Montgomery County Bi-monthly Report **Final 12/19/08**
November 2008 Market and 2009 Forecast

"Still A Weak Market – but, a Bottom in 2009"
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Maryland Real Estate Sales Overview

Through November, Maryland sales were down over 28%, with average and median price declines of 5.6% and 8.5%, respectively. Sale and price performance was better through the summer. For the month, 2,740 sales units statewide were 28% below a year ago. Price declines have worsened from the summer months, with both the average ($309,337) and median prices ($262,109) down 10.7% from last November. On the supply side, active listing inventory was 47,620 units statewide – down only about one-half of one percent from a year ago. A lower inventory would provide more support for prices.

Montgomery County Single-Family Homes

Single-family home settlements in November (410) came in 5.5% below the levels of a year ago. Year-to-date November contracts (6,741) were about 9% below 2007 levels and settlements (6,208) dropped nearly 16%. The good news was that November contracts (540) rose 9% above the 2007 level. Better news is that the active listing inventory declined significantly in November. Total actives in November (3,687) were almost 8% below those of November 2007. And, the 698 new listings were 20% below those of November 2007.

Similar to the trend in settlements, year-to-date prices are continuing to be down relative to a year ago. Through November, the average sales price in the County was $559,197 -- down 9% from 2007. Similarly, the November year-to-date median of $440,000 was 12% lower. The November contracts rate suggests the market may be coming back and would help bottom-out the price trend. With the Federal Reserve pushing short-term interest rates down to almost zero and also buying Freddie and Fannie securities, the expectation is that financing conditions will improve in 2009.

Finally, the declining inventory will help to put a floor under prices, while the anticipated lower mortgage interest rates will provide support. We may be close to the price bottom, if the local economy maintains itself, but supply needs to adjust a bit more. At the November contracts rate, total actives represented a 6.8 months supply -- up from the middle of the summer, and still above the benchmark six-month level.

Montgomery County Condo/Coops

Condo/coop markets have continued to suffer declines in sales and prices. For November, settlements totaled 112 properties and were down 9% from a year ago. The new contracts pace (108) fell 38% from last November; and, cumulatively for the last 11 months, contracts (1,642) were down 27%. In parallel fashion, year-to-date settlements (1,531) dropped 30%. With the 38% drop in recent contracts, the condo/coop market will be down at least 30% for the year.

Through most of the year, condo/coop prices continue to be softest in the middle of the market. Year-to-date, the median priced unit ($260,000) is down 8.8% from the comparable figure in 2007. This is a significant decline for the middle-market units. However, the average price of $313,700 was only 3.4% below the same 2007 value. The more upscale units have taken smaller percentage hits on price.

At the November contracts pace there was still a 10.6 months supply of listings. As with single-family properties, inventory needs to play a bigger role in supporting prices. The November inventory of 1,146 properties was only 4% below the level of a year ago. However, the good news is the November rate of new listings (217) was 40% lower than a year before, so supply adjustments seem to be working.

Recent Economic Trends

Surprise! It is now official: *Since December 2007, the national economy has been in a recession!* The Business Cycle Dating Committee of the National Bureau of Economic Research – an association of academic economists from top universities – looked at a number of monthly indicators of domestic production and employment and recently came to this conclusion. Payroll employment peaked last December and has declined every month since then. First quarter real GDP growth was put at 1.0% and the second quarter was 0.5%; however, third quarter is estimated at -0.5% and most economists are expecting about 6% to 7% shrinkage for the fourth quarter. The national figures are shaping up to be at least as bad as the 1980-82 recessionary period.

But, I'm still stubbornly clinging to the opinion that the recession will not be worse than the 1980-82 period. The government is committed to spending as much as it takes. The Obama administration will use this as an opportunity to invest in infrastructure projects and develop new industries for the future. The downside risk of these policies is that once the economy stabilizes, the Fed and Treasury will have to pull back on the money machine or we will see inflation and high interest rates a few years after we exit the recession.

Nevertheless, while the County's real estate recession goes on its economy is still is doing very well relative to the rest of the country. In October, the County unemployment rate was only 3.6%. This is up a bit from earlier in the year, but that compares favorably with the 5% rate for all of Maryland. Furthermore, the national rate was 6.5% in October, and for November the rate rose to 6.7%. Clearly, the County's economy is doing quite well.

A year ago, most economists felt the financial sector problems would not leak into the "real"/production sector. It was believed that the financial securities industry, real estate and mortgage finance would suffer the most pain, but that the rest of the economy would not be impaired. However, the unraveling of the financial sector has affected lending risks and liquidity in the real sector. This unwinding of excessive leverage (borrowing) by consumers and investors will continue for at least a few more years. And, unfortunately, most of the troubles in real estate are not likely to fade away until well into 2010. Analysts expect that the next two years will bring high default and foreclosure rates on Alt-A loans (undocumented income) and Option ARMs. The Alt-A problems could affect homes sold in upper-bracket areas.

Consumer Prices and Energy Costs

The national Consumer Price Index in November declined almost 2% from the October index level; and, current annual inflation has been only 1.1% when measured since November 2007. This is a serious set back for inflation. Among the various components since November 2007: food and beverage prices increased 5.9%; housing costs rose only 2.7%; retail apparel prices were unchanged; energy dropped 13.3%; transportation fell 8.9%; and, medical care rose only 2.7%. Over the last year, the 'core' inflation rate rose only 2%. These results have lessened Fed concern about inflation and have allowed them to become more aggressive about pumping up the economy.

The Fed and Mortgage Rates

In an unprecedented move, the Fed has cut its short-term lending rate to between 0% and 0.25%. This will put downward pressure on lending rates in the system. Furthermore, the Fed has indicated it will buy securities of government agencies (up to $600 billion worth, including Fannie Mae and Freddie Mac) and Treasury bonds to push down long-term rates. In its purchase of bank assets so far, the Fed has spent almost $1 trillion in Federal Reserve System funds, separate from the Treasury's TARP program.

The mid-December Freddie Mac surveys showed rates on traditional types of loans incredibly affordable for those who qualify along more traditional standards. National average 30-year contract rates averaged 5.19% with 1-year adjustable rate mortgages (ARMs) at 4.94%. Fifteen year loans averaged 4.92%, with 5/1-yr. ARMs at 5.6%. The 30-year rate is about 100 basis points below the beginning of the year.

With the Fed intervention in financial markets, the rates on conforming mortgage loans have never been better. For those borrowers who can, this is truly the time to buy. In just the past week or so, rates have dropped significantly, and more declines are expected. Recent rate quotes are even lower than above, and in some areas 30-year fixed can be had for under 5%. At least for the first half of 2009, we will see mortgage rates below 5%, or not much above. This will put a nice support below prices.

The Bottom Line

We will probably see some further declines in sales and prices in Montgomery County neighborhoods into 2009, but there is a good chance most markets will bottom by spring. Sellers will still need to be motivated and buyers will be aggressive with offers, but great interest rates will temper low-balling. The bad news about defaults will be with us for probably another year or more. Rate resets on Alt-As and Option ARMs could affect the more upscale markets. However, the County's economic strength and more government spending will bring more support next year.

The coming real estate year will continue to weak, but hopefully the real estate market will bottom by mid-year. For the rest of the country, that will not be the case. The best news is that interest rates are going down, but also that supply is adjusting. New construction is declining and a significant portion of resales are previously foreclosed units. The market is slowly cleansing itself. Happy holidays, but don't overindulge – we're not out of this yet.