Market Watch
Washington, DC
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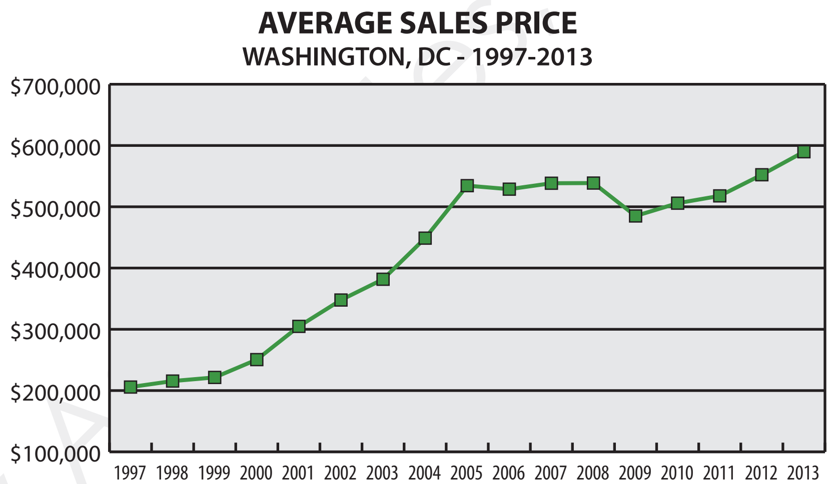
NORMAL

It has been said that the only **normal** people are the ones you don't know very well. The same can be said for the real estate market in Washington, DC – it's been so long since we've had a "normal" real estate market that many are entirely unfamiliar with what that looks like!

During the past 10 or 12 years, we've seen unprecedented and rapid shifts in the real estate landscape. Starting in 2002, fueled by the enormous increases in post 9/11 defense-related spending, the market exploded. Prices started to climb, and the emerging boom went into afterburners with speculation, public policy that encouraged "everyone" to own a home, and low teaser-rate mortgage loan products that brought an enormous supply of buyers into the market hoping to cash in on the boom. The average annual price appreciation from 2002 through 2005 was more than 15%. When home prices soared to levels that could not be supported by even the ridiculous loan products, buyers all but disappeared. Prices were flat in 2006 through 2008 and then dropped by more than 10% in 2009. DC also had record foreclosures and short sales. There was nothing normal about that.



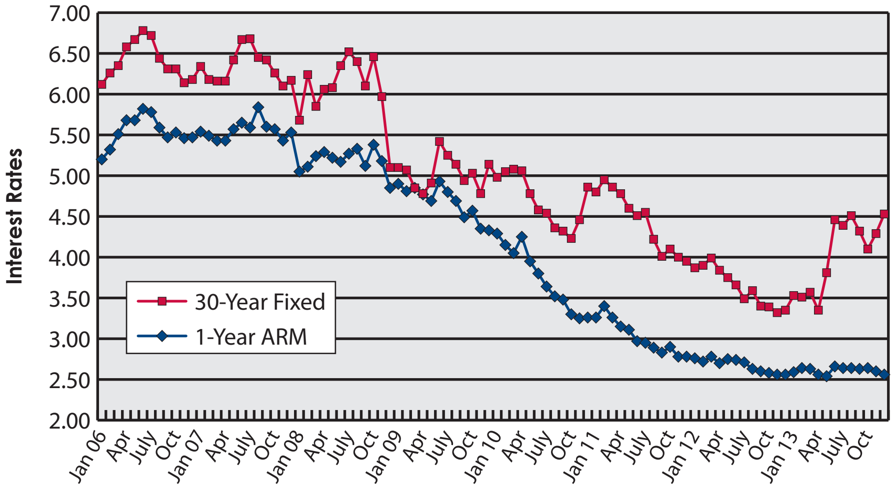
To bring the market back, we've seen everything from big tax breaks for first-time homebuyers to mortgage interest rates kept artificially low by Fed intervention, the so-called quantitative easing. We're not suggesting those were the wrong moves – it's just that when you look at the past decade, there's been nothing normal about anything in this market.

For the first time in a long time, we think the market will be returning to normal in 2014. Rising mortgage interest rates, while still very low, will price some buyers out of the market, and that will keep a lid on demand. As the economy improves, there is going to be a big increase in household formation – but a significant percentage of those new, younger households are going to rent before they buy. They won't be in a big a hurry to buy as their parents were a generation before. Rising home prices will bring more sellers into the market, but we need to remember that there are plenty of homeowners who have refinanced during the past few years and have locked in historically low rates for the long term – they won't be in a hurry to sell unless they have a specific need. The currently tight supply of homes isn't going to change quickly.

All in all, we believe that we'll see a much more balanced market as the year progresses, with sustainable – let's call it normal – increases in home prices in the range of 5% - 7%. And by the way, as hard as this may be to believe, the average annual price appreciation in this area from the end of the Civil War until 2000 was slightly more than 6%.

30-YEAR FIXED AND 1-YEAR ADJUSTABLE RATES

Month-End Mortgage Rates - January 2006-December 2013

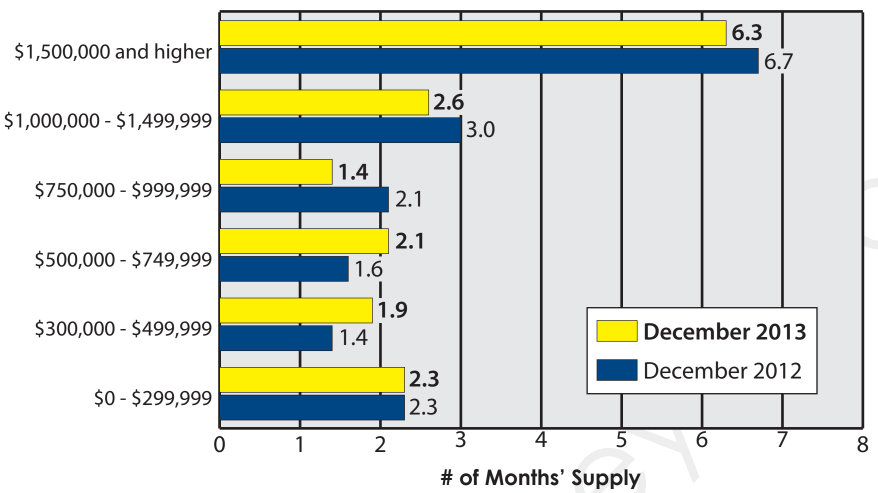


MORTGAGE RATES

- 30-year fixed interest rates at the end of December averaged **4.53%**, compared to 3.35% at the end of December 2012.
- One-year adjustable rate mortgages were 2.56% at the end of December 2013, which is the same as at the end of December 2012.
- Expect rates to rise through 2014 as the Fed backs off buying mortgage-backed securities. Don't be surprised if rates are near 6% by year's end.

MONTHS' SUPPLY

Washington, DC - End of December 2012 vs. End of December 2013 by Price Range

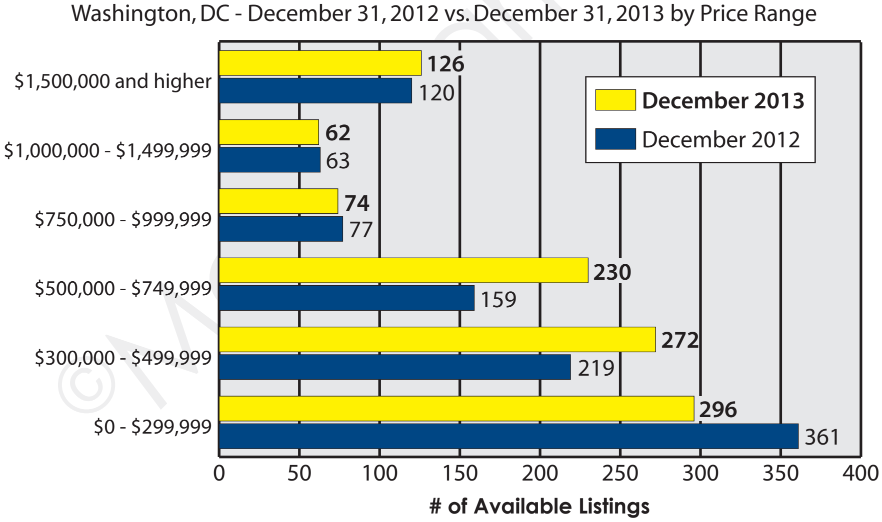


MONTHS' SUPPLY

- The overall supply of homes on the market at the end of December was **2.2 months**, up from 2.1 months at the end of December 2012, and that's the lowest supply in the metro area.
- DC has, by far, the most balanced market in the region across all price categories, as well as the lowest overall supply.

FULLY AVAILABLE LISTINGS

Washington, DC - December 31, 2012 vs. December 31, 2013 by Price Range



FULLY AVAILABLE LISTINGS

- Month-end inventory for December 2013 was **up 6.1%** from December 2012. There was also an increase in the number of new listings coming on the market.
- In "normal" markets with overall tight supply, we would expect that even more owners would be putting their homes on the market to take advantage of rising prices. But most are in no hurry to do so because they're happy where they are, they have low interest rates locked in, or they are simply cautious after seeing the market's roller coaster ride during the past decade.