

Housing Market Outlook 2010

Northern Virginia

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THE
CONCORD
GROUP

The following outlines The Concord Group's ("TCG") outlook on the Northern Virginia housing market. Northern Virginia, as defined by TCG, is comprised of the Arlington, Fairfax, Loudoun, Stafford, Fauquier, and Prince William Counties, including the independent cities of Alexandria, Falls Church, Fairfax, Manassas, and Manassas Park. The area is home to 2.3 million people living in 858,000 households and encompasses approximately half of the Washington, DC metro area's ("DC Metro") 2.4 million jobs. TCG's conclusions draw from demographic- and employment-driven demand assessments and various tools for evaluating supply levels and absorption velocity. Housing market recovery timing drives immediate acquisition, planning and disposition decisions. Our conclusions are derived within the context of our ongoing analyses in the region for developers, capital sources and public agencies.



Executive Summary

New home pricing and sales volume in Northern Virginia's housing market have declined considerably following the strong run-up from 2000 through 2005. However, economic factors and market trends suggest that Northern Virginia will be among the first areas in the United States to recover in terms of both increased home sales volume and home price appreciation. Below are key findings and conclusions from TCG's analysis:

- Northern Virginia, with Median income of \$96,000, one of highest income regions in U.S.
 - Loudoun, Fairfax, and Prince William Counties three of ten highest income counties in U.S.
- Resilient DC Metro economy among strongest in country
 - Employment has decreased from peak only 1.1% as of 4Q 2009.
 - United States down 5%
 - Chicago down 5%
 - Los Angeles down 7%
 - Las Vegas down 10%
 - Phoenix down 11%
- High growth area becoming increasingly built out
 - 2000 through 2009, added approximately 128,000 households (average 1.8% per year)
 - Loudoun County primary location for growth
 - County represents only 12% of total households in Northern Virginia, but 35% of household growth from 2000 through 2009
 - Northern Virginia household growth expected to slow to more moderate pace as area is built out and housing affordability and availability decrease

- Sales volume significantly below long-term annual demand potential; employment, credit market, and consumer confidence recoveries required to underpin sales
 - Average 11,000 per year 2000-2008; approximately 2,700 in 2009
 - Approximately 13,000 new units available (including actively selling and stalled communities, competitive foreclosures built since 2004, and finished lots)
- New home sales price down approximately 31% from peak, bringing prices approximately in line with historical affordability levels
- Major builders beginning to explore finished lot acquisition, with finished lot-to-home price ratios ranging from 30% at base to approximately 40% in most attractive locations
- TCG projects housing market recovery, defined as three to four new home sales per month per subdivision with low single-digit home price appreciation, in 3Q 2011 with demand for new finished lots in 3Q2010 and re-entitlement and repositioning opportunities immediately.

Area Characteristics and Economic Drivers

Northern Virginia, as defined by TCG, is comprised of Arlington, Fairfax, Loudoun, Stafford, and Prince William Counties, including the independent cities of Alexandria, Falls Church, Fairfax, Manassas, and Manassas Park. Northern Virginia is home to 2.3 million people living in 858,000 households. Once a suburban bedroom community for the Washington, DC employment core, the area is now a mix of urban and suburban patterns, with 1.4 jobs per household (compared to the national average of 1.2 jobs per household). Northern Virginia comprises approximately 50% of total DC Metro employment, and major job centers in the area include Herndon, Reston, Rosslyn and Tysons Corner. Northern Virginia is one of the highest income regions in the United States. Loudoun, Fairfax, and Prince William Counties are three of the ten highest income counties in the United States.

	<u>2000</u>	<u>Peak</u>	<u>2009</u>	<u>2000-2009</u>	<u>Peak-Current</u>
Washington, DC Metro Area*					
Employment - Total (in 000s)	2,132	2,432 (08)	2,405	12.8%	-1.1%
Government	483	572 (09)	572	18.2%	n/a
Prof. & Business Svcs.	445	559 (08)	557	25.2%	-0.4%
Educational & Health Svcs.	215	272 (09)	272	26.4%	n/a
Information	108	108 (00)	70	-35.3%	-35.3%
Manufacturing	53	53 (00)	38	-28.2%	-28.2%
Northern Virginia					
Population (in 000s)	1,963	2,318 (09)	2,318	18.1%	n/a
Households (in 000s)	731	859 (09)	859	17.5%	n/a
New Home Sales (Closings)	12,505	17,999 (05)	2,724	-78.2%	-84.9%
Median New Home Price**	275,800	597,600 (05)	409,700	48.5%	-31.4%
* DC Metro area includes District of Columbia, Calvert Co, Charles Co, Prince George's Co, Arlington Co, Clarke Co, Fairfax Co, Fauquier Co, Loudoun Co, Prince William Co, Spotsylvania Co, Stafford Co, Warren Co, Alexandria City, Fairfax City, Falls Church City, Fredricksburg City, Manassas City, Manassas Park City, Jefferson Co					
** Excludes Stafford, Arlington, and Fauquier Counties; data available only for Loudoun, Prince William, & Fairfax Counties					

Employment

Northern Virginia economic and demographic conditions are linked to those of the greater Washington, DC metro area ("DC Metro"). The DC Metro economy has significantly outperformed that of the overall United States during the recession. Since peaking in 2008, DC Metro employment has decreased by only 1.1% as of 4Q 2009. In comparison, United States employment has decreased approximately 5% from peak while employment in Chicago, Los Angeles, Las Vegas and Phoenix has decreased from peak by 5%, 7%, 10%, and 11%, respectively.

Three primary industry sectors that drive the DC Metro economy are: Government; Professional and Business Services; and Education and Health Services. The Government sector and the Education and Health Services sector, which comprise approximately 24% and 11%, respectively, of total DC Metro employment, have *added* jobs during the recession. The Professional and Business Services sector employment, which comprises approximately 23% of total employment, has declined by less than a half percent from peak.

In keeping with national trends, the two sectors with the greatest employment decline in DC Metro were Information and Manufacturing. Information sector employment, which comprises approximately 3% of total jobs, decreased by 35% from 2000 to 2009. During the same time period, Manufacturing sector employment, which comprises less than 2% of total jobs, declined by approximately 28%.

Demographics

Northern Virginia has experienced strong household growth since 2000. From 2000 through 2009, the region added approximately 128,000 households, representing an average annual growth rate of 1.8%. In comparison, the average annual growth rate for the overall United States is approximately 1.1%. Within Northern Virginia, Loudoun County has been the primary location for growth. The county represents only 12% of total households in Northern Virginia, but accounted for 35% of household growth in the region from 2000 through 2009. Looking ahead, growth in Northern Virginia is expected to slow to a more moderate pace as growth nodes such as Loudoun County become built out and housing affordability and availability decrease.

Job Creation and Housing

The growth in the DC Metro housing market during the 2000s was proportionate to job creation in the metro area during that time. While many housing markets during the boom were fueled by speculation and other ephemeral factors, DC metro averaged 1.7 new jobs for every housing start from 2000 through 2008. In comparison, during that same period, the United States averaged only 0.5 new jobs per housing start. DC Metro's favorable jobs-to-housing ratio suggests that the region did not generate an oversupply of housing the way that many other metro areas did during the housing boom.

Home Sales and Prices

Volume

Despite relatively strong underlying employment conditions, Northern Virginia has experienced a major decline in new home closings volume. There were approximately 2,700 new home closings in Northern Virginia in 2009, 85% below peak (18,000 closings in 2005). Recent sales volume – a more timely barometer of market conditions than closings – indicates a significant increase over the closings trough of 2009. Illustrating this trend, overall DC Metro 3Q 2009 new home *closings* volume was 15% below 3Q 2008 volume, while new home *sales* volume was approximately 40% higher than in 3Q 2008.

Prices

Following a sharp run-up from during the housing market boom, new home prices in Northern Virginia have declined markedly over the past several years. From 2000 through 2005, median new home price increased an average of 17% per year, from \$276,000 to a market peak of \$598,000. From 2005 through 2009, median new home price decreased an average of 7% per year to reach approximately \$410,000. The price correction has brought affordability levels back in line with historical norms, based on current income levels and conservative interest rate assumptions.

Foreclosures

DC Metro has the 13th highest REO rate (REO inventory as a percent of total mortgageable properties) among major metro areas in the United States. According to the Brookings Institution, REO inventory comprised 0.7% of mortgageable properties in the metro area in September 2009. In comparison, the REO rate was 1.7%, 1.2%, 0.5%, and 0.2% in the Las Vegas, Phoenix, Chicago, and Boston metro areas, respectively. The average REO rate for the top 100 US metro areas was 0.4% (approximately 40% lower than in DC Metro).

Suburban areas have accounted for a large share of foreclosure activity in DC Metro, driven in part by the high volume of new home deliveries during the housing boom and by elevated subprime loan activity. Three Northern Virginia counties (Prince William, Loudoun, and Stafford) are among the five counties with the highest REO rates in DC Metro.

Land Market

Builder demand for finished lots has increased over the past quarter in prime locations such Loudoun County. Major builders with substantial capital are targeting deals with small to moderate lot counts (i.e., 25 to 50 finished lots), planning for home closings in 2010 while limiting their risk exposure. Finished lot-to-home price ratios range from 30% at the base to approximately 40% in the most attractive locations. Given the remaining supply of available inventory – approximately 13,000 units total in actively selling and stalled communities, competitive foreclosures built since 2004 and finished lots – builder demand for paper lots is minimal. However, private capital groups have begun to evaluate paper lot positions in the “A” locations within Northern Virginia.

TCG Market Outlook

TCG analyzed published employment projections, household growth forecasts, household turnover, homeownership data, affordability and financing assumptions, and other factors to quantify new home demand potential by price segment within Northern Virginia. TCG projects long-term Northern Virginia demand potential for approximately 9,500 new homes annually. In comparison, there was an average of approximately 11,000 new home sales annually from 2000 through 2008, with a peak of 18,000 in 2005. Economic struggles and poor consumer sentiment will prevent the market from reaching intrinsic demand levels until 2012. In the interim, some velocity increase is expected in 2010 and 2011, assuming employment projection accuracy and credit market relief.

TCG projects housing market recovery, defined as three to four new home sales per month per subdivision, with low single-digit home price appreciation, in 3Q 2011. Demand for new finished lots is projected to precede housing recovery by 12 months (3Q 2010). As such, reentitlement and repositioning strategies will need to commence immediately in order to prepare for lot deliveries in late 2010 and home sales in late 2011. When assessing lot acquisitions and/or asset management strategies, rezoning or re-entitlement options should be carefully considered. Based on TCG’S experience, reducing infrastructure costs (on and off-site) and/or home sizes (and therefore nominal cost and sales price) are key strategies to target buyer preferences and to maximize absorption potential in today’s market.

Richard M. Gollis

Principal

949.717.6450

rmg@theconcordgroup.com

Jeffrey R. Glew

Director

617.451.1100

jrg@theconcordgroup.com

About The Concord Group

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