



Putting the Virginia Housing Market in Context 2007 Year-End Market Report

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The year 2007 was an uneasy year for the housing market in the Commonwealth of Virginia and across the nation. As we begin 2008, national factors are driving the discussion of the future of the housing market—When will the foreclosure crisis ease? Will federal government policy reshape the home mortgage industry? Can the Fed bolster consumer confidence and increase spending with its recent rate cut? These national factors will determine how swiftly the housing market recovers nationally. In Virginia, the economy is strong and traditional housing demand and supply factors will lead the housing market to settle into a pattern that more closely mirrors long term trends.

In 2007, national phenomena significantly affected local housing markets:

- The crisis in the mortgage market and tightening of available credit made it more difficult for even well-qualified borrowers to get a home loan.
- Potential buyers who were already cautious waited to see how the uncertain credit situation was going to unfold.
- Mortgage default rates were on the rise and some homeowners were forced into foreclosure or had to list their home for less than they owed on the mortgage.

In 2008 and 2009, the condition of local housing markets across the Commonwealth will depend not only on national factors, such as interest rates and government policy, but also on the state and local economy. Virginia—particularly its major metropolitan areas—is better positioned to experience a housing market rebound than other places because of its strong job growth, low unemployment rates and continued increases in demand for housing.

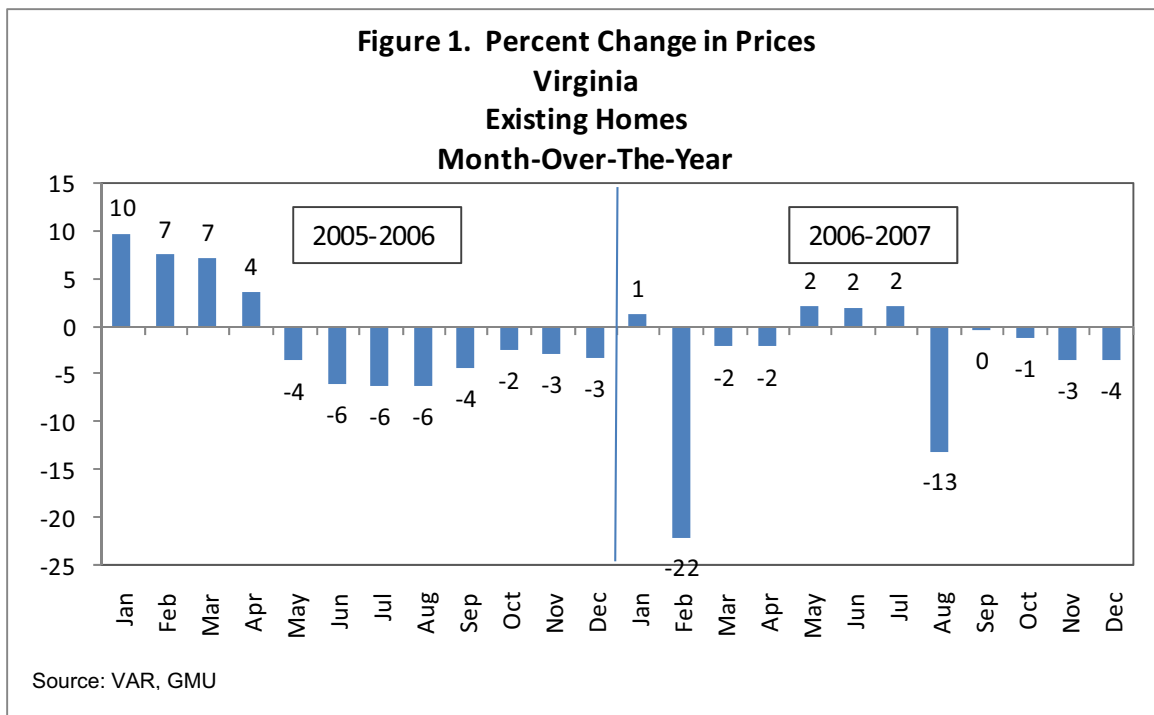
Housing Statistics at a Glance

- Home prices were relatively flat in 2007. Median home prices in Virginia were up 1.2 percent in 2007, while average prices were down 3.1 percent. Over the past 30 years, home prices in Virginia have increased an average of 6.4 percent annually.
- There were 95,323 homes sold in 2007, down 15 percent from 2006.
- Homes stayed on the market an average of 88 days, up from 70 in 2006, but below the long-term average of about 90 days.

The State of the Virginia Housing Market

The median price of an existing home in 2007 was \$262,300 while the average price was \$327,700.¹ The 2007 year end prices are relatively unchanged from 2006. **The median price is up 1.2 percent**, while the average price is down 3.1 percent statewide. There was wide variation in home price appreciation across the state. Home prices were up in 2007 in several areas, including Charlottesville, Lexington/Buena Vista, and Southwest Virginia. Prices were basically flat in the state's two largest markets—Northern Virginia and Hampton Roads.

Figure 1 below shows the month-over-the-year percent changes in average home prices—that is, the change in the average price in a particular month in one year compared with the *same month of the prior year*. Prices were up statewide in the first quarter of 2006, compared with the first quarter of 2005, and were negative for the remainder of the year. In 2007, prices have generally remained flat compared with 2006, with the exception of February and August.



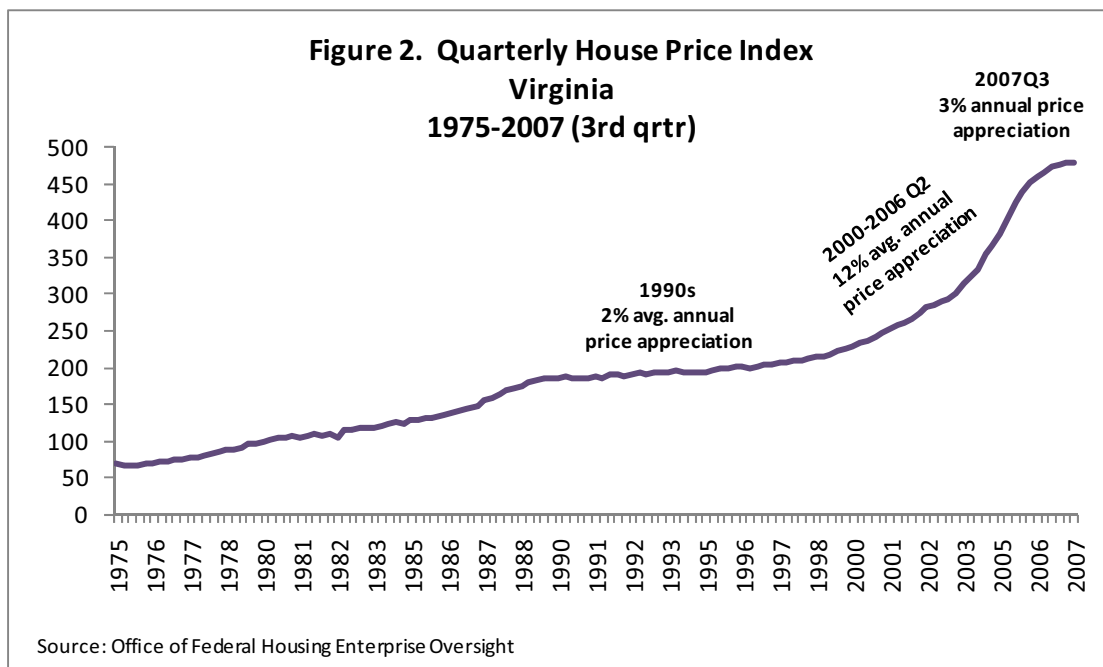
The price decline in February appears to be an anomaly and a factor of the particular mix of homes sold in that month. However, the drop in August may be a symptom of the escalation of the credit crunch in summer 2007. In August, real estate agents and mortgage brokers were reporting that home loans were nearly impossible to get, even for borrowers with excellent credit, as the national mortgage industry was responding to the situation in the subprime market. Home mortgages became a little easier to get in September, though tightening of industry standards will mean that borrowers have fewer options now than they did two or three years ago.

¹ The median is the middle value. One-half of homes had sold prices above the median, while one-half of homes sold had prices below the median.

Fewer homes were sold in 2007 compared with 2006 and homes stayed on the market longer. In 2007, there were 95,323 homes sold, which is down 15 percent over 2006. At the same time, the average number of days on the market was 88, compared with 70 in 2006.

It is important to put the current housing market in a longer term context. For example, while 88 days sounds like a long time when comparing the 2007 housing market to the market in 2004 or 2005, the long-term average length of time to sell a home is about 90 days.

It is also easy to interpret current home prices and home price appreciation only in the context of the housing market of 2004-2005. However, **over the long term, home prices have increased moderately—and steadily.** Figure 2 presents data from the Office of Federal Housing Enterprise Oversight for Virginia.² In the 1990s, home prices in Virginia appreciated at an average rate of about two percent annually. From 2000 through the 2nd quarter of 2006, the situation was quite different, with average prices increases about 12 percent annually. In the 3rd quarter 2007 (latest data available), the house price index (HPI) shows home prices up three percent compared with the 3rd quarter of 2006.



In recent analyses of the housing markets in Richmond and Northern Virginia, the George Mason University Office of Housing Policy Research found that over the past 30 years, there was no seven-year period in which average prices fell in those markets. (Seven years was the average length of time a homeowner lived in his home.) Comparing rates of return on investment in housing in these markets and investment in the NSDAQ showed that over the long-term, housing was the better investment.

² The house price index (HPI) is based on single-family transactions involving conforming, conventional mortgages purchased or securitized by Fannie Mae or Freddie Mac. The HPI measures average changes in repeat sales or refinancing on the same properties.

In order for the housing market to return to a more normal state, there will be periods of slower than average growth to follow the five years of rapid growth. We are currently in that period of slower growth. Market dynamics—housing demand and housing supply—will drive how quickly the state’s housing market returns to a state of normalcy.

The Outlook for the Virginia Housing Market

The economy and the housing market are inextricably linked. The story has nearly always gone as follows: As the number of jobs grow, incomes rise, and interest rates fall, demand for housing increases. If new home construction can not keep up with demand, prices will rise. Between 2000 and early 2006, however, something was different. We experienced a run up in home prices beyond what traditional supply and demand factors would have predicted. An increase in residential real estate investment and widespread availability of subprime and other mortgage products added fuel to the already hot housing market. Who would have predicted in 1999 that home prices would rise 10, 15, even 25 percent annually in some markets for several years in a row?

In 2007, we also see a disconnect between the economy and the housing market. Regions with strong economic growth still see slower than average housing market activity. The uncertainties in the mortgage market continue to keep many buyers on the sidelines. A reduction in the types of mortgage products available may leave some unable to qualify for a home loan. The increase in foreclosures increases the supply of homes for sale.

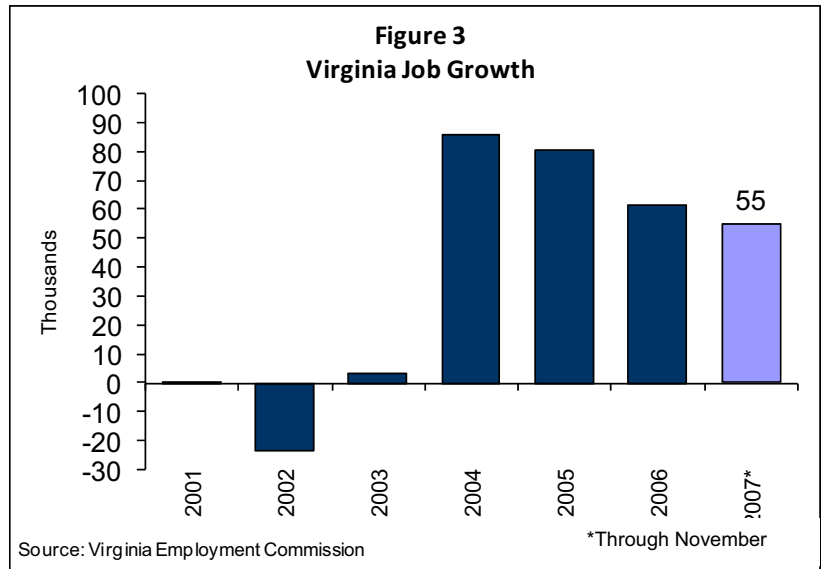
The housing market will recover and the recovery will come sooner in Virginia than in many other places as we return to the basics.

- Interest rates still are at near-historically low levels.
- Job growth in Virginia is strong and the unemployment rate is among the lowest in the country.
- Personal income is growing, but not as fast as in other years, which means that potential homebuyers will be looking for bargains.

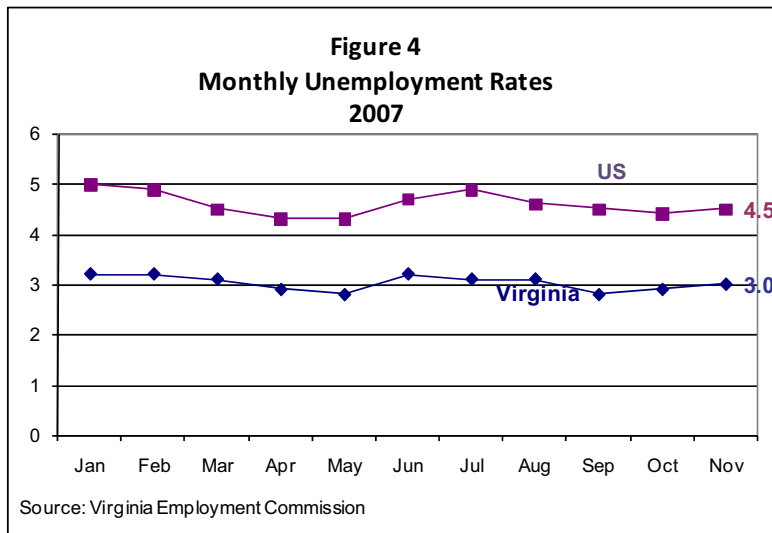
Housing Demand

In a typical market, housing demand is driven by interest rates and the state of the economy. Interest rates remain low and the Virginia economy is doing relatively well.

The Commonwealth of Virginia has been named the best state for business by Forbes.com in 2006 and 2007. **Jobs continue to come to the state, which will continue to drive the demand for housing.** Based on data available through November, we estimate that the Commonwealth of Virginia will add 55,000 new jobs in 2007, down from the job growth in 2004 – 2006 but still only slightly lower than the long-term average annual job growth of 59,000 jobs (Figure 3). Assuming each housing unit houses 1.5 workers on average, in 2007 there was a demand for nearly 38,000 new units across the state.



Forty percent of the job growth in 2007 was in Northern Virginia. The Virginia Beach metropolitan area accounted for 22 percent of the state’s job growth, while the Richmond metro area captured 14 percent. Overall, each of the state’s metropolitan areas gained jobs in 2007.



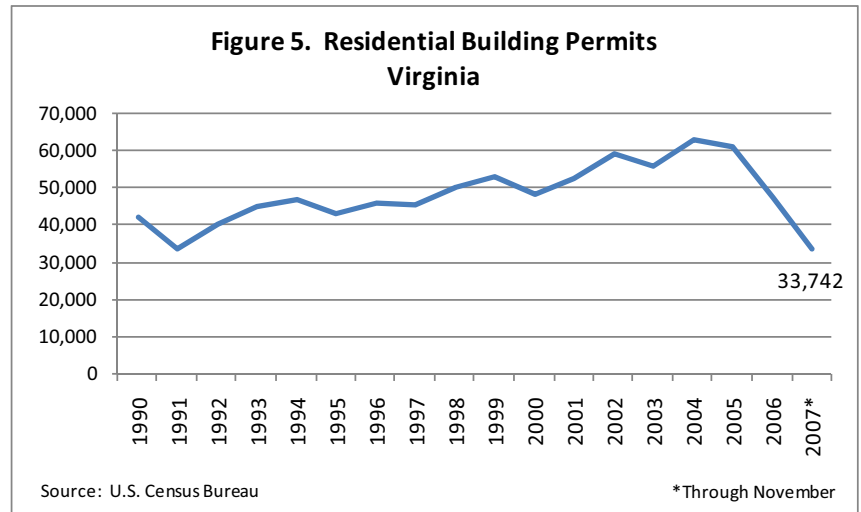
The unemployment rate in Virginia remained lower than the U.S. average in 2007. In November 2007, the state unemployment rate was 3.0 percent, compared with 4.5 percent for the nation (Figure 4). In fact, Northern Virginia and Virginia Beach had among the very lowest unemployment rates in the nation, at around 2.2 percent.

While job growth continues and unemployment rates are at historic lows in the Commonwealth, personal income growth has been moderate over

the past 18 months. While Virginia had lagged slightly behind the U.S. in income growth in 2006, in 2007 the rate of income growth in the Commonwealth was slightly higher. Between the 1st and 2nd quarters of 2007, personal incomes in Virginia grew by 1.3 percent (compared with 1.2 percent for the nation).

Housing Supply

New home construction was down in 2007 (Figure 5). There were 33,742 building permits issued in Virginia through November 2007. The fall off in home building has negative repercussions for people who work in the construction industry; however, the slowdown in building is a positive for the state's housing market. The build up of inventory in most local markets across the state continues to keep prices low. Until that inventory begins to be drawn down, prices will not rise. Fewer new homes gives buyers and sellers the opportunity to work through the existing inventories.



2008...and Beyond

Some of the factors that will influence the Virginia housing market in 2008 and beyond are difficult to predict:

- **The Fed cut interest rates this week by three-quarters of a point.** This rate cut will reduce rates on home equity loans and some adjustable rate loans and credit cards, which may make credit easier to get, in general, and could make it easier for potential homebuyers to get into the housing market. But they will be looking for bargains.
- **The impact of foreclosures on the housing market will depend to a large extent on actions by the federal and state governments.** Virginia has one of the lowest foreclosure rates in the country, but foreclosures will rise in 2008. Some neighborhoods will experience a rise in foreclosed properties for sale which will continue to dampen prices. Others will remain virtually unaffected by the foreclosure situation.
- **Homebuyers' confidence is increasing** but it is unclear what mortgage options will be available as they return to the market. Government actions may determine how easy it is for homebuyers to secure a home mortgage in 2008.

While many of these factors are still uncertain, the basic supply and demand factors that have driven local housing markets for decades are easier to interpret. **Overall, Virginia faces stronger market fundamentals than many other states, with a relatively strong economy and a housing market with a relatively small share of investors.** Across the state, local markets where job growth is slower or foreclosure rates are higher will continue to experience an uneasy market in 2008. **We expect that markets in Virginia that have strong job growth and low unemployment rates—which includes most of the metropolitan areas throughout the state—will see increases in the demand for housing in 2008 and prices will begin to rise.** Even within metropolitan areas there will be variations in the path to recovery. In some desirable neighborhoods—that is, places close to jobs, amenities and transportation routes—the recovery is already happening.