Our Housing Market Turns the Corner

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After a very difficult half decade characterized by falling sales and prices, a surge in foreclosures and many underwater homeowners, it is now fair to say that residential housing markets in Hampton Roads are on the mend. While some significant economic challenges remain, both sales and prices are up, foreclosures are down and the proportion of underwater homeowners who owe more on their home than it is worth has declined.

Still, it was a difficult several years. As Graph 1 reports, the median (50th percentile) selling price of an existing home in Hampton Roads fell 24 percent between the third quarter of 2007 (our all-time peak) and the first quarter of 2013. True, this was less than the disastrous price reductions that occurred in locations such as California, Florida and Nevada. Even so, it was still slightly larger than the national median (22 percent from its peak in the third quarter of 2005 and the first quarter of 2013).

Table 1 illustrates the source of our housing market grief. The median sales price of existing homes in Hampton Roads fell every year between 2008 and 2011. This followed a 90 percent increase that occurred between 2002 and 2007, suggesting that a housing price bubble divorced from economic fundamentals had developed in our region. Finally, in 2012, median sales prices for existing homes began to increase, albeit by only 2.78 percent. We are on track for a 5.5 percent increase in 2013.

TABLE 1

MEDIAN SALE PRICE OF EXISTING RESIDENTIAL HOMES IN HAMPTON ROADS: 2001-2013*

Year	Median Price	Annual Percent Change
2001	$109,000	9.1%
2002	$116,900	7.3%
2003	$130,000	**11.2%**
2004	$156,500	**20.4%**
2005	$192,000	**22.7%**
2006	$214,900	**11.9%**
2007	**$223,000**	3.8%
2008	$219,000	**-1.8%**
2009	$207,000	**-5.5%**
2010	$203,900	**-1.5%**
2011	$180,000	**-11.7%**
2012	$185,000	**+2.78%**
2013*	$182,000	**+2.25%**

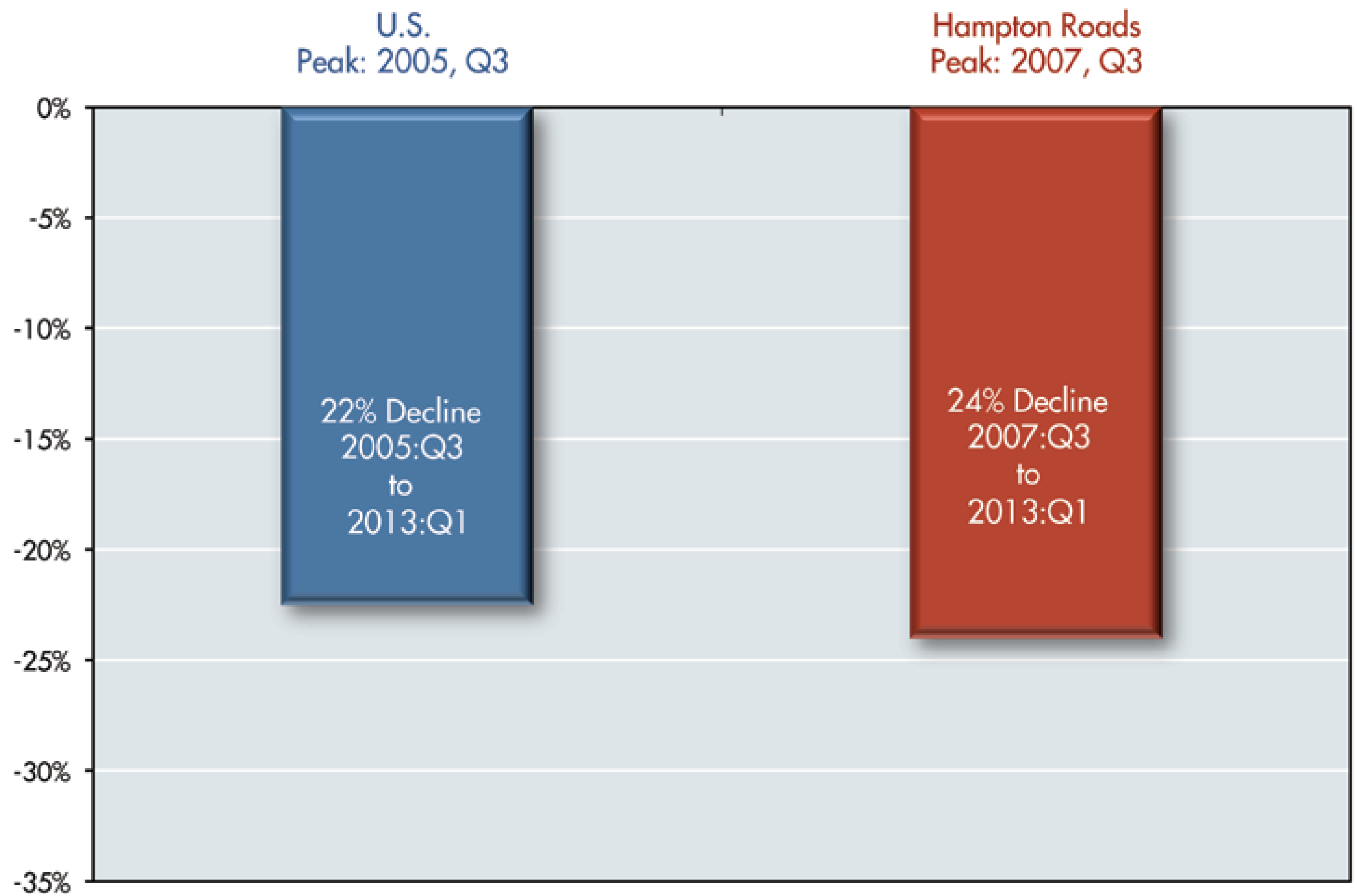
90% Increase between 2002 and 2007

19% Decrease between 2007 and 2011

Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project
*Data are from YTD May 2013 and YTD May 2012.

GRAPH 1

CUMULATIVE DECLINE IN MEDIAN SINGLE-FAMILY HOUSE PRICES FROM PEAK PRICES FOR EXISTING HOMES (EXCLUDING CONDOMINIUMS), IN HAMPTON ROADS



Sources: National Association of Realtors, Real Estate Information Network and the Old Dominion University Economic Forecasting Project

Housing Inventory And Time On Market

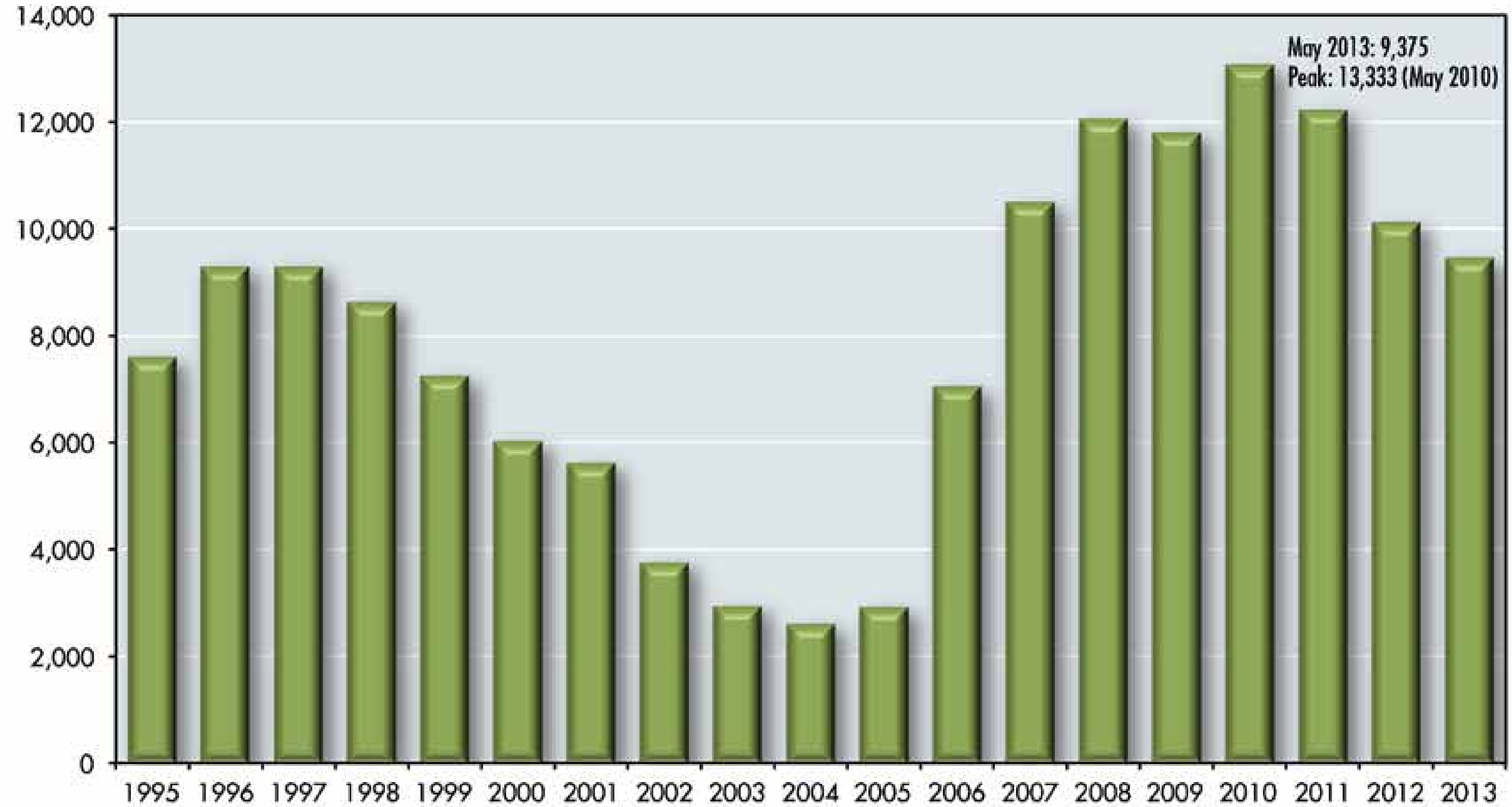
For some time, Hampton Roads has experienced what one real estate agent refers to as "a substantial overhang of unsold homes" that has stifled the market. Fortunately, this appears to be changing. One can see in Graph 2 that our estimates of unsold existing residential homes on the market underline a significant decline in unsold housing inventory. We estimate that 9,375 unsold existing residential homes are on the market now in Hampton Roads, down from a peak of 13,333 in 2010. It's worth noting, however, that these numbers fluctuate throughout the year and are the highest during the summer.

Further good news is evident in Graph 3, which charts both the number of existing residential homes sold in Hampton Roads since the turn of the century and the average number of days those homes were on the market prior to their sale. Sales are trending modestly upward and there is a modest downward trend in the average number of days each home is on the market until sale.

How much housing inventory is available in Hampton Roads today and ready for sale? A good way to obtain a feel for this is to compute the average number of months of supply of existing homes. This tells how long it would take to eliminate the existing inventory of unsold homes at current sales rates. Graph 4 discloses that we had an average of 5.56 months of supply of unsold existing homes for sale between 1996 and 2013. Currently, we have 6.48 months of unsold homes for sale, but this is down from the previous high of 10.24 months in November 2010.

GRAPH 2

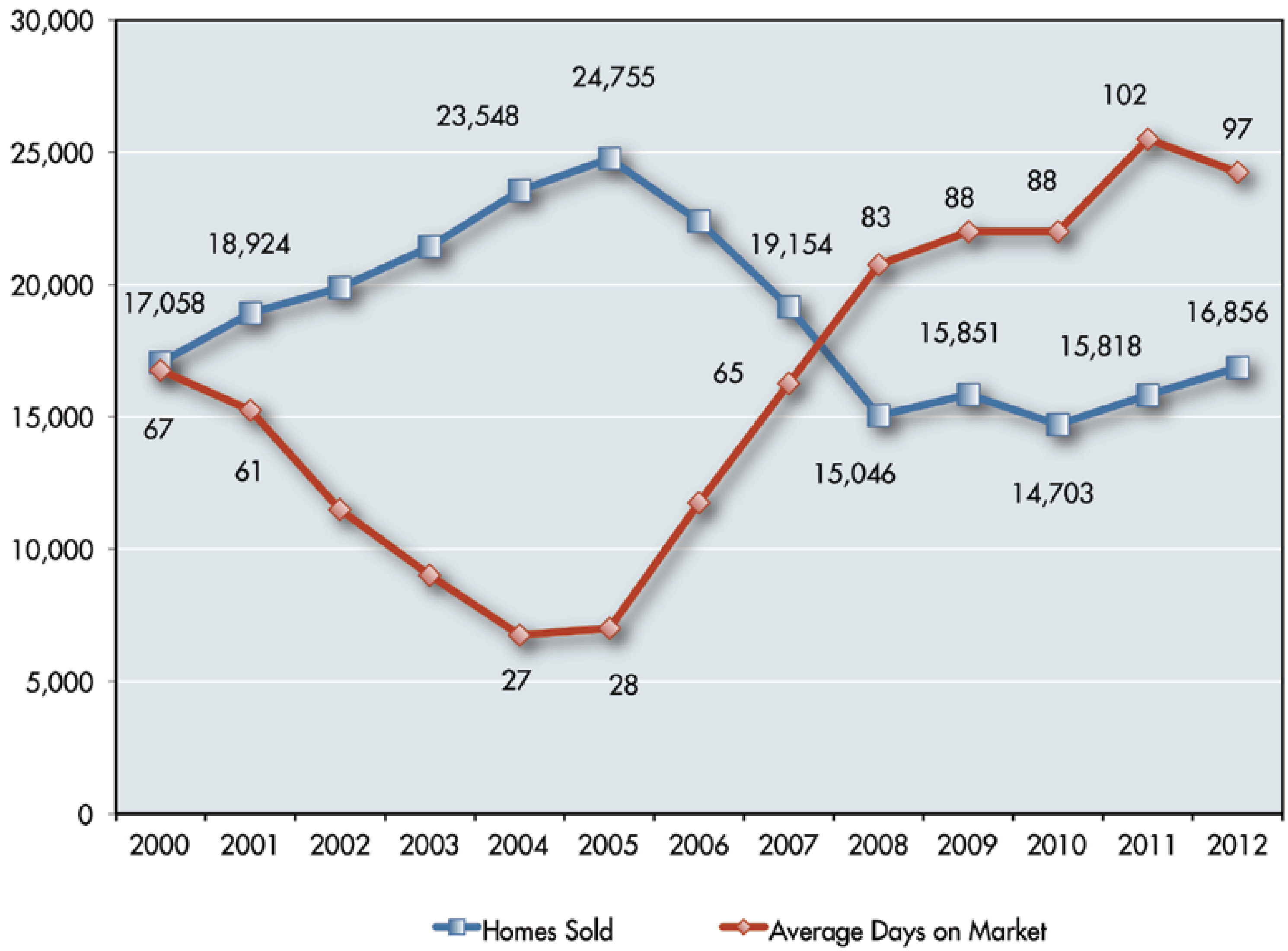
ESTIMATED INVENTORY OF EXISTING RESIDENTIAL HOMES AS MEASURED BY ACTIVE LISTINGS ON MAY 31 OF EACH YEAR



Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project

GRAPH 3

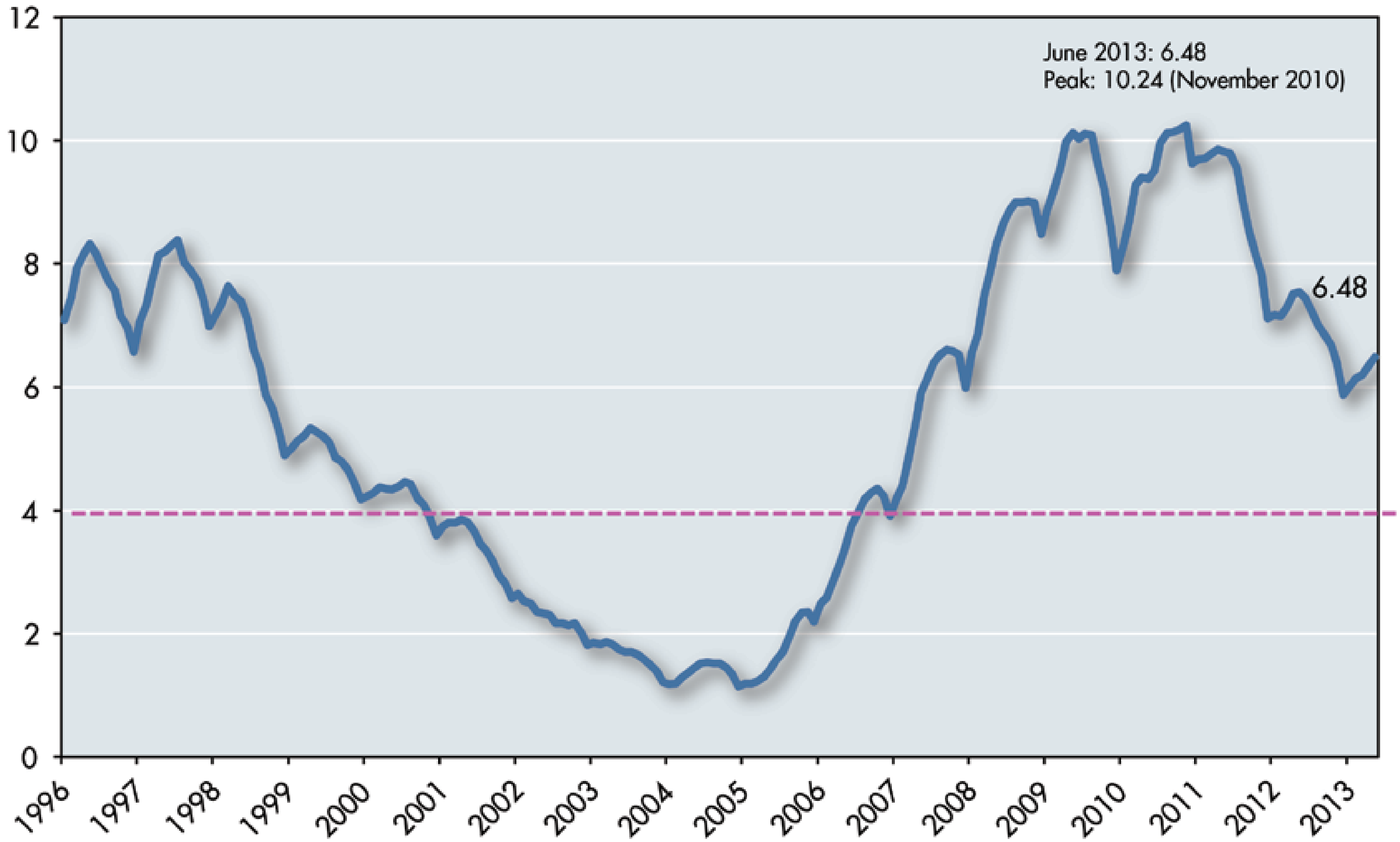
EXISTING RESIDENTIAL HOMES SOLD AND AVERAGE DAYS ON THE MARKET IN HAMPTON ROADS, 2000-2012



Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project

GRAPH 4

ESTIMATED MONTHS OF SUPPLY OF EXISTING HOMES IN HAMPTON ROADS, JANUARY 1996 – MAY 2013



Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project (based on average number of sales in preceding 12 months)

Distressed Homes And Foreclosures

Distressed home sales are those that involve: (1) the sale of REO (real estate owned) homes that have been acquired by banks, often via foreclosure or abandonment; or (2) a "short sale" of a home for which an owner no longer has the ability or desire to service the mortgage, and the home then is sold at best possible price. Distressed sales push down prices for several reasons. The owners of distressed homes are anxious to get rid of them and buyers know this. But it's also true that some distressed homes deteriorate in value because of lack of maintenance, or outright misuse.

Financial institutions understand that short sales of homes still occupied by individuals no longer able to pay their mortgage tend to diminish the probability of extensive property damage, at least when compared to foreclosures that have been preceded by an eviction. Consequently, short sales usually result in higher prices being paid for the homes in question. Knowledge of this has pushed many financial institutions to prefer short sales to sales preceded by foreclosures.

The depressing effect of distressed home sales on home prices can be seen in Table 2, which supplies home sales price information for Hampton Roads for 2006 through 2013, and then compares the sales prices of non-distressed homes with those that were sold as a distressed sale. In 2011, for example, short sales of distressed homes resulted in average sales prices that were 90.1 percent of the average non-distressed home sales price, while bank-owned REO average prices (usually the result of a foreclosure) were only 57.3 percent of the average non-distressed sales price.

The market dynamics associated with distressed housing sales are simple: Why buy a "regular," non-distressed home at full price if you can purchase a distressed home at a huge discount? Thus, a decline in the volume of distressed sales is a sign of a stabilizing home market. Happily, this is now occurring in Hampton Roads. In March 2011, distressed sales peaked in number at 618, but fell to 401 by June 2013 (see Graph 5). Further, as Graph 6 illustrates, the number of active listings of distressed homes has fallen noticeably as well.

What does the future hold? An important source of distressed homes inventory is the residential housing foreclosures that result in the departure of the owner. Graph 7 reveals that the number of foreclosures in Hampton Roads is down significantly from its 2010 high, although the 2012 number (8,267) is higher than the 2011 number (6,988). The increase in 2012 reflects a rather curious reality that actually depends upon the increasing health of our housing market. Financial institutions are not in the housing business and hence are reluctant to foreclose on homes that they believe will be difficult or impossible for them

TABLE 2

AVERAGE PRICE OF EXISTING SHORT SALE, REOS AND NON-DISTRESSED RESIDENTIAL HOMES SOLD IN HAMPTON ROADS, JANUARY 2006 - MAY 2013

Year	Non-distressed Sales	Short Sales	Short Sale Price Percentage of Non-distressed Price	Bank-owned REO Sales	REO Price Percentage of Non-distressed Price
2006	$250,254	$241,666	96.7	$120,817	48.3
2007	$261,723	$237,897	91.3	$163,421	62.4
2008	$255,852	$239,110	95.0	$184,462	72.1
2009	$243,902	$239,913	98.4	$164,229	67.3
2010	$251,572	$231,211	91.9	$151,612	60.3
2011	$236,358	$212,967	90.1	$135,304	57.3
2012	$237,215	$187,527	79.1	$134,535	56.7
2013	$241,025	$180,249	74.8	$131,285	54.5

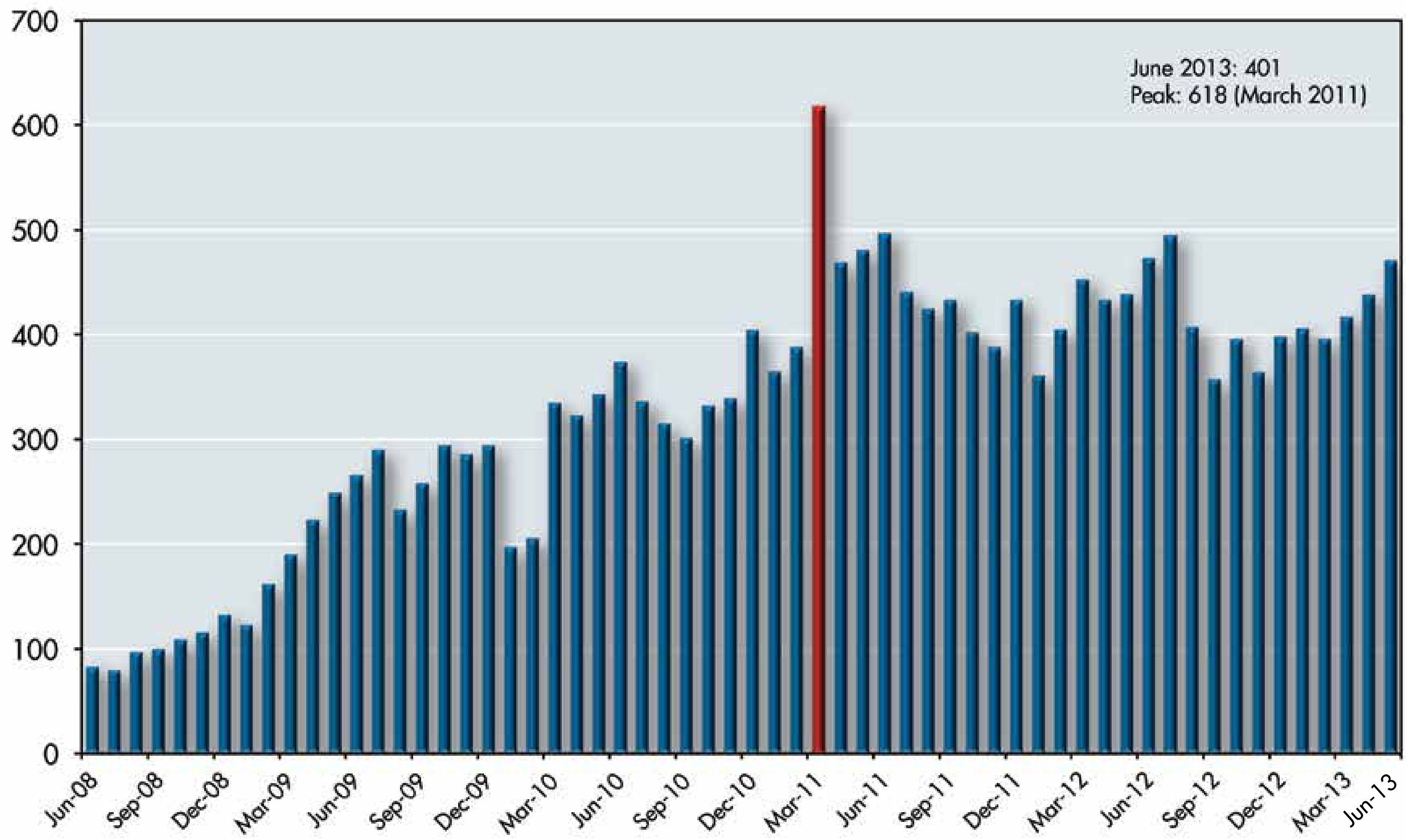
Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project. Distressed homes are bank owned or short sale homes.

to sell. The improving health of our housing market has provided financial institutions with the confidence that they literally will be able to get rid of nonperforming mortgages on homes upon which they foreclose.

Nevertheless, sales of distressed homes still constitute a rather large proportion of total home sales in Hampton Roads. Graph 8 demonstrates this; in June 2013, more than 22 percent of all residential home sales in our region still were classified as distressed. This is down from the December 2012 peak of 29.12 percent, but is evidence that, even though our housing market is healing, it has not yet recovered.

GRAPH 5

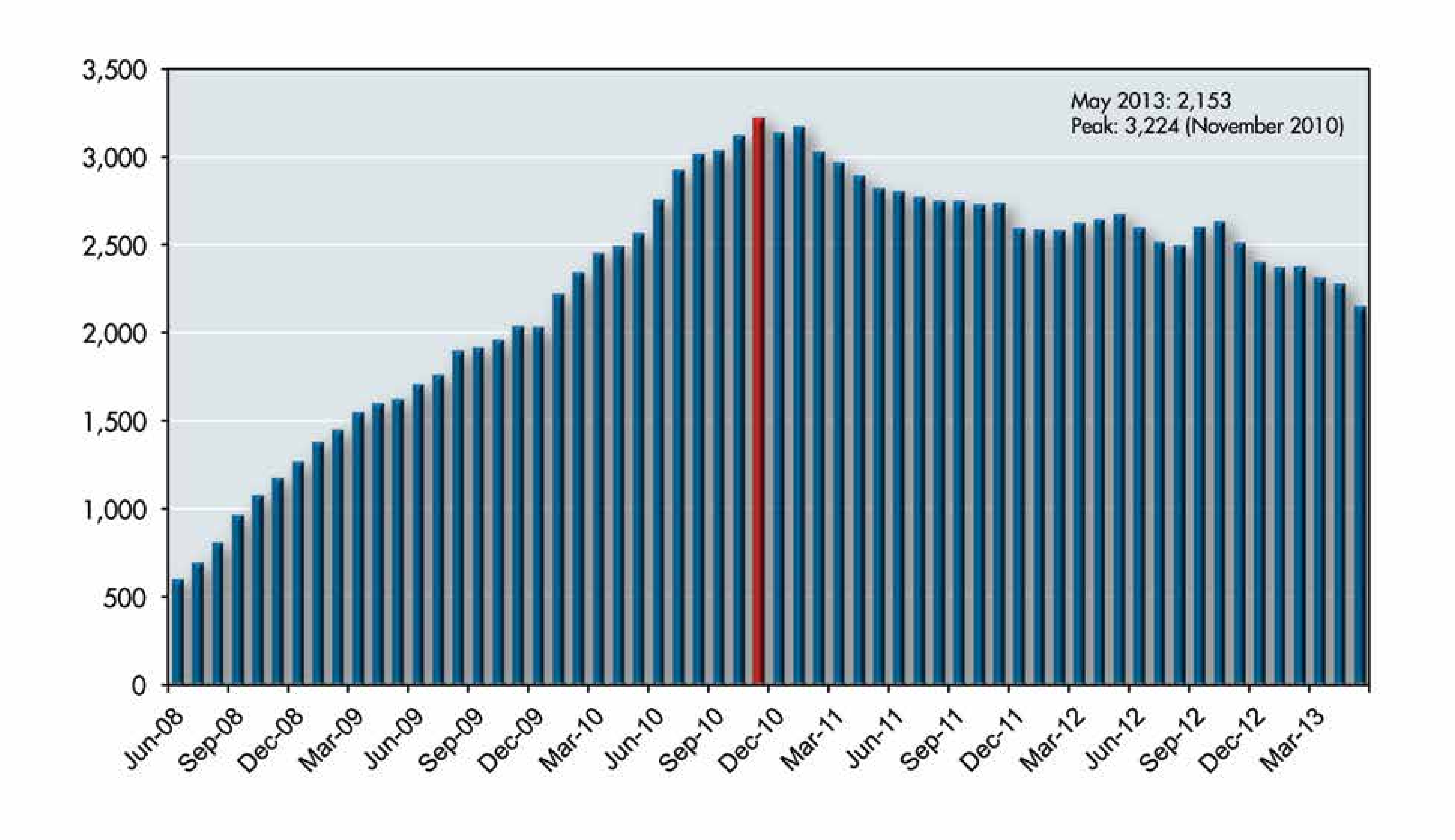
NUMBER OF DISTRESSED HOMES SOLD (REO AND SHORT SALES) IN HAMPTON ROADS, JUNE 2008 – JUNE 2013



Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project

GRAPH 6

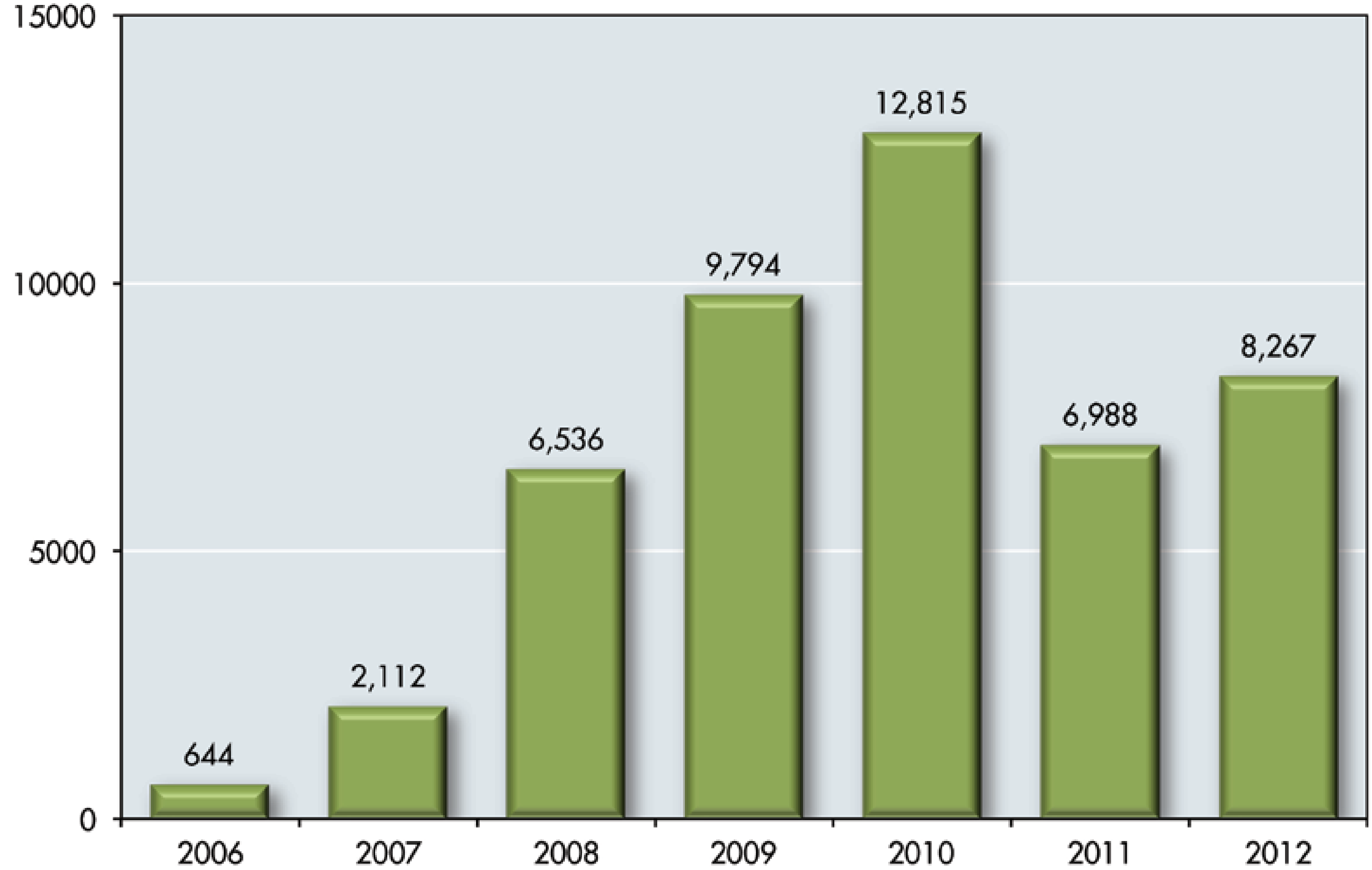
NUMBER OF ACTIVE LISTING OF DISTRESSED HOMES (REO AND SHORT SALES) IN HAMPTON ROADS, JUNE 2008 – MAY 2013



Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project

GRAPH 7

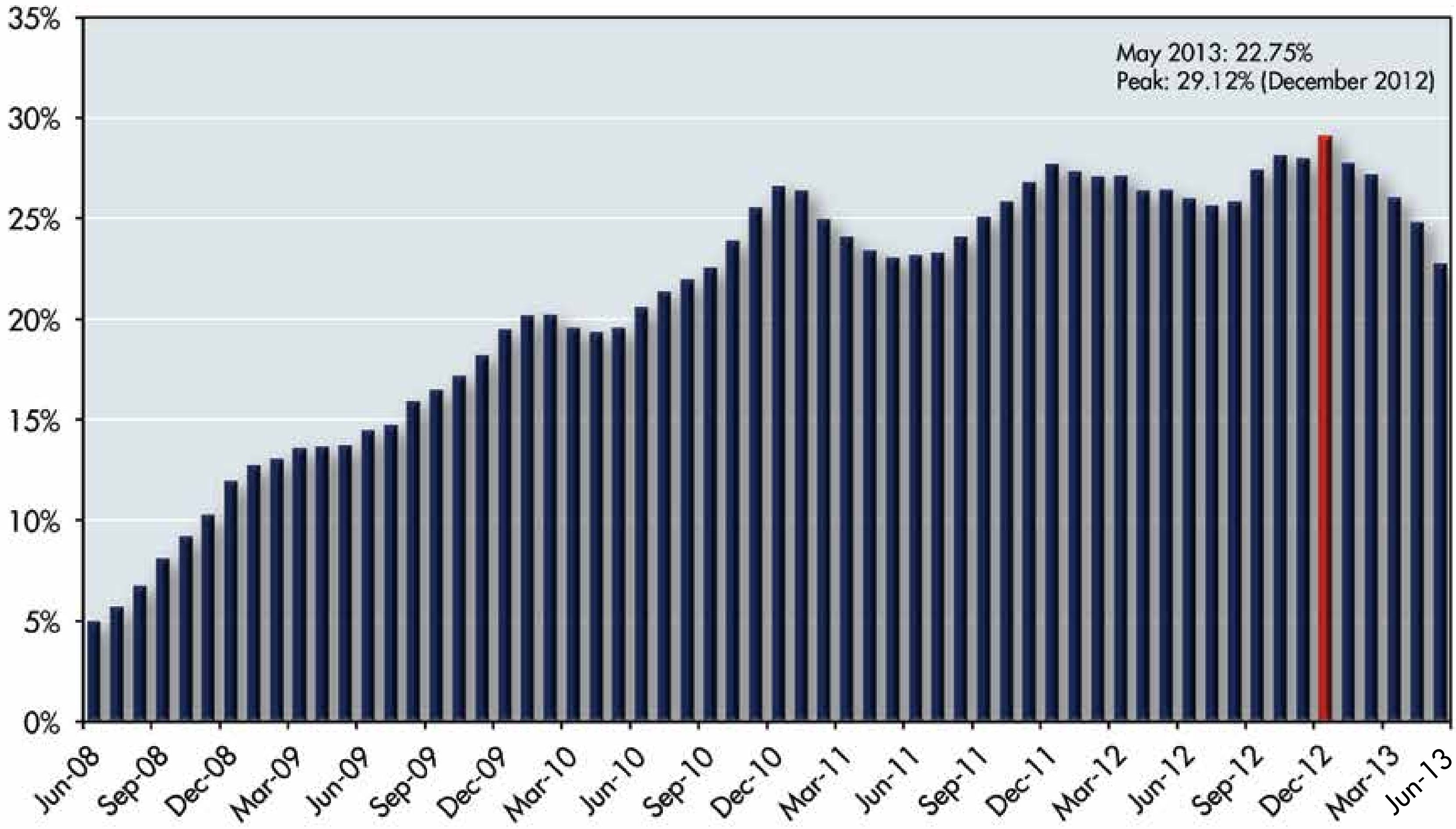
HAMPTON ROADS RESIDENTIAL FORECLOSURE FILINGS, 2006-2012



Sources: Realty Trac and the Old Dominion University Economic Forecasting Project

GRAPH 8

SALE OF DISTRESSED HOMES (REO AND SHORT SALES) AS A PERCENTAGE OF TOTAL EXISTING RESIDENTIAL HOMES SOLD IN HAMPTON ROADS



Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project

Housing Affordability

By historical standards, this is a very good time to buy a home in Hampton Roads. The major alternative, of course, is to rent a home rather than buy. Cost is an absolutely critical consideration. In Table 3, we compare the median monthly rent that must be paid to rent a three-bedroom apartment to the principal and interest payment that must be paid to service the mortgage on a median-priced home. The ratio of the rent to the mortgage payment is a measure of the relative attractiveness of each strategy.

It is apparent that home ownership has become increasingly attractive when compared to renting; the rent/mortgage payment ratio rose to 1.74 in 2013 after hitting a low of only .83 in 2006 and 2007. The numbers assume a no money down, historical average 30-year mortgage rate for each year and 3.8 percent in 2013.

Housing costs constitute one side of the housing affordability coin; the other side depends upon household income. The most commonly used measure of a household's ability to purchase a median-priced home is the ratio of median monthly household income to the average monthly payment a household would have to pay to own the home. Graph 9 makes those computations; one can see that in 2013, the average monthly payment for a new home was only 18.3 percent of median household income in Hampton Roads (and only 19.6 percent nationally). Both percentages are well below the 30 percent of income level that often is cited by financial advisers as the most that a household should pay for housing.

Households in our region currently have a much greater ability to purchase a home than they have had in nearly every year in the past. At the height of the housing boom in 2006, it took 30.6 percent of median monthly household income in Hampton Roads to make the monthly mortgage payment on the median-priced existing home. Of course, it's one thing to say homes are affordable and another thing to obtain financing. Mortgage standards have risen in recent years (probably a good thing) and not as many households qualify for financing today as did in the heydays of 2006 and 2007, when zero down payments were in vogue.

TABLE 3

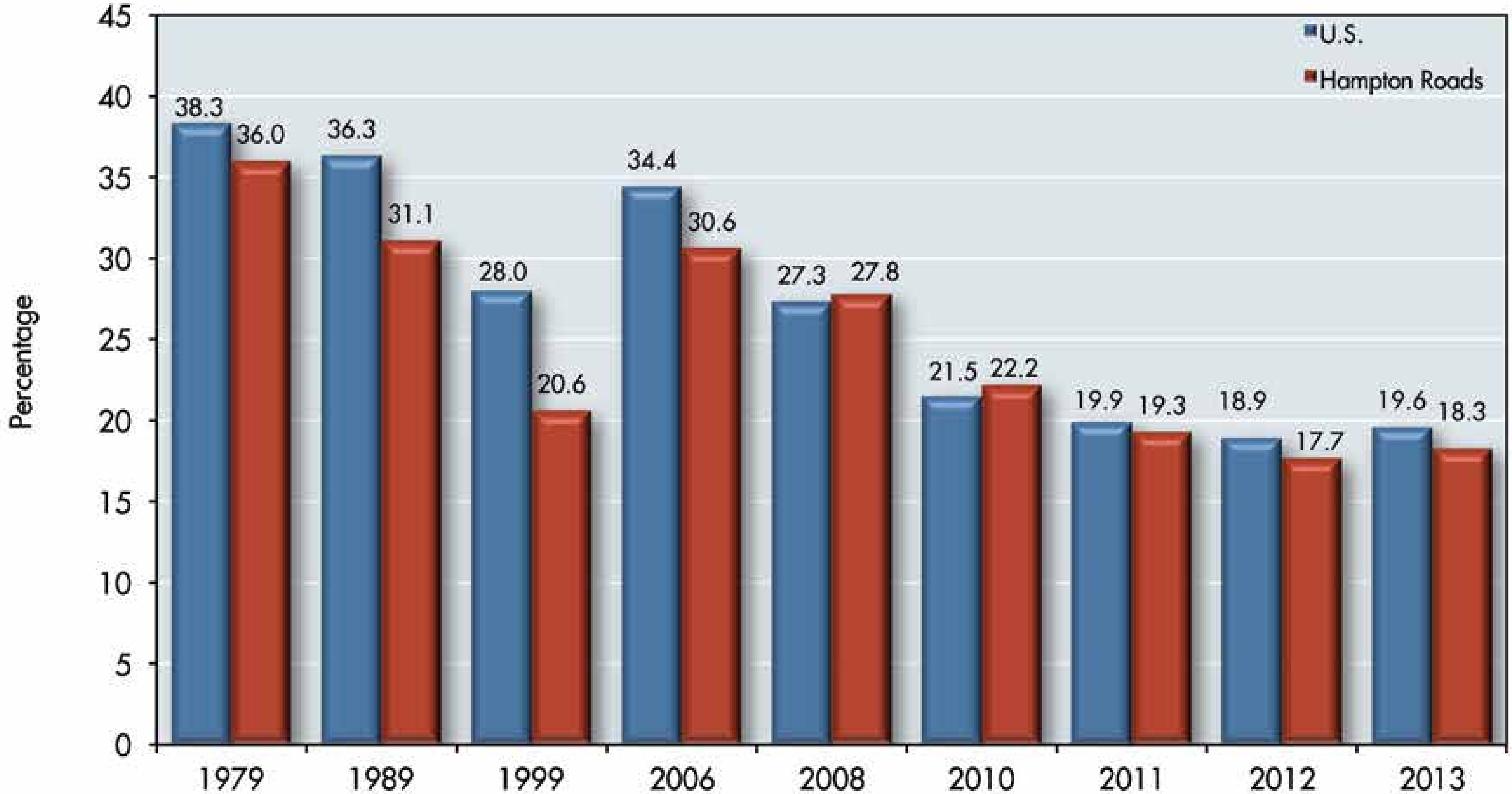
ESTIMATED HOUSE RENTAL AND PRINCIPAL AND INTEREST FOR A HOUSE PAYMENT IN HAMPTON ROADS, 2001-2013

Year	Median Monthly Rent for a Three-Bedroom House	P&I Monthly for a Median House	Ratio of Monthly P&I to Rent
2001	$882	$743	1.19
2002	$911	$761	1.20
2003	$1,037	$780	1.33
2004	$1,044	$940	1.11
2005	$1,087	$1,152	0.94
2006	$1,118	$1,353	0.83
2007	$1,164	$1,409	0.83
2008	$1,247	$1,323	0.94
2009	**$1,336**	**$1,132**	**1.18**
2010	**$1,382**	**$1,062**	**1.30**
2011	**$1,427**	**$922**	**1.55**
2012	**$1,454**	**$859**	**1.69**
2013	**$1,570**	**$900**	**1.74**

Sources: HUD and the Old Dominion University Economic Forecasting Project

GRAPH 9

HOUSING AFFORDABILITY: MONTHLY PAYMENT FOR A MEDIAN-PRICE RESALE HOUSE AS A PERCENTAGE OF MEDIAN HOUSEHOLD MONTHLY INCOME IN HAMPTON ROADS AND THE U.S., 1979-2013



Source: Old Dominion University Economic Forecasting Project (assumes an average 30-year mortgage rate of 3.8 percent in 2013)

New Home Construction And Sales

It should not come as a surprise that the combination of home prices that still are 20 percent or more below their peaks in 2007 plus very high levels of housing affordability have resulted in increased home sales. One can see in Table 4 that both the sales of existing homes and newly constructed homes rose two years in a row in 2011 and 2012. The slow, but evident, recovery of new-home construction is a welcome sign that builders and developers now sense a changing economic climate. After eight consecutive years of declines in the number of newly constructed residential homes sold in Hampton Roads (see Table 5), more new homes now are being constructed and sold. While this improvement primarily is a reaction to our rallying regional economy, the revival of new residential home construction soon will become an economic engine on its own.

TABLE 4

NUMBER OF EXISTING AND NEW-CONSTRUCTION HOMES SOLD IN HAMPTON ROADS, 2001-2013*

Year	Existing Homes Sold	New-Construction Homes Sold	Percent New-Construction
2001	18,924	4,836	**20.4%**
2002	19,869	**4,969**	20.0%
2003	21,421	4,757	18.2%
2004	23,548	4,587	16.3%
2005	**24,755**	4,379	15.0%
2006	22,405	4,327	16.2%
2007	19,154	3,912	17.0%
2008	15,046	3,178	17.4%
2009	**15,851**	2,673	14.4%
2010	14,703	2,265	13.4%
2011	15,818	2,366	13.0%
2012	16,856	2,664	13.6%
2013*	7,160	1,059	12.9%

Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project. Data here represent those properties that are listed through Real Estate Information Network by REIN members and may not represent all new-construction activity in our region. *Data are for YTD May 2013.

TABLE 5

NUMBER OF NEW-CONSTRUCTION RESIDENTIAL HOMES SOLD IN HAMPTON ROADS, 2001-2012

Year	Number Sold	Percent Change Year to Year
2001	4,836	18.1%
2002	**4,969**	2.8%
2003	4,757	-4.3%
2004	4,587	-3.6%
2005	4,379	-4.5%
2006	4,327	-1.2%
2007	3,912	-9.6%
2008	3,178	-18.8%
2009	2,673	-15.9%
2010	2,265	-15.3%
2011	2,366	4.5%
2012	2,664	12.6%

54% Decrease between 2002 and 2010

Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project. Data here represent those properties that are listed through Real Estate Information Network by REIN members and may not represent all new-construction activity in our region..

Individual Housing Markets: A Breakdown By Cities

"Location, location, location" is the well-known observation of real estate professionals about what is most important in determining the value and salability of a home. Hampton Roads as a region boasts a wide array of cities and neighborhoods. Let's provide a bit of context to the regional housing data we supplied in the sections above by subdividing those data by city. Let's begin with sales prices (see Table 6).

Table 6 reveals that the median sales price of existing homes in Portsmouth fell substantially more than sales prices of existing homes in any other city in Hampton Roads between 2007 and 2012. This is unlikely to be good news for that city, but could simply represent a change in the mix of homes sold in Portsmouth (involving a higher proportion of lower-priced homes) rather than a catastrophic fall in the sale of all homes. Further, while Williamsburg recorded one of the smallest declines in prices (only 12.1 percent), that city's unemployment rate also is among the highest of any city in the region and we already have detailed the problems that the Historic Triangle is having in attracting tourists and hotel patrons. The housing market in Williamsburg, however, has benefited from a continued influx of retirees and other people who are attracted by the city's cultural and recreational amenities.

Table 7 reports analogous data, but focuses solely on newly constructed homes in each city between 2006 and 2012. This shakes up the previous relationship; Portsmouth no longer is the outlier and Virginia Beach now surges to the front in terms of the smallest decline in median sales price. Note that the decline in the median sales price of a newly constructed home between 2006 and 2012 (21.7 percent) was larger than the comparable decline in the median sales price of an existing home (17 percent). As is usually true, new-home construction took the brunt of the adjustment when housing markets deteriorated.

TABLE 6

MEDIAN SALES PRICE OF EXISTING RESIDENTIAL HOMES IN HAMPTON ROADS BY CITY, 2007 AND 2012

City	Median Price 2007	Median Price 2012	Percent Change
Chesapeake	$250,100	$217,900	-12.9%
Norfolk	$195,000	$145,000	-25.6%
Portsmouth	$165,500	$107,000	-35.4%
Suffolk**	$257,500	$199,000	-22.7%
Virginia Beach	$245,000	$219,000	-10.6%
Hampton	$180,000	$135,000	-25.0%
Newport News	$199,250	$145,800	-26.8%
Williamsburg*	$284,450	$250,000	-12.1%
Hampton Roads	**$223,000**	**$185,000**	**-17.0%**

Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project.
*Williamsburg represents Williamsburg, James City County, York County and Gloucester County.
**Median price in Suffolk peaked in 2006 at $263,950.

TABLE 7 MEDIAN SALES PRICE OF NEW-CONSTRUCTION RESIDENTIAL HOMES IN HAMPTON ROADS BY CITY, 2006 AND 2012			
City	**Median Price 2006**	**Median Price 2012**	**Percent Change**
Chesapeake	$385,225	$268,750	-30.2%
Norfolk	$309,700	$235,000	-24.1%
Portsmouth	$287,015	$208,775	-27.3%
Suffolk	$368,500	$268,900	-27.0%
Virginia Beach	$380,725	$355,300	-6.7%
Hampton	$325,000	$259,450	-20.2%
Newport News**	$292,733	$233,293	-20.3%
Williamsburg*	$345,138	$266,298	-22.8%
Hampton Roads	**$349,900**	**$273,950**	**-21.7%**

Sources: Real Estate Information Network and the Old Dominion University Economic Forecasting Project
*Williamsburg represents Williamsburg, James City County, York County and Gloucester County.
**Median price in Newport News and Williamsbug markets peaked in 2005 and 2007 at $315,900 and $368,900, respectively.

Final Observations

The Great Recession pulverized regional housing markets. "It was the worst I had seen in 30 years," commented a shell-shocked real estate agent. Things have improved significantly since then. Prices and sales are up, inventories are down and the volume of distressed homes that flooded the market just a few years ago has declined.

Nevertheless, approximately one-quarter of all home sales in our region still involve distressed properties. We continue to be tied at the billfold both to the absolute volume of defense spending and its particular mix. We've largely avoided significant hurricane damage in recent years; however, rising sea levels render us increasingly vulnerable to very high levels of property damage and reductions in economic activity.

Finally, as always has been the case, civilians in Hampton Roads have very little ability to influence events in potentially explosive locations such as North Korea, the East China Sea, Syria and Iran. Adverse developments in such locations may represent bad news for the world and for the United States, but might represent good economic news for Hampton Roads if they result in a surge of additional military expenditures similar to those that occurred after 2001. Ironically, bad news for the world and the U.S. may represent good news for us, and vice versa. Such is the interesting nature of our economy and our housing markets.