

## Introduction

*"For myself, I am an optimist—it does not seem to be much use being anything else." - Winston Churchill*

The residential real estate market in the Washington Metro Area is amidst its most trying and interesting cycle in recent memory. The damage has been done and its extent is mostly known. However, the full effect of that damage is only beginning to be felt and will not be fully realized for some time. Changes in the residential market are anything but swift, especially with the financial and lending trouble that has nearly brought the industry to a halt. We are beginning to see the signs of what the future will hold; how deals will get done, how buildings will be built and how new neighborhoods will form. The trademarks of the current situation are slow, but deliberate, absorption of existing product, minimal new deliveries and fewer starts. Developers are using this time to await a better lending environment and to sharpen or realign development plans.

While some bad news is still circulating, there are several bright spots and areas of opportunity. Submarkets inside the Beltway (Arlington, Alexandria, DC) are seeing signs of life. These are the areas where the recovery has begun and most new activity will be located in the next 24 months.

The following highlights and subsequent posts at MBHomeFinder.com over the coming days will aim to highlight where we at McWilliams|Ballard believe the new condominium market is currently, and where it is heading over the next 12-24 months. Unless otherwise stated, the information presented does not pertain to condominium resales.

The market has become highly segmented. Close-in markets (The District, Arlington, Alexandria, and southern Montgomery County) are driving sales and developing most of the positive news in the Metro Area. Farther-out markets (northern Montgomery County, Fairfax, Loudoun, Prince William and Prince George's County) are suffering from lack of demand and devaluation from foreclosures and short sales.

There were 1,147 gross sales in the first half of 2009, a 48% decline from the first half of 2008. (*Gross sales are all sales that occurred during the subject time period. Net sales are all gross sales less any cancellations and/or defaults that occurred during the period. MB believes gross sales are a better measure of current activity because it represents the actual demand that occurred during the subject period*)

There were 537 defaults or cancellations across the Metro Area in the first half of 2009. The majority of these were expected because of new product delivery and drawn out settlement/default processes. This trademark of the recent market is in its final stages as 86% of all available inventory has delivered.

Subtracting negative net sales, there were 600 net sales in the first half of the year. This is a 30% decrease over the same period in 2008.

The District, Arlington, Alexandria and Montgomery County accounted for 78% of gross sales.

The first quarter was one of the worst for sales since before the boom. The second quarter was markedly better and it outperformed the first quarter by 37% on a gross sales basis. The second quarter also outperformed the fourth quarter of 2008 by 12%.

Inventory is under 7,000 units for the first time in over five years. Based on gross sales pace in the first half, there are 2.6 years of supply market wide.

Certain submarkets (RB Corridor, Mount Vernon Triangle, Logan Circle/U St.) have less than one year's supply. Once this supply sells out, buyers will be limited to purchasing resale units. This decreased supply will cause price stabilization, if not appreciation, assuming demand stays the same.

This supply shortage may entice developers to switch under construction and planned apartment projects to for sale condominiums. Hopefully this will loosen some of the credit freeze on new development.

Some submarkets currently have development activity. Arlington and The District each have over 2,000 multifamily units currently under construction. Some of these units may become condominium inventory.

## **Introduction Cont.**

Lack of supply may also lead to apartment conversions in 2010 and 2011 similar to the 2002-2005 conversion boom.

The resale market has improved, especially in the second quarter. The number of sales in the second quarter is up in every jurisdiction and days on market are down in seven of the eight jurisdictions.

Overall average close price in the second quarter increased over the first quarter, but is still down 15% from the first quarter of 2008.

Foreclosures have had an undeniable negative effect on the market. Thirty-five percent of sales in the first half of the year were either short sales or foreclosures.

We believe that the bottom of the new condominium market has passed. Price appreciation may be 12-18 months away, but pricing will be stable until then. Further significant price reductions should not be expected.

McWilliams|Ballard is the sales firm for 23 of the top 35 selling projects in the first half of the year on a gross basis.

The next 24 months in the multifamily housing market in the Washington Metro Area will be interesting and dynamic. Smart ideas and critical thinking will be needed for success. McWilliams|Ballard feels that the recent downturn has ultimately changed this market for the better. No longer will condominiums be seen as perpetually appreciating assets, meant to be built and sold as quickly as possible wherever they'll fit. Developers, architects and brokers will need to realize that building and unit design, finishes, amenities and location are important again and that buyers are more aware and informed than ever before. A condominium will no longer be seen as a mere commodity, a gift from the developer to the buyer. Buyers will want exceptional design in a prime location and the lack of either (or both) will require the appropriate discount.

There will always be attempts to pinpoint the bottom of the market. We believe that this bottom can only be identified retrospectively. As for new condominiums, MB believes the bottom has come and gone. Mortgage rates have settled just above 5% and prices at new condominiums have been adjusted across the Metro Area, waiting for prices to decline further is no longer prudent. The result has been an increase in absorption, particularly in the second quarter of this year, showing that the time to purchase a new condominium is now.