Montgomery County Bi-monthly Report **Final 3/9/09**
February Market 2009 Forecast

"Single-families Have Mixed Start – but, Weakness Lingers in Condo/Coops"
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Maryland Real Estate Sales Overview

In January, Maryland sales were down about 18%, with average and median price declines of 13% and 15%, respectively. For the month 2,209 units were sold statewide. Price declines have worsened from a year ago for both the average ($292,311) and median ($244,820). On the supply side, active listing inventory was 43,160 units statewide – down about 3 percent from a year ago. The state overall is still having significant declines in sales and prices and probably won't turn that around until the end of the year.

Montgomery County Single-Family Homes

So far, the single-family market performance is mixed. Settlements in February (356) were 4.6% below the levels of a year ago; and, year-to-date closings (671) were 6% below 2008 levels. But, the news is better for sales contracts. February contracts (720) were a full 22.4% higher than in 2009; and for the first two months, they were 14.4% above a year ago. The recent low interest rates and affordable prices are the reasons. Inventory has also done its part to help stabilize the market. New February listings (1,064) came in 19% below a year ago with the total active inventory (3,225) almost 18% under the level of the first two months in 2008. Currently, at the February contracts pace, we have a 4.5 months supply, well under the 6-month typical level.

A major contributor to sales has been the decline in prices. Through February, the average sales price in the County was $455,417 -- down about 18% from the same period in 2008. Similarly, the median of $350,000 dropped almost 20%. Some of the price decline reflects buyers purchasing lower cost properties, while 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.

However, it is not clear that average and median prices have hit bottom yet. The trend line is still downward and we will have to see how the spring market bounces. There is a ton of negative news out there and it will continue to be difficult to sell seven-figure properties. The next six months will be crucial in determining when we are at the price bottom, but we seem to be getting close to a sales bottom. By the end of the year, we should see both prices and sales in recovery.

Montgomery County Condo/Coops

The picture for condominiums and cooperative units in 2009 is still a bit clouded. All major indicators are still in a decline mode. February year-to-date settlements (154) were down 14% from the same period a year ago; and, those in February dropped almost 19%. For contracts, the direction was the same. Cumulative contracts (233) declined 15%, while February sales (121) were down about 10%.

The only good news seems to be the inventory figures. February new listings (262) were 20% below the levels of 2008; and, actives totaled 1,068 or about 11% below the same period a year ago. The tell-tale sign is that, at the February contracts rate, there was an 8.8-month supply, a number that still needs to decline into the 6-month range for the market to stop sliding.

Of course, prices are continuing their slide. The average price through February was $284,919 – down almost 9% from 2009. The middle of the market is certainly taking its lumps, but inventory needs to decline more to stop the slide.

<u>Recent Economic Trends</u>

The national recession is deepening and we will not get out of it for another year. Although 2008 real GDP grew 1.1% from the level in 2007, the last two quarters showed substantial negative growth. The third quarter came in at -0.5%, but the last quarter was roaring recession with -6.2% real growth. Most economists are expecting about 6% to 8% shrinkage for the first quarter of this year. The national figures are shaping up to be at least as bad as the 1980-82 recessionary period; some are saying it will be worse. Recently, a well-respected macro economist at Harvard estimated that there was about a 20% chance of a depression (a decline of 10% or more in GDP).

The Obama administration and Fed have been working night and day to shore up the financial and auto sector. But the recent bailout bill of about $787 billion will not be as stimulative as originally proposed and much of it will not impact the economy until 2010. This suggests the country will be in a deep recession throughout this year and will not recover until 2010 at the earliest. Also, because the Fed and Congress are "creating" so much money, there is a real threat of inflation down the line. This could kill the value of the dollar and bond investments in the future.

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 December, the County unemployment rate was 3.9%. This is up from earlier in the year, but that compares favorably with the 5.4% rate for all of Maryland. Furthermore, the national rate just hit 8.1% in February and is expected to go to 10% before year-end. Clearly, the County's economy is doing much better than both the state and the rest of the country.

But where do you put your money, if you have any, that is? The stock market continues to tank along with this unraveling of the financial sector. Essentially, it is going back to the values of the mid-1990s before the leveraging (borrowing and debt build-up) that created the real estate and stock bubbles. And, this unwinding of excessive borrowing by consumers and investors will continue for at least another year. The new legislation affecting mortgage contracts, lending and Federal borrower bailouts will help some, but we will still see substantial defaults on recent mortgages over the next two years. Working out all of those mortgages will take a while and the painful news stories will continue.

Consumer Prices and Energy Costs

The January national Consumer Price Index (all urban consumers) was up 0.3% from December 2008; but, annual inflation (since January 2008) for all items was flat. This is good news given the fall in the values of assets such as stocks, bonds, and real estate. Even more importantly, the index for all items less food and energy (the 'core' index) rose only 1.7%, so we are having slight inflation in the less volatile categories. Among the various components since January 2008: food and beverage prices increased 5.2%; housing costs rose only 2.2%; retail apparel prices declined 0.9%; energy dropped 20.4%; transportation fell 12.6%; and, medical care rose only 2.6%.

The Fed and Mortgage Rates

The Fed has done about as much as it can with interest rate policy and is moving toward purchasing Fannie/Freddie debt to help support lower interest rate levels. Over the past few months, the Treasury and Fed have been dramatically expanding the money supply by lending through its TARP (Troubled Asset Relief Program, Treasury) and TALF (Term Asset-Backed Securities Loan Facility, the Fed) facilities. So far, the results have been modest in terms of impacts. They have kept the financial markets from totally failing, but the pre-crash lending patterns have yet to be re-established.

The stimulus package should definitely be a boon to the Washington, D.C. metro. But, many of these projects will take a while to kick-in and much of the stimulus effect will not occur for about a year. The country needs to expect to spend much of the year in a full-blown recession – possibly one worse than in 1980-1982. The metro area should be on the mend by the end of the year; but some areas and real estate markets will still be feeling it into 2010 and possibly longer. There has been tremendous overbuilding and consumers will also reassess their housing preferences. 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.

The early March Freddie Mac surveys showed rates on traditional types of loans very affordable for those who qualify along more traditional standards. National average 30-year contract rates averaged 5.15% with 1-year adjustable rate mortgages (ARMs) at 4.86%. The 30-year rate is about 90 basis points below a year ago and the one-year ARM is just 8 basis points below. Fifteen year loans averaged 4.72%, with 5/1-yr. ARMs at 5.08%.

The Bottom Line

Expect to see further declines in prices in Montgomery County neighborhoods through 2009, but there is a good chance most markets will bottom by the end of summer. Nevertheless, the County's economic strength and more government spending will bring more support next year. A lot of new mortgage and stock market clean-up jobs will be opening up in the Washington metro. Firms are "lawyering-up" to fight Obama's policy prescriptions, so there will be growth in those jobs. But retail and restaurants will continue to have problems as consumers wind down debt balances.

The markets will eventually clean themselves up, but it will take time. And, business will not be the same as before. Sellers will still need to be motivated and buyers will be aggressive with offers. Home purchasers are being a lot tougher, as they have seen the investment value of real estate change significantly. In the future, selling a 'home' or a 'life style' will be better than selling an 'investment'.