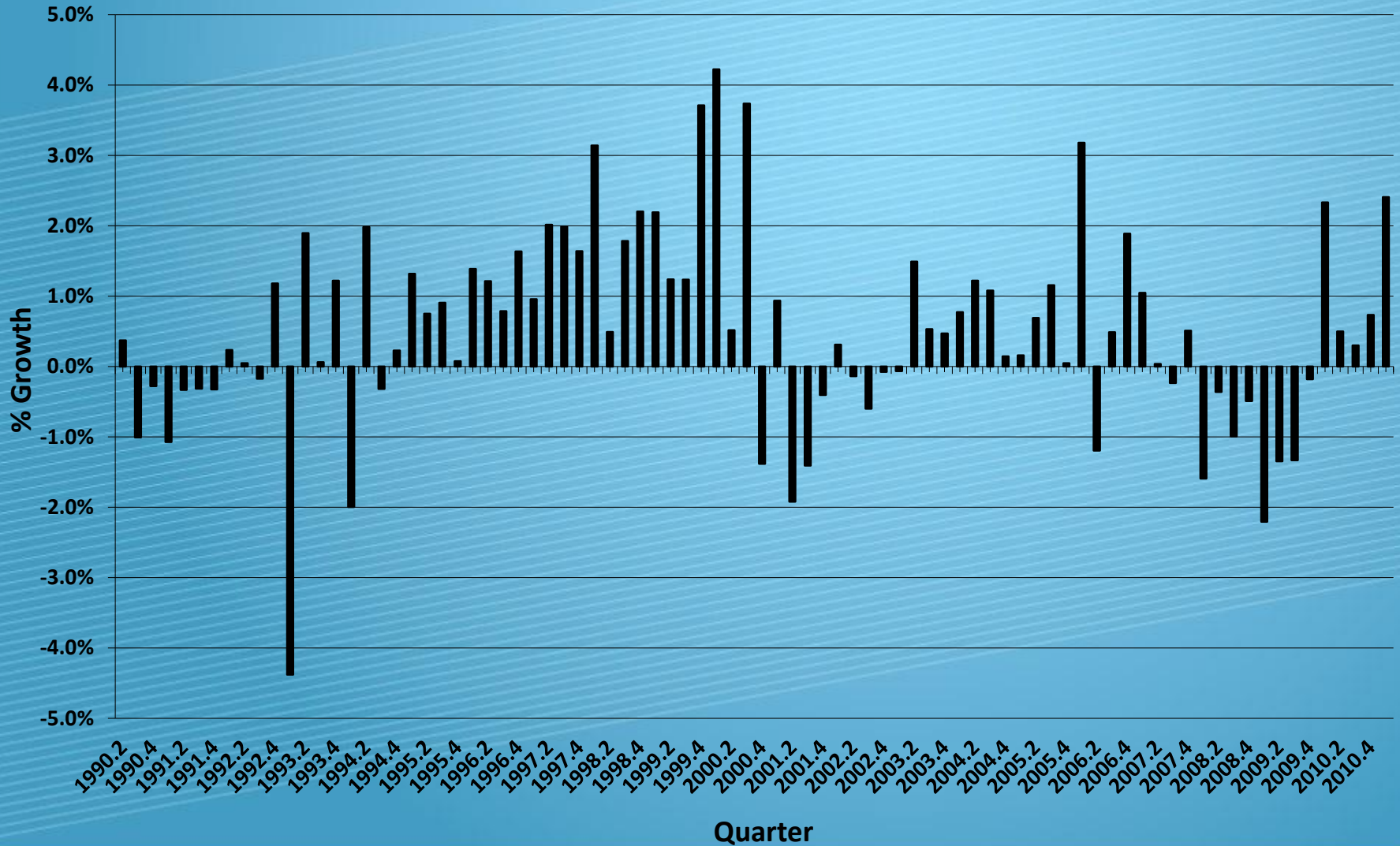
# Policies and Governmental Issues

- Prop 13 rollback as an example: something is coming
- Commercial
  - More likely of the two
  - Affects fewer properties, not necessarily fewer square feet
  - Especially an issue in metro areas
- Residential
  - A tough battle here
  - As long as residential real estate remains in some downturn, very unlikely to see Prop 13 repeal

# CA Personal Income Growth, 2003\$, 1990-2011



# CA Wage and Salary Growth, 2003\$, 1990-2011



# Real Estate as a Market: Answering Riddles about Bubbles

# Demand Analysis

- Pricing is a major factor, but other factors are involved, changing demand at all prices
  - Availability of credit
  - Incomes
  - Preferences
  - Number of buyers
  - Price of Substitutes and Complements

# Demand (cont.)

- Pricing
  - How important is price to real estate transactions?
- The bank determines the availability of credit
  - Interest rates become a key factor here
- Income
  - Economic recovery depends somewhat on labor market recovery and also housing market recovery

# Demand (cont.)

- Number of buyers
  - Residential
  - Commercial
- Preferences\*
  - Rental or homeownership?
  - This is easy, with one complication: commuting
  - In terms of commute, from where?
- Demography here also

# Demand (concl.)

- Price of substitutes and complements
  - Substitutes: Rental or commute?
  - Complements
    - Gas prices (as weird as that is)
    - Public transport (will SMART matter?)
    - Wealth values otherwise
    - Car prices
    - Furniture prices, etc.

# Supply

- North Bay supply of residential and commercial a function of three major factors
  - Construction and development
  - Policies and permitting
- Macroeconomic recovery
  - Existing units dynamics affected by recovery continuing
  - Development of new properties a function of forecasted demand

# Supply (cont.)

- Policies and permitting
  - Looking for income where it can be found (think elasticity of demand)
  - Will local governments provide more flexibility and speed in permitting for remodels and for new homes?
  - NIMBY issues remain, especially in commercial
  - Commercial converted to residential?
  - What about affordable housing?
- Construction and Development slow into foreseeable future
- **Existing units a key issue going forward**

# Group Exercise

- What is are the three main factors to revitalize real estate markets through 2015?
  - Residential
  - Commercial
- Will we ever look at real estate markets the same way again?
- Break!

# North Bay Real Estate Market

# North Bay

- Emerging from recession
  - Lagging national recovery, but past bottom ... for now
  - Due mainly to ag, retail exposure: macro forces here
- Mix of industries not as broad as southern neighbors
  - Where is tech in this mix?
- Wine, other ag and tourism: cannot be outsourced
- Real estate in 2011 looks slightly better than 2010
  - Need job growth
  - Commercial RE markets function of income growth, business growth: need to capture innovative industries

# Demography: Census 2010

- North Bay older, more Latino, more female
- Sonoma
  - 2.5 years older than 2000
  - 37,000 more people over 55 years old
- Marin
  - Over 3 years older than 2000
  - Almost 21,000 new residents over 55 years old
- Sonoma lost 2,812 households with kids under 18
- Marin gained 740 households with kids under 18

# Incomes, Employment and Real Estate

- Regional markets and follow state and national trends
- Job creation a factor here, and a changing demography also a slow moving issue
  - Ethnicity, age, employment profiles changing
- Where incomes derived a factor in real estate
  - More senior population: smaller living space
  - More senior population: less commercial demand?
- Are jobs the source of residential and commercial demand?

# Taxes

- Sales tax increases
  - Regressive (hurt lower income more than higher income)
  - How has the ¼ percent for SMART changed real estate?
- Income taxes
  - If these taxes rise, does this hurt real estate?
  - More damaging if on capital gains than earned income?
- Estate Taxes
  - Changes here make real estate transactions more tricky
  - Planning a major issue for many families, especially large landowners

# The Region

- Sonoma County
  - Over 4 million of vacant commercial
  - Median home prices not rising quickly
  - Wine and tourism a driver: can this drive demand?
  - Did we overbuild commercial for industries that never came?
- Napa County
  - Similar to Sonoma County in terms of wine, tourism exposure
  - Little in terms of tech industries and balance otherwise
  - Retail, personal and professional services may fill commercial

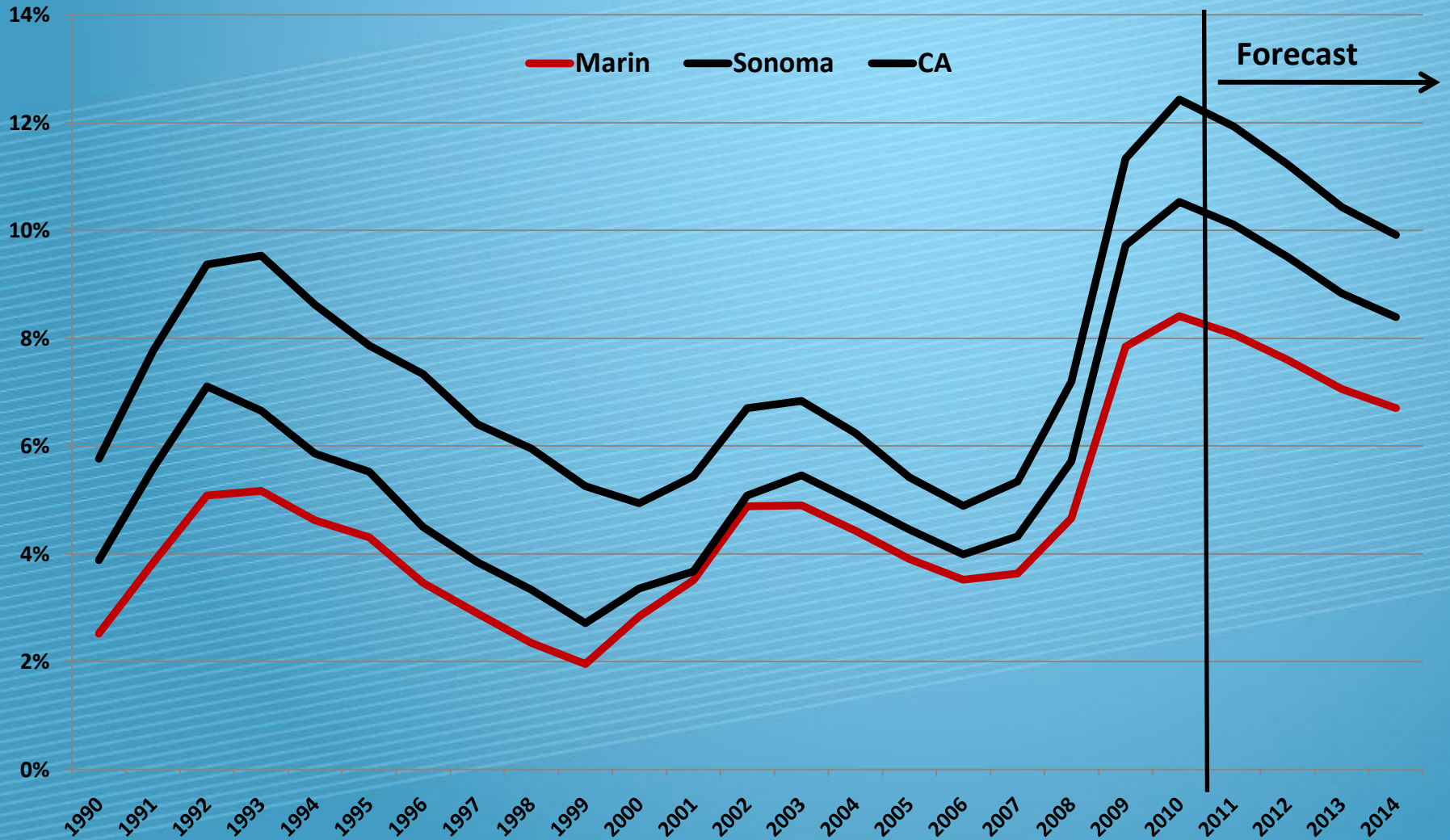
# The Region (cont.)

- Marin County
  - Recovery more obvious here, both residential and commercial
  - Tipping point on residential: more exposure to changing demography than otherwise in region
  - Over 1 million ft<sup>2</sup> in vacant commercial
  - Heavy influence from SF
- Recognize a regional market for both commercial and residential

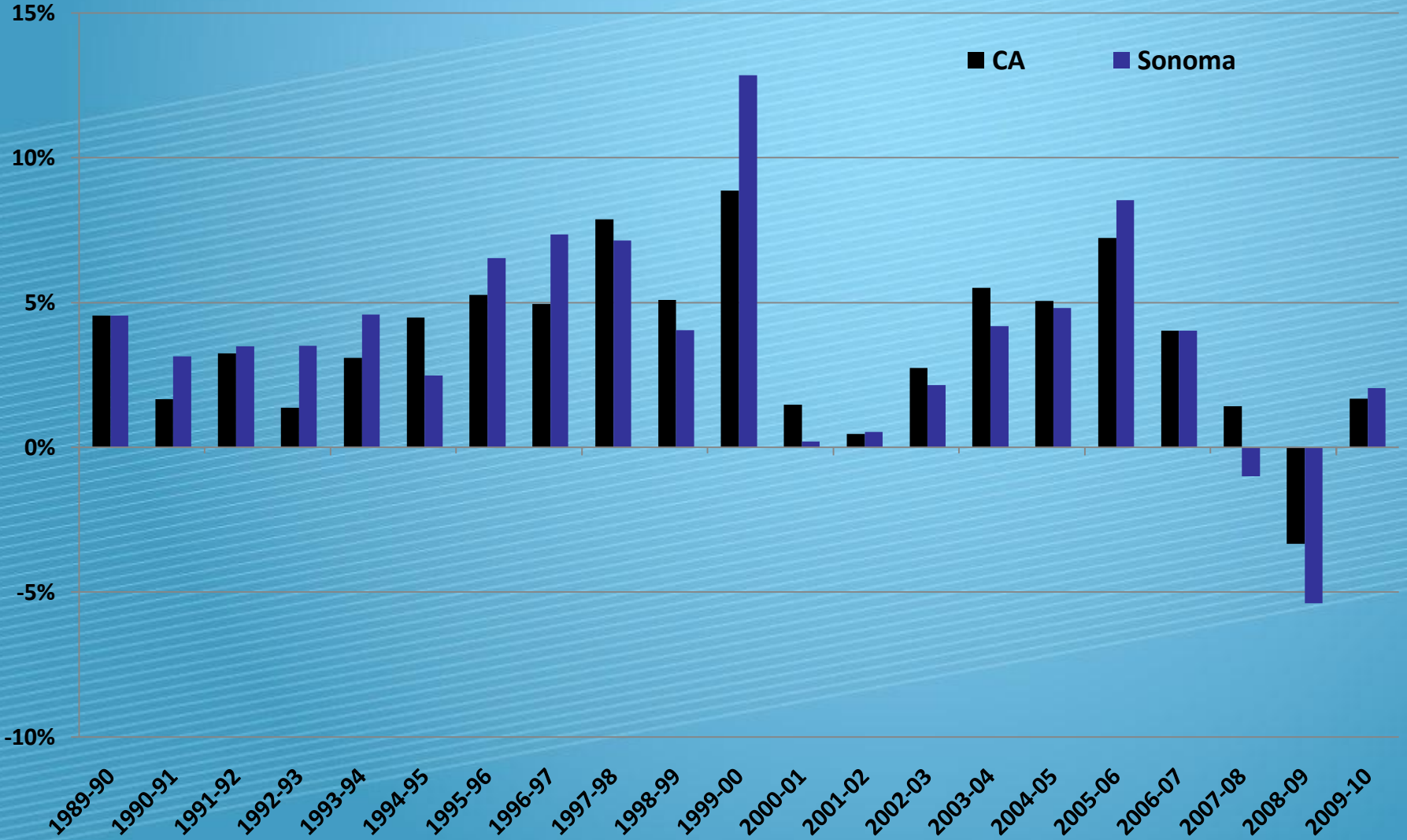
# Political Economy Issues

- Economic Development
  - Want to create jobs, and “good” jobs
  - Where will people live and where will they work?
  - Natural increase in demand for both commercial and residential if job attraction and retention takes place
- NIMBY issues and elected officials
- Balanced growth and entrepreneurial support key
- Too much competition, southern Marin and northern Napa the fates to befall us: is this a bad real estate thing?

# Unemployment Comparison, North Bay and CA, 1990 - 2014



# Personal income per capita Comparisons, 1990 - 2010



# New UI Claims: CA, North Bay and Sonoma counties, 2002-Present, SA



# Recovery through 2011 ... 2012?

- Labor market recovery slow
  - Fuels consumer confidence and business forecasts
- State economy will lag national
  - Recovery has started, needs to seize opportunities
  - Expect some labor market shifts for state and local gov't
- Economic Development means tenants
  - Will residential RE vacancies be filled by workers?
  - Will commercial vacancies be filled at all?
- Recognize regional connections and economies

# Takeaways

- As local areas age, income more a mix
  - Derived from wealth and labor
  - Jobs maybe less important for real estate...maybe
- International economics and politics affecting local RE markets
  - Preferences, commuting, other costs of living
- Local political economy remains a mystery
  - Job growth needs a focus on commercial real estate
  - More workers means either more residents or more commuters
- Rates going to rise: watch the financial markets closely
  - ECB rate hikes, and Chinese rate hikes, likely to trigger FED action by end of 2011
  - Bond markets the big issue: can we continue to sell national debt