

The Tumultuous Mortgage Market Undermines Northern Virginia Housing Market Recovery

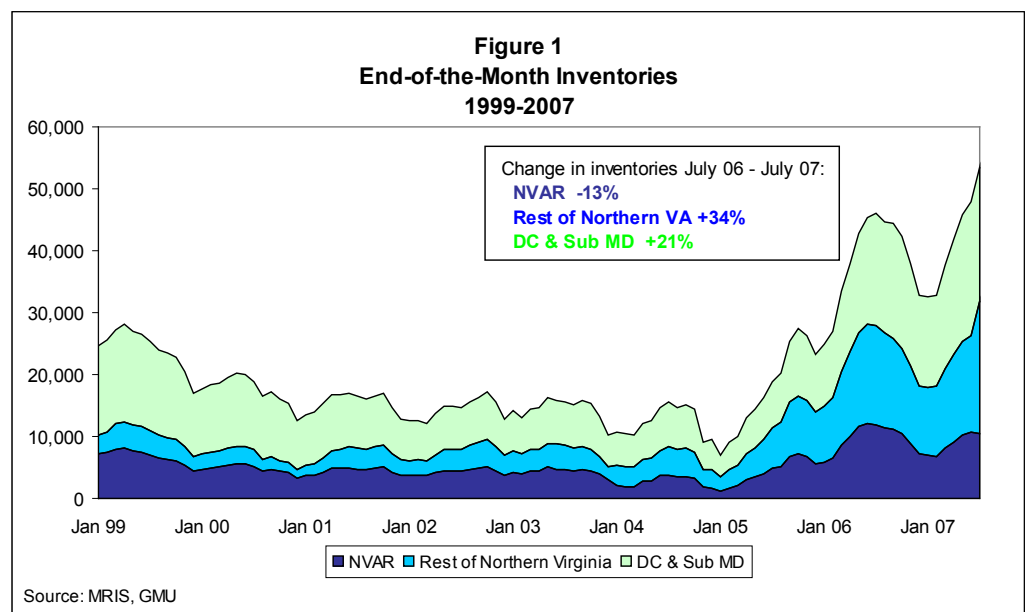
By Lisa A. Fowler, PhD

Late summer is typically characterized by a slower pace. Work productivity slacks off. Congress is out of session. And, yes, activity in the housing market tends to slow down. However, signs in June and July pointed to an upturn in parts of the region's housing market. The closer-in jurisdictions of Northern Virginia, in particular, showed positive signs of inventories being drawn down, homes selling more quickly, and prices increasing modestly. However, the upheaval in the residential mortgage market may stall the market's recovery before it is able to really get started. In fact, the situation may get worse before it gets better. Without the problems in the mortgage market, it was anticipated that the area housing market would return to a more normal state by the third quarter of 2007. The mortgage shake up will push that recovery into 2008.

Signs of Improvement?

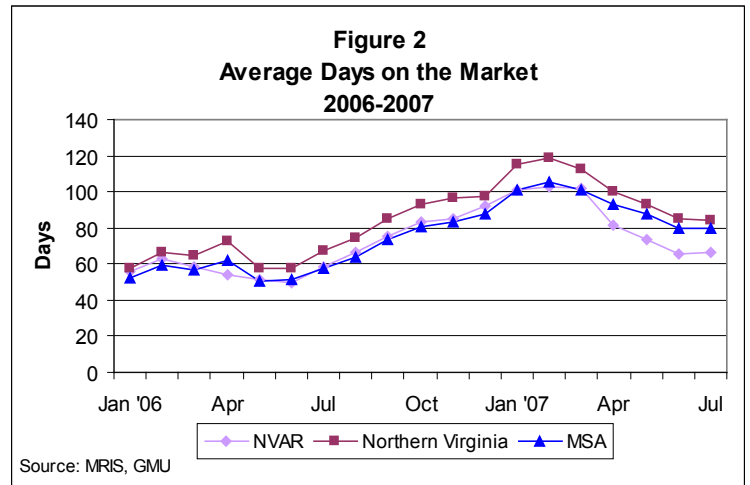
An extraordinary run-up in inventories began in the third quarter of 2005. At the end of October 2005, the number of active listings in the region represented by the Northern Virginia Association of Realtors (NVAR) was more than double the number of listings active at the end of October 2004. (The NVAR region includes Arlington and Fairfax counties and the cities of Alexandria, Falls Church and Fairfax.) Inventories continued to rise dramatically in late 2005 and 2006 (with typical seasonal highs and lows), peaking at 12,096 in June 2006. In the NVAR region, inventories started to be drawn down beginning in March 2007, while in the rest of the Washington DC metropolitan region inventories continued to rise. At the end of July 2007, there were 10,368 listings in the NVAR region, down 13 percent from the previous July. In contrast, inventories were up 34 percent in the rest of Northern Virginia (i.e. Loudoun, Prince William, Stafford, Spotsylvania and Warren counties and the cities of Fredericksburg, Manassas and Manassas Park.)

At the same time that inventories were being drawn down, the average days on the market decreased dramatically in the NVAR region. The average days on the market in the Washington DC metropolitan area peaked in July 2007 at 105 days. Since then, the average days on the market has dropped off across the region, but the decline was more significant in the NVAR region. In July 2007, homes were on the market an average



of 66 days in the NVAR region, just 7 days higher than the July 2006 average. For the entire Washington DC metropolitan area, homes were on the market an average of 80 days in July 2007, up 22 days over July 2006. The long term average for the region is about 90 days.

Prices have not stabilized completely in the NVAR region; however, in recent months, home prices ceased their downward trend. Overall, price appreciation in the NVAR region was stronger than in the outer suburbs of Northern Virginia. Home prices were up 3.1 percent in July 2007 in the NVAR region. The average price of a single-family detached home was \$751,000, up 1.1 percent over July 2006. The average price of single-family attached homes was basically flat, \$477,000 in July 2007 compared with \$478,000 in July 2006. Condominiums had made the strongest gains in July, with prices up 3.9 percent over July 2006. Price appreciation was stronger in the District of Columbia and Suburban Maryland, but weaker in the outer suburbs of Northern Virginia. For example, prices in Loudoun and Prince William counties were down about 4.5 percent, largely due to the competition created by the abundance of new homes in those jurisdictions.



Mortgage Crunch Dampens the Good News

The turmoil in the residential mortgage market is primarily driven by the meltdown in the subprime market. Many subprime loans have interest rates that reset at some point into the amortization period (usually two years.) Many subprime borrowers had poor credit or inconsistent income. Just as these interest rates were resetting—from six to eight or even 10 percent—home values flattened or depreciated. Homeowners were unable to refinance and many have defaulted or have gone into foreclosure. The number of foreclosure filings in July 2007 was nearly double the number a year ago. Statewide, foreclosures were up 300 percent

The problems originating in the subprime market have spilled over into the conventional mortgage market. As interest rates rise and foreclosures increase, the mortgage industry is tightening its qualifications, making it more difficult for even well-qualified borrowers to secure a home loan. Potential homebuyers needing so-called jumbo loans (i.e. >\$417,000) are having the hardest time. In August 2007, the interest rate for a 30-year fixed rate convention loan was 6.60 percent, while a 30-year jumbo loan had a rate between 6.8 and 7.5 percent. The gap in interest rates means a buyer with a \$417,000 loan will have a much higher payment than one with a \$416,000 loan. Potential homebuyers in high cost areas like Northern Virginia will be particularly hard hit by the differential.

The tightening of the credit market makes it especially hard for first time homebuyers. If this population is unable to buy, there will be a domino effect. Homeowners wanting to move up will be able to because they cannot find a buyer for their home.

It will become clearer in the fall how the mortgage market will respond to the continuing shake out in foreclosures. Sales in the fall will be slower than anticipated as buyers have to look longer to find a mortgage with terms they can meet. The interest rate differential between conventional and jumbo loans should increase the demand for condos and other lower-priced homes. Sellers of more expensive homes will be faced with a challenging market where they will have to make their home as attractive as possible, plan to be patient, and—above all else—anticipate offering price concessions to attract buyers.