The Virginia Housing Market in Uncertain Times
First Quarter 2008 Report

By
Lisa A. Fowler, PhD
Director, Office of Housing Policy Research
George Mason University School of Public Policy
And
John C. McClain, AICP
Senior Fellow, Center for Regional Analysis

The word "uncertainty" sums up the current housing market. A national recession, foreclosures on the rise, tight credit markets, potential federal legislation—all of these factors make it difficult to predict where the market is going. In Virginia, the housing market is performing better than in some other states, although certain local markets within the state are in for a rocky 2008.

National Recession Likely

Economic growth nationally was an anemic 0.6 percent in the 4th quarter of 2007, and most national economic signals through the first quarter of 2008 point to the likelihood of a recession in the first half of the year:

- National job growth has dropped from an annual average of 2.13 million in December 2006 to a rate of 0.48 million in March 2008, a decline in growth of 77 percent.
- The U.S. Coincident Index (which measures current economic performance) was positive in 2007 and the first two months of 2008, but has declined in the last few months. However, the Leading Index (which projects the economic performance 6 to 9 months ahead) has been negative for five consecutive months and 11 of the past 16 months.
- Oil prices have continued to rise and have been above the $100 mark for several weeks.
- Housing continues to be a drag on the economy with both new and existing home sales down nationally and foreclosure rates up substantially in several markets.
- Consumer confidence indices and spending are declining and have dropped to levels last seen in the early part of the decade. Consumer spending accounts for two-thirds of the economy.

The formal definition of recession is two consecutive quarters of decline in the Gross Domestic Product (GDP). Given the economic trends and measures noted above, it is likely that later in

2008 the data will all be in and a recession will be declared for the first six months of 2008. How will the national recession affect the Virginia economy and housing markets?

Virginia Fares Better than Nation During Recessions

Virginia weathered the most recent recession earlier in this decade very well relative to the rest of the country. Nationally the unemployment rate peaked in 2003 at 6.4 percent while Virginia's rate peaked at 4.2 percent, which was only slightly above normal trends. While the national economy lost 1.83 million jobs in 2002 and 2003, the Virginia economy lost only 16,000 during that period, and then added 86,000 jobs in 2004. Current trends show that job growth in Virginia is moderating but the state is still gaining jobs and adding to its economic base. Virginia added 62,000 jobs to its economy in 2006 and 34,000 in 2007. For the first two months of 2008 the economy is growing on an annualized basis of 19,000 new jobs per year.

Virginia's diverse economic structure is a key factor in its ability to weather a national downturn. Only five of the 12 sectors of the state's economy experienced job losses over the 12-month period February 2007 through February 2008—construction, manufacturing, information, financial, and federal government.

Figure 1. Job Losses and Gains in Virginia

Sector	Job Losses Feb. 07 – Feb. 08	Sector	Job Gains Feb. 07 – Feb. 08
Construction	- 3,500	Professional and Business Services	+ 9,600
Manufacturing	- 10,100	Education and Health Services	+ 11,300
Information	- 1,900	Leisure and Hospitality	+ 5,100
Financial	- 3,200	Other Services	+ 2,600
Federal Govt.	- 900	State and Local Govt.	+ 10,600

Source: Bureau of Labor Statistics, GMU Center for Regional Analysis

Losses in the construction, manufacturing and financial sectors are strongly related to the decline in the housing sector. On the other side of the ledger, job gains have been strong in the professional, education and health and other services, along with state and local Government. These are healthy economic sectors—which tend to have higher wages—and show continued economic strength.

Whether or not a national recession will be formally declared later this year, the national economy in the first half of 2008 is sluggish. The Administration's stimulus package should encourage consumer spending and begin economic recovery in the second half of 2008. The economy will slowly gain momentum in 2009, especially in the second half of the year. Most economists are characterizing the outlook as a shallow recession with slow expansion coming out of the downturn.

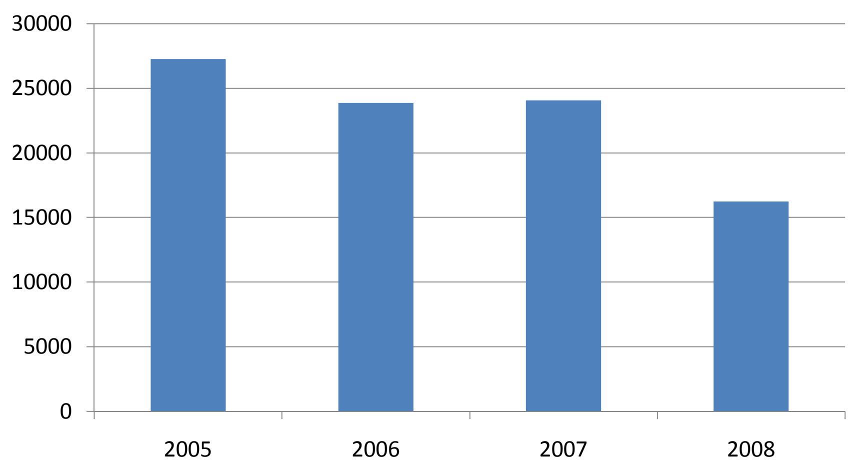
Given the partial insulation from recessions that has been experienced historically in Virginia, it is unlikely that the state's economy will enter a recession, although economic activity will slow down, particularly in sectors directly and indirectly related to housing. Slow growth can be expected until about the middle of 2009 and then the pace will pick up and return to long-term levels.

While the state's housing market continues to be uncertain, there is no evidence that a statewide recession will impede the housing market's ability to recover.

Sales Still Down, Prices Flat in the First Quarter of 2008

Statewide, home sales in Virginia were down 26 percent in the first quarter of 2008 compared with the first quarter of 2007 (Figure 2). Almost of the local markets experienced a slowdown in sales as buyers continue to wait to see if federal legislation is passed to help homeowners and/or to increase regulation of the mortgage industry. Potential homebuyers are also waiting to see what will happen to interest rates, perhaps anticipating that they will go lower.

Figure 2
Total Sales 1st Quarter Sales
Virginia



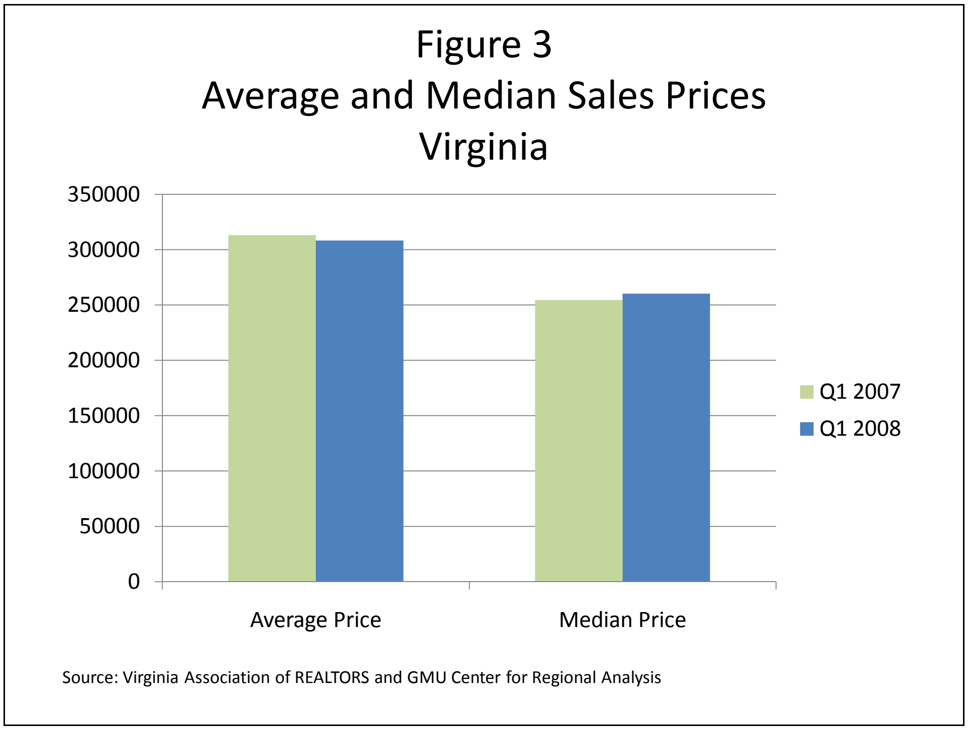
Source: Virginia Association of REALTORS and GMU Center for Regional Analysis

Another bright spot in the sales activity was in Prince William County, where the number of sales in the first quarter of 2008 was 3 percent higher than it was in the first quarter of 2007. Since Prince William County has a large inventory of homes on the market and is on the frontline of the foreclosure situation (see below) this increased sales activity could be a signal that conditions in this local housing market might be poised to improve.

Sales were down in both small and larger markets around the state. In the smaller markets of the Dan River region and Masanutten, the numbers of homes sold in the first quarter of 2008 were down 32 and 31 percent, respectively, compared with the first quarter of 2007. In larger markets, such as Charlottesville and Roanoke Valley, sales were down 27 and 18 percent, respectively.

However, sales were up or stable in some diverse local markets across the state including Southwest Virginia (sales up 2 percent) and Lexington/Buena Vista (sales up 30 percent.)

The average sold price in the first quarter of 2008 was $307,654, down 5 percent from a year ago. The median sold price was $259,969, unchanged from a year ago (Figure 3).[1]



While home prices were down in some markets throughout the state, the Northern Virginia and Prince William markets put the most downward pressure on prices statewide because they are relatively large markets. In Northern Virginia, average prices were down 6 percent and median prices were down 11 percent in the first quarter of 2008. In Prince William, average and median prices were down 25 percent and 28 percent, respectively.

[1] The average price is the mathematic average of all prices of homes sold. The median price is the middle price of all homes sold—half of the homes sold for more than the median and half sold for less.

The state's other large markets did not experience the same price drops. In the Hampton Roads area, the average home price was up 5 percent in the first quarter of 2008 while the median price was virtually unchanged.

Many small and medium markets across the state continued to see positive price appreciation. In Lynchburg, the median sales price was up 13 percent in the first quarter of 2008, while the median price in the Charlottesville area was up ten percent and the median price in Southwest Virginia was up nine percent.

The potential for continued downward pressure on statewide median and average prices will likely come from the Northern Virginia markets as they work through their unsold inventory, short sales and foreclosures.

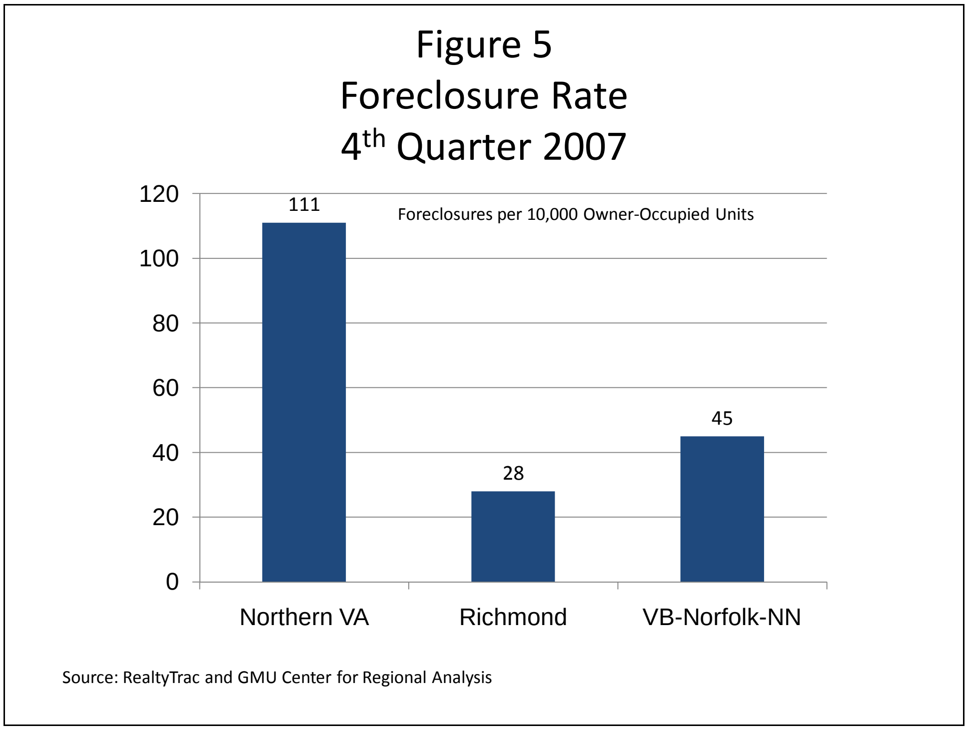
Foreclosures Affect Local Markets

The number of foreclosures in Virginia continues to climb, but the state's foreclosure rate is still moderate relative to other places around the country. Furthermore, the foreclosure problem is not a statewide issue, but is concentrated in a few local markets across the state.

As of the 4th quarter of 2007, Virginia ranked 24th in foreclosure rates. The foreclosure problem is most severe in parts of Northern Virginia, particularly Prince William County, and is much more mild in many other parts of the state. Each quarter, RealtyTrac ranks the foreclosure rates of the 100 largest metro areas in the country. In the 4th quarter of 2007, the Washington Metro Division (Northern Virginia, D.C., and three Maryland counties) ranked number 41, Virginia Beach-Norfolk-Newport News Metro area ranked number 86, and the Richmond metro area ranked number 95.[2]

The Center for Regional Analysis estimates the end of December foreclosure rates as shown in the chart with Northern Virginia at 111 foreclosures per 10,000 owner-occupied units, with Richmond at a rate of 28 and Virginia Beach-Norfolk-Newport News at a rate of 45 (Figure 5).

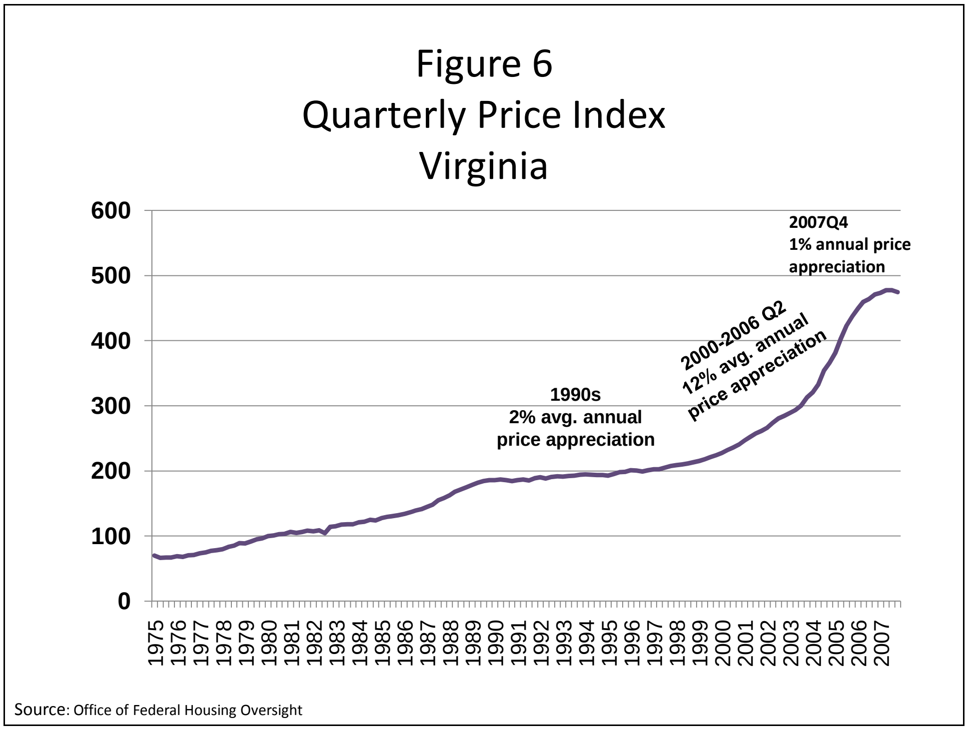
[2] While RealtyTrac data has some problems related to over counting foreclosures in many areas and lack of complete coverage in others, it remains the best source of data for comparing foreclosure rates across metropolitan areas.



Where are Home Prices Headed?

The housing market in the state of Virginia is in a period of transition; however, it is unlikely that the overall market is going to worsen considerably. While some have argued that Virginia will have one of the steepest price declines, the state's economic context and the current housing market trends belie that prediction. Some local markets—particularly those that have been hard hit by foreclosures—will see dramatic price drops. But overall, prices in many parts of the state may drop only a little or stay flat in 2008.

Figure 6 shows home price trends in Virginia from 1975 through 2007. After a fast run up in prices in the early 2000s, the increases are moderating. However, according to this index, even in the 4^{th} quarter of 2007, prices were 1 percent higher than they had been in the 4^{th} quarter of 2006. The general trajectory of this line implies that prices will be slightly lower statewide in the first half of 2008 compared with the first half of 2007. But dramatic, double digit price declines in Virginia seem implausible.



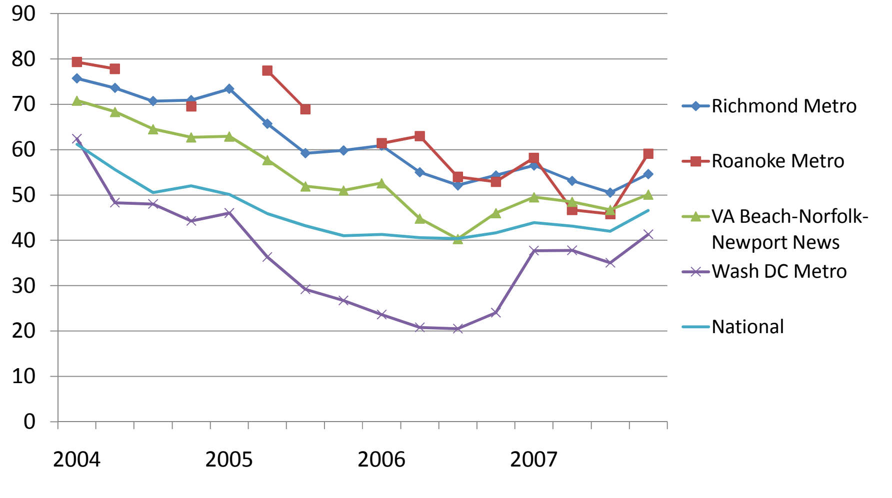
There are some trouble spots in the state where prices may fall by 10, 15 or even 20 percent. In Prince William County, the average price of an existing home was down 27 percent in March 2008 compared with March 2007. Prices were down 21 percent in Loudoun County and 17 percent in Stafford and Spotsylvania counties. Based on the levels of unsold inventory in these Northern Virginia markets, it is likely that the situation will not stabilize for another 10 to 12 months.

The good news in Prince William County is that pending sales are up, which implies that in the next month or two, there should be more closings. While pending sales were down 28 percent statewide, the number of pending sales in Prince William increased from 1,645 in the first quarter of 2007 to 2,341 in the first quarter of 2008.

Housing in Virginia remains relatively affordable in most parts of the state. According to the NAHB/Wells Fargo housing opportunity index for the fourth quarter of 2007, a household with the average income in Richmond, Roanoke or the Virginia Beach metropolitan areas can afford between 50 and 60 percent of homes on the market (Figure 7).[3] Nationally, the average income household can afford only 47 percent of homes on the market.

[3] The NAHB/Wells Fargo Housing Affordability Index is available for only a select set of metropolitan areas. The Richmond, Roanoke, Virginia Beach, and Washington DC metropolitan areas are the only ones included for the Commonwealth of Virginia.

Figure 7
Housing Affordability in Virginia
2004-2007



Source: NAHB/Wells Fargo

The Washington DC Metro area, which includes the Northern Virginia markets, was much less affordable than the nation in 2005 and 2006. However, recent price moderation has actually had the benefit of making the region more affordable so that in the fourth quarter of 2007, the average income household in the Washington DC Metro area could afford 41 percent of all homes for sale, up from just 20 percent in mid-2006. This increase in affordability will increase demand for housing in the Northern Virginia region.