

### REALITY CHECK

**“Home Values to Fall 50 Percent.”** That tidy little prediction was attributed to Yale economics professor Dr. Robert Shiller on Boom2Bust.com on September 20, 2007. Dr. Lawrence Yun of the National Association of REALTORS® says that we can expect **“respectable home price gains.”** That’s from the September 2007 edition of Real Estate Insights. Real Estate blog Patrick.net intones, **“U.S. Housing Crash Continues – It’s A Terrible Time to Buy.”** Noted economist Dr. Stephen Fuller of George Mason University projects that this area’s housing market will, by 2008 and 2009, return to our **normal annual appreciation rates of around 7%.**

So let’s see: Home prices are crashing. No, home prices are **going** to crash. Wait a minute, home prices are just fine. Hold on, the market has just about reached bottom. Seems everyone has an opinion – or an axe to grind. Wall Street pundits question NAR’s numbers because REALTORS® only care about selling houses and will find any way to make the numbers look good. We REALTORS® may question Wall Street because money that flows into real estate doesn’t flow into Wall Street. More newspapers are sold on bad news than on good news. So as a consumer, who are you supposed to believe? While I might be tempted to say, “Believe us, because we’re right and everyone else is wrong,” the real answer is this: **Identical market conditions impact individuals in dramatically different ways, and you should act in accordance with your needs and beliefs.**

Dr. Shiller himself provides an excellent illustration. He has been called “Mr. Worst Case Scenario” on CNNMoney.com. He’s so relentlessly negative about the long-term value of housing that he and his partners at MacroMarkets LLC have developed a futures market for real estate to hedge against falling values, with the long term intention of selling insurance against those declines. It appears there is value in being negative. On ABC’s Nightline on March 26, 2006, he said this: “The idea that homes are a great investment is just wrong...Do you know what homes have done? It’s just about zilch. They do not go up. That’s one of the biggest misconceptions...I don’t know how the story got started that homes are such a great investment. It’s just not true.” As negative as he is about the investment value of one’s principal residence, he is even more sour about vacation/second homes, predicting a 50% decline in those properties over the next several years. So it would stand to reason that Dr. Shiller would shy away from buying a vacation home right, right? Not so much. Dr. Shiller and his wife bought a summer home on Long Island in 2002. Why in the world would they do something like that? The answer he provided to CNNMoney.com in an interview on January 25, 2005 was very simple: “We wanted to live there in the summer.” So it would seem that the prophet of real estate doom and gloom is either not sold on his own advice, or that personal considerations can outweigh market forces.



As the long-term reader of this space might expect, we do not agree with Dr. Shiller’s unrelentingly negative perspective and, to be fair, he is often taken out of context. Case in point: the blog posting on Boom2Bust.com with the “Home Values to Fall 50 Percent” headline included a link to an on-air interview Dr. Shiller had with Maria Bartiromo on CNBC, and what Dr. Shiller actually said in that interview was that he believes a 50% decline **might** occur over a period of several years in cities that have boomed a lot. So behind the sensational headline was a much more cautious perspective, and the good Dr. Shiller even acknowledges there are markets in the United States that appear to have turned the corner and are appreciating.

As much fun as it is to tweak Dr. Shiller for apparently not following his own advice, we take market trends very seriously. (We also respect Dr. Shiller’s insights into the psychology of how markets operate, as well as his very important Housing Index.) Our job is to help our clients make sound decisions about real estate because we’re not in the business for today’s listing or sale; our clients’ long-term interests are the same as ours. There is no escaping the objective reality that the residential real estate market in the metropolitan Washington area has seen a significant decline in contract activity, a significant increase in inventory and an undeniable “chill” among would-be purchasers who don’t want to buy in a declining market. But we remain very confident in the long-term health of this region’s economy, and therefore in the housing market as well.

## REALITY CHECK . . .

A reality check on local market conditions has to begin with, well, reality.

Contract activity throughout the region is down considerably. In Northern Virginia (Fairfax and Arlington Counties, Alexandria, Falls Church and Fairfax Cities), there has been an **11.1% decline** in the number of homes going under contract through the first nine months of the year compared to the same time last year. In Loudoun County, the drop has been **13%**, and in Prince William, the drop has been a whopping **29%**. Homes are taking longer to sell and are selling at a deeper discount to list price as well.

What's the worst part of the market? Clearly, anyone who purchased at the peak of the market – they've owned for two years or less – and **has** to sell now is in a tough spot. Those that bought with no money down on an adjustable rate mortgage and who can't absorb the hike in payments are going to have a rough time as well. An example: the average sales price of a townhouse in Ashburn in Loudoun County in the second quarter of 2005 – the peak of the market – was \$455,000; the average sales price in the third quarter of 2007 was \$395,000. **That's a 15% drop.** However, someone that bought in the second quarter of 2003, when the average sales price was \$277,000, would be fine if they had to sell now. It underscores our central point that market conditions impact individuals in dramatically different ways.

So, in the face of a 15% drop in the price of a townhome in Ashburn in the last 27 months, just why is it that we remain confident about the long-term health of the region's housing market?

Let's look at another example. The average price of a detached home in Arlington County in the second quarter of 2005 – again, the peak of the market – was \$767,000. The average price in the just completed third quarter of 2007 was \$827,000. That's an **increase of 7.8%**. Does that mean that home prices are rising rapidly in Arlington? No, but it does mean, as we have contended many times in this space, that real estate is driven by primarily local conditions, and even though they occupy the same metropolitan area, the markets in Arlington County and Loudoun are different.

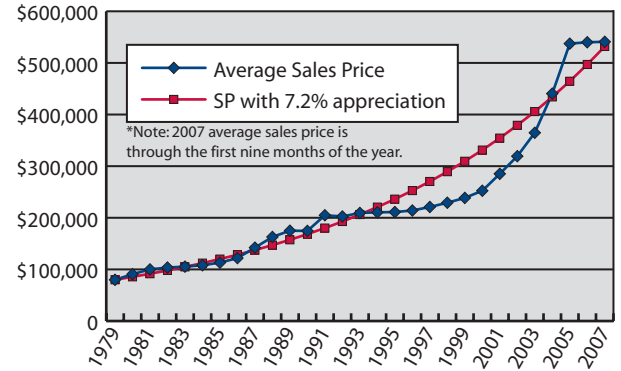
But that's a short-term look; what about the long term? Despite Dr. Shiller's contention that home price appreciation has been "zilch," we know that has not been the case here. George Mason University's Center for Regional Analysis has calculated the average annual appreciation of a home in this area over the last 30 years as 7.2%, and the chart at the top of the page plots the average annual sales price since 1979 against a line showing that 7.2% appreciation. Over that 30-year period, one that encompasses three national recessions and mortgage interest rates varying from a low of 5.5% to a high of 18%, prices here have held up remarkably well. But is that past indicative of future trends? If one believes as we do, that the fundamentals that created that remarkable appreciation will continue to exist, then the answer is yes. We continue to have a very low unemployment rate regionally; the region continues to create jobs and households and we have economic stability that the federal government provides which truly makes this region unique. And even though the market will be impacted by foreclosures and short sales – we haven't seen the worst yet – the chart above indicates that the pace of foreclosures is running well below the national average and below every other major metropolitan area other than Minneapolis.

The market downturn here is real, and it isn't over and, in some places, price drops have been significant. As the market seeks balance, average prices are not going to appreciate at 7.2%; they will fall below that red line in the chart of the top of the page for a while, just as they have done before. There is nothing to suggest that prices are going to plummet 50%. Just remember – the fundamentals remain strong, location and timing continue to matter and, as Dr. Shiller's own actions indicate, individuals buy and sell real estate for personal reasons, reasons that transcend individual market conditions.

### AVERAGE SALES PRICE vs. AVERAGE APPRECIATION

Northern Virginia - 1979-2007

1979 Base Line Year



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