Review of Regional Market Conditions and Trends

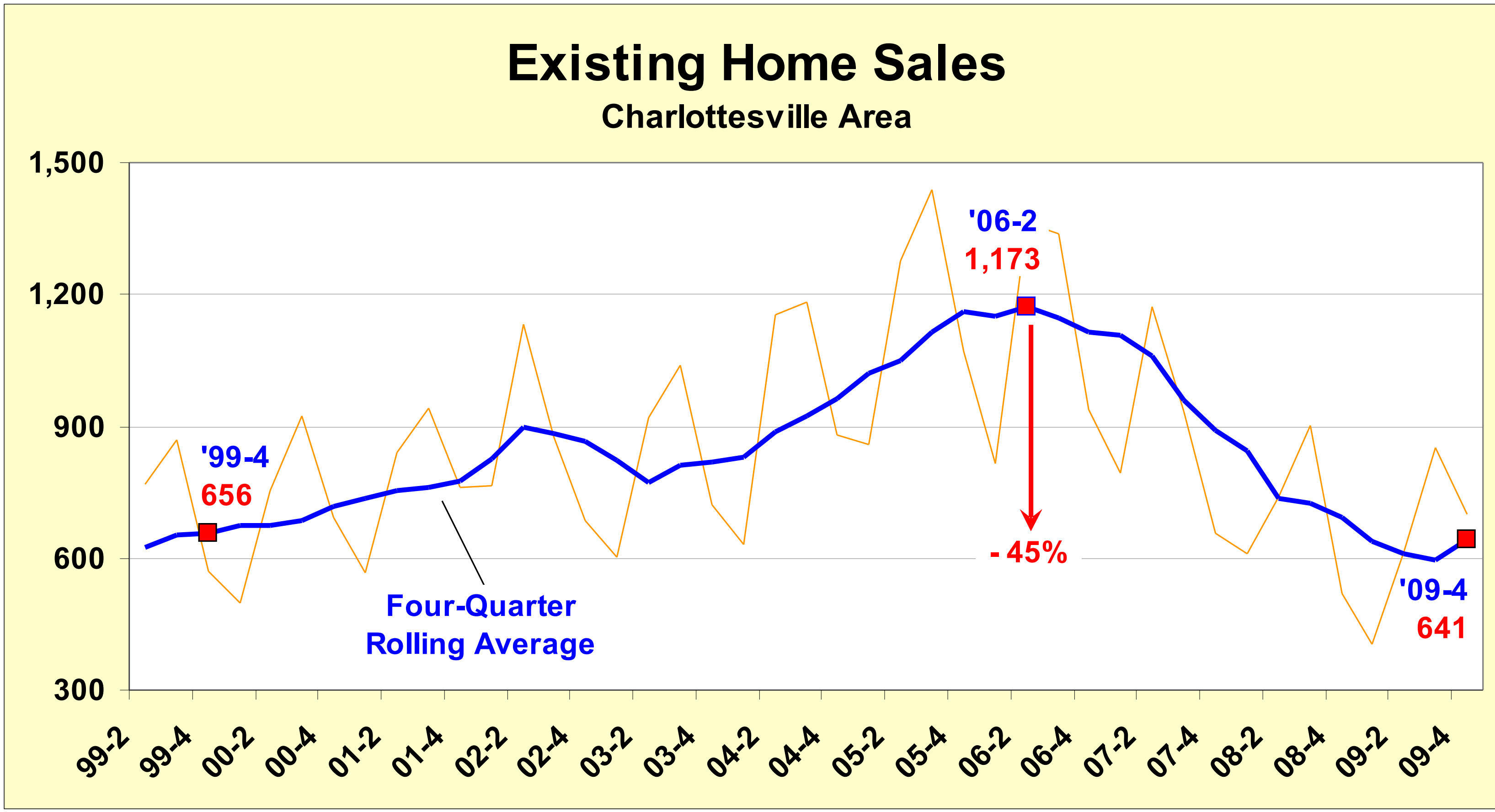
Charlottesville Area Association of Realtors
February 4, 2010

Virginia Housing Development Authority

VHDA®

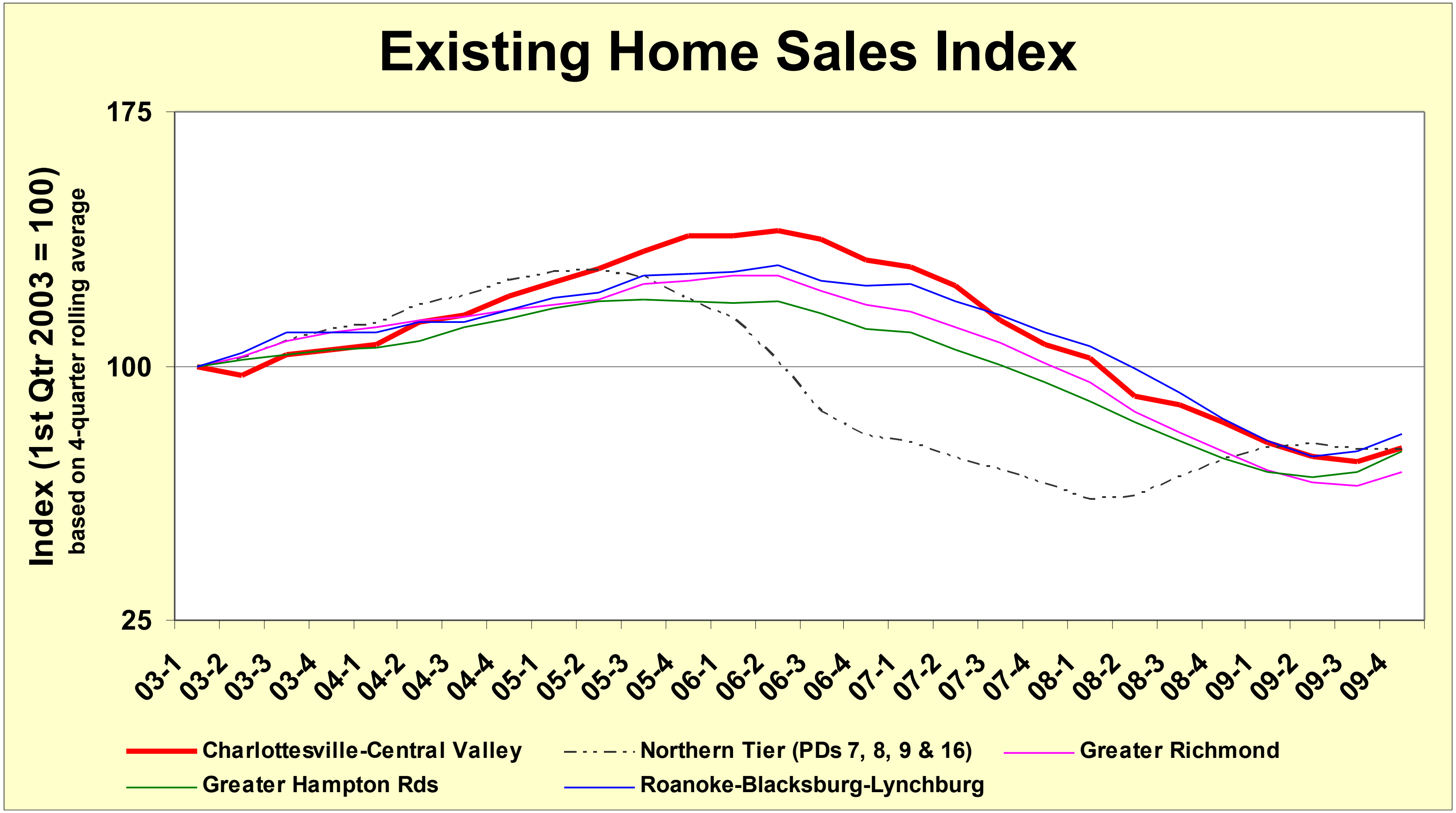
The Charlottesville area housing market has begun a slow recovery

Home sales hit bottom in the 3rd Quarter, but remain below the level of a decade ago



Source: VAR

The Charlottesville market continues to track other "downstate" markets



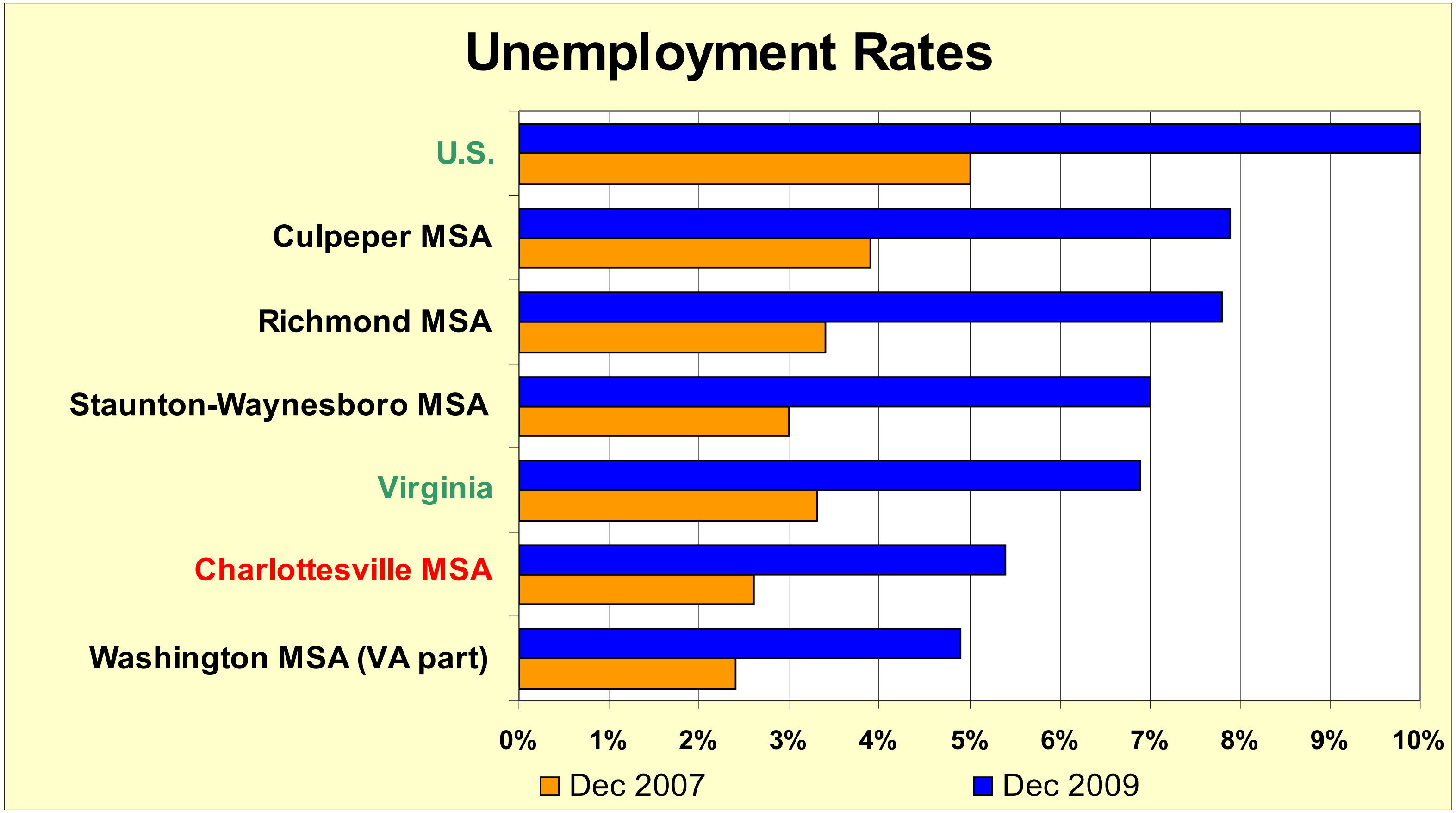
Source: VAR

Four things are needed in order to achieve sustained housing market growth:

1. Recovery of employment
2. Stabilization of home prices
3. Reduction in mortgage defaults
4. Revival of a stable private mortgage market

Employment

Unemployment is up sharply, but is well below rates in most markets

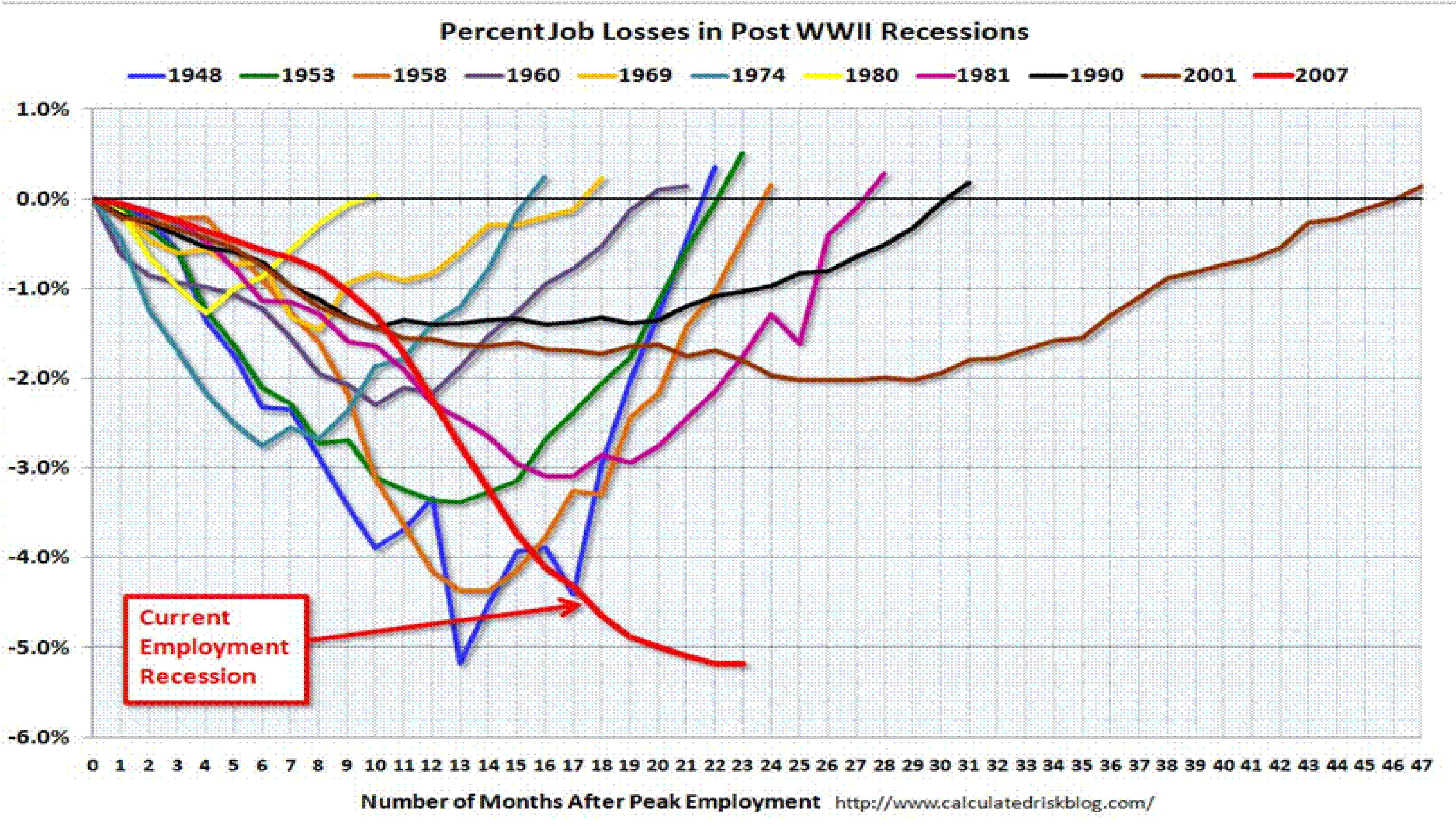


Source: Bureau of Labor Statistics and Virginia Employment Commission

Weak employment will likely remain a significant market drag

- Area employment is stabilized by large public and agricultural sectors, and a lower share of manufacturing jobs than in other markets.
- However, employment and income levels could suffer from prolonged state and local fiscal distress.
- The losses in employment and income have been steep and will take time to recoup.

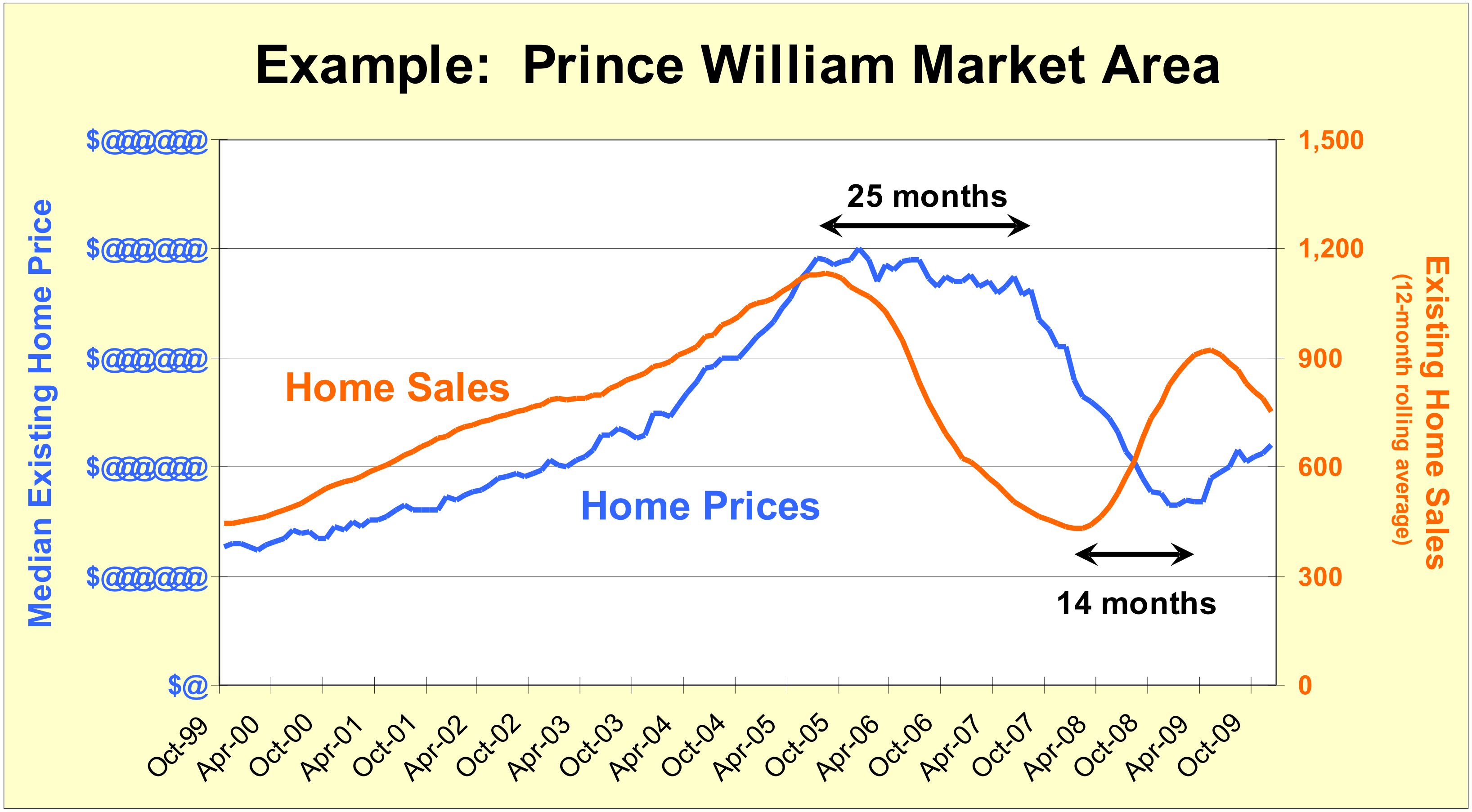
The recovery in jobs will take longer than in all but the 2001 recession



Data for the 2007 recession is through Nov 2009

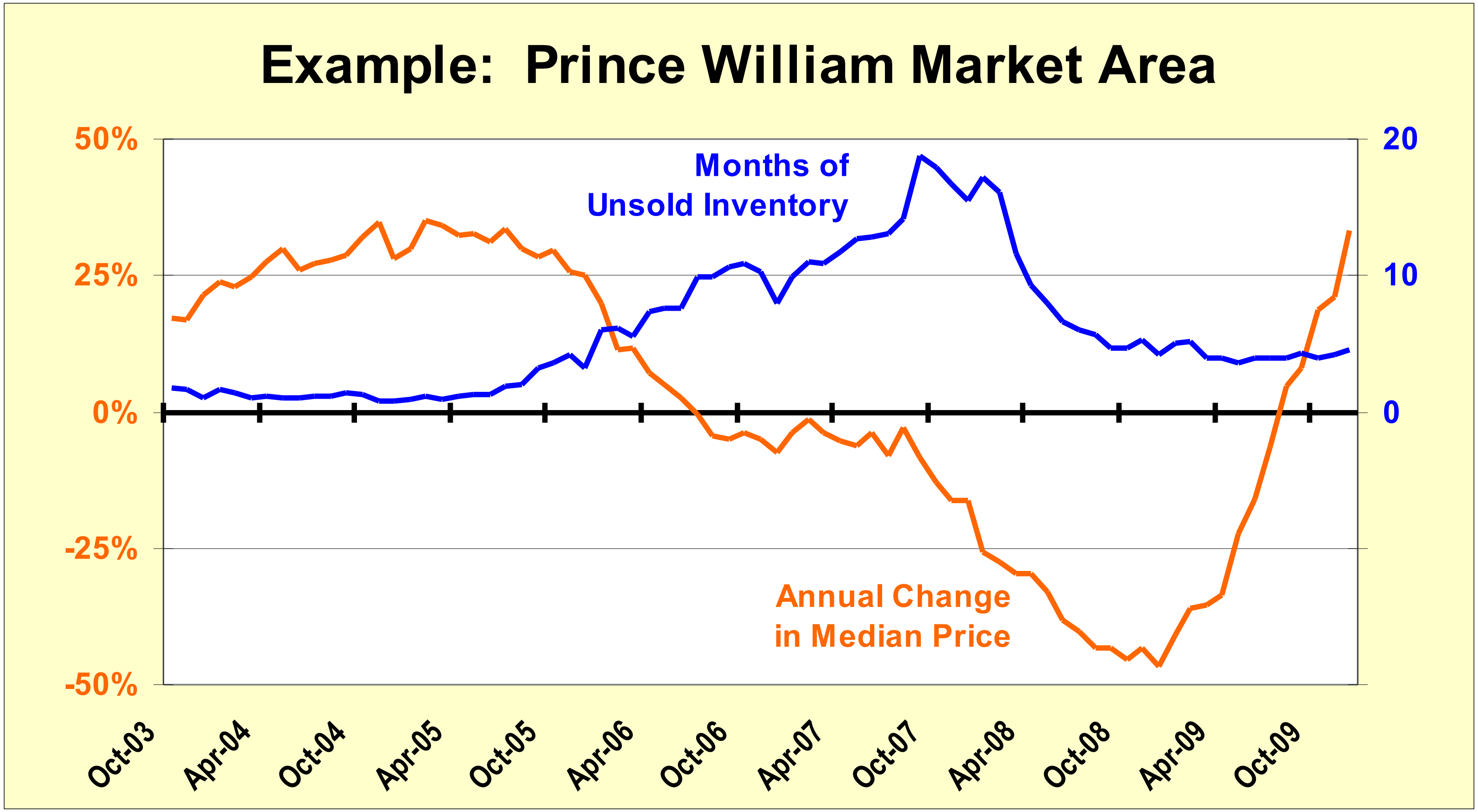
Home Prices

Price changes generally lag behind changes in sales volume



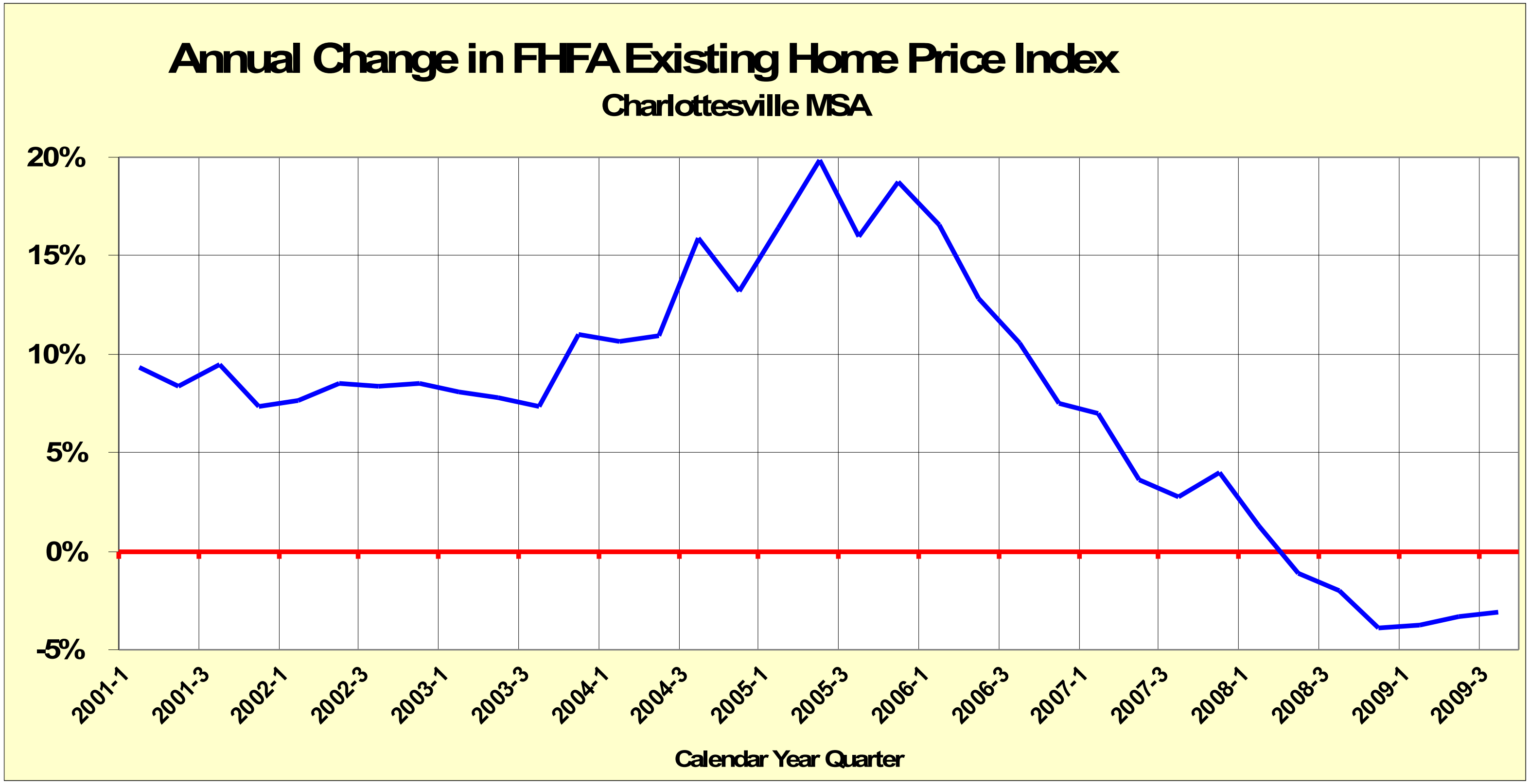
Source: MRIS

Unsold inventory must first decline in order to put a floor under prices



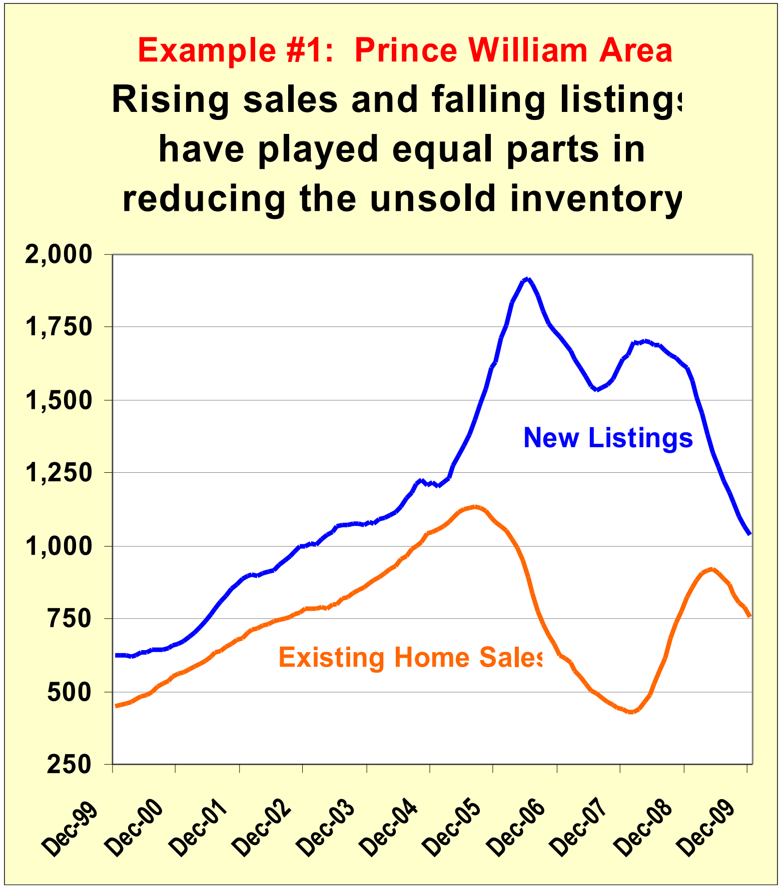
Source: MRIS

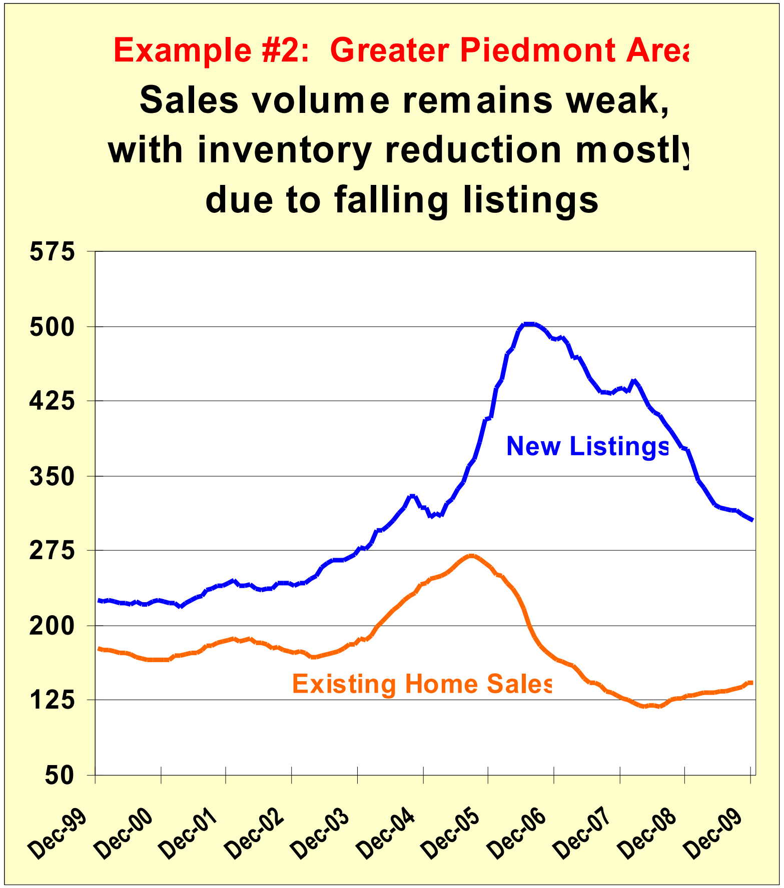
The Charlottesville area's unsold inventory is still large and must decline further in order for home prices to stabilize



Source: Federal Housing Finance Agency (FHFA)

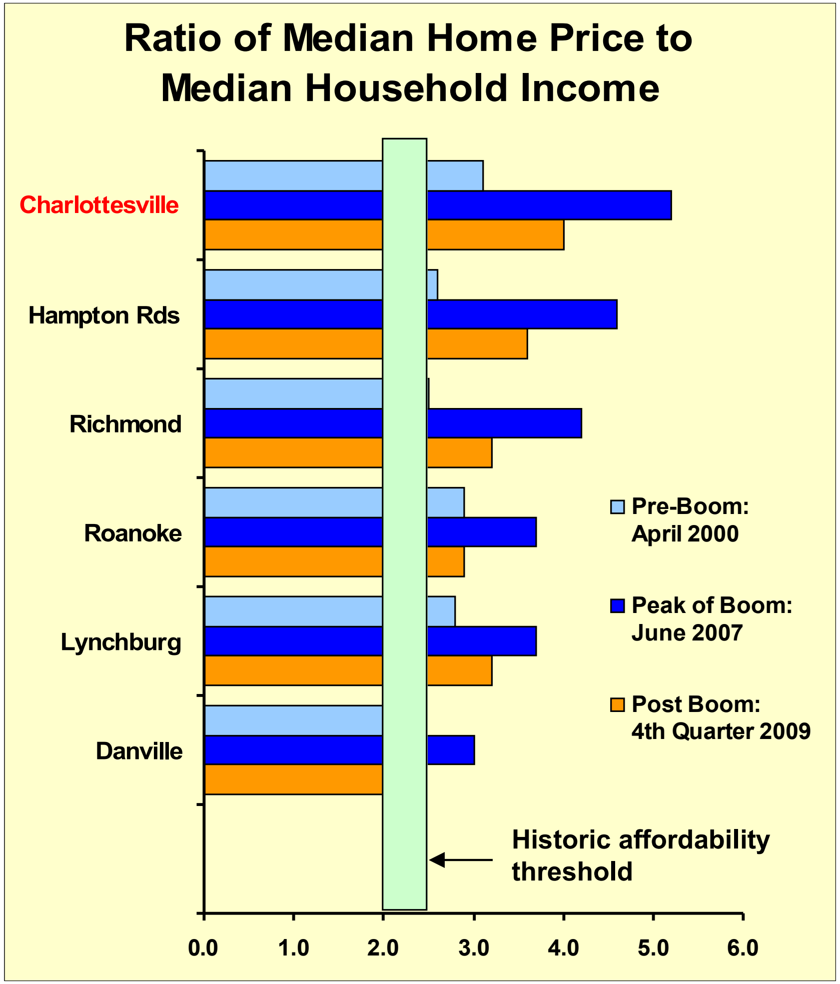
In the Northern Tier, the reduction in unsold inventory has occurred in two ways





Source: MRIS / data reflect 12-month rolling averages

Increased affordability is still needed in Charlottesville to sustain increased sales



Source: VAR and Census Bureau

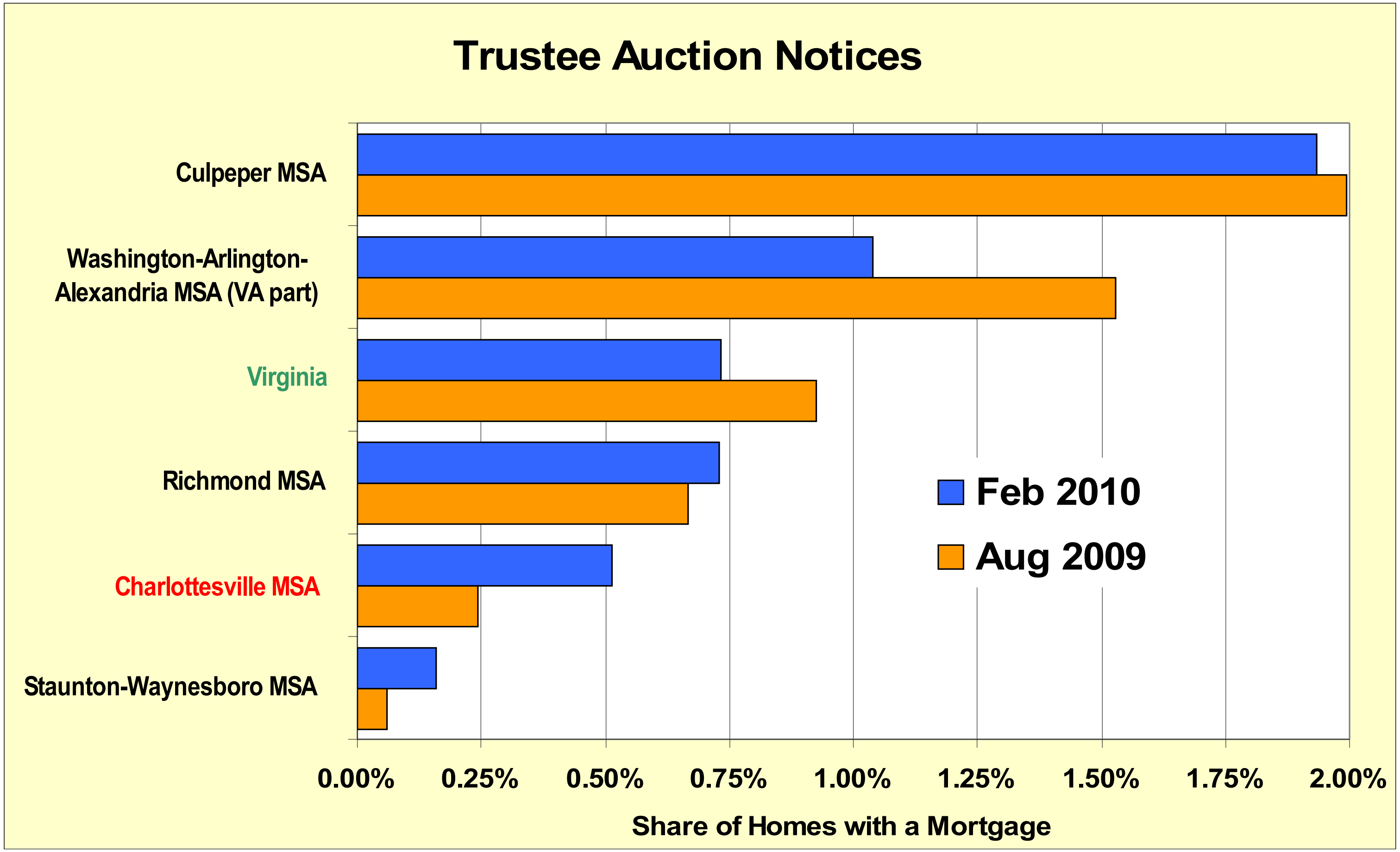
- In the Northern Tier—especially in Pr. William—price declines have returned affordability to pre-boom levels.
- Downstate, prices are still correcting (chart), with Charlottesville prices remaining most out-of-line with affordability norms.

Home prices continue to face several major headwinds

- Tightened credit and down payment requirements offset declining sales prices.
- During the boom, rising prices in the adjacent and much larger Northern Tier and Greater Richmond markets supported price inflation in Charlottesville.
- Now the substantial inventory of distressed homes in the Northern Tier and economic weakness in Greater Richmond undercut the area's ability to sustain higher values.
- The federal tax credit has put a floor under sales and prices, but has not generated a strong enough market rebound to fully offset the strong foreclosure and economic undertows.

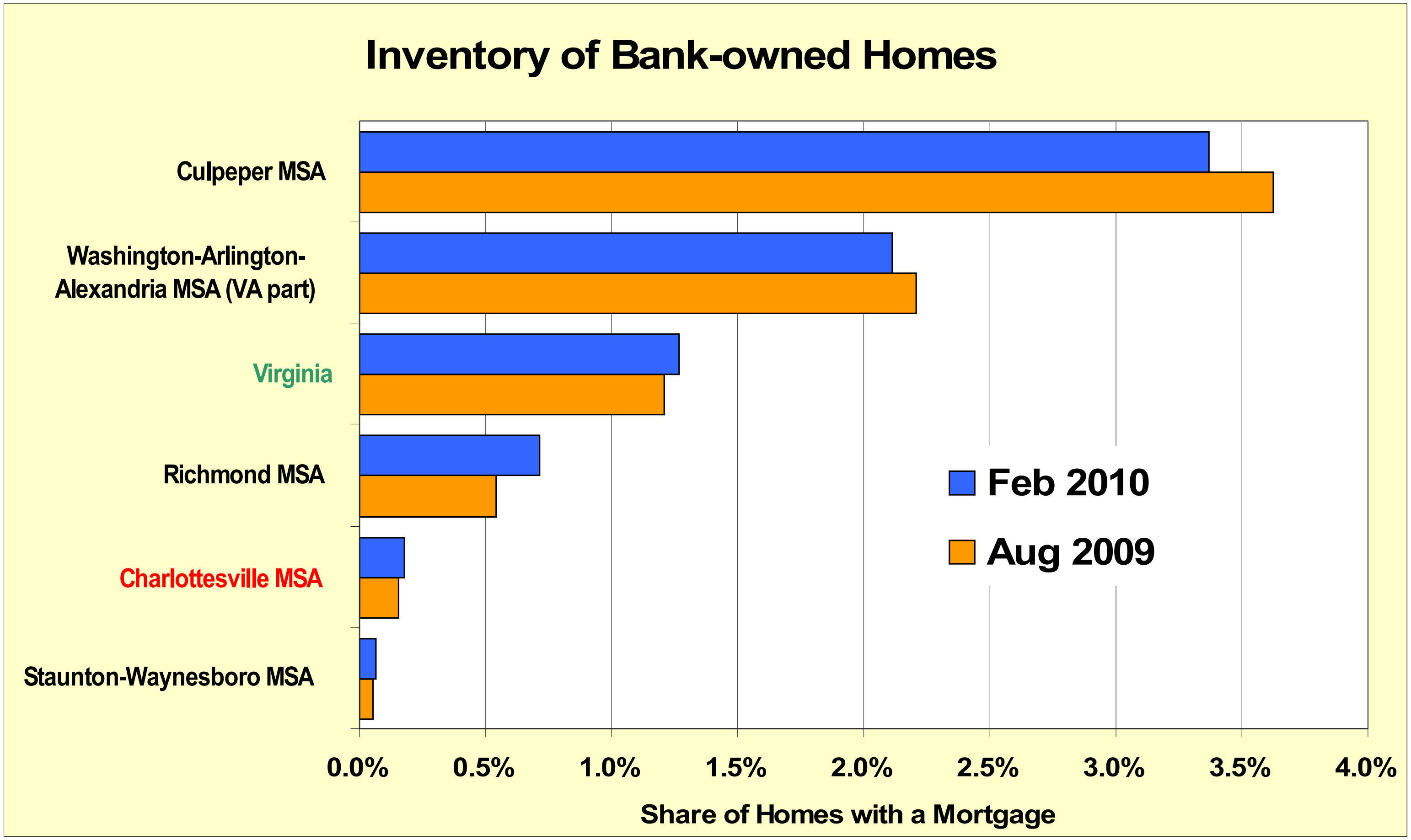
Mortgage Defaults

Area foreclosures are rising, but remain relatively low



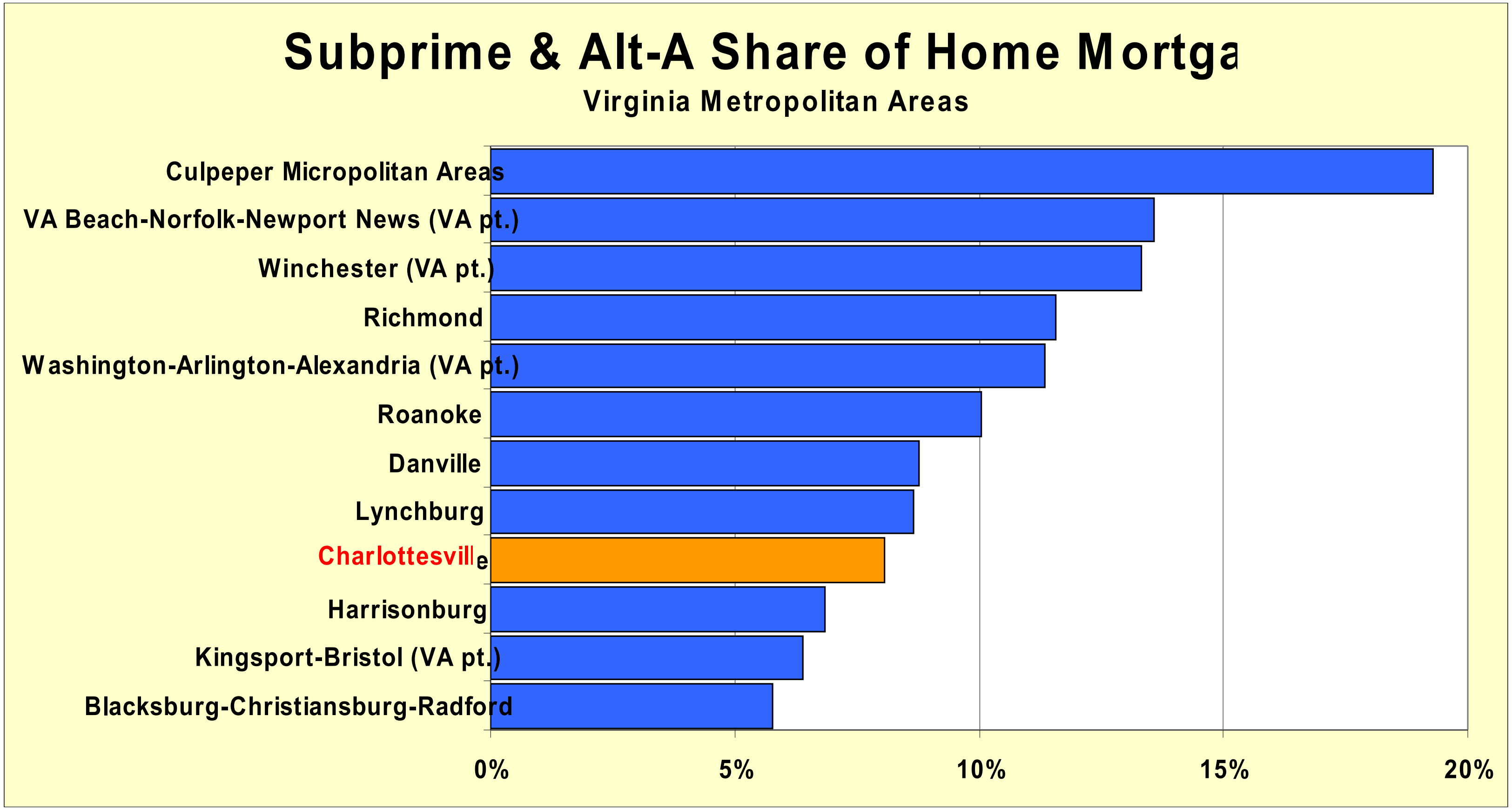
Source: RealtyTrac and Census Bureau

Rising area foreclosures have not created a large "distressed" inventory



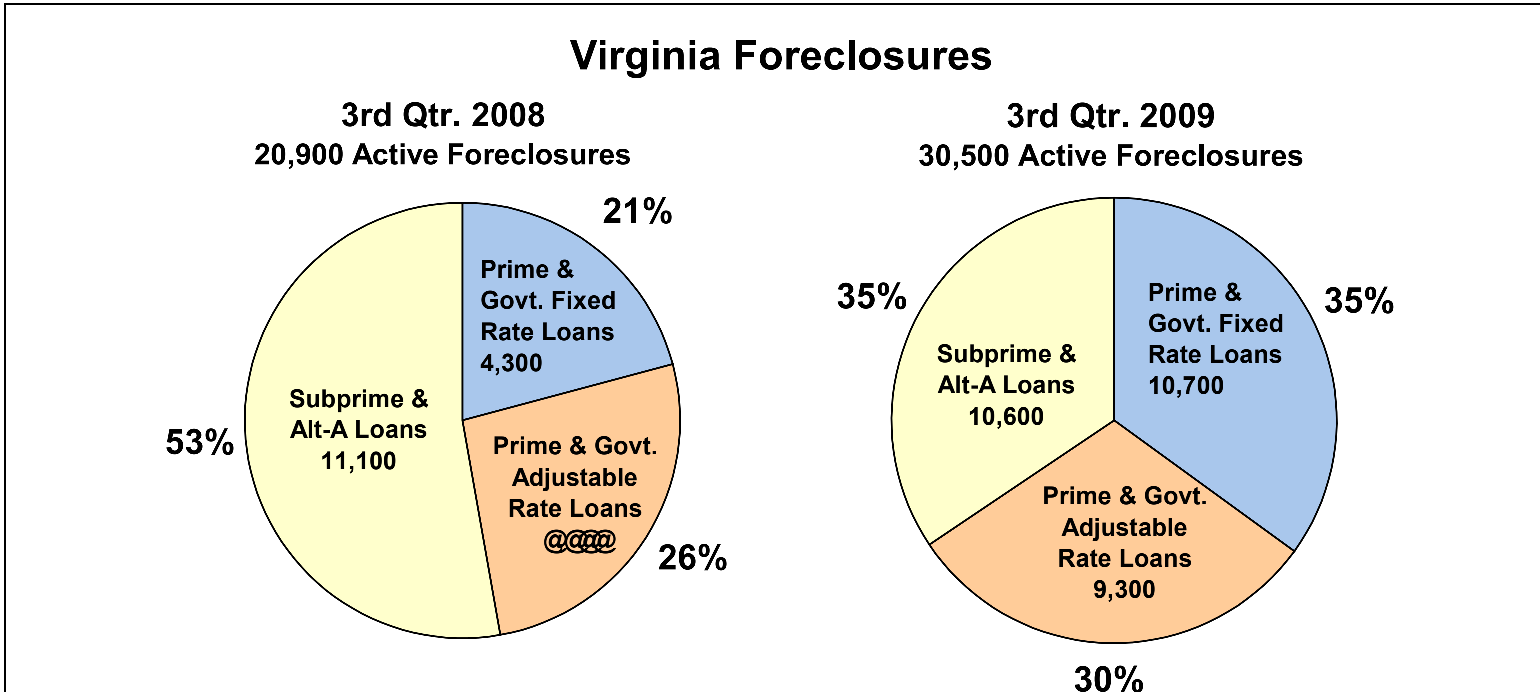
Source: RealtyTrac and Census Bureau

Lower area foreclosures are the result of fewer high-risk loans



Source: 1st American CoreLogic and Census Bureau

The recession was triggered by foreclosures on high risk loans, but now unemployment is driving a new wave of mortgage defaults

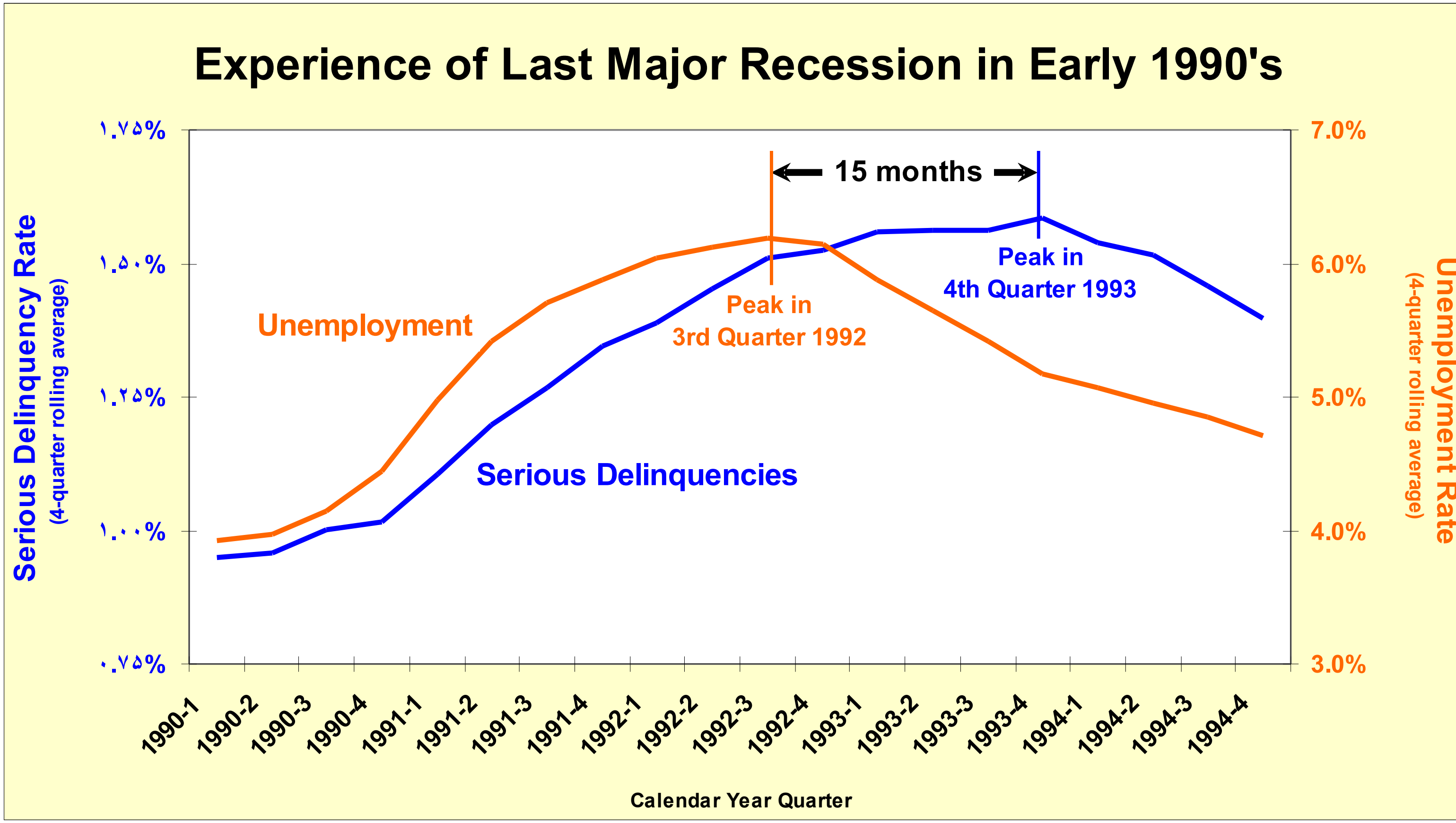


Change 2008 to 2009

Subprime Foreclosures	- 500
Prime & Govt. ARM Foreclosures	+ 3,800
Prime & Govt. Fixed Rate Foreclosures	+ 6,400

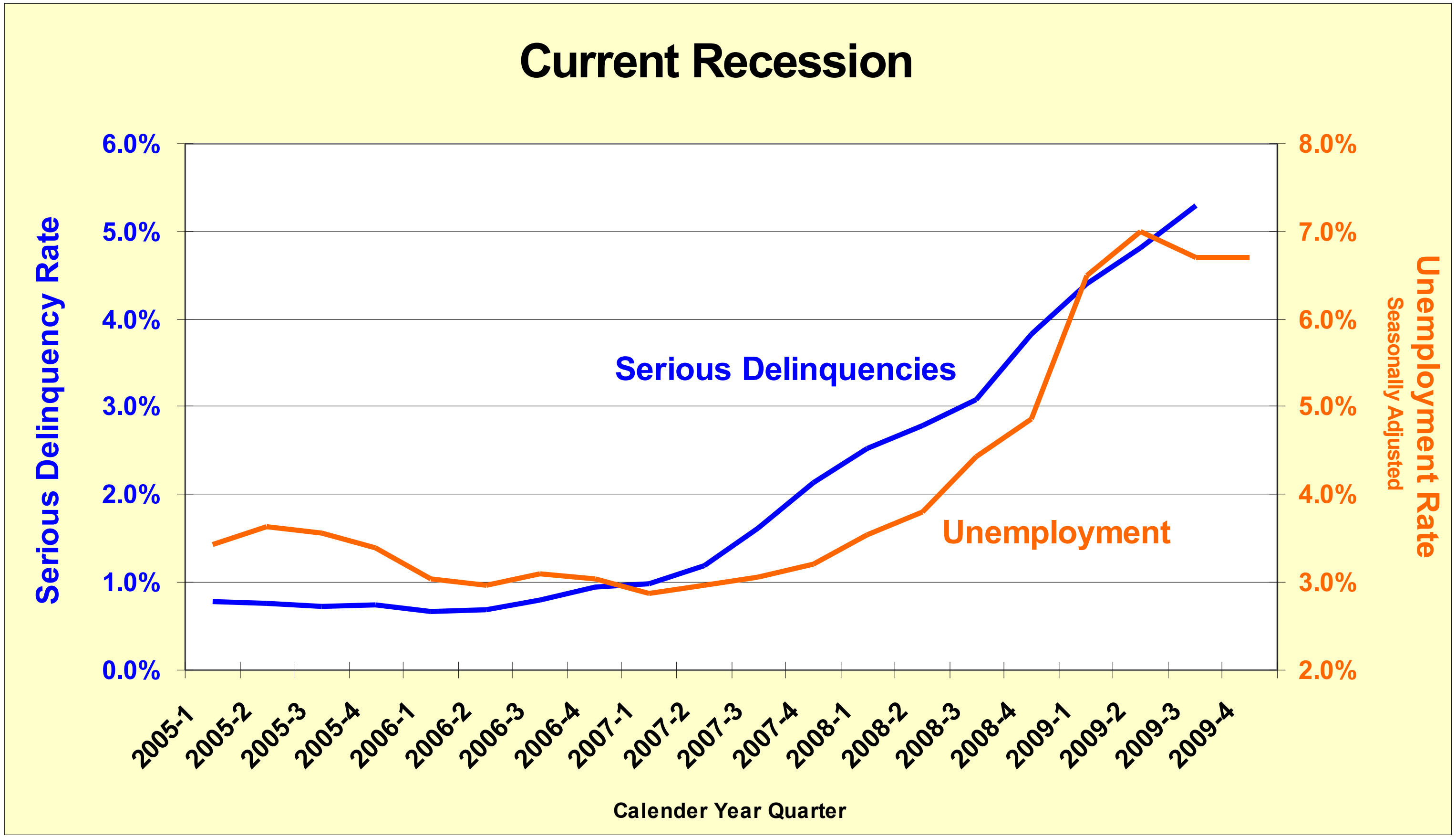
Source: Mortgage Bankers Association (MBA)

In the past, delinquency was driven by job losses, and lagged recovery



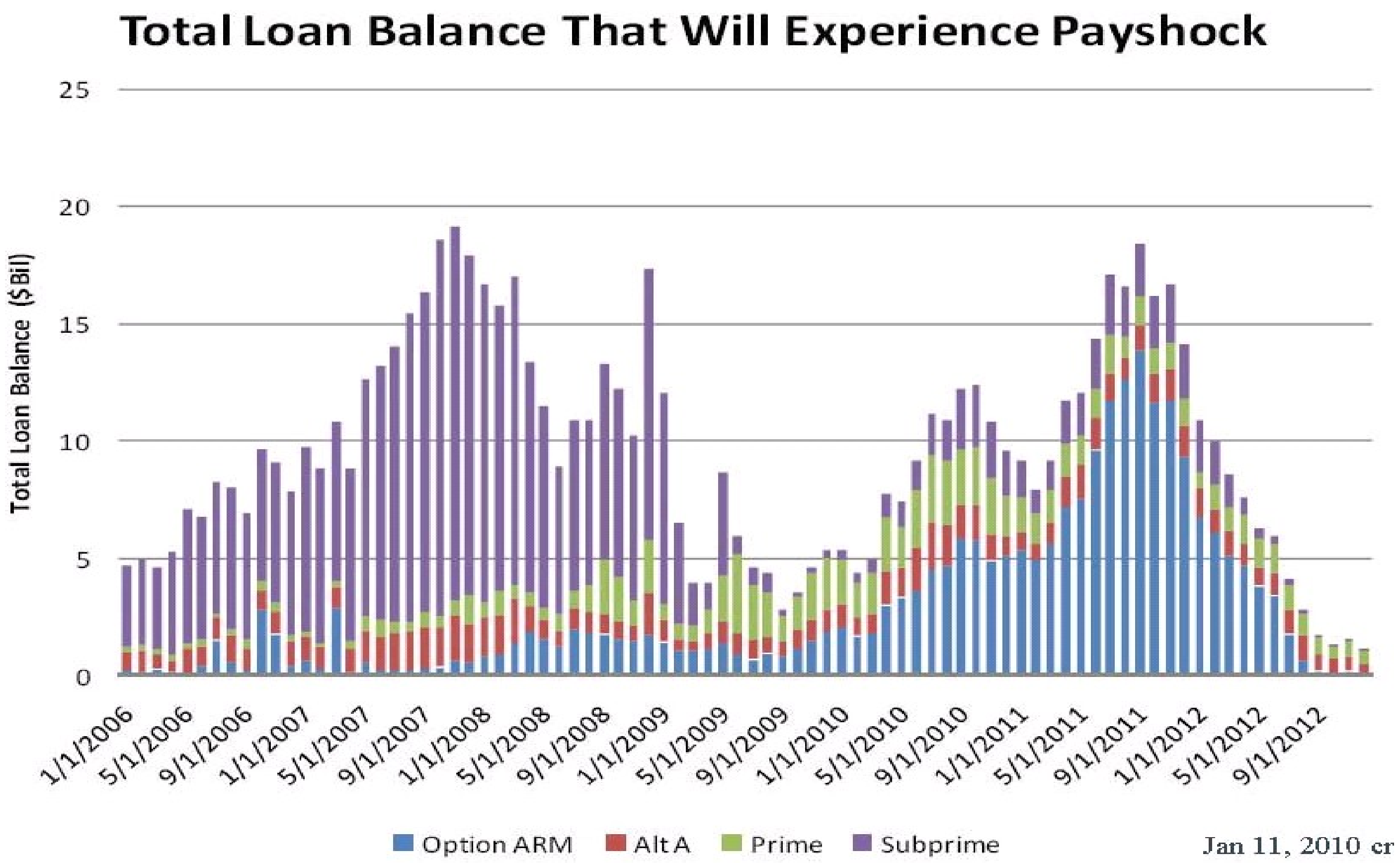
Source: Mortgage Bankers Association (MBA) and Virginia Employment Commission (VEC)

This time, defaults led job losses, but are still likely to trail a jobs recovery



Source: Mortgage Bankers Association (MBA) and Virginia Employment Commission (VEC)

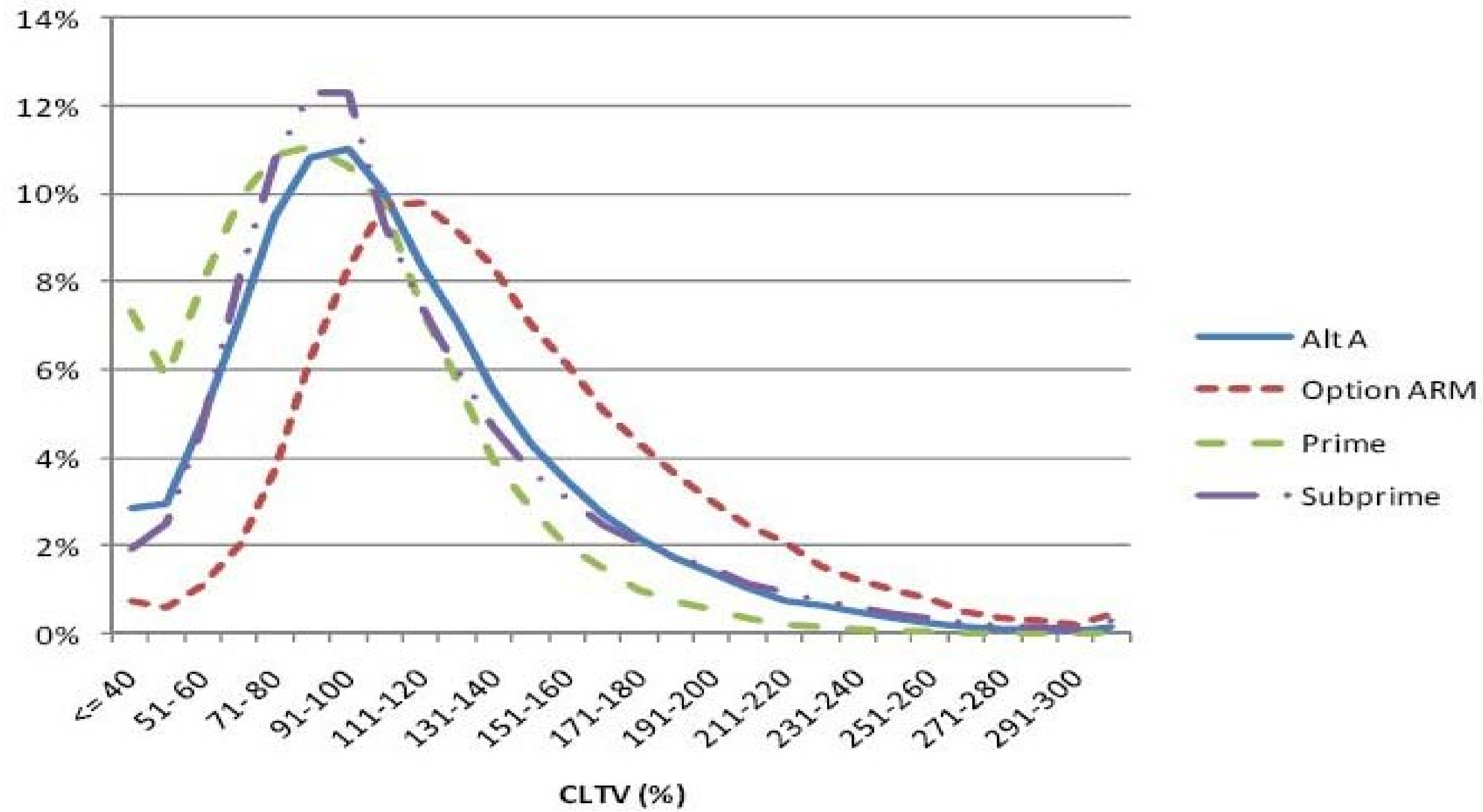
The wave of sub-prime resets is over, but "option ARMs" are now at risk



Source: Loan Performance, Amherst Securities

A large majority of “option ARMs” is substantially “under water”

Balance Distribution (by CLTV), January 2010



Source: Loan Performance, Amherst Securities

Problem loans, depressed prices and unemployment will keep defaults high

- “Option ARM” loans pose major risk of loss. Loan resets could generate “strategic” defaults that would destabilize weak local markets.
- Distressed properties and tightened credit standards continue to depress values, and keep a large share of mortgages “under water.”
- Now, unemployment is driving growing numbers of homeowners into default, especially those who are under water and cannot sell.

Mortgage Markets

The mortgage market remains highly reliant on federal intervention

- The private mortgage-backed securities market remains dysfunctional, with access to affordable capital still dominated by governmental entities (the GSE’s and Ginnie Mae).
- Non-conforming / non-government loans—especially jumbo mortgages—still pay premium prices.
- The federal government continues to stimulate the market with historically low rates and tax credits.
- However, two competing goals are being balanced—1) stimulus to the market & homeowner debt relief **versus** 2) reduction in losses to FHA and the GSEs.

The stimulus tax credit is only partially offsetting the impact of tighter credit

- Minimum credit scores, tighter lending ratios and risk-based pricing—including higher mortgage insurance premiums—are reducing the pool of first-time buyers.
- VHDA is continuing to provide a flow of flexible capital through Ginnie Mae securitization and the sale of tax-exempt housing bonds to the GSEs through the Treasury's bond support initiative.
- Our "Homebuyer Tax Credit Plus" and "FHA Plus" programs are providing needed down payment assistance.
- VHDA and other state housing finance agencies are working with FHA to preserve flexible lending standards while addressing the need for prudent risk management.

In 2010, there are four challenges in weaning the market off federal support

1. Maintaining a delicate balance between market stimulus and curtailment of credit risk
2. Modifying distressed but viable loans on a sustainable basis that does not merely postpone lender losses
3. Containing “strategic” defaults
4. Enabling private capital markets to restart without creating credit shortfalls and/or a spike in mortgage rates

2010 brings major unresolved questions as federal industry reform gets underway

– What impact will new federal regulatory structures have on the availability and affordability of mortgage financing?

– Can the private MBS and PMI markets achieve sustained recovery?

– What is the future of Fannie Mae and Freddie Mac?

– How large a role can and should FHA play?

What is the market outlook?

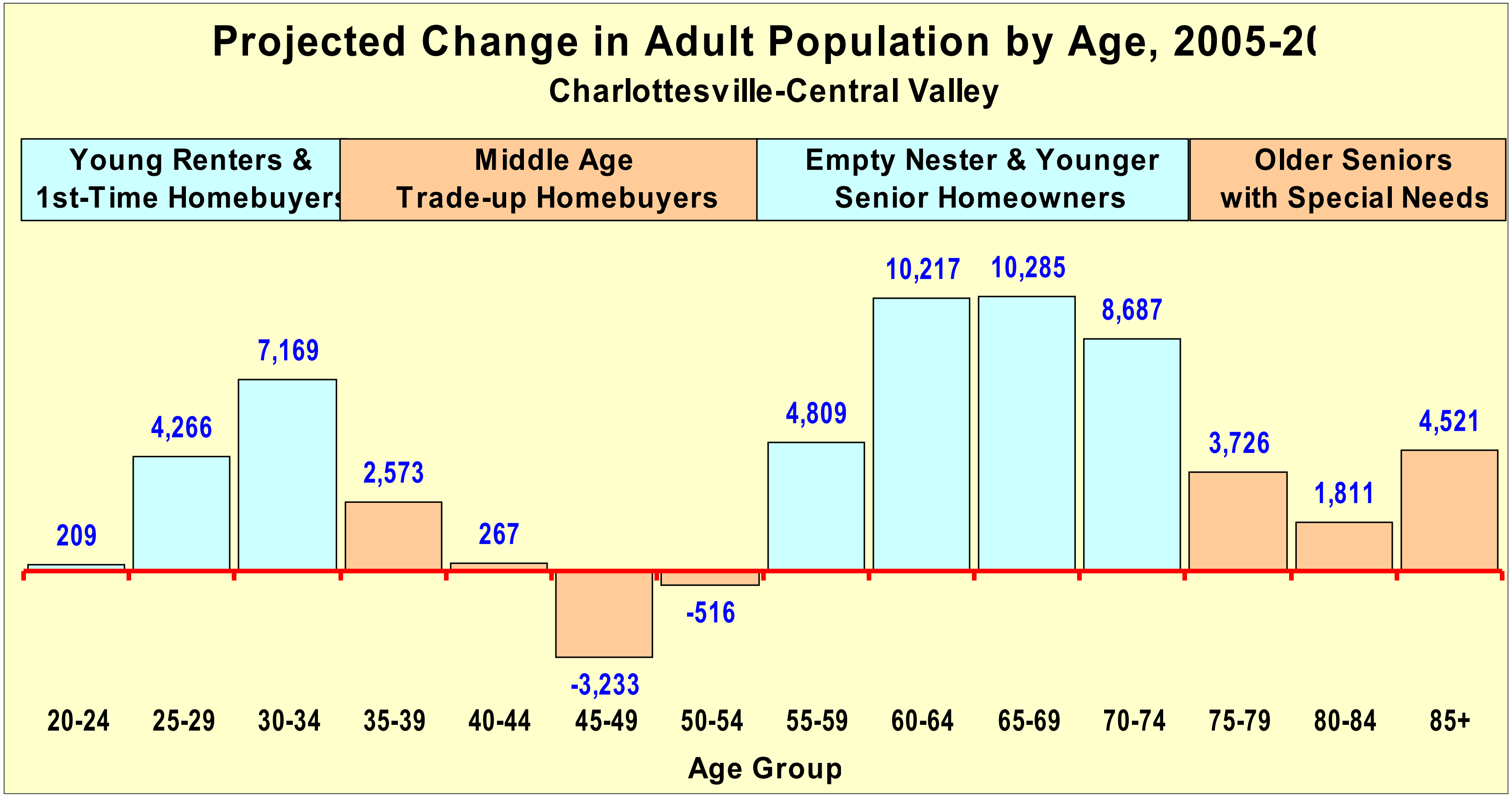
The Charlottesville area market is likely to remain weak in 2010 and into 2011

- Home sales, while rising, are likely to remain below the pre-boom levels of the first half of this decade.
- Prices will remain depressed until inventories are further reduced and the foreclosure rate declines.
- The ongoing severity of loan defaults will depend on how much further unemployment rises, how long before jobs growth returns, and the magnitude of further price declines.

Longer-term prospects for the Charlottesville market are bright

- The local economy is strong and poised for growth.
- The region is projected to experience balanced demographic growth—
  - Household growth will be much stronger than in southern and western parts of the state with less severe impact of “graying” on growth as the population ages
  - Nor will the region experience the growth challenges faced by the Northern Tier.
- Nonetheless, the market will experience fundamental demographic shifts with demand looking very different from the recently ended “trade-up” boom.

Market demand will be dominated by first-time buyers and early retirees



Source: VEC and Census Bureau

VHDA

Recovery depends as much on federal actions as on traditional demographic and economic drivers

- The federal restructuring of the mortgage market will reset the playing field for who can obtain mortgage credit and under what terms and conditions.
- In turn, this will drive who enters the home purchase market and the type of home they choose to buy.
- Over the next decade, these changes, coupled with a generational shift in demographic market drivers, will fundamentally alter the housing market as we have come to know it.