

The “New Normal” for the Washington, DC Metropolitan Region:

The Retail & Real Estate Perspective

**Metropolitan Washington Council of Governments
November 10, 2009**



A.J. DWOSKIN
& ASSOCIATES, INC.

REAL ESTATE DEVELOPMENT & MANAGEMENT

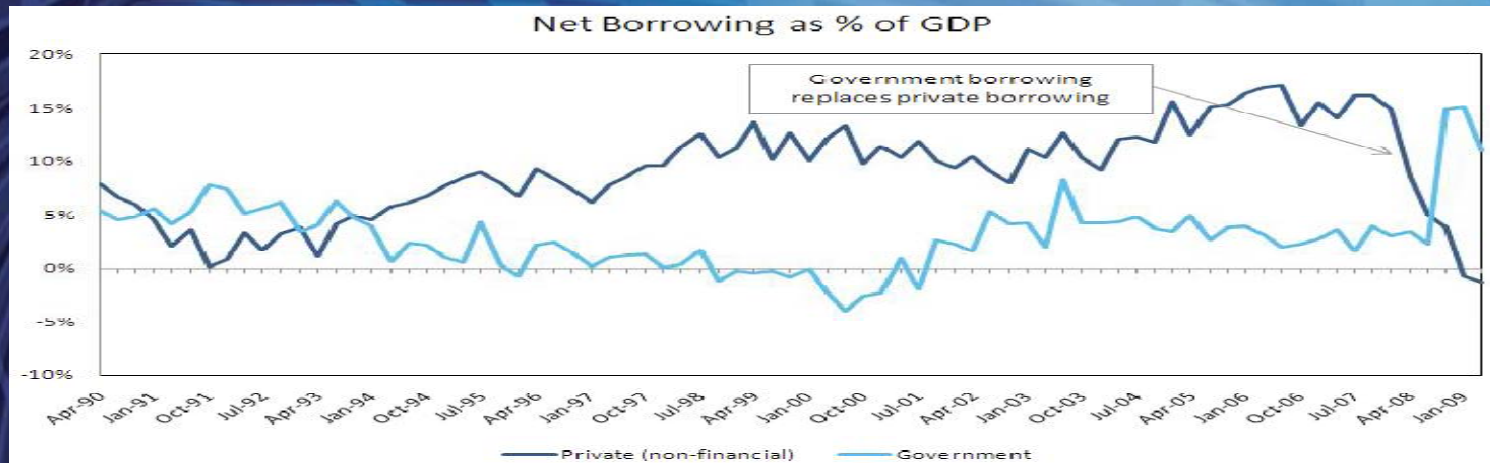
Order of Presentation

- Introduction
- Housing
- Consumer Spending
- Commercial RE
- Finance
- Local Government

Why the Research

- Response to information gap: Local perspective on the credit crisis given less attention
- Focus on Northern Virginia extended to Washington, DC area
 - Our view: This region better off than other regions, especially close-in areas
 - Employment levels higher than national average
 - Proximity to Washington, DC.
- Advantage: relevant data in one place
- Intention
 - Data-based trend analysis and insights for policy making
 - Audience: local government officials, business leaders, thought leaders

Macroeconomic Adjustment I: Unsustainable Budget Deficit



- **Federal government demand for funds rising to record levels**
 - Support of financial and auto industries
 - Stimulus spending
 - Rising interest payments and entitlements
 - Inevitable assistance to certain states running large deficits?
- **Financing sources constrained**
 - Competition for the global savings: upward limit on foreign investment in U.S. debt
 - Rising U.S. savings rate from low level
- **Federal government competing with corporate, mortgage, consumer borrowers = upward pressure on rates without continued Fed intervention**

Source: Hanover Investments

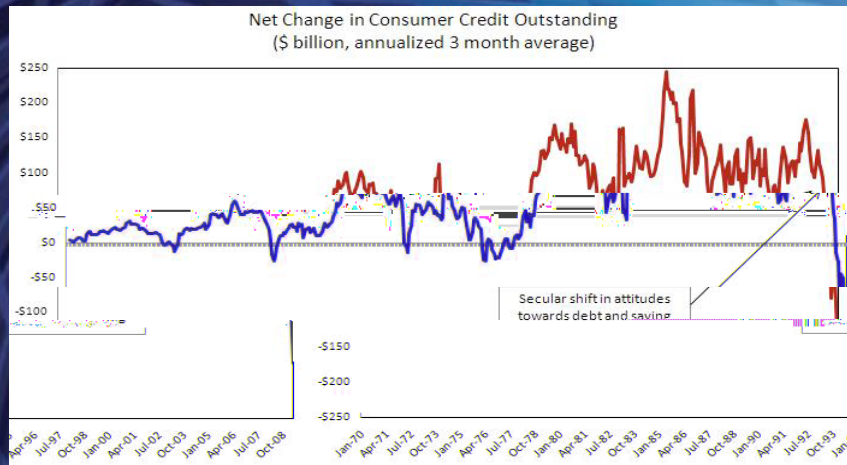


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Macroeconomic Adjustment 2: Consumer Behavior Shift



- Consumer spending led economic growth until the recession
- New dynamic: savings rate grows, consumer debt slows
- Consumer spending no longer counted on as dominant economic growth driver
 - Negative wealth effect
 - Employment anxiety
 - Probability of rising aggregate tax levels
 - Less Credit + Shift in Consumer Savings/Debt Attitude

Source: Hanover
Investments



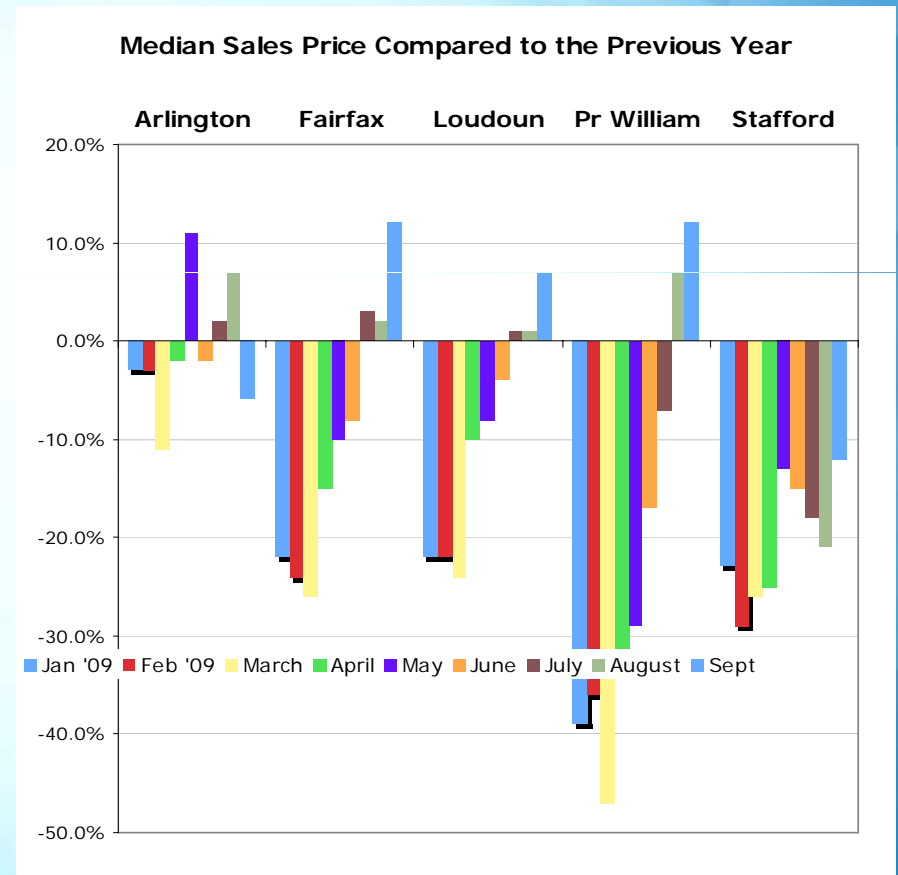
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Downturn Started in Residential Real Estate: Too Early to Call a Price Recovery

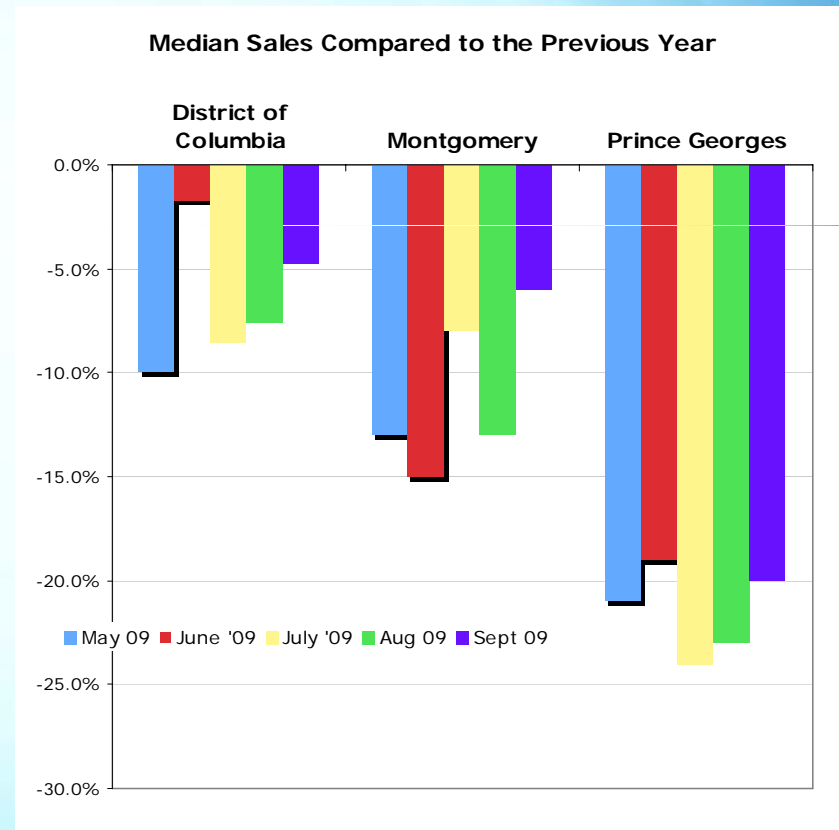
- Outer No Va suburbs most affected through mid-year
- Price slippage started in 2006
- Recent upswing could be result of short-term events - the foreclosure moratorium, first-time home owner tax credit and low conforming mortgage rates.
- Too early to call a price recovery.



Source: MRIS

Downturn Started in Residential Real Estate: Recovery Further Away in MD, DC

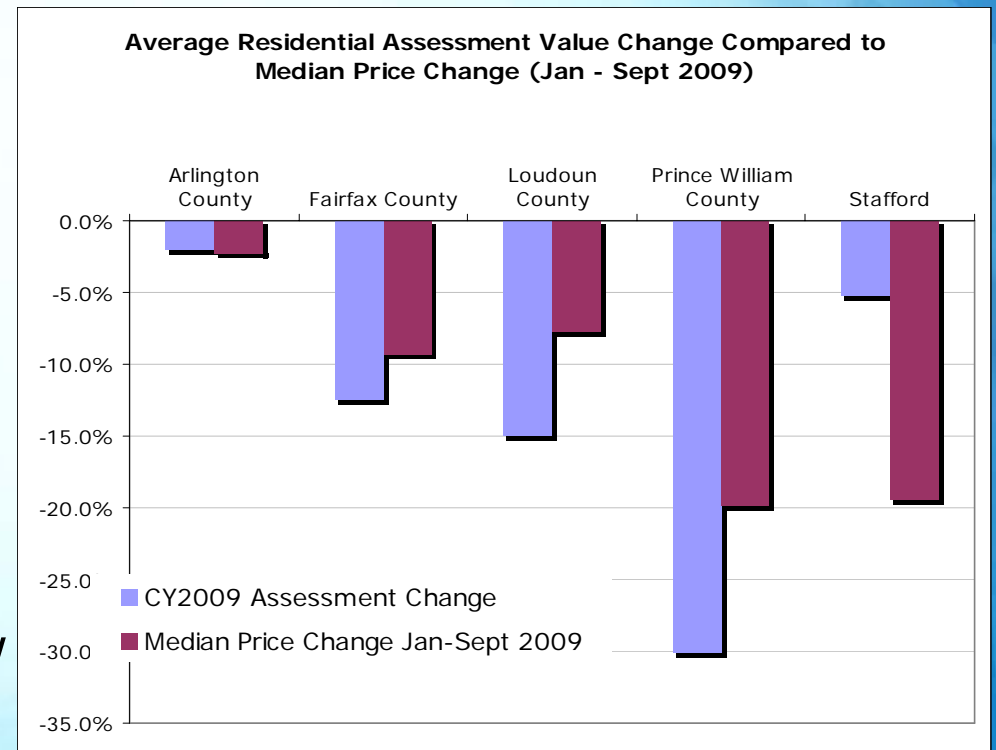
- MD outer suburbs also more affected
- Price trend still in the “red” despite the foreclosure prevention, first-time home owner tax credit and low conforming mortgage rate policy.
- Price recovery seems further away.



Source: MRIS

Residential Property Tax Assessments Fall in Line

- Assessment decline expected next year – could be in line with this year or less severe.
- Second half of the year (post-foreclosure moratorium) will tell the story – price declines slowed in comparison to the Aug-Sept crash last year.
- Commercial assessments now declining, will continue.

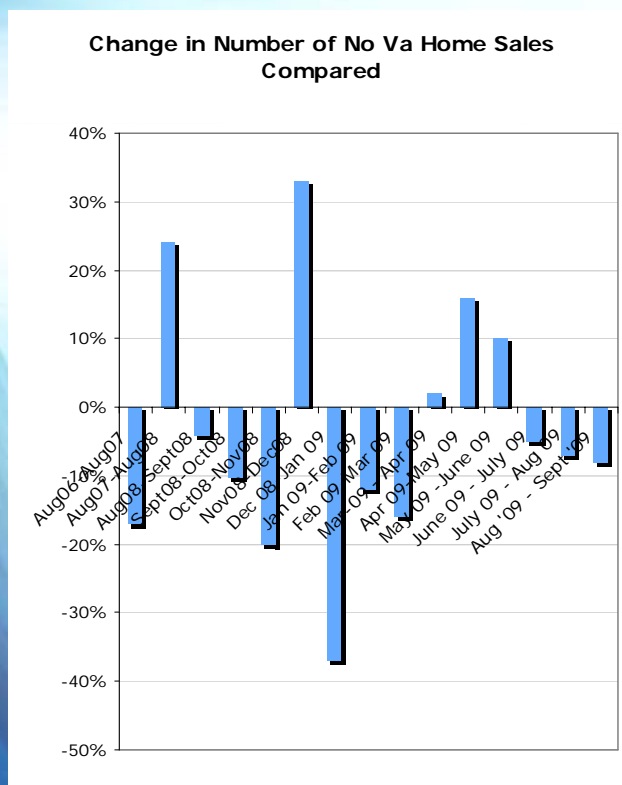


Notes: Assessments based on most recent county reports as of June 2009 and MRIS for median price change

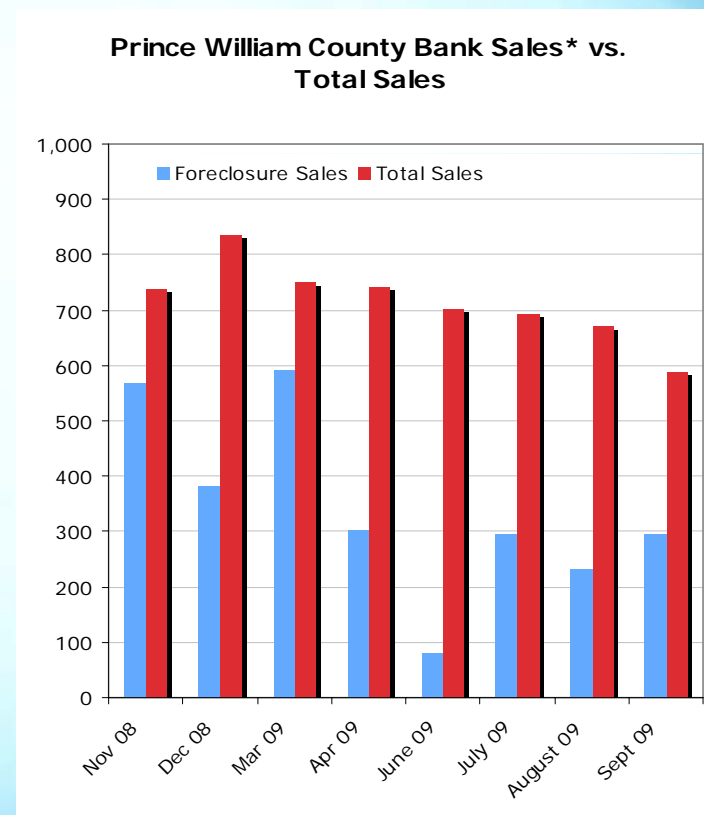


Foreclosure and Distressed Sales Dominate Weak Markets in NoVa

- Distressed buyers and sellers drive down prices
- Foreclosure moratorium led to increased private residential market activity; private residential sales now slowing, foreclosure sales gaining.



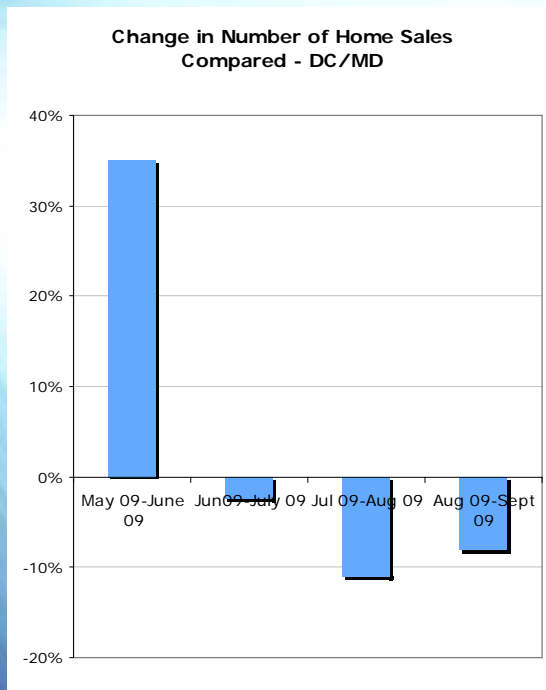
Source: MRIS



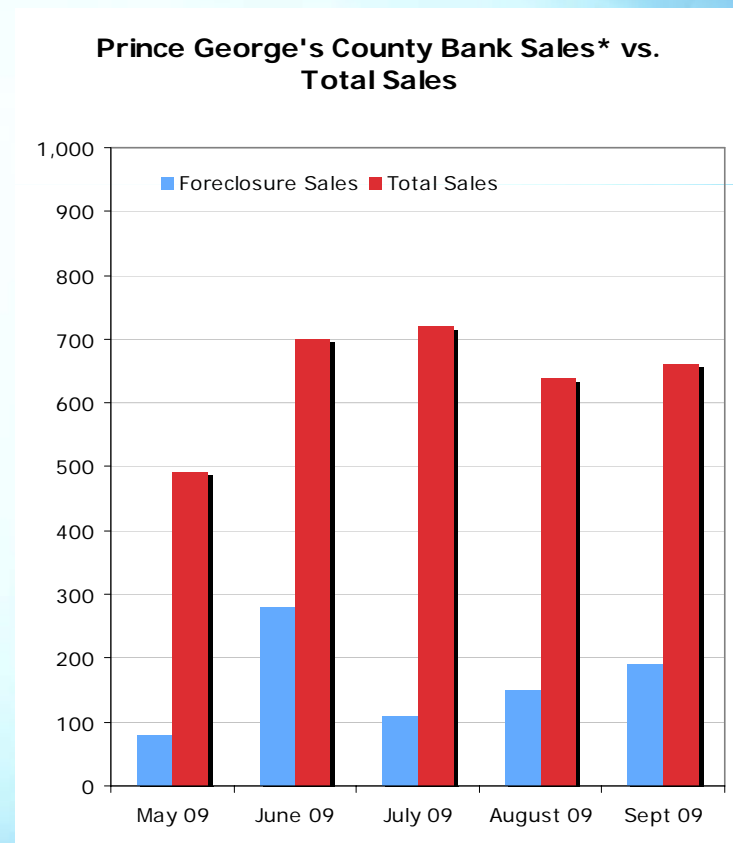
*Bank sales are defined as properties that were foreclosed by lenders and the lenders, in turn, have sold the properties. Note foreclosure moratorium from late 2008 through end of March 2009. Source: Realty Trac, MRIS

Foreclosure and Distressed Sales Dominate Weak Markets Region-Wide

- Distressed buyers and sellers drive down prices
- Foreclosure moratorium led to increased private residential market activity; foreclosure sales now rising, conventional sales slipping.



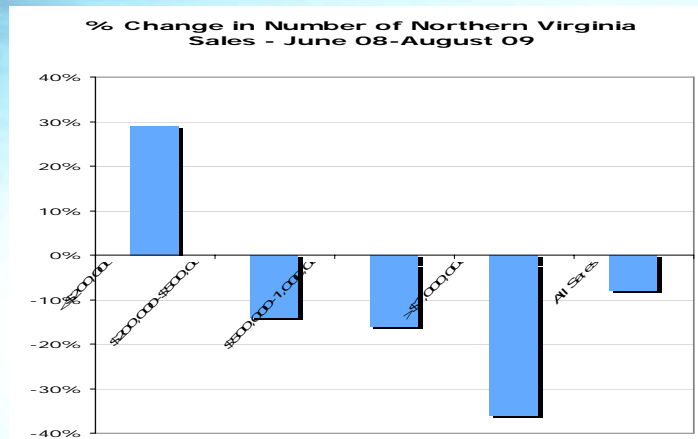
Source: MRIS



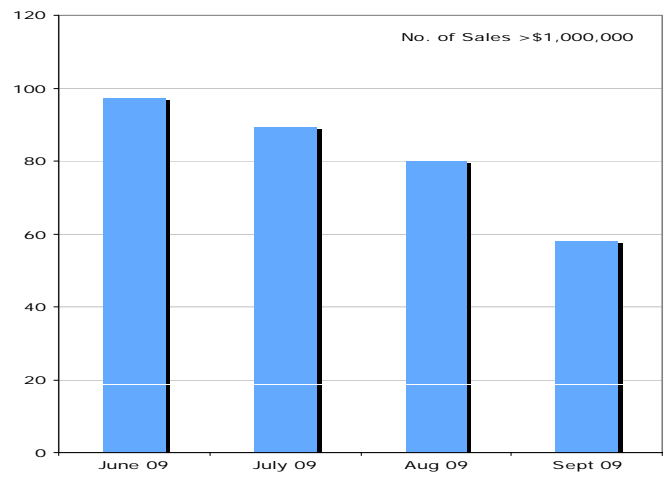
*Bank sales are defined as properties that were foreclosed by lenders and the lenders, in turn, have sold the properties. Note foreclosure moratorium through end of March 2009.
Source: Realty Trac, MRIS

Residential Sales Concentrated At Lower End

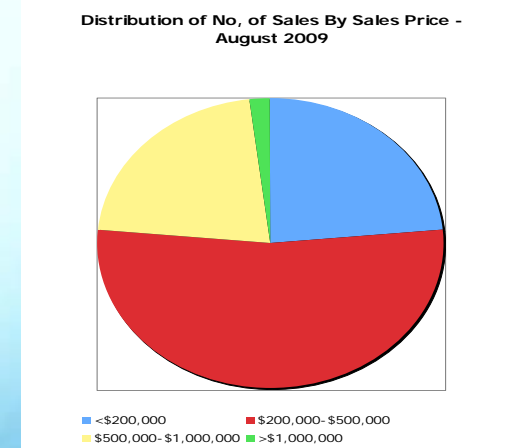
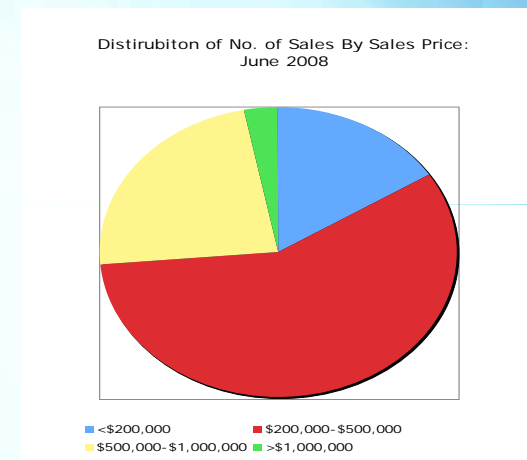
- Trend may be moderating but high end sales still dropping - affects tax base, real estate market vitality and ability of (first-time) home owners to move up
- Low end helped by first-time home buyer tax credit – ends before year-end.



High End Sales Fall June-Sept 2009

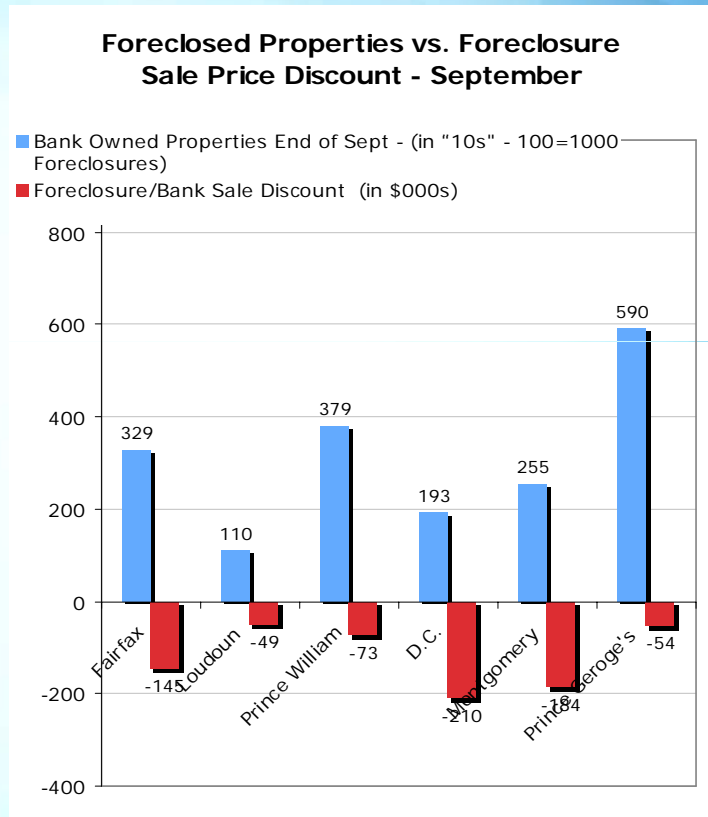


Source: MRIS



Foreclosures and Distressed Properties Rising

- Foreclosed properties add to total listings – sharply increase housing inventory
 - Foreclosed properties larger portion of market relative to multiple listings in high-foreclosure markets and in Northern Virginia
- Foreclosed properties sell at a significant discount to average sales price despite rising demand/multiple bids for bank owned properties – drag on housing market for foreseeable future
- Foreclosures increased significantly since mid-May, following the moratorium
 - **Incidence of foreclosures especially high in outlying areas**
 - Rising delinquencies and falling prices lead to additional foreclosures and distressed properties
 - More than 45% subprime mortgages and 25% Alt-A in Virginia delinquent as of Mar 31 according to CoreLogic data
 - One in three mortgaged properties “upside down” or negative equity as of June, more than doubled in six months in VA
 - 28% in MD
 - 23% in DC



State of VA	Mortgages	Negative Equity Mortgages	Near** Negative Equity Mortgages	Negative Equity Share	Near** Negative Equity Share
Oct '08	1,110,253	177,005	238,414	15.9%	21.5%
June '09	1,228,451	406,660	469,413	33.1%	38.2%

Note: This data only includes properties with a mortgage. Non-mortgaged properties are by definition not included.

** Defined as properties within 5% of being in a negative equity position.

Source: First American CoreLogic

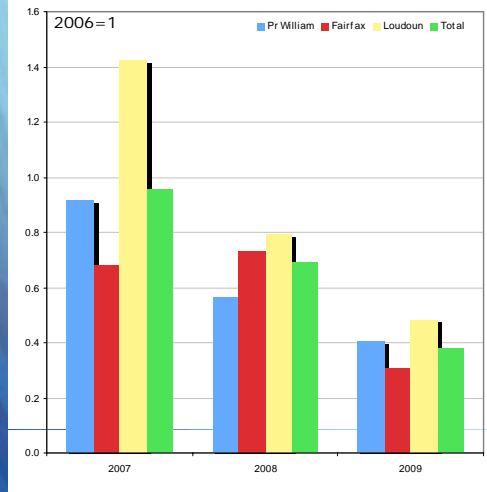
Mortgaged Properties with Negative Equity By State as of 3/31/09

State	Mortgage	Negative Equity Mort	Near** Neg. Equity	Neg Equity Share	State	Mortgage	Negative Equity Mort	Near** Neg. Equity	Neg Equity Share
Alabama	319,022	52,649	74,702	16.5%	Nebraska	215,801	65,146	82,281	30.2%
Alaska	83,453	17,118	22,456	20.5%	Nevada	613,161	398,754	418,862	65.0%
Arizona	1,360,230	658,902	718,127	48.4%	New Hamp	197,809	58,734	70,188	29.7%
Arkansas	220,824	58,341	77,568	26.4%	New Jerse	1,868,511	447,438	532,841	23.9%
California	6,997,317	2,989,064	3,245,095	42.7%	New Mexic	227,055	43,000	54,893	18.9%
Colorado	1,125,019	398,321	476,831	35.4%	New York	1,798,824	233,526	304,305	13.0%
Connecticut	797,173	132,865	167,033	16.7%	North Caro	1,419,495	346,577	469,175	24.4%
Delaware	174,701	40,248	49,513	23.0%	North Dakc	39,174	6,322	8,616	16.1%
Florida	4,657,754	2,290,261	2,461,199	49.2%	Ohio	2,197,424	889,749	1,028,070	40.5%
Georgia	1,558,093	564,323	688,702	36.2%	Oklahoma	388,009	87,577	126,200	22.6%
Hawaii	230,764	31,870	40,179	13.8%	Oregon	702,320	159,085	198,594	22.7%
Idaho	213,826	51,364	62,550	24.0%	Pennsylvan	1,736,995	279,750	366,673	16.1%
Illinois	2,206,670	628,029	761,744	28.5%	Rhode Isla	223,558	44,058	51,116	19.7%
Indiana	153,571	21,933	29,739	14.3%	South Carc	551,208	131,689	174,537	23.9%
Iowa	298,299	75,190	102,133	25.2%	South Dak	NA	NA	NA	NA
Kansas	283,889	67,171	86,943	23.7%	Tennessee	912,037	264,473	335,095	29.0%
Kentucky	256,419	67,104	88,836	26.2%	Texas	3,145,949	823,131	1,055,663	26.2%
Louisiana	NA	NA	NA	NA	Utah	467,309	108,465	136,102	23.2%
Maine	NA	NA	NA	NA	Vermont	NA	NA	NA	NA
Maryland	1,369,608	382,105	447,683	27.9%	Virginia	1,225,523	402,956	464,802	32.9%
Massachu:	1,472,842	319,608	380,461	21.7%	Washingto	1,399,455	319,063	400,672	22.8%
Michigan	1,369,250	666,252	739,683	48.7%	Washingto	101,094	23,691	28,363	23.4%
Minnesota	502,467	126,726	152,493	25.2%	West Virgi	NA	NA	NA	NA
Mississipp	NA	NA	NA	NA	Wisconsin	545,258	143,063	175,641	26.2%
Missouri	767,844	196,385	246,050	25.6%	Nation	46.7 M	15.2 M	17.7 M	32.5%
Montana	103,317	13,042	17,411	12.6%					

Residential and Commercial Retail Construction Hit

- Multifamily Residential construction reduced.
 - Multifamily building permits down by >50%, single family permits almost at 2008 pace, again concentrated at low end.
 - Increased investor demand for existing apartment buildings?
- Commercial retail construction declining.

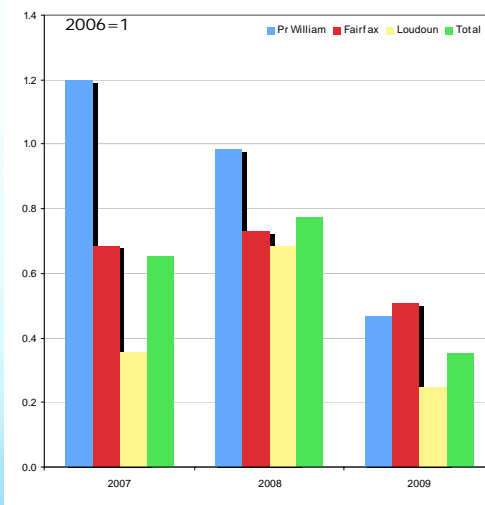
Total Residential Construction Indexed, 2007-2009 (Projected)



Source: McGraw Hill Construction –

8 Research and Analytics, Bedford, Mass.

Northern Virginia Retail Construction Indexed, 2007 - 2009 (Projected)

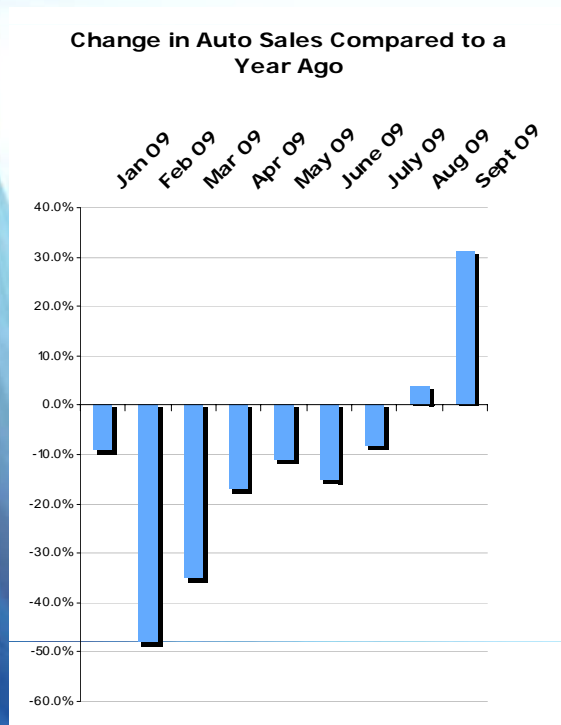


Source: McGraw Hill Construction –

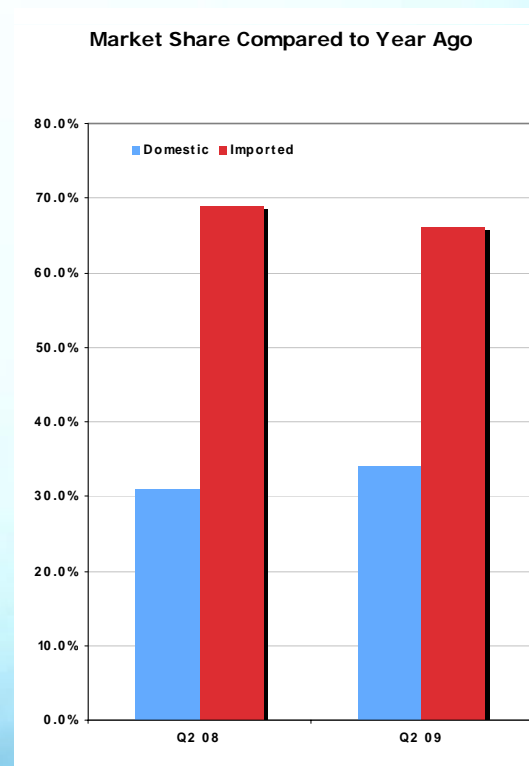
Research and Analytics, Bedford, Mass.

Auto Sales: Example of Credit Crunch Effect on Consumer Spending

- Similar to housing, other consumer purchases drop, especially those that are credit-dependent
- Example: Northern Virginia new auto sales – fall in sales accelerated in early 2009. Sales increased by domestic auto dealer inventory liquidation, “cars for clunker” program that ended in late August.



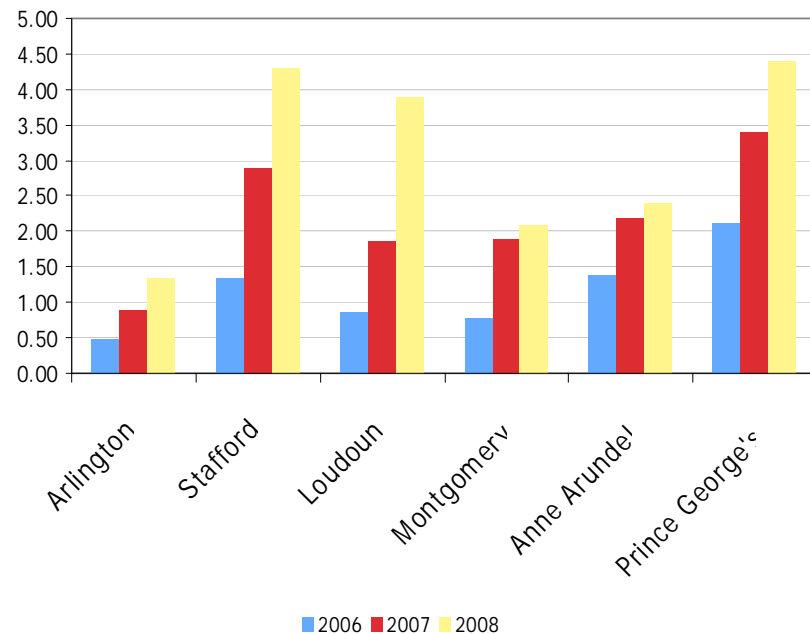
Source: Virginia Auto Dealers Association



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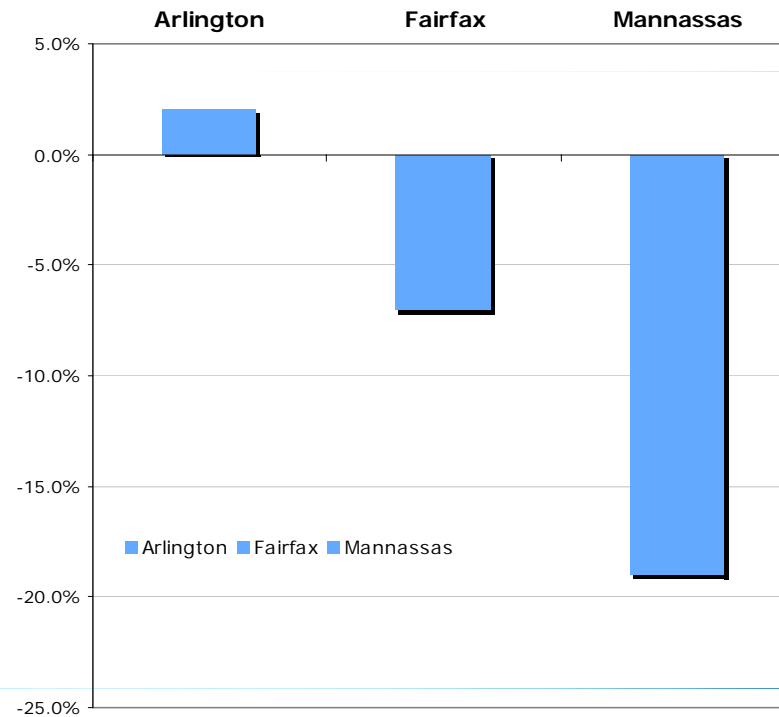
Less Consumer Spending Slows Demand For Retail Space

Rising Bankruptcies (Per 1,000) Factor in Credit-Dependent Consumer Spending



Source: Moody's Economy.com, FDIC

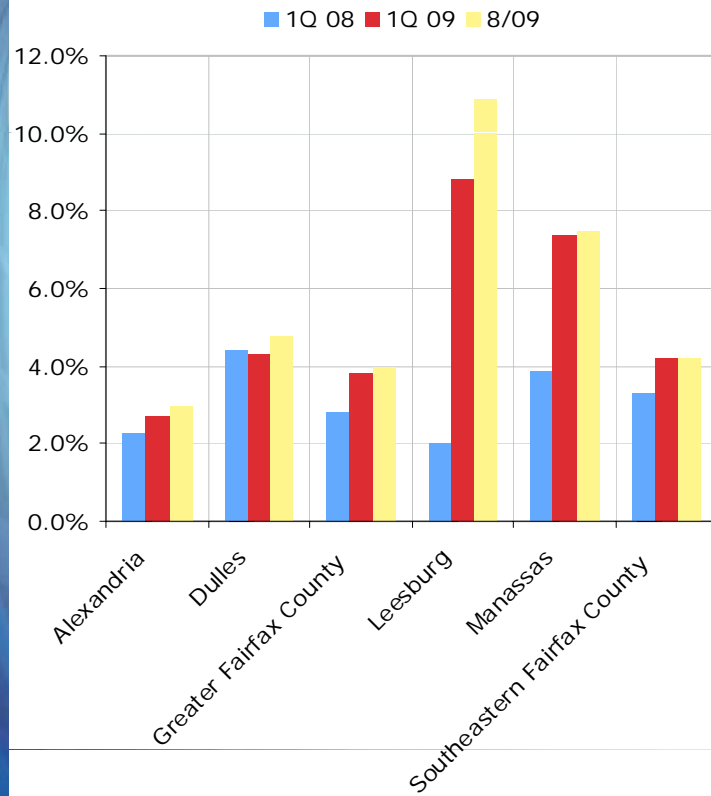
Change in Taxable Sales: 2007-09



Source: Cooper-Weldon, Virginia

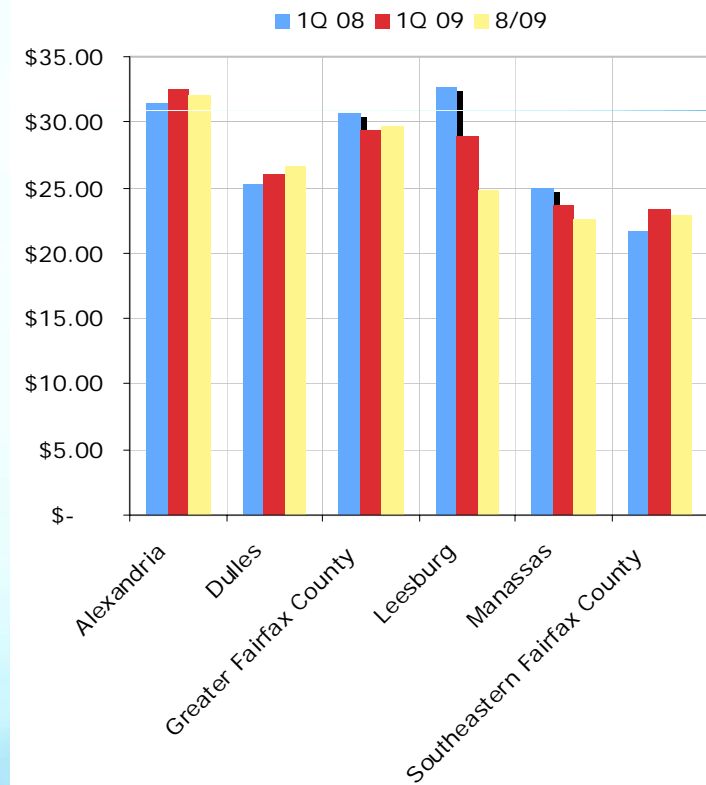
Distant Retail Markets Slump in NoVa

Retail Vacancy Rates Rise Further Out



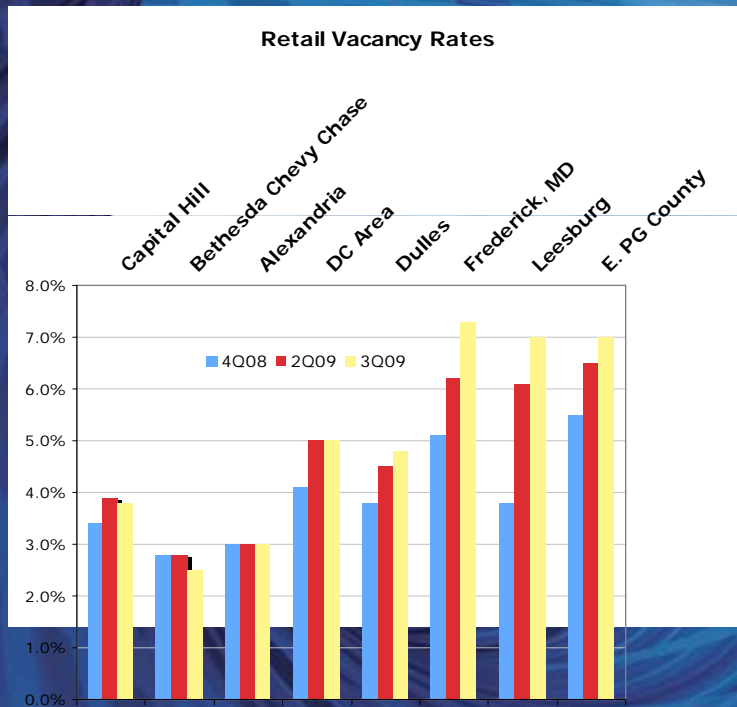
Source: CoStar

Retail Lease Rates Follow Vacancy Rates



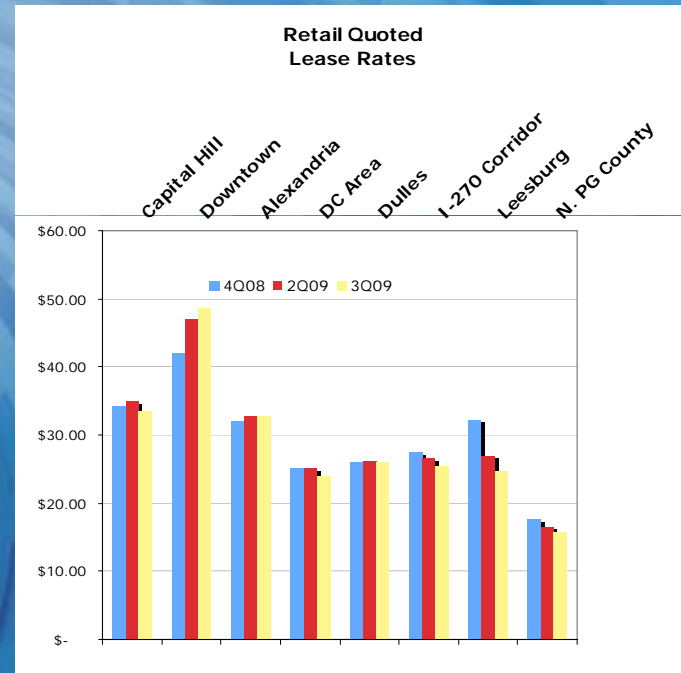
Source: CoStar

D.C. Area Retail Market Hit, Especially Areas Further Out



Source: CoStar

Source: CoStar



Note: Quoted lease rates may differ from final negotiated rates



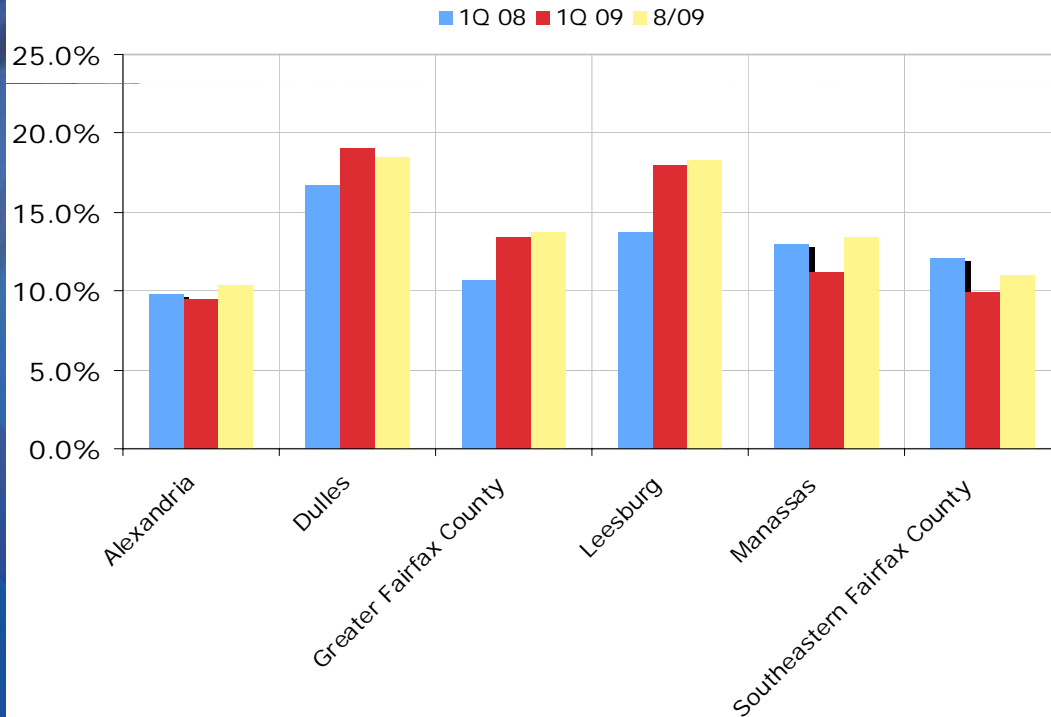
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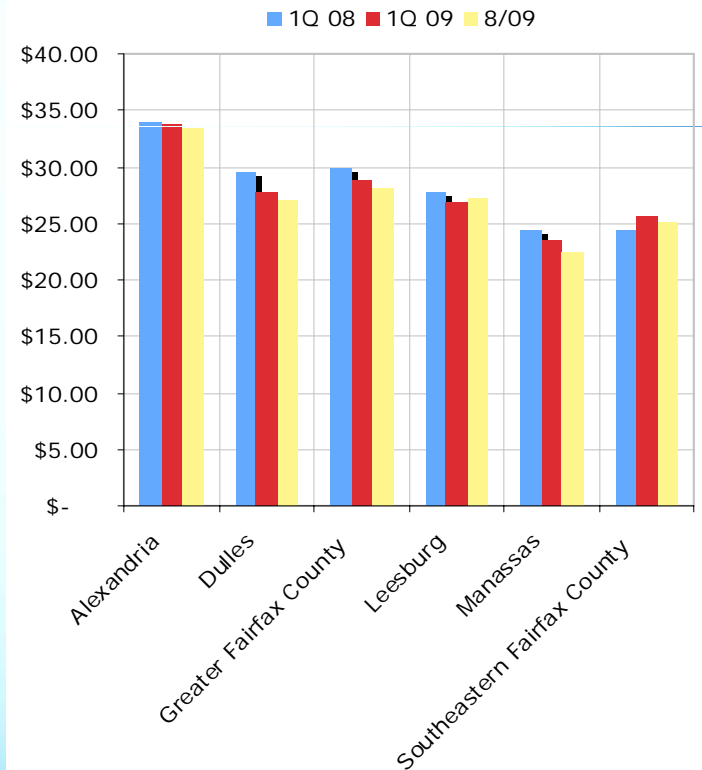
Construction Boom, Soft Economy Hit Distant Office Markets in Northern Virginia the Hardest

Office Vacancy Rates Higher



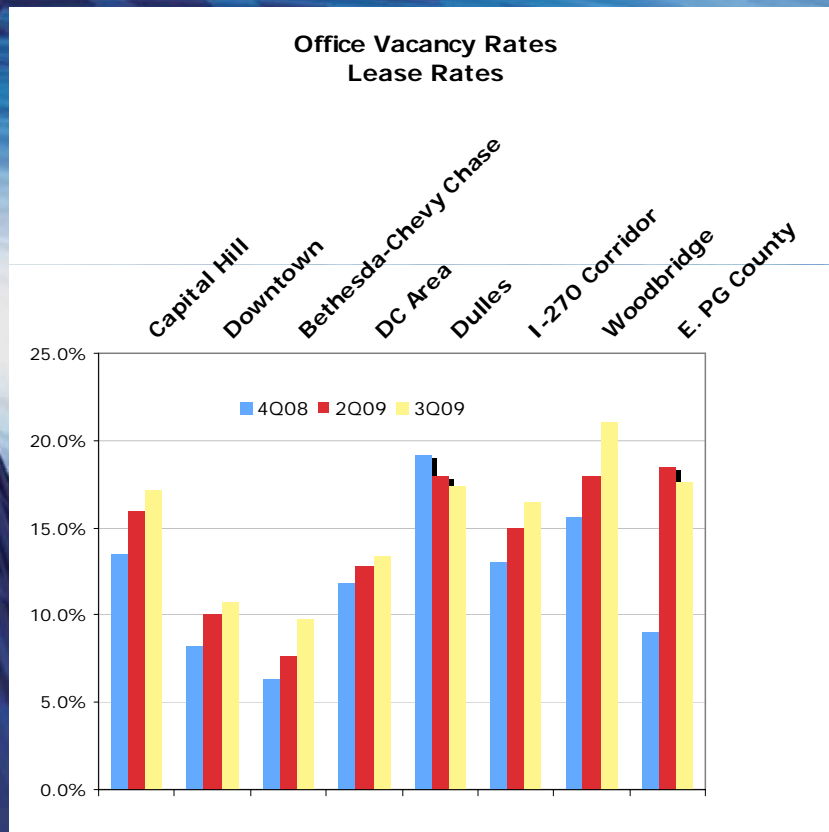
Source: CoStar

Office Lease Rates Lower



Source: CoStar

Economic Downturn Weakens Regional Office Market

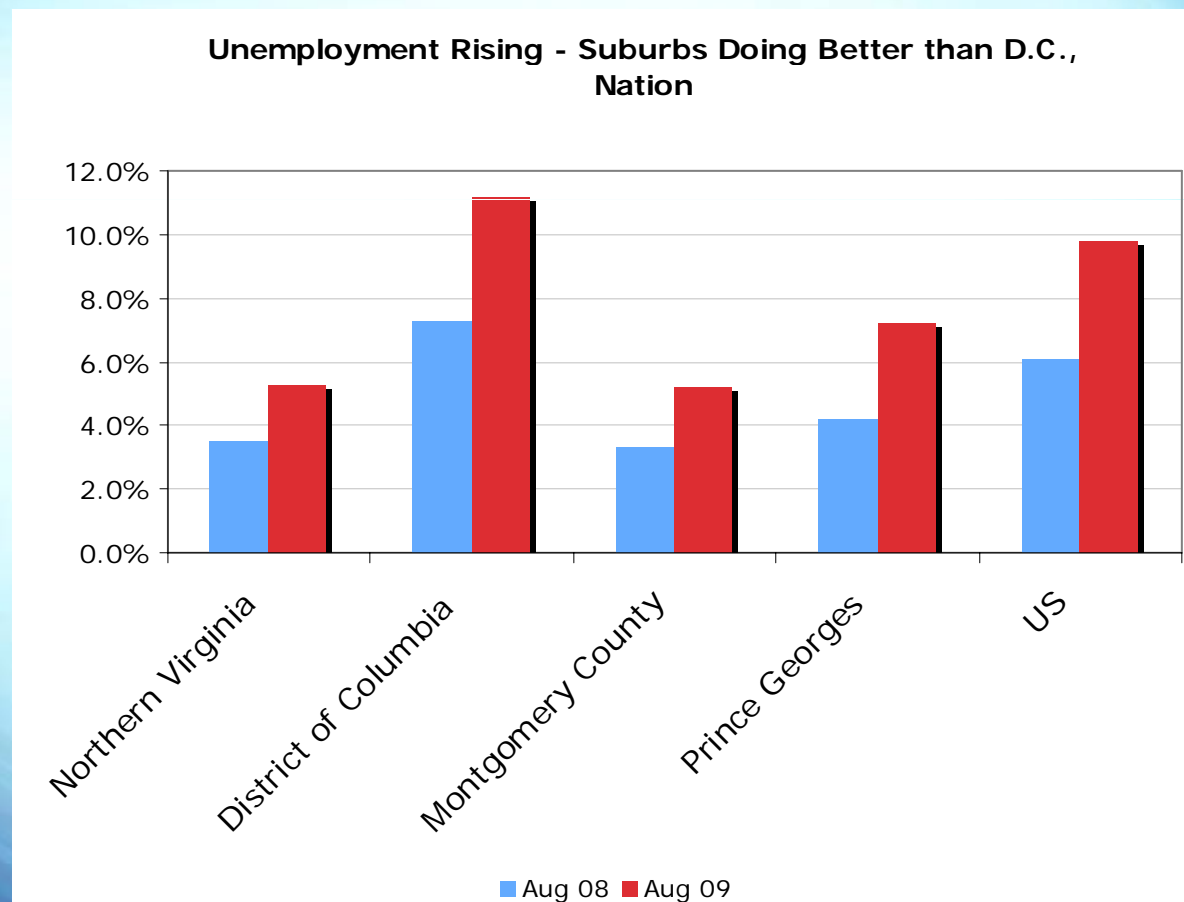


Source: CoStar



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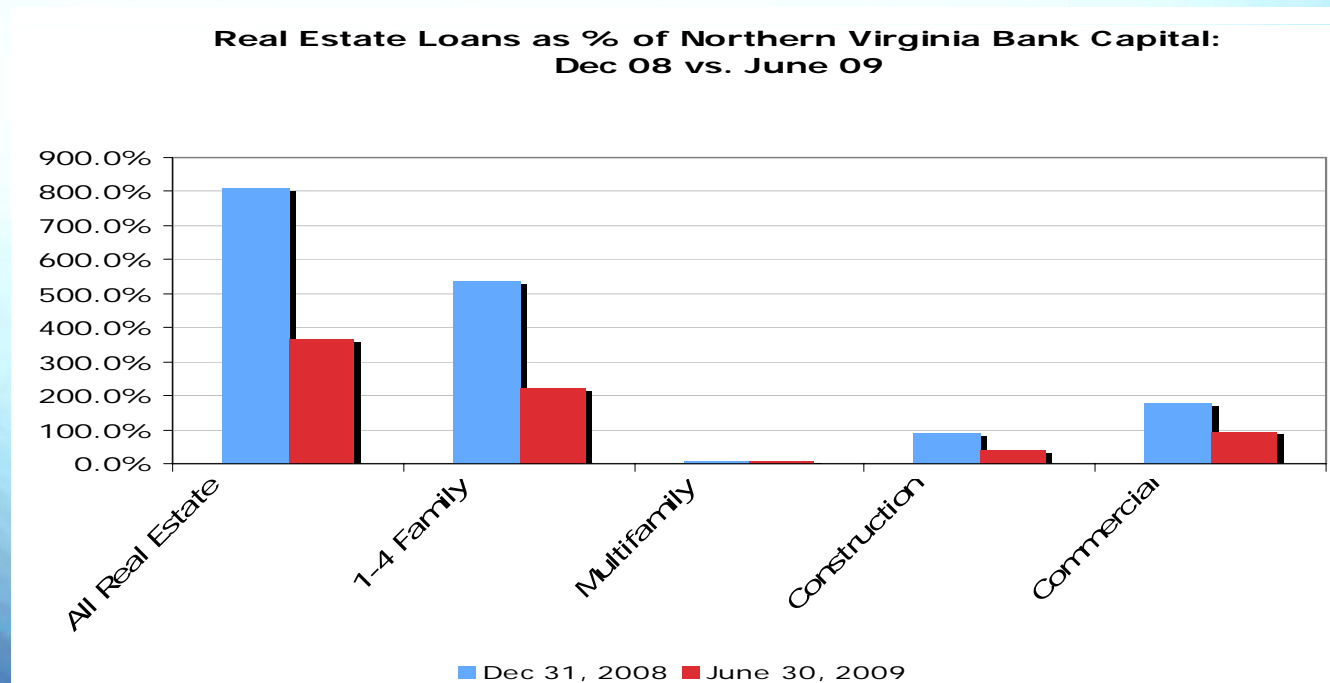
Relatively Stable Employment in Closer VA, MD Suburbs Mitigate The Downturn; The District and the Nation Harder Hit. Unemployment to Increase Further.



Source: US Department of Labor

Banks' Real Estate Lending Capacity Stressed But New Capital Eases the Pressure

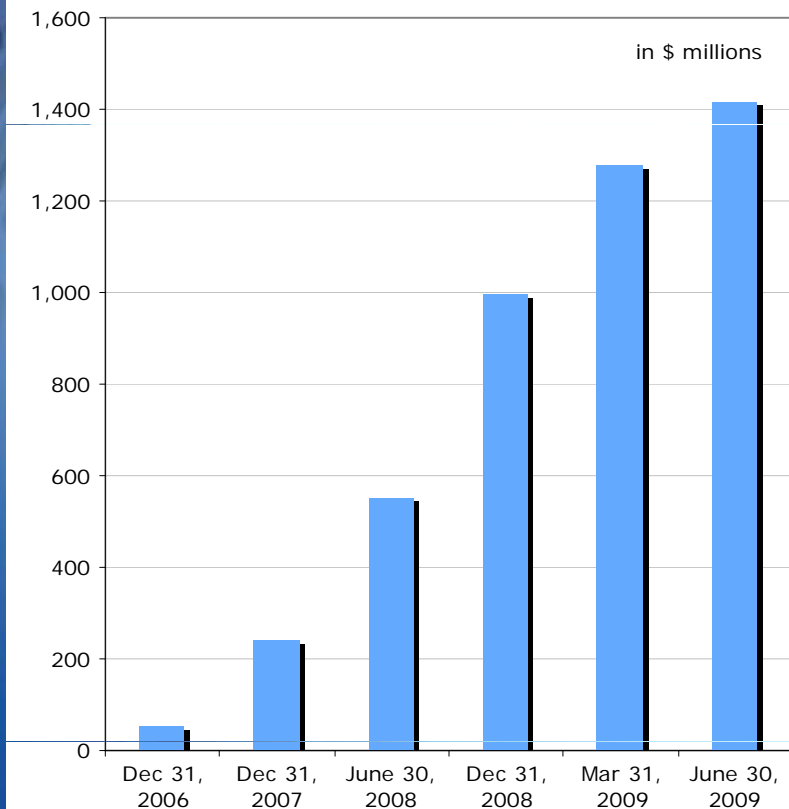
- FDIC records indicate for Northern Virginia-headquartered banks and thrifts lending continued to be constrained. (Note that Capital One and E*Trade Bank are excluded, and Chevy Chase Bank accounts for almost half of the assets).
- Lending exposed to real estate, multiple of bank equity capital.
- Fresh capital expands lending capacity.



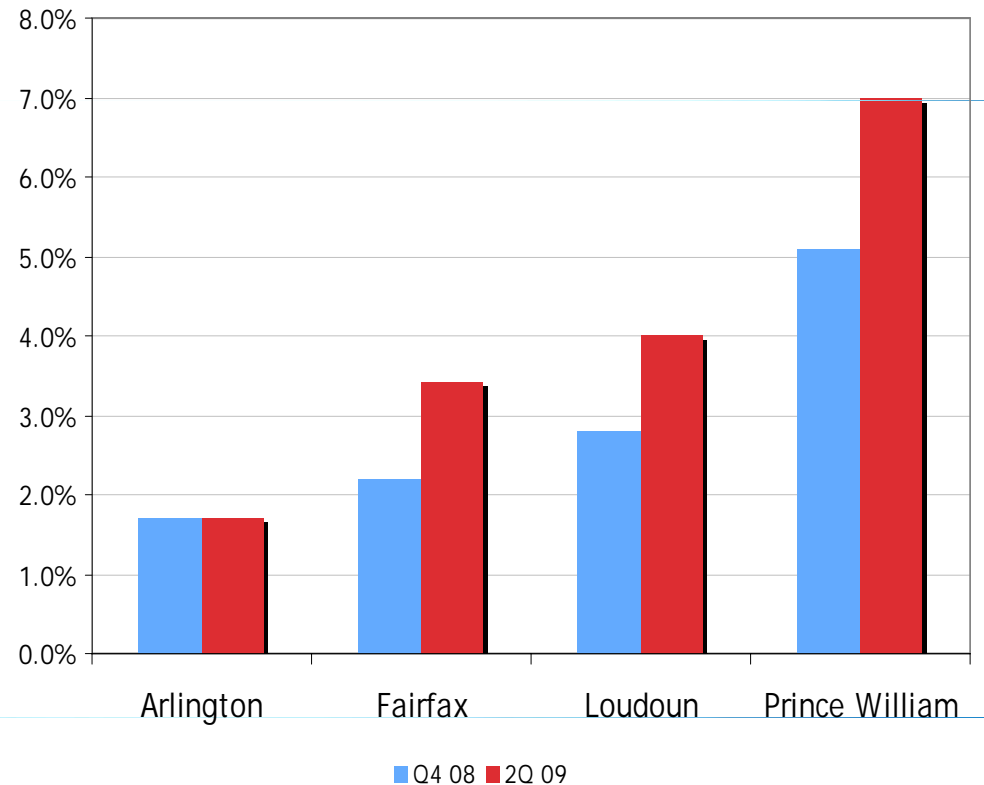
Source: FDIC

Nonperforming Loans Mount in Northern Virginia Banks

Total Nonperforming Loans at Northern Va Headquartered Banks: Construction Loans Major Source of Delinquencies



Percent Seriously Delinquent Single Family Mortgages by County

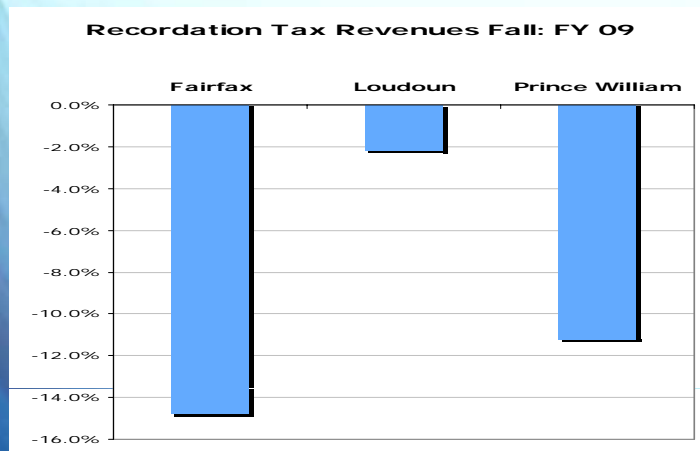


Nonperforming loans defined as 90 days or more past due.
Source: FDIC

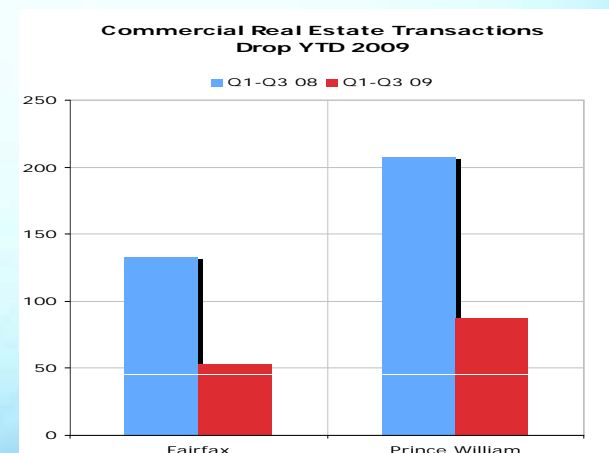
Defined as percent of all single family mortgages 90 days or more past due
Source: Trans Union, Federal Reserve Bank of NY

Local Government Feels the Heat

- Counties faced budget cuts last fiscal year, in some cases severe
 - Bigger cuts this fiscal year (FY '10) and beyond
 - Local government revenue base closely tied to real estate
 - Recordation taxes lower this fiscal year; some jurisdictions budget increase in FY '10 assuming more distressed/foreclosure sales
 - Sharp drop in commercial real estate transactions further slows recordation tax revenues.



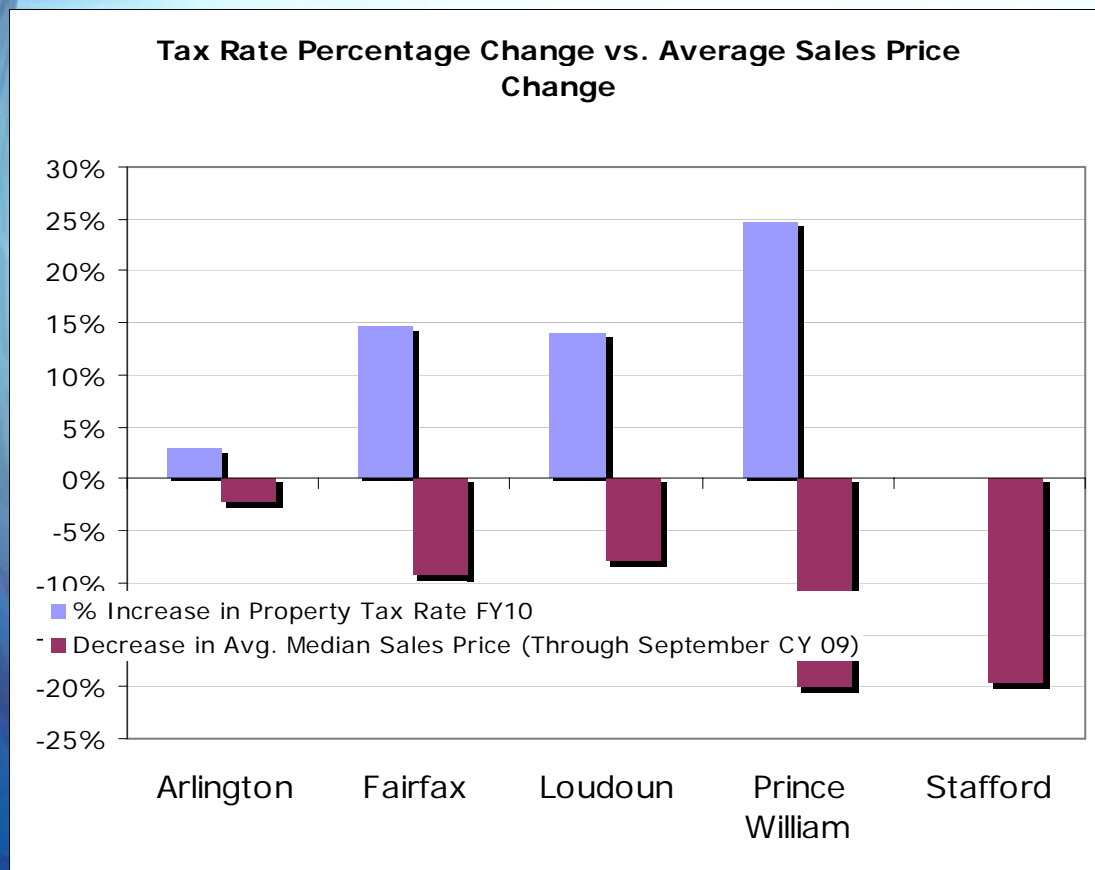
Source: County Budget Data



Source: Fairfax and Prince William Newsletters

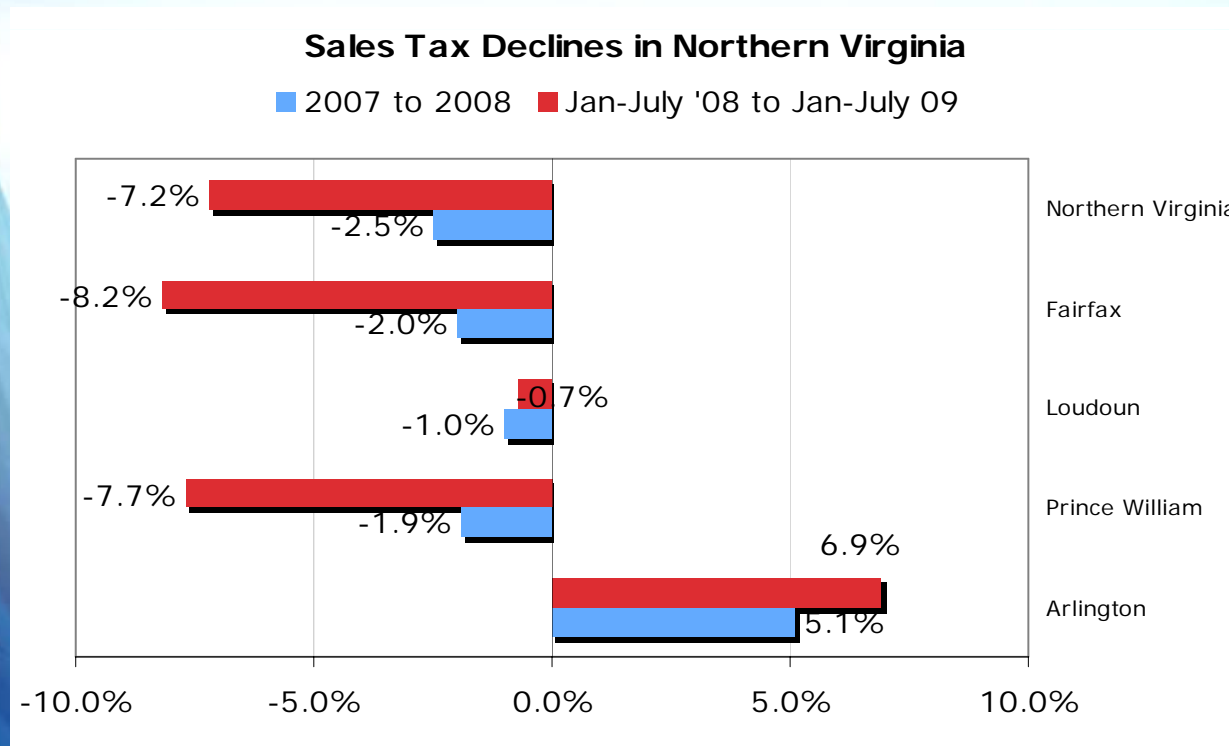
Property Taxes – Major Source of Local Government Revenues

- Property taxes, on average, make up over 60 percent of the local revenue base and residential assessments, on average, make up over 70 percent of the property tax base.



Sales Tax Revenue Change in 2008 and 2009

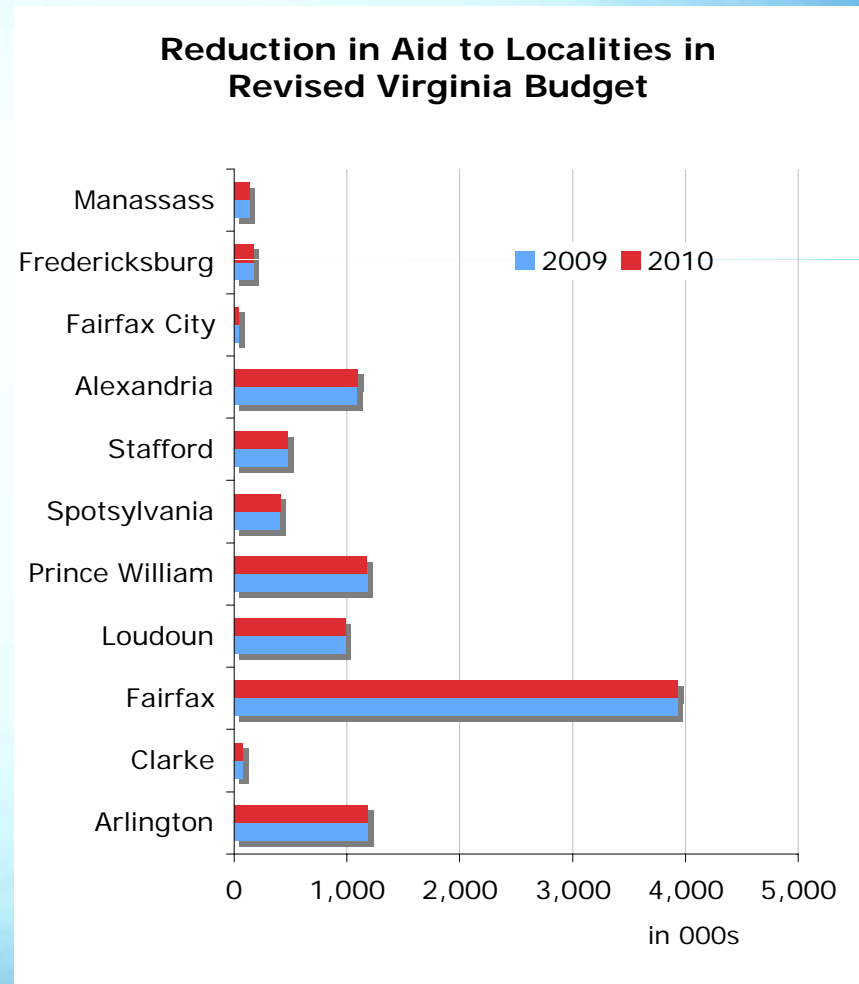
- Sales taxes are another important local government revenue source.
- Excluding Arlington, recession has slowed sales tax revenues and, again, the impact greater this year.



Source: Cooper-Weldon (Commonwealth of Virginia)

State Aid to Localities Expected to Decrease

- Virginia budget under similar stresses
- Aid to localities cut this fiscal year and next



Source: Commonwealth of Virginia

Summary

- **The region in better economic shape than other regions but credit crunch has significant effects and leads to a “new normal” at the local level – most negative in further out jurisdictions.**
- **Residential real estate market trend looks to be moderating but too soon to call a recovery with sales volume lower, especially in further out jurisdictions: price pick up (in NoVa) aided by tax credit, distressed sellers and foreclosures will continue to be a major driver of the market region-wide, and sales are concentrated at lower end of the market.**
- **Bank lending capacity constrained but less so than in other regions.**
- **Consumer credit pulled back, cuts retail spending, outlook for commercial retail properties and demand for retail construction.**
- **Eventual recovery will be from a lower base.**
- **Biggest effect on commercial real estate markets furthest away from Washington, DC center.**
- **Local government revenues primarily real estate dependent - downward trend continuing, accelerating in FY 10.**
- **No easy choices, economic pain - public policy response critical variable.**