MarketWatch NORTHERN VIRGINIA
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Champagne, Baths – and Real Estate

Bubbles are great to have in champagne, baths, and a host of other things, but they are not good for the real estate market.

A real estate bubble generally is caused by unjustified speculation in the housing market that leads to a rapid and unsustainable increase in prices. When it bursts, prices decline quickly – often to levels lower than when the run up in prices began. The whole country experienced a painful bursting bubble almost a decade ago, and its impact was felt far beyond the real estate market.

There is no doubt that home prices have risen significantly in the metro area during the past several years and affordability, especially for first-time homebuyers, is a real concern. But are we in a bubble? The short answer is no.

From 2002 through 2005, home prices in the Washington, DC metro area skyrocketed. Demand was artificially high, driven by ridiculously low "teaser" interest rate mortgages. Prices were up 14% in 2002, 15% in 2003, 20% in 2004, and 21% in 2005. Since mortgage underwriting guidelines were essentially non-existent, more and more buyers rushed into the market to buy homes they could not afford, with the expectation they could cash in their gains later.

When those artificially low adjustable rate mortgages started to adjust and guidelines tightened, demand plummeted. There was a 40% drop in the number of home sales in 2009, compared to the peak in 2005. At the same time, the market was flooded with new inventory as homeowners rushed to sell homes they could no longer afford. With the enormous drop in demand and the jump in homes on the market, prices dropped almost 15% in 2009. Prices only started to head back up in 2012.

None of those supply and demand conditions exist today.

Let's take a look at demand. There are three basic ways to increase the desire for housing: an upturn in economic activity, an increase in population, and generally low interest rates. To a large degree, all three of those exist today. The region's economy is doing pretty well, especially in The District. Further, the region has grown by 1,000,000 residents in the last 14 years. Finally, low mortgage interest rates have created an extremely attractive environment for prospective home purchasers, and yet, demand has not exploded. The number of home sales this year in the metro area will be virtually identical to the number that sold in 2003. There have been significant demographic shifts – people are waiting longer to marry and form households, and student loan debt makes it harder for many to buy their first home. And despite those low interest rates, it is harder to qualify for a loan. In short, demand is reasonable, and it not being fueled by speculation.

On the supply side, inventory of available homes is at a historic low. Just as buyers are waiting longer, homeowners are staying put longer. Nationally, the median number of years sellers have been in their homes has risen from six years in 2000 to 10 years today. New construction isn't keeping pace with household formation.

Low inventory has certainly contributed to increasing home prices, but even in the hottest market area in The District, annual appreciation rates have been between 6% and 8% during the last three years. It is far lower in the suburbs. If demand were greater, the lack of inventory would have pushed prices much higher.

Markets seek balance over time, as long as they are not artificially stimulated or restricted. The hottest areas in our region are due for an adjustment because 6%-8% appreciation isn't sustainable forever. In our more suburban markets, current appreciation rates are in line with historic norms. And we know that eventually, mortgage interest rates will climb, and that will ease some of the upper pressure on home prices. We believe the inevitable market adjustment will come in the form of lower appreciation rates, not a drop in prices.

ABSORPTION RATE BY PROPERTY TYPE

The following tables track absorption rate by property type, comparing the rates in the just-completed month to the rates in the same month of the previous year. The absorption rate is a measure of the health of the market, and tracks the percentage of homes that were on the market during the given month and in the given price range that went under contract. [The formula is # Contracts/(# Contracts + # Available).] An example: The absorption rate for attached homes priced $500,000-$749,999 in July 2017 was 33.4%. That compares to a rate of 31.7% in July 2016, and the increase means the market was better in 2017 for that type of home. If the absorption rate was less in 2017 than in 2016, we have put the 2017 rate in **red**. This month there was **improvement for 11 of 18 individual price categories**, and one remained the same.

Condo/Co-op	July 2016			July 2017		
Absorption Rates	Listings	Contracts	Rate	Listings	Contracts	Rate
$299,999 & under	702	332	32.1%	520	322	**38.2%**
$300,000 - $499,999	515	210	29.0%	374	209	**35.8%**
$500,000 - $749,999	117	35	23.0%	129	42	**24.6%**
$750,000 - $999,999	46	9	16.4%	73	10	**12.0%**
$1,000,000 - $1,499,999	25	1	3.8%	26	3	**10.3%**
$1,500,000 & higher	13	3	18.8%	21	4	**16.0%**
Grand Total:	**1418**	**590**	**29.4%**	**1143**	**590**	**34.0%**

ABSORPTION RATES – CONDOS AND CO-OPS

- The overall absorption rate for condos and co-ops for July 2017 was **34.0%**, an increase from the 29.4% rate in July 2016.

Fee Simple Attached	July 2016			July 2017		
Absorption Rates	Listings	Contracts	Rate	Listings	Contracts	Rate
$299,999 & under	43	38	46.9%	16	27	**62.8%**
$300,000 - $499,999	453	339	42.8%	333	305	**47.8%**
$500,000 - $749,999	287	133	31.7%	255	128	**33.4%**
$750,000 - $999,999	72	32	30.8%	79	34	**30.1%**
$1,000,000 - $1,499,999	39	9	18.8%	38	7	**15.6%**
$1,500,000 & higher	18	0	0.0%	24	2	**7.7%**
Grand Total:	**912**	**551**	**37.7%**	**745**	**503**	**40.3%**

ABSORPTION RATES – ATTACHED HOMES

- The overall absorption rate for attached homes in July 2017 was **40.3%**, an increase from the 37.7% rate in July 2016.

Fee Simple Detached	July 2016			July 2017		
Absorption Rates	Listings	Contracts	Rate	Listings	Contracts	Rate
$299,999 & under	0	1	100.0%	5	1	**16.7%**
$300,000 - $499,999	249	155	38.4%	212	133	**38.6%**
$500,000 - $749,999	808	391	32.6%	777	377	**32.7%**
$750,000 - $999,999	576	183	24.1%	575	183	**24.1%**
$1,000,000 - $1,499,999	556	71	11.3%	472	102	**17.8%**
$1,500,000 & higher	494	44	8.2%	478	39	**7.5%**
Grand Total:	**2683**	**845**	**24.0%**	**2519**	**835**	**24.9%**

ABSORPTION RATES – DETACHED HOMES

- July 2017's absorption rate for detached homes was **24.9%**, a slight increase from the 24.0% rate in July 2016.
- There were five homes priced less than $300K on the market at the end of the month.