East Bay Regional Park District

Assessed Value Forecast

August 2024

Beacon Economics

East Bay Regional Park District

National Commentary

Two years ago, concerns about a potential recession in the U.S. economy began making headlines. These worries were initially fueled by a surge in inflation, followed by a steep rise in interest rates. By the beginning of 2023, it seemed as if the pundits simply assumed the downturn was a given and the only question was how long and how deep it would be. Of course – like Godot – no recession showed up, and to the chagrin of the doom-mongers, the U.S. economy has continued to expand at a steady pace.

While there are still jitters about inflation, the pace of price increases has slowed sharply in the last year, decelerating from 7% to between 2% and 3% year-over-year according to the PCE deflator from the U.S. Bureau of Economic Analysis. [1]There is little to suggest it will stray from this range, in either direction, in the near future. While it isn't enough to persuade the Federal Reserve (the Fed) to cut rates, as was widely (and like the recession call, ridiculously) expected, it is a slow enough pace to placate investors and consumers.

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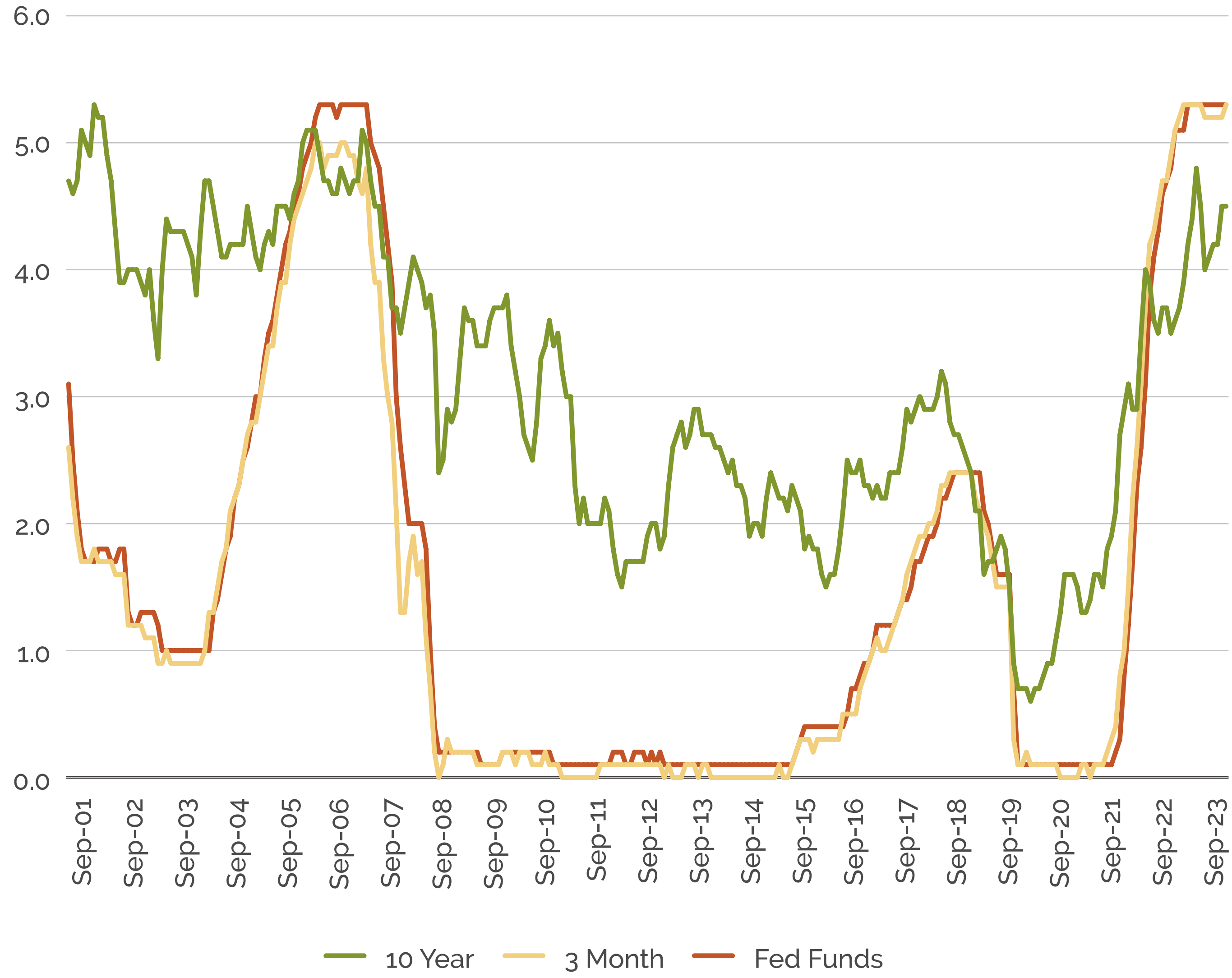
Still, there is little doubt that the brakes the Fed applied in response to inflation delivered a very real negative shock to the U.S. economy in the form of higher interest rates. The collapse in real estate transactions, the number of failed banks, and the sharp decline in borrowing activity are all evidence of that. But higher interest rates clearly didn't hit the U.S. consumer and that's all that really matters to the nation's economy. After all, consumer spending comprises over two-thirds of all U.S. economic activity and can carry the rest of the economy on its back. Growth in consumer spending has and will continue to drive the economy forward. Things are slightly slower than they were two years ago, but only because all the money that has been floating around the economy is declining as the Fed continues to mop up the excess cash through quantitative tightening (QT).

Even the hard-hit real estate sector has shown surprising signs of stability despite the collapse in resales. The pace of housing starts has decreased compared to 2021, but it remains higher than it was before the pandemic. Indeed, real investment in structures has risen over the last year and is now at the same level it was pre-pandemic, despite all the problems with commercial real estate valuations. That's good news for anyone worried about a recession, but bad news for those hoping for multiple Fed-driven interest rate cuts this year. (Just as this report was being published, the Fed indicated that it expects to cut rates only once this year).

[1] The CPI price index tends to get more media attention because it comes in more quickly than the PCE. But the CPI is not chain linked and uses different weights, hence, it tends to overestimate price increases by a modest but still significant amount.

U.S. Interest Rates



Source: U.S. Treasury Department, Board of Governors of the Federal Reserve System; Analysis by Beacon Economics

There are crises brewing that we should worry about, instead of focusing on problems that don't really exist at the catastrophic level politicians and pundits would have us believe. And, of course, each political party has their own distinct set of crises, fueling a level of partisanship not seen in the United States for many decades. With that said, the political drama this year will play out amid an economic expansion that still has legs, no matter how shaky they may prove to be in the longer run.

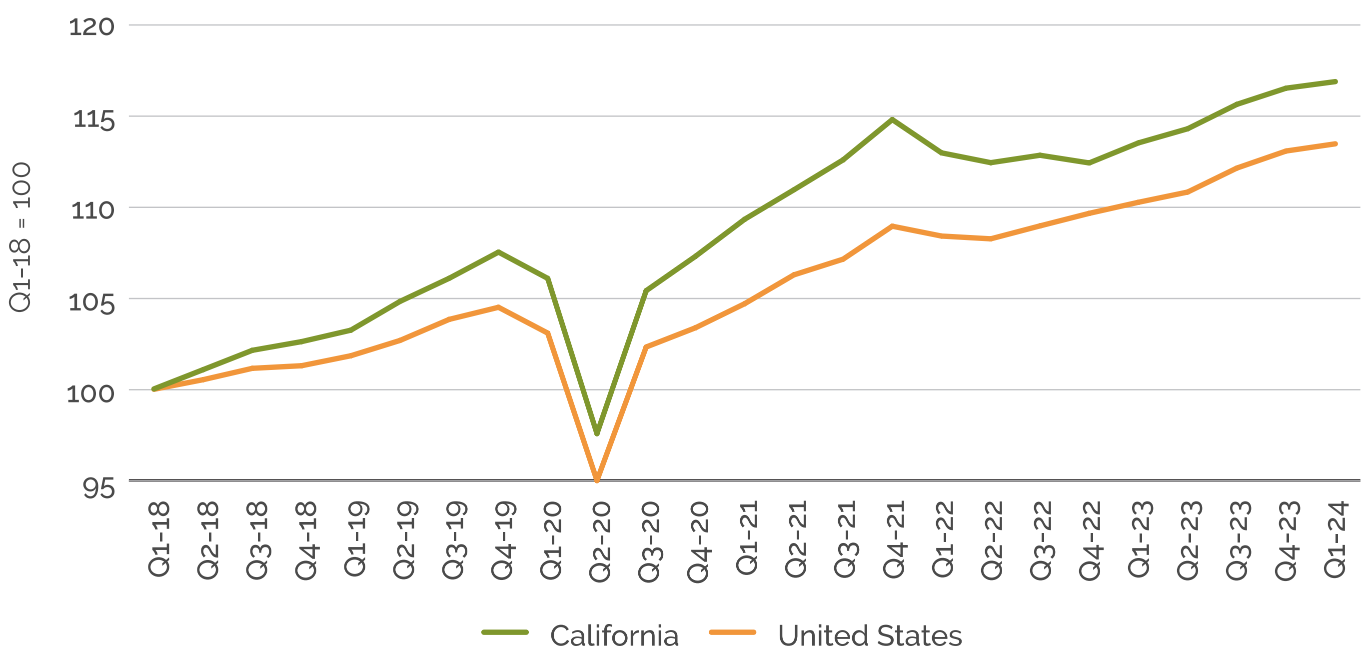
California Commentary

California faces some critical challenges, but these two standard narratives largely misinterpret the causes and consequences of the problems. First, these issues are not a sign that California's economy is doing badly, and certainly not as badly as headlines would suggest. The state's economy is growing, just at a slower-than-typical rate. Second, a closer look at the issues highlighted by The Economist indicates that California's problems relate to a number of unforced policy and fiscal errors, which have impeded the state's ability to grow. A change in approach would serve California well, but this can only happen if the depiction of the state's economy matches the reality.

First, the good news. California is not doing as poorly as is commonly believed. In fact, things are looking up. The state's economy came close to stalling in early 2023 but has since rebounded. According to the most recent data, through the first quarter of 2024, state output grew by 3% in real terms over the last year, slightly faster than the nation overall and a solid uptick from the previous year. Strong growth in Retail, Construction, Information, Health Care, Professional Services, and Non-Durable Manufacturing drove the increase in output. Overall, the state's economy has expanded by 6.9% in the last three years, slightly below the national pace of 8.4%.

> California's problems relate to a number of unforced policy and fiscal errors, which have impeded the state's ability to grow

Indexed Real Gross Domestic Product



Source: U.S. Bureau of Economic Analysis; Analysis by Beacon Economics

California’s output and job growth data do not suggest a state that has hit hard times. Rather, the data reflects a state in which growth is shifting from the extensive margin to the intensive margin, as might be expected in a region that has seen no labor force growth in the last half decade. This extensive-to-intensive shift in growth can be seen in the state’s per capita income data. Consider that California’s per capita personal income has been rising more rapidly than in the nation overall for a full decade. Per capita personal income in California is currently 17.5% higher than the national average. This equates to an approximately 5% increase in real terms, when adjusting for the state’s relative costs. In short, Californians are still faring better than the average person in the United States, at least on average.

A declining population is constraining the state’s labor supply, and thus preventing more rapid job growth and (likely) better revenue growth. California’s household population has fallen by 360,000 in the last five years, a decline of slightly less than 1%. This drop is being driven primarily by negative net migration, meaning more people have moved out of the state than have moved in. However, California’s population size held steady from 2023 to 2024, suggesting the worst of the declines are in the past.

For California’s population to grow faster and, in turn, for the state’s labor force to grow faster, housing production needs to increase – something that has conspicuously not happened despite promises from Governor Gavin Newsom dating back to before his first term in office. The state continues to produce fewer than 10,000 housing permits per month, the same number as in 2017.

That is the critical issue. California’s economy is being held back by the state’s housing shortage, not by housing affordability. The failure to address the actual unit shortage, and focus instead on affordability, misses the point and fuels gentrification. As the lack of housing supply drives home prices up, higher income families are moving in, raising housing prices even further, and pushing lower income families out of the state. Today’s market prices partly reflect the incomes of those moving in, which is why housing costs as a share of income have not really increased in the last decade. California’s higher housing costs reflect the higher incomes of both renters and owners. In sum, California’s economy is doing fine – except where it is stressed by well-intentioned policies that do more harm than good.

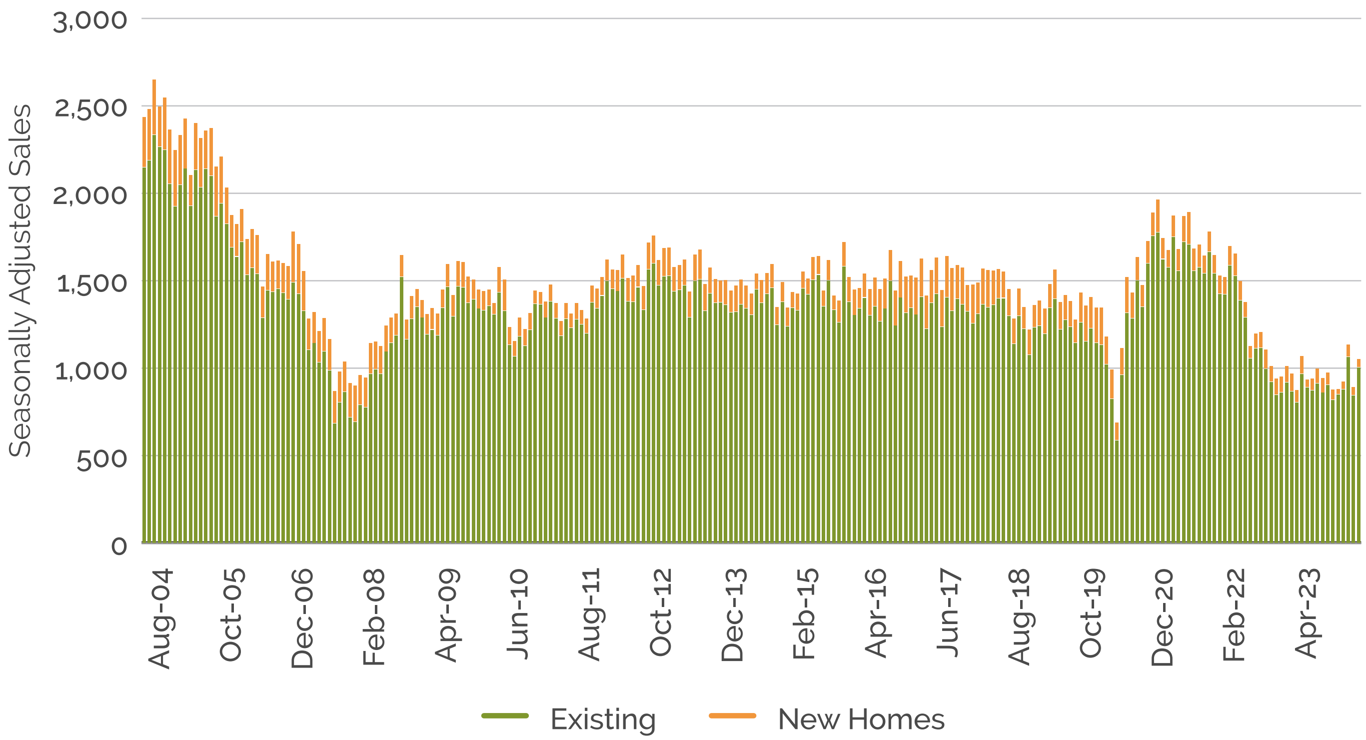
> “ **California’s economy is being held back by the state’s housing shortage, not by housing affordability**

East Bay Assessed Value Commentary

Since Beacon Economics' last report for the EBRPD, the assessed value (AV) base in the East Bay has continued to grow, and in fact has come in higher than projected in the previous forecast. For the 2024–25 fiscal year, total gross AV was estimated to be $724.2 billion, a 4.8% increase over the prior fiscal year. The stronger AV growth can be partially attributed to growth in Alameda County, where AV increased 5%. Growth was still low compared to the historical average, where AV has typically grown at a rate of 5.5% year over year.

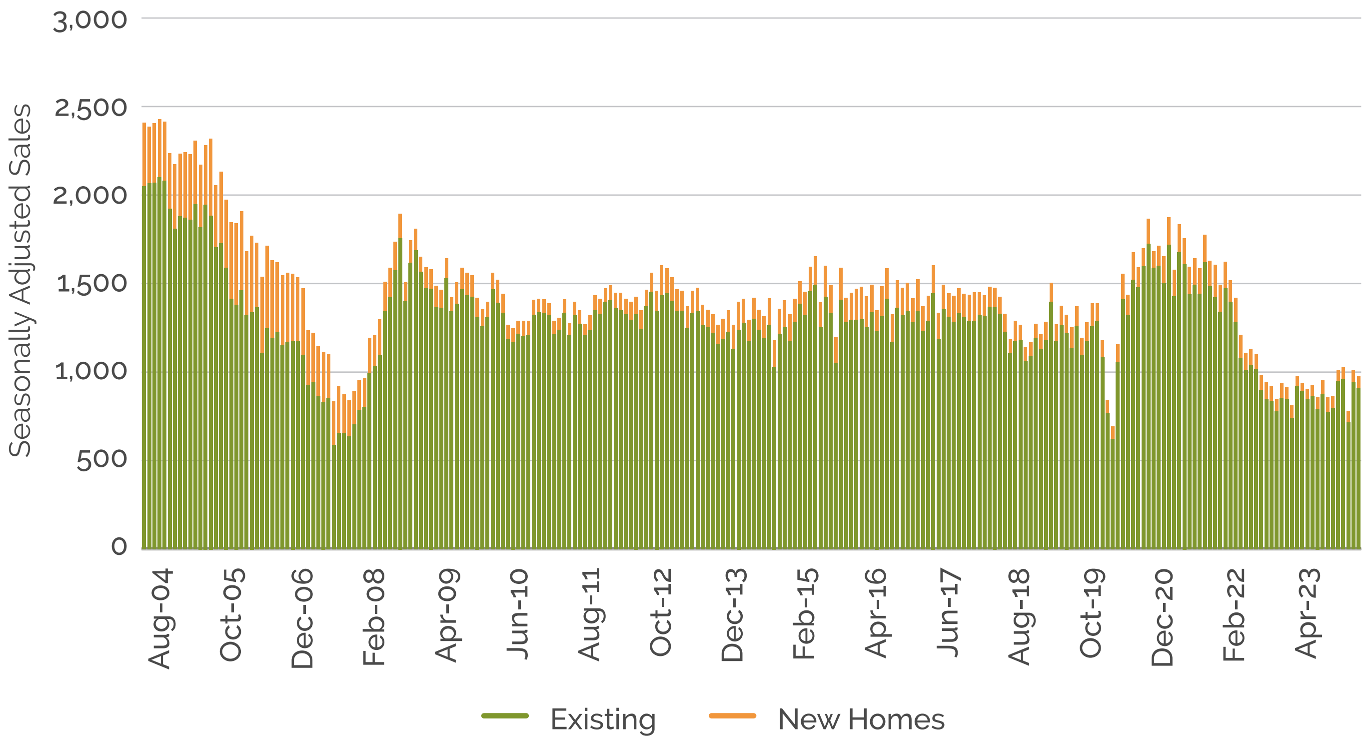
There's no doubt that the pandemic galvanized the residential real estate market in the East Bay and across California. Among the primary factors that drove the rapid upswing in both prices and sales after the pandemic first hit was a steady decline in interest rates and a shift in consumer preference for more space. The overall effect was a collapse in inventories, as newly listed homes were snapped up by prospective buyers willing to pay above asking prices and engage in bidding wars. Fast forward to today and the lack of inventory continues. But the major hindrance to more available housing now is the ultra-low mortgage rates homeowners currently enjoy. Interest rates have skyrocketed since the Federal Reserve began its rate hikes in March 2022, and homeowners who sell now will face a jump from a sub-3 rate to something in the 7+ category, a move most homeowners are unable or unwilling to make, unless they have to.

County of Alameda Home Sales



Source: CoreLogic; Analysis by Beacon Economics

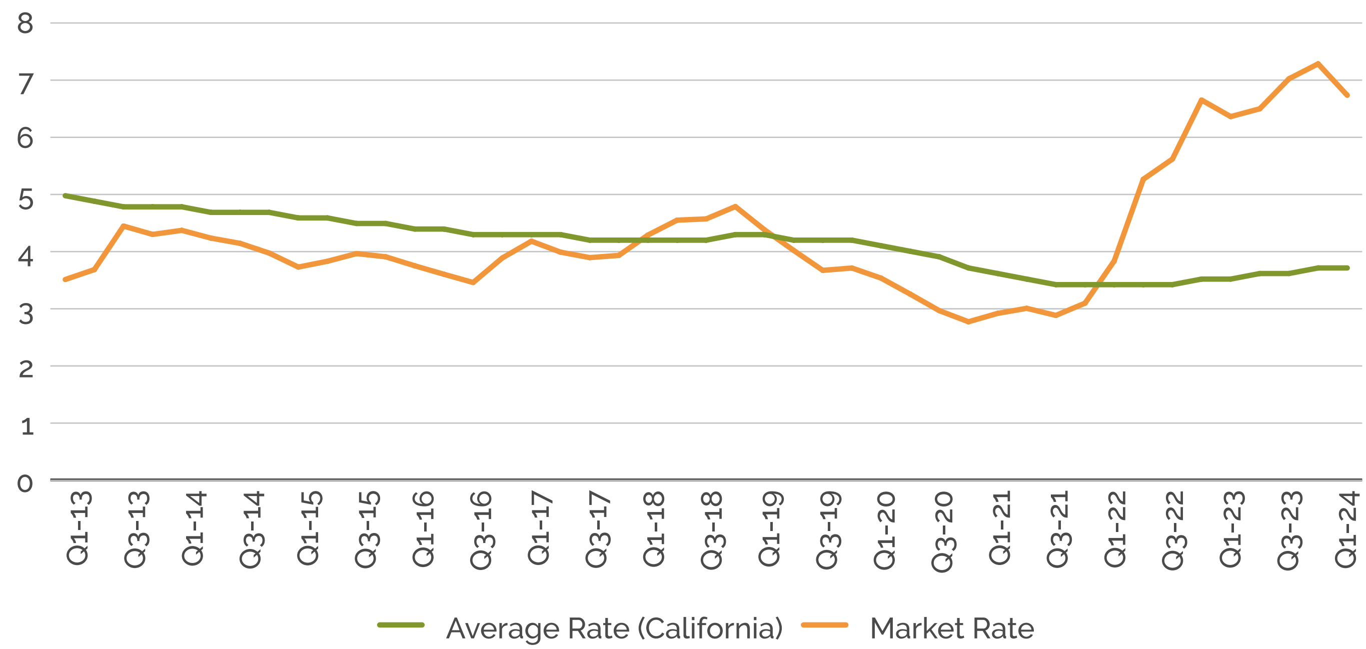
County of Contra Costa Home Sales



Source: CoreLogic; Analysis by Beacon Economics

Home sales across the East Bay have continued to disappoint, due in large part to a limited supply of homes coming on the market and the reluctance of homeowners to forgo the low rates they're locked into. Existing home sales, which comprise the bulk of real estate transactions, have been exceptionally weak in both Alameda and Contra Costa counties. In Contra Costa, single-family resales have trended below 1,000 for every month since October 2022, averaging roughly 850 homes sold each month. Sales activity in Alameda County has also been weak, with a noticeable drop-off also starting in October 2022, where mortgage rates hit a multi-decade high of over 7.5%. In Beacon Economics' view, sales activity is likely to trend 900-1,000 range for the foreseeable future.

Mortgage Rates: Market vs Residential Average



Source: Fannie Mae, Freddie Mac; Analysis by Beacon Economics

Inventories of homes for sale are historically low from a long-run perspective, which is one reason why prices have barely budged despite exceptionally weak sales. However, according to data from real estate brokerage Redfin, listings in the East Bay have finally started to rise, increasing by more than 57% from June 2023 to June 2024. This is a positive sign for the market and suggests that sellers are beginning to accept that above-average mortgage rates aren't going anywhere anytime soon. Housing inventories slowly returning to levels seen in the period following the Great Recession is a positive development, and this trend is expected to broadly stimulate the outlook for AV, as increased inventory can lead to more turnover.

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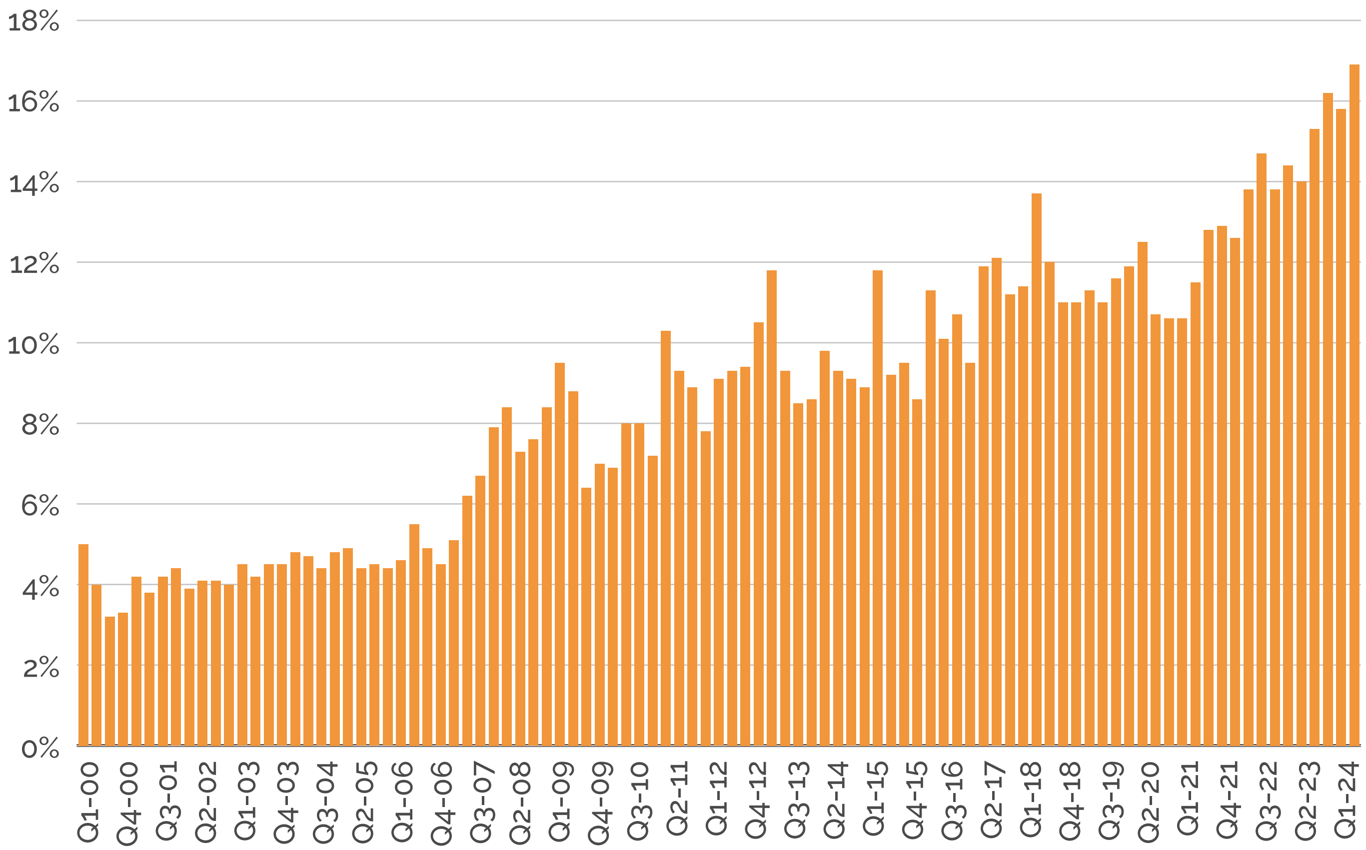
The increase in residential listings is also promising considering how weak sales activity has been, both in the East Bay and across the state. As mentioned earlier, sales activity has been suppressed because current homeowners are benefiting from record-low mortgage rates, and most have been unwilling or unable to list their properties on the market. Factors such as job changes, divorces, deaths, and other life events mean some turnover in the housing market is inevitable. But ultra-low rates continue to limit the number of homes being put up for sale and help maintain high price levels even though demand remains weak. Without doubt, this is still a seller's market. Beacon Economics expects prices to stay in positive territory, primarily due to the limited inventory of homes available for purchase, which bodes well for AV growth in the near term.

Housing Inventories in the East Bay

Source: Redfin; Analysis by Beacon Economics

Who is buying houses in today's market? Recent data indicates that investors are contributing significantly to the uptick in housing market purchases, with activity reaching unprecedented levels. In the East Bay, the share of homes bought by investors hit a record high in the first quarter of 2024. This trend suggests that investors are capitalizing on market conditions, potentially driving up prices and competition for available properties. Although the share is relatively low, at 17% , it is rising throughout the Bay Area. Investor purchases in the San Jose MSA jumped nearly 28% year over year, which was the largest increase among the nation's major metros. The East Bay saw the second largest increase at 22%. Investor presence in the market highlights a shift in the dynamics of homeownership and could have long-term implications for an already constrained housing supply. This is concerning when looking at conditions for first-time buyers, which have slowly worsened over the last decade.

Investor's Market Share in the East Bay



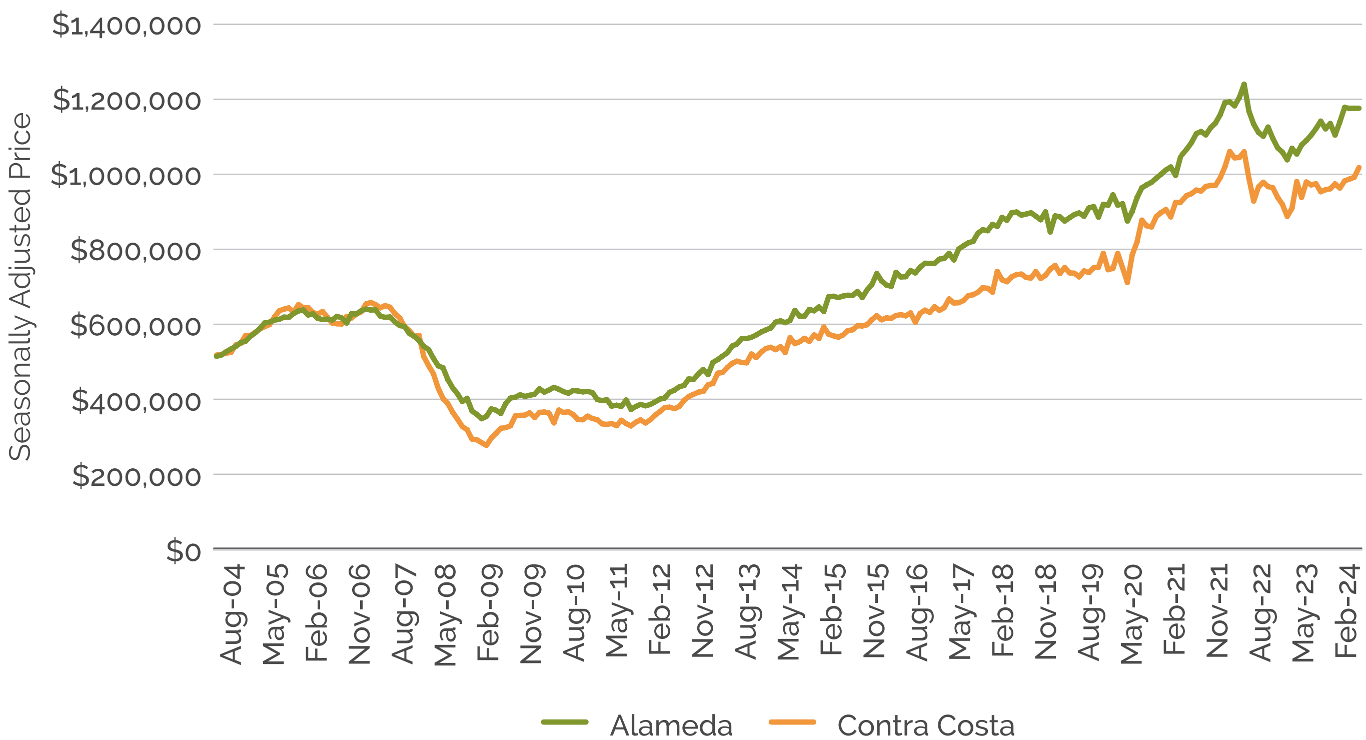
Source: Redfin; Analysis by Beacon Economics

First-Time Buyer Affordability Index

Source: California Associations of Realtors; Analysis by Beacon Economics

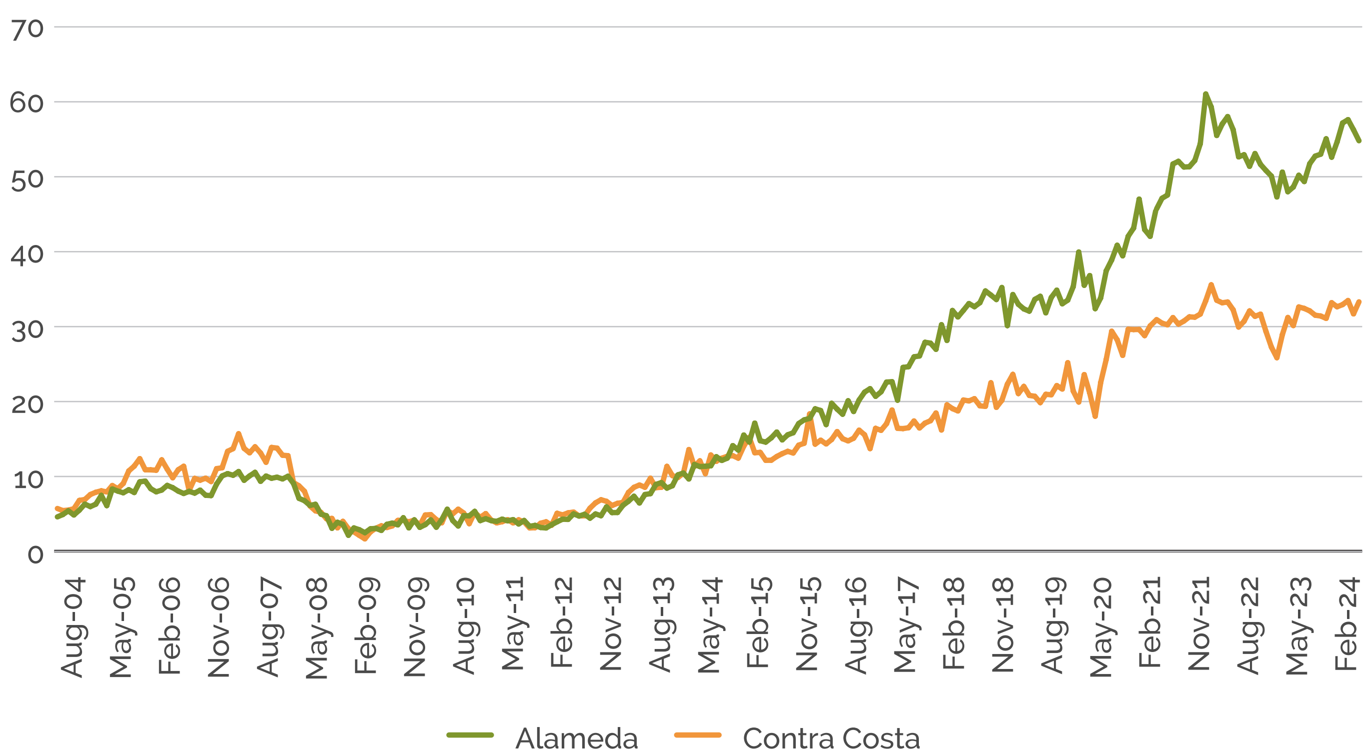
Prices for single-family homes in both East Bay markets did peak in the early part of 2022, due largely to a spike in interest rates that priced out a portion of the market. However, prices have started to rise again and, in nominal terms, are inching closer to all-time highs. From May 2023 to May 2024, the median priced home sold in Alameda County hit $1.176 million, a 9.4% increase over the previous year. Prices in Contra Costa County have also passed a million dollars, with the median priced home selling for $1.019 million, an increase of 8.8% over the previous year. Limited inventories might limit overall growth in the volume of home sales, but the properties that do turn over are assessed at much higher values. This supports Beacon Economics' outlook for AV growth in the near term, as higher property assessments drive up overall AV despite fewer transactions.

Median Price of Homes Sold in the East Bay



Source: CoreLogic; Analysis by Beacon Economics

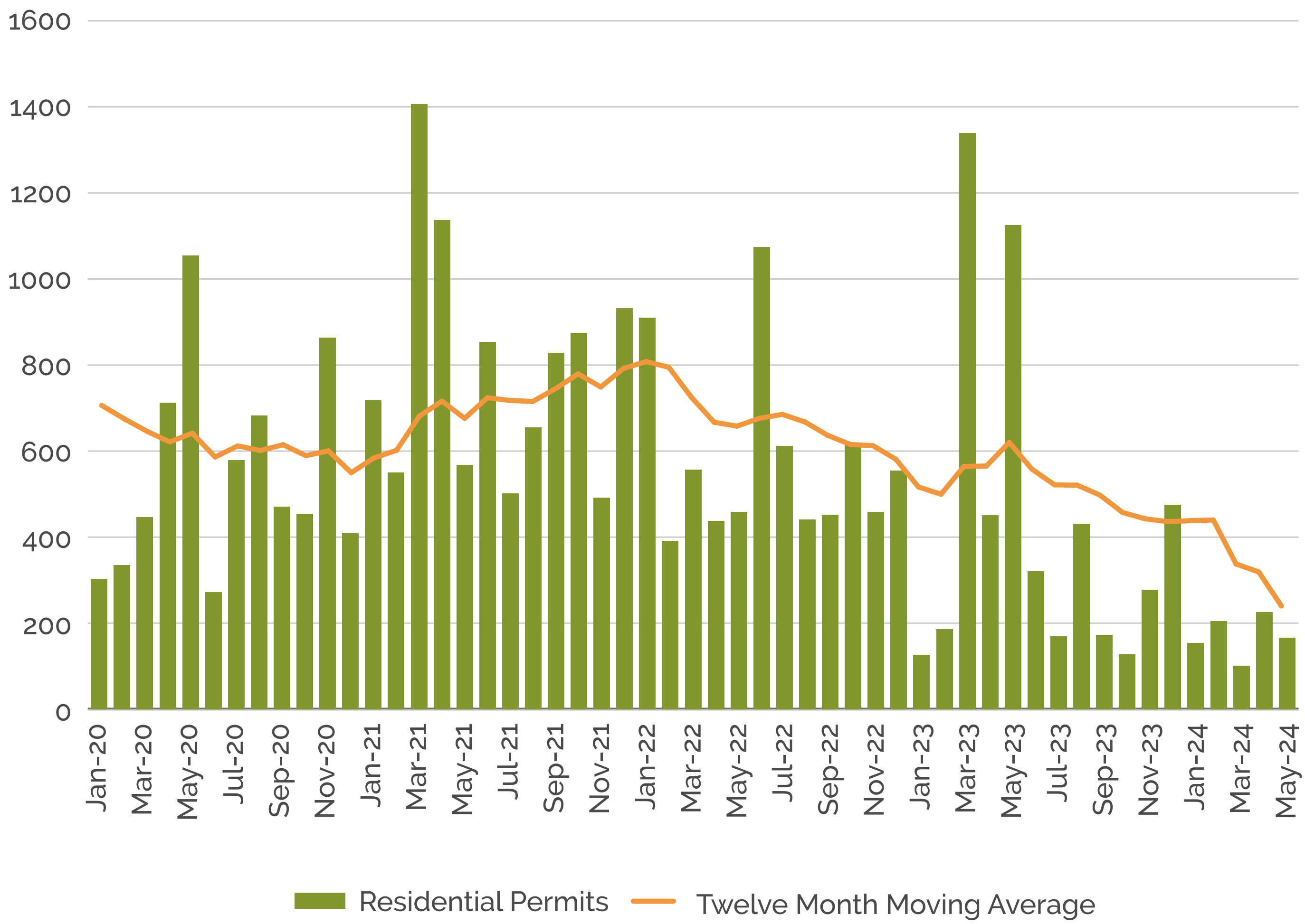
Share of Homes Sold: $1 Million +



Source: CoreLogic; Analysis by Beacon Economics

In the East Bay, properties valued at over one million dollars are making up a larger portion of the homes sold. During the height of the housing bubble, no more than 10-15% of properties sold were priced above a million dollars. In Alameda County, more than half of homes sold are above one million, whereas roughly one-third of homes in Contra Costa are above the million-dollar mark. In the 2000s and into the early 2010s, the proportion of homes sold above $1M in Alameda and Contra Costa counties remained relatively similar. However, starting around 2015, a notable divergence occurred. The share of $1M-plus home sales in Alameda County began to increase significantly, outpacing Contra Costa County, which showed a more modest rise. Several factors could explain this. Being closer to major tech hubs like Silicon Valley and San Francisco, Alameda County may have experienced higher demand and price increases due to the influx of tech professionals and abundance of higher-paying jobs. Additionally, Alameda County's urban amenities and desirable neighborhoods might have driven up home values more quickly compared to the suburban and rural areas of Contra Costa County.

Housing Permits Issued in the East Bay



Source: Construction Industry Research Board; Analysis by Beacon Economics

New construction could offer relief to the residential market and add badly needed housing stock. Despite occasional spikes, the total number of residential permits has steadily decreased. This is evident from the twelve-month moving average of residential units permitted, which helps smooth out monthly fluctuations. Rising interest rates have likely affected some construction activity, making financing for new developments more expensive. Consequently, there is little relief on the supply side of the market. The decline in residential activity is not confined to either market. The total value of residential permits issued through the first five months of May was down 33% compared to the first five months of 2023. The number of units permitted was also down significantly compared to last year, a drop-off of 76% year to date. The lone bright spot was residential alterations and additions in Alameda County, which increased 9.2%.

> New construction could offer relief to the residential market and add badly needed housing stock

Residential Permit Activity, East Bay

	Single Family Unit	Multi Family Unit	Total Units	New Single Family Valuation	New Multi Family Valuation	Residential Alteration and Addition	Total Residential
County of Contra Costa							
2023	535	736	1,271	230,046,917	129,347,494	157,164,098	516,558,509
2024	272	135	407	116,270,067	47,986,393	130,041,884	294,298,344
County of Alameda							
2023	188	2,028	2,216	78,803,875	243,481,290	172,775,301	495,060,466
2024	135	310	445	54,967,126	140,003,565	188,595,763	383,566,454
Total East Bay							
2023	723	2,764	3,487	308,850,792	372,828,784	329,939,399	1,011,618,975
2024	407	445	852	171,237,193	187,989,958	318,637,647	677,864,798
YTD through May	-44%	-84%	-76%	-45%	-50%	-3%	-33%

Source: California Homebuilding Foundation; Analysis by Beacon Economics

The non-residential market fared better, depending on the region. For all of 2023, the total value of non-residential construction in Alameda County declined by 20.6%, while in Contra Costa County non-residential activity advanced nearly 38% year over year. The decline in Alameda stemmed from a sizeable drop-off in non-residential alterations and additions, which declined by 41.7%. Despite the sizeable decline, non-residential alterations and additions still comprised more than half of all (non-residential) construction activity. By comparison, non-residential alterations and additions increased by 15.7% in Contra Costa County.

Non-Residential Permit Activity, East Bay

	Alameda		Contra Costa	
Segment	2023 ($000s)	Annual Growth	2023 ($000s)	Annual Growth
New Commercial	402,830	42.7%	36,206	-29.3%
Office	2,027	-98.0%	0	-
Retail	72,044	-38.5%	36,206	74.7%
Other Commercial	328,759	413.1%	0	-
Industrial	65,576	94.4%	3,542	41.1%
Other Nonres.	46,472	-39.1%	195,888	160.5%
Nonres. Alts./Adds.	562,403	-41.7%	308,827	15.7%
Total Nonres.	1,077,281	-20.6%	544,463	37.6%

Source: Construction Industry Research Board; Analysis by Beacon Economics

The outlook for AV remains broadly positive, despite ongoing challenges in the housing market. Although housing is still in short supply, recent increases in inventory are a promising sign. Properties that are turning over are being assessed at significantly higher rates, contributing to AV growth. Additionally, new buyers are gradually acclimating to higher mortgage rates, which should help market stability. While construction activity, especially in the residential sector, remains weak due to rising rates, the cumulative effects of higher property assessments and improved inventory levels suggest that AV growth will be stable in the near term. The East Bay in particular will see stable demand as more residents take advantage of lower home prices there compared to San Francisco and San Jose, while commuting to those job centers. Alameda County is well positioned geographically to benefit from high growth areas to the west and south, and this is reflected in the strong AV growth in the Assessor's latest estimate. Contra Costa County will become increasingly more attractive as prices rise elsewhere.

> "The outlook for AV remains broadly positive, despite ongoing challenges in the housing market

About Beacon Economics

Founded in 2006, Beacon Economics, an LLC and certified Small Business Enterprise with the state of California, is an independent research and consulting firm dedicated to delivering accurate, insightful, and objectively based economic analysis. Employing unique proprietary models, vast databases, and sophisticated data processing, the company's specialized practice areas include sustainable growth and development, real estate market analysis, economic forecasting, industry analysis, economic policy analysis, and economic impact studies. Beacon Economics equips its clients with the data and analysis they need to understand the significance of on-the-ground realities and to make informed business and policy decisions.

Learn more at **beaconecon.com**

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