

February, 2005

A HOUSING BUBBLE?

Introduction: For the past several years, the media has barraged us with talk of a potential “housing bubble.” Given the huge run-up in the stock market in the late-1990’s and subsequent crash beginning in March, 2000, I understand people’s fear that any asset inflation may be “too good to be true,” and that all major run-ups are subject to severe “market corrections.” Those who know me realize that I have had a different perspective over the past few years, and I offer our latest perspective.

Real Estate is Much More of a Local Phenomena: Many of the financial writers harping on a bubble the past few years are not experts in residential real estate. Few economists or Wall Street analysts have come close to being accurate in their predictions on residential real estate trends, yet they are still quoted for their alleged expertise in predicting the future. One basic fact is: real estate is a local phenomena. The factors underpinning prices in Washington, D.C. differ in many ways from Boston, New York, Dallas, or Las Vegas. Economic models which declare certain cities as “20% overpriced” or “15% undervalued” make for nice light reading over Saturday morning coffee, but these models have rarely, if ever, proven to be correct.

Relative Value is Our Emphasis: All regions are subject to macro factors such as interest rates and the state of the economy. I can assure you that most people who have tried to make a living betting on the direction of interest rates have ended up poorer as a result. We do not base our value analysis on future projections on interest rates. *We have consistently focused on relative value. We have been, and continue to be, extremely bullish on the future of the Washington, D.C. metropolitan area. Relative to its peers on the East Coast, we have touted the Nation’s capital as an undervalued area, one in which we will continue to see migration of quality jobs and industry, somewhat at the expense of other major metropolitan areas in the Northeast.*
Conclusion: *Relative to other major metropolitan areas, housing prices in Washington, D.C. will outperform.*

The Trend is Clear: Statistics are in for 2004. The D.C. metropolitan area had the lowest unemployment rate of any major area: 2.6%. Job growth was greater in this area than any area other than the currently booming town of Las Vegas. New York and Boston both experienced job declines and unemployment rates more than twice the D.C. area. The trend of D.C. outperforming these cities has been in place for many years, and we believe is one that will continue for decades.

Conclusion: *The quality of life, intelligent work force, diverse economy, presence of the federal government of the world’s richest country, and many more advantages are becoming more well known. This dynamic combination of factors is driving real estate growth and values, and will continue to do so relative to other areas for many years. Remember the talk that Northern Virginia was so driven by internet companies and telecom that any decline in these industries would devastate its economy? Five years after a total collapse in these areas, the region is stronger than ever. This is not a one*

industry town with a work force incapable of adjusting to new realities. Any comparisons between the D.C. area and another strong growth area like Las Vegas, for example, have no meaning to us. The vulnerability to severe declines in one area is fundamentally different from the other.

Relative Value Within Our Community: Of most concern to us is the relative value of many communities within our area. Given the diverse nature of life styles, schools, amenities, transportation, and the like, we pride ourselves in being regional specialists in addition to experts in our own immediate communities. *In a market in which quality listings rarely stay on the market for more than a few days, it is crucial for buyers to work with real estate agents who know the various areas which may appeal to you, and quickly pinpoint those homes and regions which match your needs in an uncompromising way. We have met many potential buyers who have been searching for over a year, never quite finding what they seek and subsequently watching prices skyrocket as they meander through neighborhoods. If you are in this position, please stop the insanity.*

What is the Immediate State of the D.C. Housing Market?: Last year at this time we confidently stated that the bubble talk of the day was totally ludicrous, and that the D.C. area would experience a vibrant housing market in 2004 with rising prices beyond that predicted by most market pundits. Simply stated, the dynamics at the time were overwhelmingly strong, yet generally unrecognized.

In the short run, the dynamics of the local market today are stronger than at any time in our recent memory. As a result, we project major price appreciation in the next few months regardless of the so-called "winter market". Appreciation will vary from town to town, and we assume that interest rates remain reasonable. Why are we so confident in saying this? The number of available listings in almost every community we follow are at record lows compared to active potential buyers. In fact, this supply/demand imbalance is so overwhelming that we would not be surprised to see major "jumps" in prices, not merely incremental price increases from one sale to the next. Our builder contacts report that they cannot keep the supply chain operating fast enough to satisfy their demand. With both new construction and available listings coming nowhere close to matching demand, prices in the immediate future will likely leap beyond expectations.

Will This Supply/Demand Imbalance Continue Throughout 2005 and Beyond?: We do not know. If interest rates remain reasonable, the market will probably continue to do well in 2005. But our focus will remain ***on relative value and finding the right home for our buying clients, keeping sellers aware of the true value of their homes, and setting the standard for quality full service presentation and reach for each listing.***

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Any opinions stated above are strictly those of its authors. All data come from sources assumed to be extremely reliable.