Montgomery County Bi-monthly Report **Final 6/30/09**
May Market 2009 Forecast

"The Beginnings of a Turnaround"
By Fred Flick, Ph.D., Consultant/Housing Economist

Maryland Real Estate Sales Overview

At the state level, the good news is that Maryland real estate sales in May were up, albeit marginally, from a year ago. For the month 4,254 units were sold statewide – up 0.3% from May 2008. In May 2008, sales were down 31%. But, on the price side, the not so good news is that prices still have not stabilized. May average and median prices came in at $305,049 and $269,913 -- showing declines of 12% and 8%, respectively, from the year before. Furthermore, the rate of May price declines has worsened -- -- a year ago, both measures were down only 6% compared to May 2007.

Nevertheless, there is some good future news for prices from the supply side. Active listing inventory totaled 45,028 units statewide, down about 12 percent from a year ago, and a definite improvement for price stability. With these "green shoots" of unit sales stability and lower inventory, the hope is that the real estate market will be a lot stronger by the end of the year.

Montgomery County Single-Family Homes

In Montgomery County, May single-family market sales performance is definitely up from a year ago. Settlements in May (680) were 19.5% above the levels of a year ago; and, year-to-date closings (2,567) were 8.5% above 2008. The news is even better for sales contracts. May contracts (1,110) were 33.1% higher than in 2008; and for the first five months, they were 25% above a year ago. More affordable prices and good interest rates are the reasons. County inventory continues to stabilize as well. New May listings (1,269) were 17% below a year ago with the total active inventory (2,985) almost 35% under last year's first five months. At the May contracts pace, there was a 2.7 months listing supply -- well under the 6-month level.

However, the May average sales price in the County ($461,437) declined 16% from 2008. Similarly, the median of $370,000 dropped almost 15%. Much of the price decline reflects buyers purchasing lower cost properties (some foreclosures), as higher-end properties take longer to sell. At least the figures show that buyers are buying, and transactions are the key to making the market work.

Nevertheless, it appears that home prices are still looking for a place to land. The trend line is still downward and, while sales are starting to come up, its will continue to be difficult to sell high-end properties. From the sales side, we are approaching a bottom. So, with lowered inventory levels, by the end of the year we should see both prices and sales in recovery.

Montgomery County Condo/Coops

The sales market for condos and coops is also improving significantly from earlier in the year. May contracts (236) were up 20% from a year earlier and year to date contracts (869) rose almost 9%. May year-to-date settlements (161) were down only 1.8% from the same period a year ago, with year to date totals (595) down only 2%. Earlier in the year, settlements were down by double digits.

Condo/coop inventory is also responding to stabilize the market. May new listings (334) were almost 10% below the levels of 2008; and, 1,049 actives were 19% below the same period a year ago. The best news is that, at the May contracts rate, there was only a 4.4-month supply of listings. This figure is half the rate of earlier in the year, and under the typical 6 months supply benchmark.

Nevertheless, condo/coop prices continue to slip. The average through May was $262,398 – down almost 16% from the figure for 2008. Similarly, the May median of $220,000 was down 15%. Again, hopefully the market will stabilize by year-end. At this point, the current sales and inventory directions augur for that to happen.

Recent Economic Trends

This is shaping up to be the worst recession since the Great Depression and it is being referred to as the "Great Recession". Unfortunately, it is likely to continue through all of 2009. Most economists are expecting about 2% shrinkage for the rest of this year. And, although recent news indicates the rate of decline of the economy is slowing, we will likely rack-up negative growth for the entire year. While the 2008 economy actually had positive growth of 1.1% over 2007, the end of 2008 and the first quarter of 2009 experienced substantial negative growth. The fourth quarter 2008 came in at -6.7%, and the first quarter of 2009 had a -5.5% real growth. In about 3 weeks we'll have a number for the second quarter. It will be around -3%, but will at least show that the rate of decline is slowing.

Nevertheless, while the County's real estate recession goes on its economy is still very well-off compared to neighbor, District of Columbia and to the rest of the country. In May, the County unemployment rate was 5.2%. This is up substantially from earlier in the year, but that compares favorably with the 7.2% rate for all of Maryland and the 10.7% rate in the District. Furthermore, the national rate in May was 9.4% and is expected to exceed 10% very soon. Clearly, the County's economy is doing much better than both the state and the rest of the country.

Consumer Prices and Energy Costs

The May national Consumer Price Index (all urban consumers) was up 0.1% from April, but on an annual basis, the change in the index was -1.3% (from May 2008). This small amount of deflation is not bad news, but it was caused solely by large declines in the cost of energy and transportation. When we look at the change in the index without food and energy costs, prices were up 1.8% from last May. Among the various components since May 2008: food and beverage prices increased 2.7%; housing costs (rental and owner) rose 0.5%; retail apparel prices rose 0.8%; energy <u>dropped</u> 27%; transportation <u>fell</u> 14%; and, medical care rose 3.2%. These figures point toward a measure of modest inflation, so we essentially have a pretty flat price profile. At this point, neither deflation nor inflation seems to be getting the upper hand. However, over the long haul, with all of the economic stimulus, the foreign wars, and increasing federal expenditures on social security and medical care, inflation is a better bet.

<u>The Fed and Mortgage Rates</u>

The Fed is on hold as far as interest rates, and trying to keep rates down. It is still "iffy" as to whether its policy of buying Fannie/Freddie debt has helped to keep longer-term rates down. Over the past few months, the Treasury and Fed TARP and TALF programs have increased stability for the banks, but the results seem modest in terms of impacts. They kept financial markets from totally failing, and there has been some establishment of pre-crash lending relationships. They did save the economy from falling off the cliff, but the move back from the precipice will be slow and arduous.

Currently, the HUD/FHA program to refinance/restate mortgages has not done much at all. What has slowed the fall of prices is the buying of bargain hunters and investors. Moreover, default rates are still high for those who renegotiated the terms of their mortgages and now solid borrowers who have recently lost their jobs are starting to fall behind in payments. As the unemployment rate trends higher, this phenomenon will increase. The legislation affecting mortgage contracts, lending and Federal borrower bailouts may have helped some, but there are a lot of borrowers who are still going to walk.

On the mortgage rate front, the late-June Freddie Mac surveys showed rates on traditional types of loans still affordable for many who qualify along more traditional standards. However, the rates have been rising and this could trigger more defaults. National average 30-year contract rates averaged 5.42%, and 1-year adjustable rate mortgages (ARMs) came in at 4.93%. Fifteen year loans averaged 4.87%, with 5/1-yr. ARMs at 4.99%. These rates could move up a bit through the summer, but overall the economy is still weak enough that the Fed is not going to do much to push Treasury yields up. While financial markets are concerned about the big spending of Obama and the Democrats, the likelihood of substantial inflation is several years away. So, these mortgage rates should fluctuate in a range around where they are now.

The stock market will probably decline more, especially after the June profit reports. Some think it is likely to head back down and possibly retest the lows of March; but, it will probably trade in a range around 8,300 to 8,700 on the Dow for a while. We are in a long-term Bear market and have just had a minor Bull run. However, we won't see another Bull like the most recent for quite a few years. All these financial woes have to be shaken out and businesses have to find "the next big thing." In the 1980s and 1990s that was computers, finance, and global investment. Computers are peaking and we all know about finance. Some think global commodities and their exploitation are the next big boom sector. Others think health, especially if the government ramps up insurance coverage. But, there are a lot of scenarios to play out before we see another fast growing economy and financial sector.

The Bottom Line

There is a good chance that most markets will bottom by the end of summer. However, this area is doing extremely well by national standards. There will still be some problems with local businesses, especially retail and restaurants, as consumers have dramatically upped their savings rates. The housing markets are cleaning up the mess -- inventory is declining and sales have increased. We are not out of the woods yet, but progress is being made. The market should stabilize early next year.

All in all, the County markets and general metro area should be on the mend by the end of the year. Nationwide, “rust-belt” areas will still be feeling the sting well into 2010. Recently, the consumer saving rate has ramped up and this will slow the comeback of the consumer economy. We have come off an almost two-decade long spending and consuming spree and it will take a while to get back to stable or rising real estate markets. Also, the imminent “carbon tax” and other new tax initiatives will take a bite out of most of the population in the middle and upper-middle classes. We underpaid for goods and services for over a decade, and now it will be payback time.