



FULTON RESEARCH
AND CONSULTING

WHERE ARE WE IN THE HOUSING CYCLE?

A review of key factors influencing the
WASHINGTON – BALTIMORE REAL ESTATE MARKETS

October 2007

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A Message from Dan Fulton

Please enjoy the October release of FRC MARKET TRENDS, a monthly publication that keeps real estate professionals up-to-date on those important market statistics driving our industry. I understand the old adage “people value what they pay for,” and several friends have recommended that I charge for this report. However, for the time being, I’ve decided to keep this report free as I see it as a critical tool for an industry experiencing critical issues.

The lead story for October is the sharp increase in the **months-inventory** of resale listings (as measured by the months required to clear listing inventory - i.e. listings / sales) resulting from the mortgage crisis. After trending up slowly all year (i.e. increasing supply), the market experienced a sharp spike upward in September. Across all markets, months-inventories increased 33% to over 80%. Granted, this is a volatile measure which changes monthly, but this inventory spike reflects a dramatic slowdown of home sales in September across the Baltimore-Washington region.

Mortgage markets took another hit last week with Standard & Poor’s downgrading of over 1,700 residential mortgage-backed securities - including first-lien subprime, first-lien Alt-A, and second-lien mortgage loans. In essence, S&P is stating that *the current supply* of loans is still a risky investment. These lower ratings result in higher jumbo mortgage rates and reduced purchasing power for consumers.

The industry shake-out will continue for the next 12 to 24 months – depending on which submarket you’re referring to. Consider that industry capacity was built up to accommodate demand upward of 40,000 new homes annually, which were built during the boom times. In 2007 we lost 40% of that demand as the market will deliver 20,000 to 25,000 new homes – suggesting that the industry has to shrink by a similar scale to match demand.

On a positive note, I attended the Urban Land Institute’s Breakfast Meeting on October 9th. The discussion focused on capital markets and the far-reaching impact of the subprime mortgage mess. There is *cautious optimism* and a positive buzz surrounding the urban markets due to strong local job growth and strong global economic conditions. While lending standards are becoming too restrictive, there are numerous sources of equity capital ready to invest in the Capitol region. Although Wall Street’s pockets have recently tightened, they should loosen in the coming months as confidence returns. In the meantime, private capital, offshore investors and banks and pension funds are filling the gap and see great potential in the Capitol Region.

Please call if you would like to discuss this report or FRC’s advisory services. We have a staff of highly trained advisors that want you to succeed. You can reach me at 703.385.3116.

All the Best!!



Resale Market Performance (source: MRIS, all product types)

- Months-inventories increased across all metro Washington/Baltimore markets due to significantly slower sales (using a month to month comparative basis).
- Montgomery County saw a considerable increase in inventory and listings and decrease in sales per month when compared to its past performance and other surveyed locations
- The District saw a significant increase in the number of listings – increasing 13% from August to September.

Resale Market Sales, Listings, and Inventory

	Washington Metro						Baltimore Metro				
MARKET AREA	NVAR*	LOUDOUN	PRINCE WILLIAM	MONT-GOMERY	PRINCE GEORGE	WASH D.C.	BALT. AREA**	BALTIMORE CO.	HOWARD	HARFORD	ANNE ARUNDEL
Months Inventory											
Jul-07	5.58	7.84	13.81	5.96	10.59	4.20	6.84	5.48	5.39	6.54	7.96
Aug-07	6.06	9.03	14.13	6.20	11.26	4.62	7.07	5.27	6.71	6.78	7.72
Sep-07	10.00	13.03	18.79	10.73	14.98	8.39	10.59	8.63	10.99	10.39	10.26
Month change	65.16%	44.25%	32.98%	73.10%	33.10%	81.40%	49.89%	63.71%	63.77%	53.39%	32.84%
Listings Per Month											
Jul-07	10,368	3,746	6,491	6,048	6,596	3,110	19,985	4,388	2,021	1,994	4,598
Aug-07	10,373	3,712	6,515	5,968	6,879	3,038	20,265	4,438	2,040	1,999	4,586
Sep-07	10,721	3,752	6,540	6,254	6,968	3,439	20,917	4,582	2,110	2,058	4,646
Month change	3.35%	1.08%	0.38%	4.79%	1.29%	13.20%	3.22%	3.24%	3.43%	2.95%	1.31%
Sales Per Month											
Jul-07	1,859	478	470	1,015	623	740	2,921	801	375	305	578
Aug-07	1,713	411	461	963	611	657	2,868	842	304	295	594
Sep-07	1,072	288	348	583	465	410	1,975	531	192	198	453
Month change	-37.42%	-29.93%	-24.51%	-39.46%	-23.90%	-37.60%	-31.14%	-36.94%	-36.84%	-32.88%	-23.74%

* NVAR encompasses Fairfax County, Fairfax City, Arlington County, Alexandria City, & Falls Church City, VA.

** BALT AREA refers to Baltimore City and Counties of: Baltimore, Anne Arundel, Carroll, Harford, and Howard



This market reflects the lack of consumer confidence in the housing market and the move-up buyers' inability to sell their current home. Thankfully, the new jobs generated create demand from households moving into the market. Otherwise, it appears that only households without a home to sell (i.e. first time buyers) are the most active in today's market.

FRC estimates that four months supply of listings represents a healthy inventory level and a point of equilibrium between supply and demand. Price pressures, both up and down, will occur when inventory levels are above or below the four month equilibrium level. During the hot market, listing inventory levels were often less than one a one month supply. This supply-demand balance led to significant home value appreciation, driving people out of the market and encouraging lenders to become overly creative.

Washington Metro Area - NoVA, WDC, Suburban MD

- The Washington market continued to see an increase in the supply of listings. Greatly decreased sales contributed to significant increases in inventory levels across the DC and Baltimore metro areas. The time required to sell listings on the market nearly doubled in the District during September (81% increase). This again resulted from a combination of increased listings and slower sales. Months-inventory levels increased 73.1% in Montgomery County and 65.1% in Northern Virginia from August to September. Months-inventories are 37% higher than one year ago (August 2006).

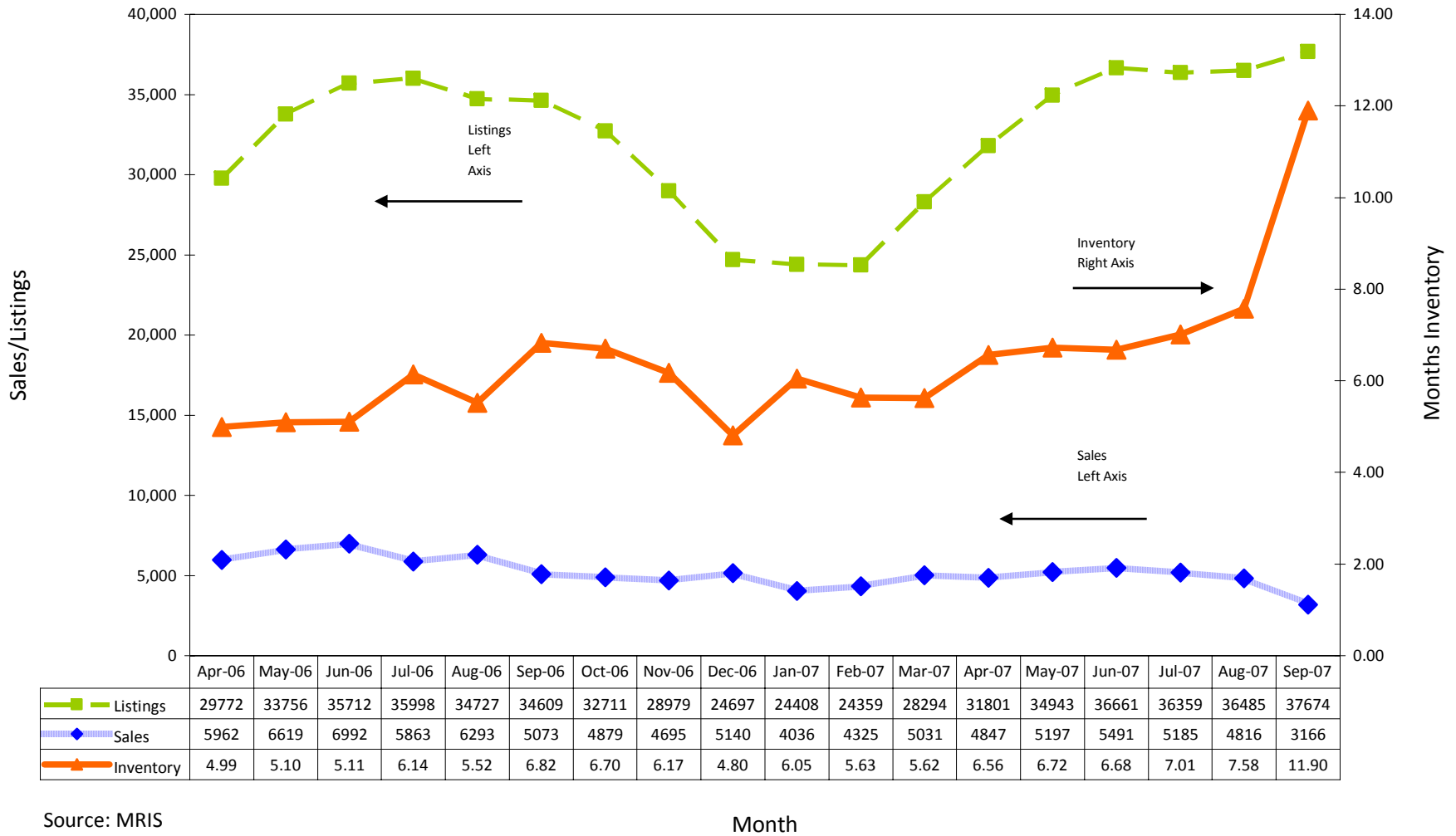
Washington area listings in July and August were nearly identical while, at the same time, the time period to sell these homes increased significantly. *The 34,500 active listings today compares to 4,957 listings in January 2005 - over seven times as many.*

- An interesting question comes to mind, if half of these 34,500 listings sell in the next 10 to 12 months...where will the sellers move?
- With 4,816 August sales in Metro DC, the volume of sales has declined from July, but levels are only slightly below the 2007 average of 4,866 monthly sales.

The following graphs demonstrate the number of listings, sales and inventory levels (listings/sales per month) for the Baltimore and Washington metropolitan areas.



Metro WDC Existing Home Market Performance
Total Listings, Sales and Months Inventory
(ARL, ALEX, FCH, FFX, LOU, PWC, MON, PGC)



Source: MRIS

Month

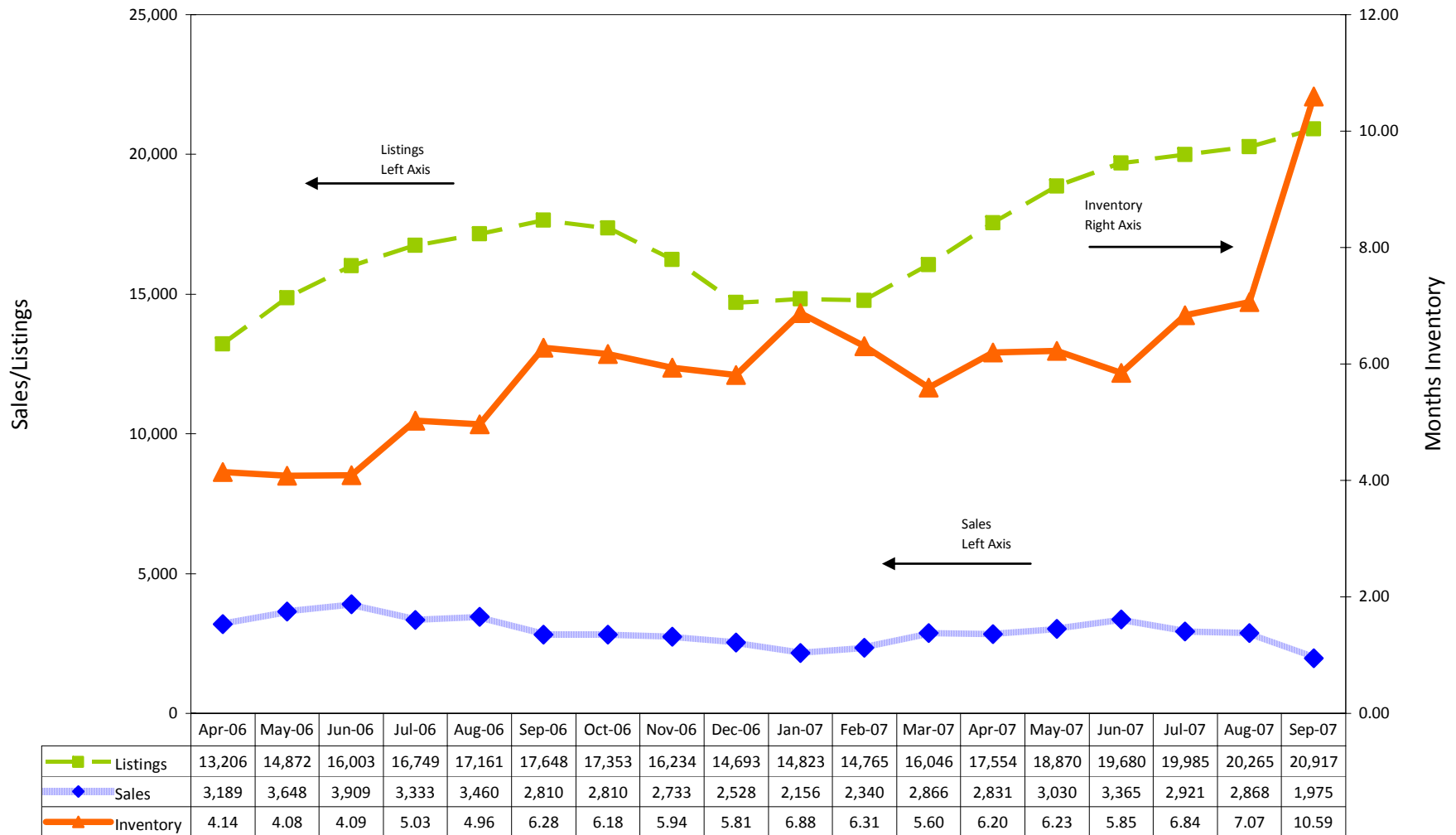


Baltimore Metro Area

- *The Baltimore metro area saw a seven month supply of listings in August 2007, an increase of 3.4% from July and 20.8% since June. Months-inventories are well above the 1.6-month level in January 2005. Compared to August 2006, (1 year ago), inventory levels grew 43%.*
- *A total of 20,265 listings were on the market in August 2007, - increasing just 1.4% from July. The August figures compare to 4,114 listings in January 2005. Today, the Baltimore market has nearly five times the number of properties for sale as existed in January 2005.*
- *With 2,868 August sales in Metro Baltimore, the volume of sales declined 2% from July 2007, but are above the 2007 average of 2,797 monthly sales. Average monthly sales in 2007 are 7% below 2006 and 25% below 2005 average sales per month.*



Baltimore Area (BALT) Existing Home Market Performance Total Listings, Sales and Months Inventory



Source: MRIS

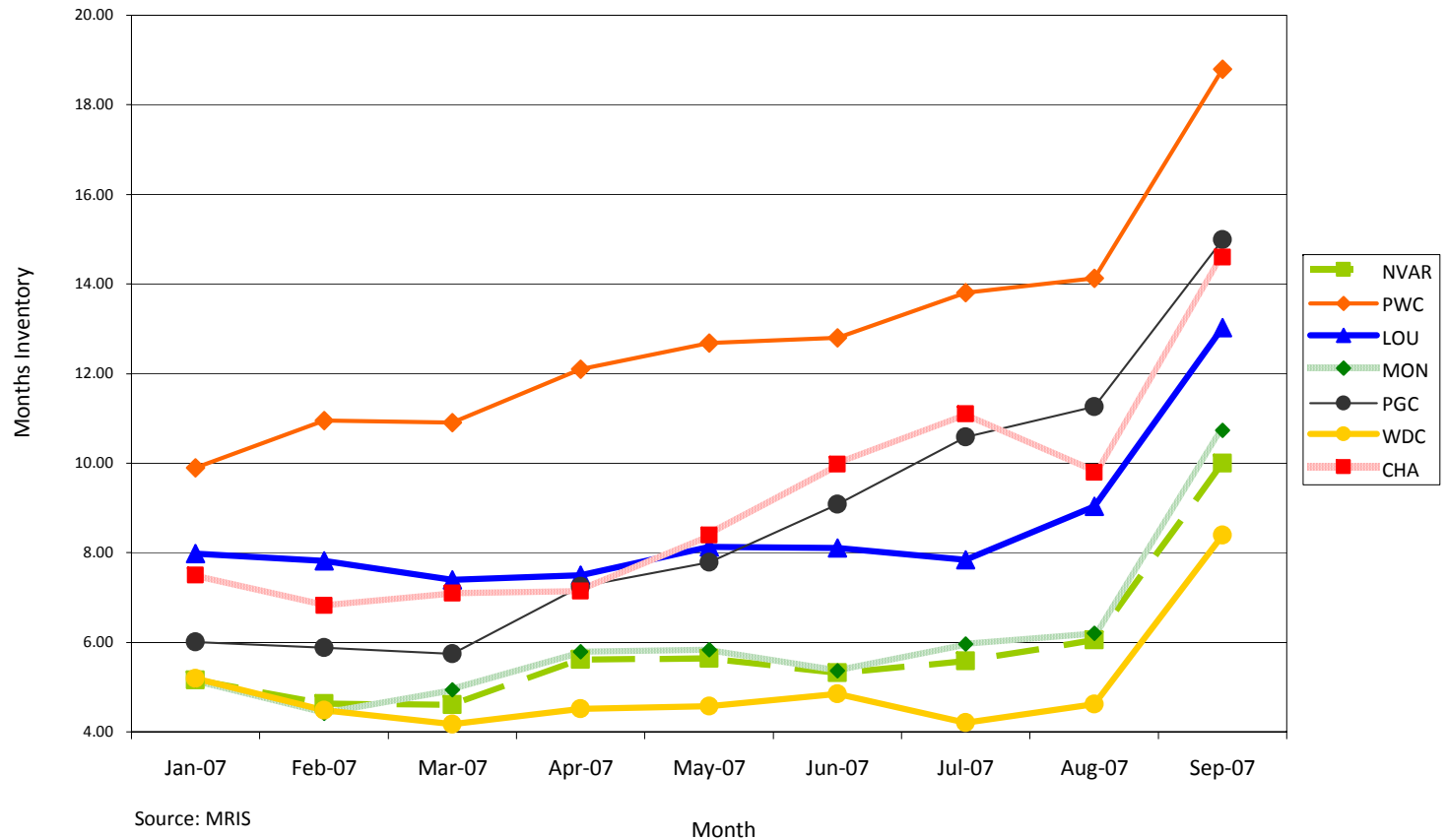
Month



County Inventory Analysis – NOVA, WDC, Suburban MD

- The DC metro area months-inventory sharply rose due to under-performing sales.
- Prince William County is at the 19 month mark after breaking the 14 month mark in August.
- Prince George’s County increased from about 11 months to 15 months in September
- The District experienced an 81% increase in months-inventory after remaining relatively stable since January. It still carries the lowest level of inventory at 8.2 months in the DC metro region
- All markets maintained their relative market position in terms of months-inventory.

Comparison of Inventory Levels (Represented by Month's Inventory) Northern Virginia, WDC, Suburban MD



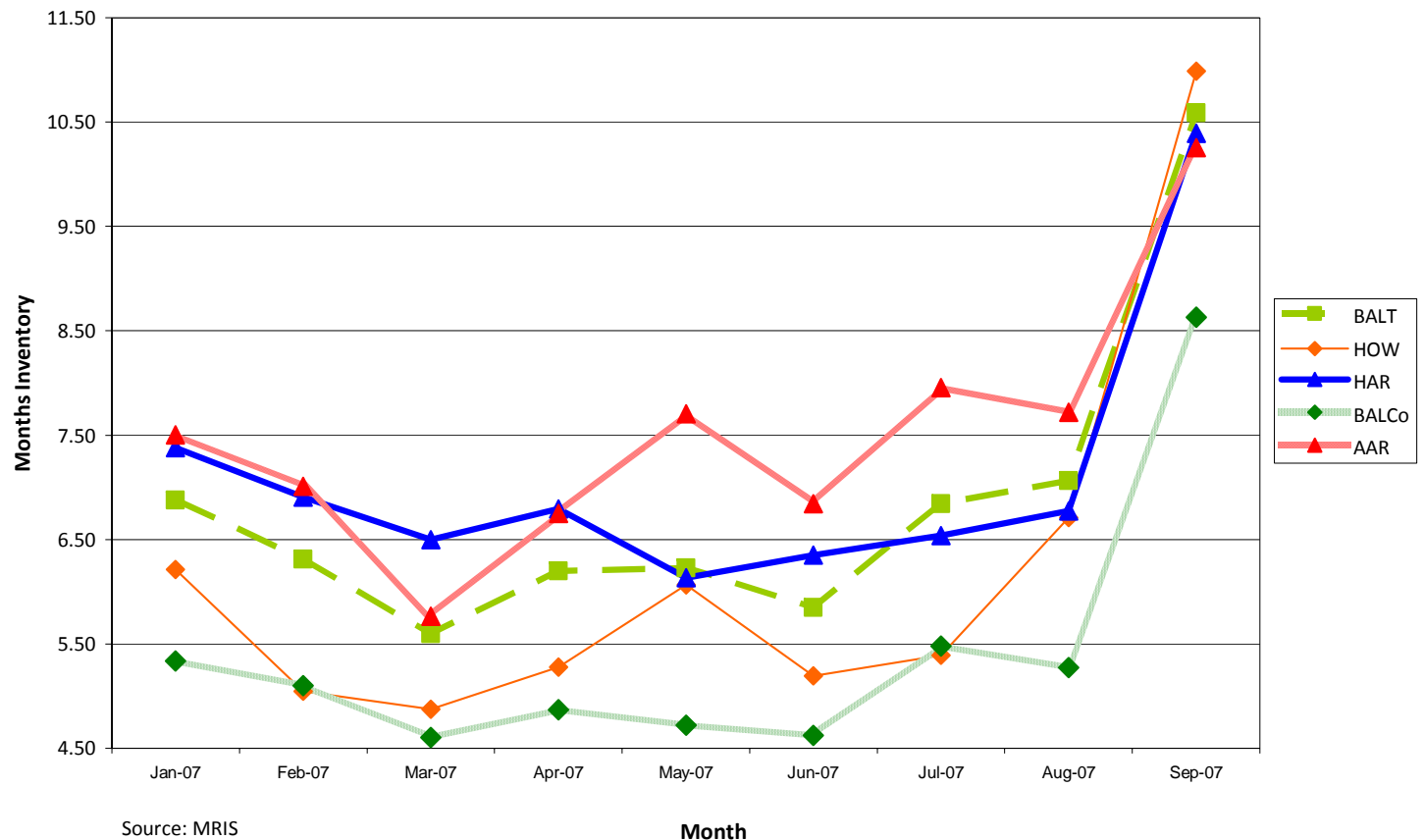
We'll watch the numbers closely to determine whether recent activity is a spike or a sustained level of months-inventory



County Inventory Analysis – Baltimore Area and Suburbs

Comparison of Inventory Levels
(Represented by Month's Inventory)
Baltimore Area and Suburbs

- As with the DC Metro market, the Baltimore area experienced severely decreased sales resulting in greater months-inventory levels across the board
- Baltimore County continues to hold the least amount of listing inventory
- Howard County bypassed Anne Arundel with the greatest months- inventory level; a 63% increase from the prior month.



Jobs (source: Bureau of Labor Statistics)

- Overall in Washington and Baltimore, the unemployment rates dropped from July to August. This change is normal for July-August and does not reflect a larger market trend.
 - Metro DC lost 35,257 jobs from July to August, although it has gained 15,658 from August 2006 (not shown). The labor force shrunk by 45,177 workers – dropping the unemployment rate by 0.3%. Note these are preliminary figures and are not seasonally adjusted.
 - Metro Baltimore’s employment picture was similar to Washington’s with 19,158 fewer jobs and 27,878 fewer workers. The overall unemployment rate in Metro Baltimore shrunk by 0.5% from July to August.
- Regional unemployment rates remain extraordinarily low – a factor which may hinder economic growth as it puts upward pressure on wages.

Baltimore and Washington, DC Job Market By County and Region

	WDC Metro	ARLINGTON	FAIRFAX	LOU-DOUN	PRINCE WILLIAM	MONT-GOMERY	PRINCE GEORGE'S	WASH., DC		BALT. Metro	BALT. CO	BALT. CITY	HOWARD	HARFORD	ANNE ARUNDEL	CARROLL
Unemployment																
Jun-07	3.30	2.00	2.30	2.30	2.3	3.20	4.20	5.70		4.20	4.10	6.40	3.10	3.80	3.60	3.40
Jul-07	3.30	1.80	2.20	2.10	2.6	3.20	4.50	6.00		4.50	4.30	6.90	3.20	4.20	3.80	3.80
Aug-07	3.00	1.90	2.20	2.20	2.5	2.70	3.70	5.70		4.00	3.70	6.30	2.70	3.70	3.30	3.20
Month change	-10.00%	5.26%	0.00%	4.55%	-4.00%	-18.52%	-21.62%	-5.26%		-12.50%	-16.22%	-9.52%	-18.52%	-13.51%	-15.15%	-18.75%
Labor Force																
Jun-07	3,010,035	130,812	602,770	156,408	201,475	524,071	453,803	319,713		1,404,230	430,722	278,915	158,688	132,793	282,653	94,676
Jul-07	3,041,868	131,481	606,566	157,339	202,726	532,303	440,240	323,359		1,424,350	436,395	283,495	160,740	134,877	286,575	96,120
Aug-07	2,996,691	130,044	599,217	155,590	200,190	521,808	434,984	320,252		1,396,472	427,825	277,787	157,668	132,266	281,040	94,237
Month change	-1.51%	-1.11%	-1.23%	-1.12%	-1.27%	-2.01%	-1.21%	-0.97%		-2.00%	-2.00%	-2.05%	-1.95%	-1.97%	-1.97%	-2.00%
Jobs																
Jun-07	2,911,606	128,134	588,881	152,852	196,224	507,560	434,893	300,823		1,344,736	413,170	261,027	153,817	127,758	272,612	91,479
Jul-07	2,941,229	129,068	593,170	153,965	197,653	515,140	461,151	303,922		1,359,958	417,847	263,982	155,558	129,204	275,697	92,514
Aug-07	2,905,972	127,518	586,048	152,116	195,280	507,721	451,875	302,020		1,340,802	411,961	260,264	153,367	127,384	271,814	91,211
Month change	-1.21%	-1.22%	-1.22%	-1.22%	-1.22%	-1.46%	-2.05%	-0.63%		-1.43%	-1.43%	-1.43%	-1.43%	-1.43%	-1.43%	-1.43%

[1] Northern Virginia Counties and Baltimore counties appear to be using a standard factor to estimate job growth.

Consumer Confidence (Source: Conference Board – national sample)

The Conference Board surveys 5,000 households monthly and asks about their confidence in the overall economy; present and future. Additionally, the survey asks consumers their propensity to purchase a home in the next six months. As of September 2007, approximately 2.7% of households plan to purchase a home in the next six months; down from 3.5% in August.

- The confidence in the overall housing market in September 2007 is only slightly lower than September 2006. New Home confidence is declining while the resale market is experiencing increasing confidence. This trend is good because it's important the resale market sells off inventory in order to generate new home move-up buyers.
- The propensity to purchase **a new home** estimate is nearly one-third lower than the level of September 2006 and the previous month of August 2007.

The underlying message from the consumer confidence figures represents the greater problem in the homebuilding industry - consumers lack confidence in the market and are therefore not willing to purchase a home.

Consumer Confidence Survey										
<i>September 2007 preliminary results vs. prior periods</i>										
"Plan to purchase a home within the next six months"										
Response	Same month - One year prior			Prior month			Prior 12 month Average			Current 12 mo. avg
	Sept 06	Sept p 07	% prior	Aug 07	Sept p 07	% prior	Prior 12 mos	Sept p 07	% prior	Overall
Yes	2.9	2.7	93%	3.6	2.7	75%	3.1	2.7	86%	3.1
New	1.0	0.7	70%	1.0	0.7	70%	0.9	0.7	82%	0.8
Existing	1.0	1.1	110%	1.8	1.1	61%	1.4	1.1	77%	1.4
Uncertain	0.9	0.9	100%	0.8	0.9	113%	0.9	0.9	106%	0.9

Permit Activity (Sources: HUD/Census)

County	YTD Change from Aug. 2006	Total Permits YTD
District of Columbia, DC	10%	1,724
Anne Arundel County, MD	50%	1,535
Baltimore County, MD	-44%	926
Calvert County, MD	23%	248
Carroll County, MD	-35%	264
Charles County, MD	-43%	541
Frederick County, MD	-13%	840
Harford County, MD	-14%	823
Howard County, MD	23%	1,105
Montgomery County, MD	38%	2,805
Prince George's County, MD	5%	2,282
Queen Anne's County, MD	-46%	189
Baltimore city, MD	-28%	209
Arlington County, VA	-46%	1,032
Culpeper County, VA	-60%	216
Fairfax County, VA	-26%	1,181
Fauquier County, VA	-51%	235
Loudoun County, VA	-17%	2,139
Prince William County, VA	-20%	2,020
Spotsylvania County, VA	-60%	416
Stafford County, VA	-17%	569
Berkeley County, WV	-37%	780

- Permit activity remains mostly down from 2006
- Counties with greater activity this year than in 2006 are shaded in yellow; counties with more than a 50% *drop in activity* this year than in 2006 are shaded gray
- Prince George's County, previously among the leading the surveyed MD locations, has fallen to fifth in activity during 2007 as compared to 2006
- Montgomery County remains a leader in MD as Anne Arundel, Howard and Calvert Counties join it to show strong increases in permit activity over 2006 levels
- Loudoun and Prince William counties continue to lead Virginia in number of permits issued. However, both counties are showing nearly 20% decline from 2006.
- Culpeper, Spotsylvania, and Fauquier counties continued to experience a 50% or greater decline from 2006 levels; while Arlington and Queen Anne's counties showed slight improvement.



Interest Rates (Sources: Freddie Mac, Bankrate.com)

High interest rates have crippled sales for the past few months. The Fed's rate reduction in September did not have an immediate impact on mortgage rates or consumer confidence.

Accordingly, we're seeing conforming rates tick down. While Jumbo rates have come down since August highs, they will stay at a relatively high level due to the limited market for residential mortgage backed securities (RMBS). Jumbo rates are not likely to go down soon as the risk associated with these loans is still considered to be high. According to the Associated Press:

NEW YORK -- Standard & Poor's said Wednesday it cut the ratings on 1,713 classes of securities, worth some \$23.35 billion, backed by mortgages issued in the first six months of this year.

The massive cut in ratings created uneasiness among investors that mortgage sector problems are still getting worse. . .

The securities downgraded by S&P are backed by subprime, alt-A and home-equity loans. Those three types of loans have gone delinquent and into default at soaring rates in recent months.

-AP, October 17, 2007

Purchasing power remains constrained due to higher rates and current tight lending practices.



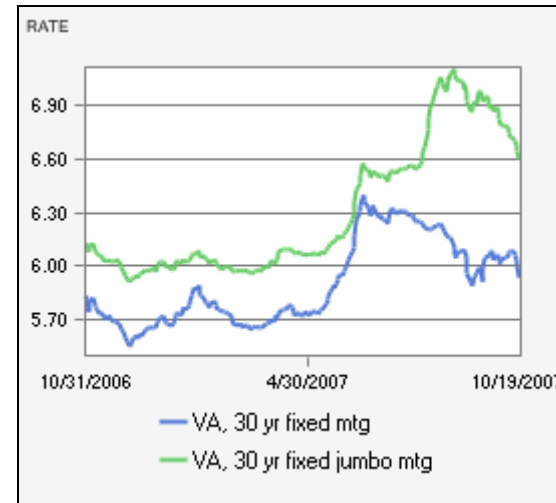
Conforming Loan Rates – Fixed Rate Mortgages (FRM)

Week of...	30-Year		4-Week
	FRM	Points	Change Basis Points
9/6/2007	6.46	0.5	-13
9/13/2007	6.31	0.5	-31
9/20/2007	6.34	0.5	-18
9/27/2007	6.42	0.5	-3
10/4/2007	6.37	0.5	-9
10/11/2007	6.40	0.4	9
10/18/2007	6.40	0.5	6
10/25/2007	6.33	0.5	-9

Source: Freddie Mac, national sample

- The rate for conforming 30-year fixed mortgage rates declined this week following increases the past two weeks when comparing rates against those four weeks prior.

**Non-Conforming Loans
Graph of Conforming and Jumbo Loan Rates**



Source: bankrate.com, Virginia sample

- The gap between jumbo and standard 30 year fixed mortgages has decreased, however the variance remains atypically high



Conclusion

As lending standards tighten and jumbo mortgage rates stay at relatively high levels, consumer purchasing power (and demand) drops and prices will be forced down. We're still adjusting prices due to the increasing jumbo mortgage rates that shot from 6% in April to over 7% in August before they settled down to 6.6% in October 2007 (source: bankrate.com).

The positive news regarding low unemployment rates coupled with relatively low conforming interest rates will, in time, attract first-time buyers to well-priced product. However, first-time buyers must now have acceptable credit scores, meet tighter lending requirements, and have a cash down payment – reducing the number of potential buyers.

How long will it be before the market reaches the equilibrium price point and inventory begins to drop? At this point the market is too volatile to be certain, but estimates calls for recovery in mid-2008 for the closer in markets and 2009 to the outer suburbs (Prince William, Loudoun, Charles, and Harford). The exurban markets will continue to struggle for the foreseeable future.

In the long run, the Washington/Baltimore region remains an attractive market for new business and real estate investment. Large players on both the financial and development sides are circling the market and waiting for a good opportunity to enter. Now is the time to plan how your company emergence from this down cycle. Those who are proactive today will emerge stronger when the market returns!



Applying FRC Market Intelligence

Knowledge is power. *Applied knowledge* gives you a competitive edge.

FRC Market Intelligence™ is critical intelligence. It is systematic data gathering of the latest information to provide you with analyses and recommendations to help you make smart, informed decisions. FRC provides you with key market statistics that show trends in job growth, housing market inventories, consumer confidence, and interest rates for your local market areas in Virginia, The District, and Maryland. These statistics are the important indicators of supply and demand.

Let us apply our market knowledge to your corporate strategy and give you that competitive edge.

Now is the time to plan for expansion

- Corporate Development Solutions helps you build that strategic business plan.
- Strategic Market Entry Studies ensure you are accurately positioned from the start. Offer the right product targeted to the right segment at the right price and you'll be successful.

Is that underperforming community dragging you down?

- Community Repositioning Studies – Have FRC evaluate your underperforming communities and we will recommend the best path to profitability.

Achieving maximum margins is more important than ever! Ensure that you are not leaving money on the table by accurately – and efficiently - tracking your competitors' moves.

- Managed CMA Program – take your local competitive intelligence to a new level. Educate your sales team, marketing team, and your executive team without the hassle of managing spreadsheets.

Call or email Dan Fulton today to discuss – (703) 385-3116 / dfulton@fultonresearch.com



FRC Products and Services

*Empowering you to make smart decisions*SM

FRC offers a variety of solutions to its clients, including:

- **FRC Market Studies** position your community for success. Market feasibility studies vary in scope from age-targeted to hi-rise, urban to rural, and from master planned communities to finished lot acquisitions. FRC Market studies provide in-depth analyses of market depth, targeted buyer profiles, economic factors, housing market environment, and competitive intelligence to build a complete picture of your community's selling environment. Our recommendations are intended to attain maximum revenues while maintaining a strong sales pace.
- **FRC Market Repositioning Studies:** FRC analyzes your community's traffic patterns, marketing campaign, product offering, and competitive position along with other critical market factors. We then recommend the proper positioning of the community to achieve maximum revenues and a strong sales volume.
- **FRC Corporate Development Program:** Whether you are expanding to a new market area or targeting a new consumer segment, FRC provides the guidance you need to make the right decisions.
- **FRC Competitive Market Analysis Program™ (CMA program):** a proprietary, user friendly system of aggregating competitive data, providing an accurate and current view of the competitive landscape, and enabling each community to achieve maximum price and sales pace.
- **Primary Research:** FRC works with you to gain insight directly from your customers and prospects using online surveys, mail surveys or focus groups.
- **Customer Satisfaction Improvement Program:** Customer satisfaction scores are a window into the operational health of your company. Good customer satisfaction scores often mean that you're running an efficient company, have solid product designs, and are enjoying the benefits of a strong referral network. FRC monitors and evaluates your customer satisfaction scores, evaluates the cause of the underperforming areas, and provides a solution to those problems.