Market Watch
Washington, DC
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WHAT'S AHEAD FOR 2016?

2015 was better than 2014 across the entire metro DC area for the two most important metrics – total settlements and new contract activity – but most other indicators were a little worse. With the exception of Washington, DC itself, homes took a little longer to sell, price appreciation was moderate at best and overall supply rose as more new listings came on the market.

What's ahead for 2016? We think the market is headed toward something we haven't seen in almost 15 years: normalcy. During the past decade and a half we've seen some wild swings in real estate, from the pause after the horrors of September 11, to the rapid run up in home prices 10 years ago with teaser rate mortgages and people buying homes who could not possible afford them, to the crash that followed.

"Normal" means a supply of three to four months of inventory along with modest and sustainable price appreciation in the range of 1%-3%. Of course, there will continue to be regional differences, with walkable communities and those areas close to major employment centers and Metro faring better than others. And that means that DC will still outperform its suburban neighbors in 2016.

There are three fundamental reasons we think 2016 is going to look a lot like 2015:

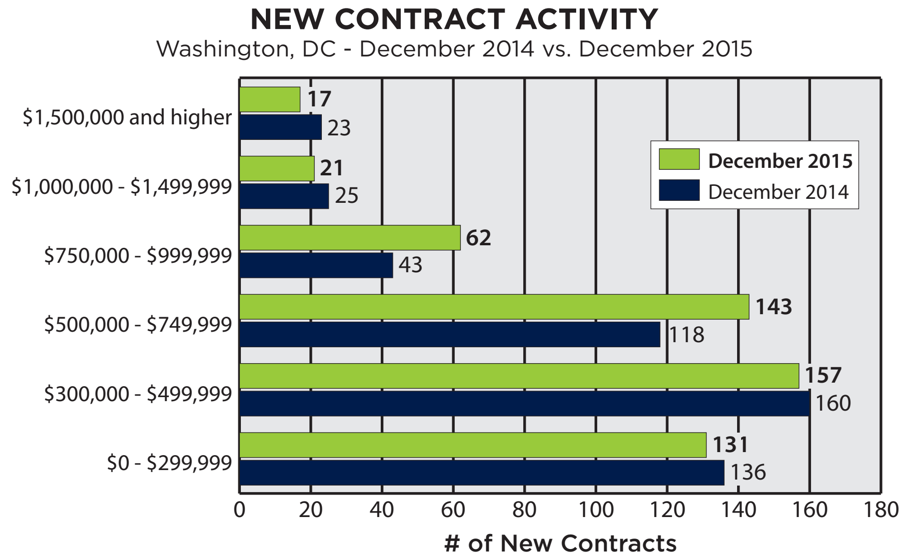
The first is the economy, regionally and nationally. The overall news isn't bad, but it isn't great either. Sure, the employment numbers are very encouraging – but real incomes haven't risen. Lower oil prices have put more money in people's pockets, but oil producers are going to take a big hit – and so are their employees. That won't be good for the overall economy. We just don't see anything on the horizon that tells us things are going to be a lot better.

The second is interest rates. Today, mortgage interest rates are still under 4% and we haven't seen anyone project rates by year-end any higher than 4.9%. There's no doubt that rising rates will make home slightly less affordable, but the bigger hurdles for buying a home for most people are the down payment and debt-to-income ratios, not the payment. We're not suggesting that rising rates are good for the housing market – we just don't see a major negative impact in 2016.

The third reason: Urgency. A couple of years ago, we created a rudimentary indicator of the health of the market called the "Urgency Index." This is simply the percentage of homes going under contract in any given month that were on the market for 30 days or less. The higher the percentage, the greater "urgency" buyers felt to act. DC has consistently had the highest Urgency Index in the region during the past several years. For all of 2015, the suburbs had a UI of about 50% while DC's was 67%. Over the last several months, the suburban markets have seen their UI drop a bit while DC's has held steady. But in both cases, buyers aren't in a huge hurry to snap up homes the moment they come on the market.

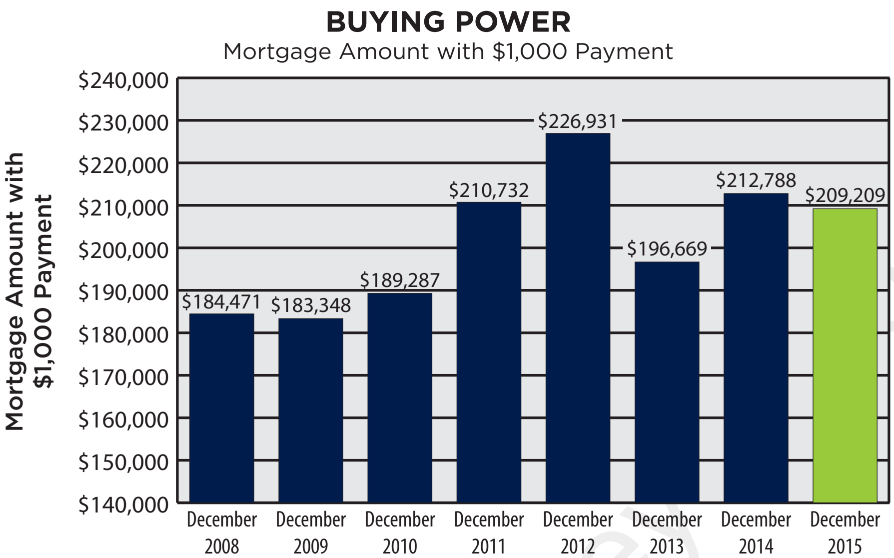
In short, we think 2016 will be a good – not great - year with a return to normalcy.

One more thought: This is an election year, and every election cycle we hear the speculation that the outcome will have a major impact on the local real estate market. It won't – regardless of the results. As we get a little closer to November, we'll talk about why. Just don't change your plans to sell or buy because there's an election on the horizon – make the move when it makes the most sense for your personal circumstances.



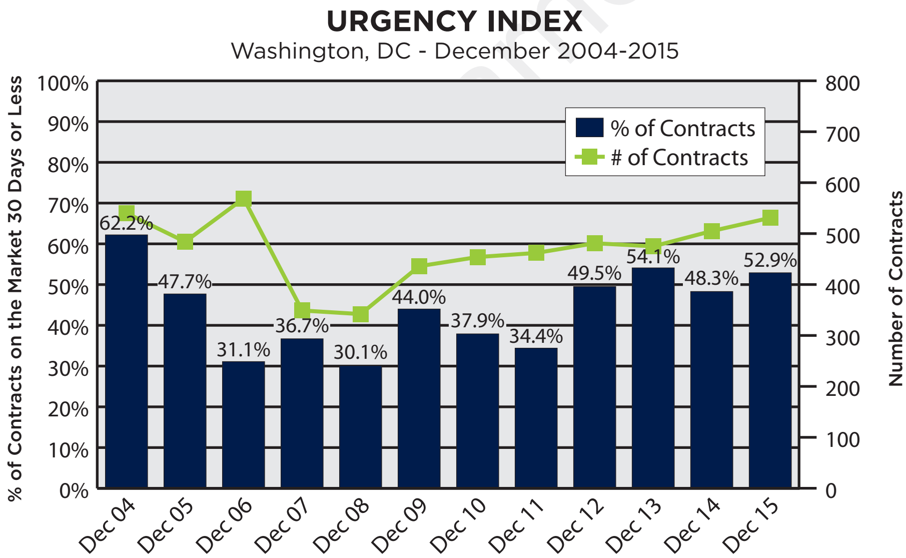
NEW CONTRACT ACTIVITY

- The number of new contracts ratified in December 2015 was **up 5.1%** from December 2014, but there were decreases for four of the six price categories.
- Contract activity for the full year 2015 was **up 5.7%**.
- **29.6%** of all homes going under contract in December had at least one price reduction. The other jurisdictions in the Metro Area are typically seeing 43% - 48% of homes with a price reduction before receiving a ratified contract.



BUYING POWER

- A $1,000 principal and interest payment supported a loan of $209,209 at the end of December, which is **$3,579 less** than December 2014 and $24,738 more than December 2008.
- We expect the interest rates on a 30-year fixed mortgage will increase to no more than 4.9% by the end of 2016 – and we won't be at all surprised if they top out at 4.5% this year.



URGENCY INDEX

- In the past 12 years, the December Urgency Index has been as high as 62.2% and as low as 30.1%.
- Look how much buyer expectations changed from December 2005 to 2006. The number of ratified contracts increased by 17.6%, but the Index fell by 34.8%, indicative of some real buyer pessimism.
- The average December Urgency Index during the past 12 years is 44.1% - which is significantly lower than where it is now in DC.