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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 Condos/Co-ops priced $500,000-$749,000 in July 2017 was 41.4%; that compares to a rate of 40.9% 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 9 of the 18 individual price categories – but DC still has the highest absorption rates in the region.**

Condo/Co-op	July 2016			July 2017		
Absorption Rates	**Listings**	**Contracts**	**Rate**	**Listings**	**Contracts**	**Rate**
$299,999 & under	174	92	34.6%	143	99	**40.9%**
$300,000 - $499,999	185	130	41.3%	198	147	**42.6%**
$500,000 - $749,999	178	123	40.9%	154	109	**41.4%**
$750,000 - $999,999	48	30	38.5%	81	30	**27.0%**
$1,000,000 - $1,499,999	24	15	38.5%	42	9	**17.6%**
$1,500,000 & higher	30	4	11.8%	47	6	**11.3%**
Grand Total:	**639**	**394**	**38.1%**	**665**	**400**	**37.6%**

ABSORPTION RATES – CONDOS AND CO-OPS

- The overall absorption rate for condos and co-ops for July was **37.6%**, a slight decrease from the 38.1% rate in July 2016.
- The absorption rate for condos across most price ranges is more balanced in DC than anywhere else in the region.

Fee Simple Attached	July 2016			July 2017		
Absorption Rates	**Listings**	**Contracts**	**Rate**	**Listings**	**Contracts**	**Rate**
$299,999 & under	45	47	51.1%	45	38	**45.8%**
$300,000 - $499,999	65	47	42.0%	82	84	**50.6%**
$500,000 - $749,999	102	91	47.2%	97	85	**46.7%**
$750,000 - $999,999	67	53	44.2%	90	53	**37.1%**
$1,000,000 - $1,499,999	44	24	35.3%	61	36	**37.1%**
$1,500,000 & higher	53	17	24.3%	55	16	**22.5%**
Grand Total:	**376**	**279**	**42.6%**	**430**	**312**	**42.0%**

ABSORPTION RATES – ATTACHED HOMES

- The overall absorption rate for attached homes for July was **42.0%**, which is slightly less than the 42.6% rate in July 2016.
- Again, look at the balance across most price ranges.

Fee Simple Detached	July 2016			July 2017		
Absorption Rates	**Listings**	**Contracts**	**Rate**	**Listings**	**Contracts**	**Rate**
$299,999 & under	20	10	33.3%	27	14	**34.1%**
$300,000 - $499,999	34	21	38.2%	47	32	**40.5%**
$500,000 - $749,999	40	24	37.5%	40	19	**32.2%**
$750,000 - $999,999	26	23	46.9%	27	18	**40.0%**
$1,000,000 - $1,499,999	23	15	39.5%	27	21	**43.8%**
$1,500,000 & higher	92	9	8.9%	81	15	**15.6%**
Grand Total:	**235**	**102**	**30.3%**	**249**	**119**	**32.3%**

ABSORPTION RATES – DETACHED HOMES

- July 2017's absorption rate for detached homes was **32.3%**, an increase from 30.3% in July 2016.
- And the balance among the price ranges is evident here as well.