The Forecast

By Lawrence Yun, *Senior Research Forecaster*

The National Picture

Home sales marched forward in 2005 to set a fifth consecutive record year. Nationally, 7.1 million existing homes exchanged hands. New home sales also rose to new heights with 1.3 million sales. Because of the strong demand, home prices increased by 13% - the highest in over 25 years.

The Federal Reserve's tightening of monetary policy has contained inflation. After a rise in the consumer price index (CPI) of 3.4% in 2005, the CPI will decelerate to 3% in 2006 and then to 2% in 2007. Low inflation will keep long-term bond rates at manageable levels. Further, the Federal Reserve can back off their interest-rate increases after one more rate hike at the end of January. The fourth quarter economic expansion was very weak at only 1.1%. This further provides reasons as to why the Fed should end the tightening money supply.

What will happen with mortgage rates? While the 30-year fixed rate will remain under 7% for the next two years, expect modestly higher rates in 2006 — 6.3% to 6.7% — compared to the 5.5-6% rates of the past three years. These higher rates will begin to rein in the super-hot national housing activity that we've seen over the last three years. Indeed, in some pricier regions of the country homebuyers have already been stretched to the max. Look at San Diego where interest-only and adjustable-rate mortgages are prevalent; the market there could encounter difficulty in bringing in a new set of homebuyers. Prices will hold their ground, but sales activity will come down measurably.

The more affordable regions of the country – the vast chunk of middle America in the Central and Mountain Time zones – will likely fare better since modestly higher rates will not greatly impact affordability. Anyone with a job and a good credit can pretty much afford a commonly available $150,000 home. Thus, home sales in the middle regions of the country will outperform the coastal regions - provided jobs get added to the local economy. Though 4 million jobs have been created in the past two years for the country as a whole, the impact has been highly uneven across different parts of the country.

The Local Picture

Home sales tumbled 7.4% in the fourth quarter in the local area but ended the past year with an increase. A total tally was 199,768 unit sales, a 4.9% growth. Home prices remained strong throughout as they rose on average by 14.8%. Price growth in 2004 was 9.5%. A typical local area home price was $345,400.

In 2006, the local job gains could total 80,000. But home sales will likely fall by 3% due to higher mortgage rates. Similarly, the local region will see slower price growth - of about 7%. The outlook for 2007 looks brighter with home sales set to rise on the back of local job gains.

Economic and Housing Market Outlook: First Quarter 2006

	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2004	2005	2006	2007
U.S. Economy														
Annual Growth Rate														
Real GDP	3.8	3.3	4.1	1.1	4.6	4.1	3.9	3.8	3.7	3.8	4.2	3.6	4.0	3.8
Nonfarm Payroll Employment	1.6	1.9	1.6	1.0	1.8	1.8	1.8	1.7	1.6	1.6	1.1	1.6	1.6	1.7
Consumer Prices	2.4	4.2	5.1	3.2	2.2	2.0	1.8	1.9	1.9	2.2	2.7	3.4	3.0	2.0
Real Disposable Income	-3.4	0.2	-2.0	5.2	8.1	5.0	4.9	4.6	5.1	3.7	3.4	1.3	4.6	4.4
Consumer Confidence	104	102	99	96	101	104	106	107	108	109	80	100	105	109
Percent														
Unemployment Rate	5.3	5.1	5.0	4.9	5.0	4.9	4.9	4.8	4.8	4.8	5.5	5.1	4.9	4.7
Interest Rates, Percent														
Fed Funds Rate	2.5	2.9	3.5	4.0	4.4	4.5	4.5	4.5	4.5	4.5	1.3	3.2	4.5	4.5
3-Month T-Bill Rate	2.5	2.9	3.4	3.9	4.3	4.3	4.3	4.3	4.3	4.3	1.4	3.2	4.3	4.3
Prime Rate	5.4	5.9	6.4	7.0	7.4	7.6	7.5	7.5	7.5	7.5	4.3	6.2	7.5	7.5
Corporate Aaa Bond Yield	5.3	5.1	5.1	5.5	5.8	6.0	6.1	6.1	6.1	6.1	5.6	5.3	6.0	6.2
10-Year Government Bond	4.3	4.2	4.2	4.5	4.7	4.9	5.0	5.0	5.1	5.1	4.3	4.3	4.9	5.1
30-Year Government Bond	4.7	4.5	4.4	4.7	4.9	5.1	5.2	5.2	5.2	5.2	5.1	4.6	5.1	5.2
Mortgage Rates, percent														
30-Year Fixed Rate	5.8	5.7	5.8	6.2	6.3	6.6	6.7	6.7	6.8	6.8	5.8	5.9	6.5	6.8
1-Year Adjustable	4.2	4.3	4.5	5.1	5.3	5.4	5.5	5.5	5.5	5.5	3.8	4.5	5.4	5.5
National Housing Indicators														
Thousands														
Existing Single-Family Sales	6,837	7,223	7,240	6,900	6,794	6,747	6,835	6,796	6,774	6,809	6,784	7,072	6,787	6,821
New Single-Family Sales	1,249	1,287	1,293	1,292	1,276	1,236	1,178	1,135	1,157	1,168	1,203	1,282	1,209	1,198
Housing Starts	2,083	2,044	2,101	2,035	2,028	1,975	1,897	1,845	1,893	1,923	1,956	2,065	1,936	1,943
Single-Family Units	1,709	1,693	1,747	1,702	1,708	1,648	1,554	1,488	1,512	1,537	1,604	1,714	1,600	1,544
Multifamily Units	374	351	354	333	320	327	343	358	381	385	345	350	337	399
Residential Construction*	584	599	610	625	623	615	602	586	582	589	562	604	607	595
Percent Change – Year Ago														
Existing Single-Family Sales	8.2	4.7	6.5	0.3	-0.6	-6.6	-5.6	-1.5	-0.3	0.9	9.7	4.2	-4.0	0.5
New Single-Family Sales	5.0	7.0	11.1	3.9	2.2	-3.9	-8.9	-12.2	-9.3	-5.5	10.8	6.6	-5.7	-0.9
Housing Starts	8.0	6.3	6.4	3.1	-2.6	-3.4	-9.7	-9.3	-6.7	-2.6	5.2	5.6	-6.2	0.3
Single-Family Units	9.4	5.9	6.9	5.0	0.0	-2.7	-11.1	-12.6	-11.5	-6.8	6.6	6.4	-6.7	-3.5
Multifamily Units	1.9	8.6	4.2	-5.5	-14.4	-7.0	-3.0	7.5	18.9	18.0	-0.9	1.4	-3.7	18.5
Residential Construction	7.7	6.1	7.2	9.4	6.7	2.7	-1.4	-6.1	-6.6	-4.3	10.3	7.6	0.4	-2.0
National Home Prices														
Thousands of Dollars														
Existing Home Prices	190.3	209.3	215.9	214.7	204.4	220.1	225.7	224.9	212.3	227.8	185.2	209.1	219.7	228.1
New Home Prices	229.9	230.2	235.1	228.7	244.4	244.0	243.7	249.2	257.3	256.0	221.0	237.3	245.2	256.3
Percent Change – Year Ago														
Existing Home Prices	10.2	13.4	14.0	13.4	7.4	5.1	4.5	4.7	3.9	3.5	8.5	12.9	5.1	3.8
New Home Prices	8.0	6.3	9.9	-0.4	6.3	6.0	3.7	9.0	5.3	4.9	3.9	7.4	3.3	4.5
Local Region														
Payroll Jobs (in thousands)	2871.1	2932.6	2938.6	2975.3	2948.630	05.9	3012.1	3046.7	3016.4	3072.0	2847.9	2929.4	3003.3	3078.4
Home Sales	39374	58124	57097	45173	35791	55102	56298	45534	36220	56644	190374	199768	192725	198506
Home Prices (in thousand $)	311.8	349.7	356.7	354.8	340.1	375.9	377.4	372.6	357.2	395.8	300.7	345.4	368.9	387.7
Percent Change – Year Ago														
Jobs	2.8%	2.8%	2.9%	2.9%	2.7%	2.5%	2.5%	2.4%	2.3%	2.2%	2.3%	2.9%	2.5%	2.5%
Home Sales	24.8%	6.8%	2.7%	-7.4%	-9.1%	-5.2%	-1.4%	0.8%	1.2%	2.8%	20.9%	4.9%	-3.5%	3.0%
Home Prices	8.4%	18.4%	18.1%	13.1%	9.1%	7.5%	5.8%	5.0%	5.0%	5.3%	9.5%	14.8%	6.8%	5.1%

Quarterly figures are seasonally adjusted annual rates.
* Billion dollars
Source: Forecast produced using Macroeconomic Advisers quarterly model of the U.S. economy.
Assumptions and simulations by Dr. David Lereah and Dr. Lawrence Yun.

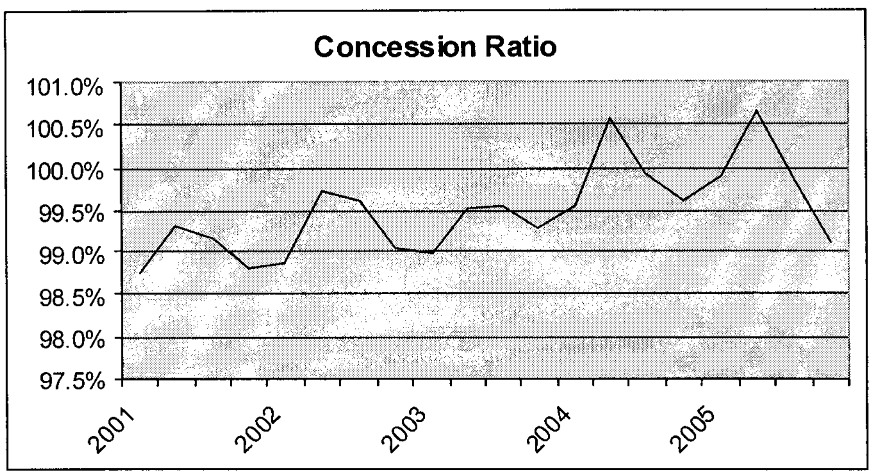
But What Does a Slowing Market Mean?

Ken Fears, Economist

Newspaper pundits have been harkening a bubble in the housing market for years. For the first time the markets are actually starting to show signs of slowing. Sharp increases in prices in 2005 and a fifty basis point increase in the 30-year fixed rate mortgage in the fourth quarter of 2005 eroded affordability conditions leading to this cooling. But the data indicates that it is just that; the market is *cooling* based on fundamental factors. Days on the market have increased in roughly half of the metropolitan areas that NAR® Research monitors.

With affordability declining demand will shrink and homes will sit on the market longer. Compounding the problem, the stock of homes for sale will begin to build up. Consequently downward price pressure will develop forcing sellers to make concessions, causing a decline in the ratio of sale price to list price, in order to meet buyer's ability to finance their purchase. However, are we there yet?

There are several reasons that may explain an increase in the concession. First, Realtors® may be listing prices high in an attempt to boost up the sale price by listing well above comparable sales prices and accepting a slightly lower selling price that is still above the current comparables. Secondly, the market may be changing and Realtors® who are used to a certain quarterly increase can no longer use this guide for pricing. For example, a year ago when pricing a home a Realtor® may have taken a recent selling price and asked 3% more assuming prices where continuing to rise, but with demand flattening, only the recent selling price is realized, creating a 3% concession *from the inaccurate list price.* Finally, if the market is truly oversaturated and has been stagnant for a protracted period, the only way to move homes may be to accept prices below recent realized sale prices...this last scenario is one in which there is a true concession.



Locally, we have seen an increase of 4.7 days to an average of 40.5 days on the market in the fourth quarter of 2005 as compared to the same quarter in 2004. Over this same time period, the area covered by MRIS has seen an increase in the concession (e.g. 1 - concession ratio) of 0.5 percentage points. This ratio stood at 99.1% in the fourth quarter of 2005. As pictured in the graph above, concessions shrank over the period from 2001 through 2005.

Even with all of this data, it is too early to tell at which stage of the concession cycle we are in. Concessions will likely rise as the supply of homes increase and days on the market expand, however, we haven't seen a sharp increase in either as of yet. Concessions have likely increased slightly, but this is due to problems estimating initial prices by Realtors®. As Realtors® get use to a more stable market, their pricing will improve and concessions will shrink, but the long-term trend will be to an expansion of concessions in order to move homes. Regardless, concessions and days on the market will rise, but this trend will only help to bring about a more equitable market, improving prospects for buyers and their Realtors®.

Economic Monitor

This table reflects data available through January 6, 2005.

Monthly Indicator	Recent Statistics	Likely Direction Over the Next Six Months	Forecast
Mortgage Rates The 30-year fixed mortgage rate slid 5 basispoints from November,averaging at 6.27% in December.Theeconomy is recovering rapidly and the resulting inflationarypressure is pushing up interest rates.Rates should hoveraround mid 6% during 2006.	Oct 6.07 Nov 6.33 Dec 6.27	↑	Higher, but do not expect the average rate to cross the 7% mark
Existing Home Sales eased 1.7% in November to a seasonal-ly adjusted annualized rate of 6.97 million units.The nationalmedian existing-home price for all housing types was $215,000in November,up 13.2 percent from November 2004.Housinginventory levels improved,rising 1.2 percent at the end ofNovember to 2.90 million existing homes available for sale – a5.0-month supply at the current sales pace.	Sep 7,290 Oct 7,090 Nov 6,970	↓	Three straight monthsof falling pending sales portend a decline ahead
New Home Sales fell 11% in November to 1.25 million sea-sonally adjusted annualized units.Despite the decrease,thepace of newly built unit sales was still strong,coming off arecord high in October.The inventory of new homes for salerose to a 4.9 month supply.	Sep 1,260 Oct 1,404 Nov 1,245	↓	Strong stock market could shift investor tastes toward financial equity over housing investment
Housing Starts rose 5.3% in November,posting 2.12 million units.Single-family starts of 1.81 million matched their all-time high level;multifamily units were again weak,with only 315,000 units.The three-month moving average of 2.1 million total starts would easily beat lastyear's annual total of 1.95 million.	Sep 2,160 Oct 2,017 Nov 2,123	↓	A substantial rise in unsold inventory of new homes gives builders a reason to pause
Employment While payroll employment rose by only 108,000in December,the previous month's figures were revised upwardsby nearly 100,000.Manufacturing jobs showed a very respectablegain of 18,000 and jobs in the professional business service sec-tor (those that require commercial office spaces) rose by 33,000during the month.In the past 12 months,2.0 million net payrolljobs have been added to the economy.	Oct 25 Nov 305 Dec 108	↑	4 million net new jobs over the next two years
Purchase Applications The December purchase applicationsindex was 455.5 – its lowest level since February 2005.The Indexcontinues to fall due to rising mortgage rates cooling down thehousing market and a decline in refinancing activities.	Oct 495.6 Nov 489.3 Dec 493.9	↓	Job losses ahead for mortgage lenders
Housing Affordability NAR's housing affordability index fellslightly in November to 115.0 – its lowest level in the last 12months.Even though household median income increased andthe median sales price of a single family home decreased duringthe month,these factors were offset by an increase in mortgagerates.	Sep 119.4 Oct 115.7 Nov 115.0	↓	Income growth continues to trail home price growth
Inflation The consumer price index (CPI) fell 0.6% in November.The decrease was due primarily to a decline in the transportationsector of –1.0%.The core index,which excludes food and energyrose 0.2%.Core prices have risen for the third straight month andare likely to remain at a strong pace through the winter as theirdemand rises from the rebuilding effort in the hurricane ravagedSouth and high fuel costs are passed through.	Sep 1.2% Oct 0.2% Nov -0.6%	↓	Inflation rate will decelerate (do not expect $3 per gallon gas price)

Notes: All rate are seasonally adjusted. New home sales, existing home sales, and housing starts are shown in thousands. Employment growth is shown as month-to-month change in thousands. Inflation is shown as the month-to-month change in the Consumer Price Index. Sources: NAR, Bureau of the Census, Bureau of Labor Statistics, Freddie Mac, and the Mortgage Bankers Association

MRIS

Local Report

District of Columbia, DC

Buyer's Market	1	2	3	4	5	Seller's Market
					↑	

Labor Market :

Washington saw 8,636 layoffs occur during October and November. Despite the decline in employment, the average monthly unemployment rate fell from 6.1% during the third quarter to 5.9% in the first two months of the fourth quarter. Despite the job losses, the labor market remains relatively strong leaving record low mortgage rates to drive home sales.

Housing Market :

	Q3' 05	Q4' 05	Q1' 06 (Forecast)
Average Price	$535,100	$558,000	↑
# Homes on the Market *	2,973	2,559	↔
# Homes Sold **	2,443	2,063	↓
# New Homes Built	42	10 ***	↓
Avg # of Days on Market	23	29	↑

* Available as of Dec. 31, 2005.
** May not add to total of zip codes.
*** During the first two months of 4th quarter.

Data by Zip Codes for Q4 2005

Zip Code	Average Price	Price Change ****	Total # Homes Sold (Quarter)	% Change in # Homes Sold ****	Average Days on Market	% of Asking Price (Sold/List Price)
20001	$483,400	17.67%	105	-40.00%	30	99.2%
20002	$454,100	15.96%	194	-29.20%	30	98.9%
20003	$588,400	10.85%	99	-7.48%	20	100.0%
20004	$505,800	-11.33%	17	240.00%	35	98.1%
20005	$521,200	29.11%	81	1.25%	28	99.7%
20006	$203,300	-75.42%	3	0.00%	39	95.1%
20007	$1,203,100	34.17%	147	-15.03%	36	95.6%
20008	$765,300	13.55%	121	-11.68%	27	98.0%
20009	$547,900	22.68%	278	-20.34%	22	100.0%
20010	$523,300	16.08%	83	-13.54%	25	99.5%

**** % Change of current quarter compared to the same quarter to year ago.

MRIS

Local Report

District of Columbia, DC

Data by Zip Codes for Q4 2005

Zip Code	Average Price	Price Change ****	Total # Homes Sold (Quarter)	% Change in # Homes Sold ****	Average Days on Market	% of Asking Price (Sold/List Price)
20011	$419,100	12.78%	212	13.98%	28	99.3%
20012	$587,700	16.28%	41	7.89%	40	98.8%
20015	$775,300	-3.52%	64	10.34%	17	100.7%
20016	$761,600	-5.30%	123	-36.27%	24	99.1%
20017	$358,200	26.84%	44	-10.20%	37	99.1%
20018	$369,300	29.99%	45	7.14%	27	99.0%
20019	$235,500	34.88%	115	-5.74%	29	99.9%
20020	$241,000	35.85%	73	-19.78%	26	99.0%
20024	$366,200	19.87%	47	-2.08%	29	97.3%
20032	$208,800	31.82%	41	17.14%	27	99.1%
20036	$359,700	0.22%	50	-16.67%	26	101.0%
20037	$781,100	37.59%	72	9.09%	77	98.2%
20307	$549,800	75.49%	4	33.33%	34	93.7%
20374	$195,000	47.17%	1	0.00%	10	100.0%
OTHER	$593,000	42.04%	3	50.00%	5	100.6%

**** % Change of current quarter compared to the same quarter to year ago.