DELTA ASSOCIATES

FOURTH QUARTER 2016

WASHINGTON AREA HOUSING OUTLOOK

THE WASHINGTON METRO AREA FOR-SALE HOUSING MARKET

Inventory in the Washington metropolitan area housing market tightened further during 4th quarter 2016 compared to 4th quarter 2015. The average sales price increased 1.1% since 4th quarter 2015, while the average number of days on market dropped during the same period. Aside from below average price growth, sales volume has continued to grow, reaching the highest 4th quarter performance since 2005. Coupled with a declining number of new listings, this has kept the region's months of inventory below balanced levels.

The recent federal hiring freeze implemented by President Trump, coupled with anticipated growth in private contracting, may affect the overall Washington housing market in both negative and positive ways over the next year. Even with the Federal Reserve's interest rate hike in December 2016, the regional housing market will likely see continued strong demand and a tight inventory in the short term due to anticipated future interest rate increases. *See Figure 1 for current housing market indicators.*

SUBURBS LEAD THE WAY

Although the average sale price for a Washington area home decreased during the 4th quarter, prices have risen by 1.1% since 4th quarter 2015. This annual price growth performance has been driven by growth in the Outer and Inner Suburbs, which more than offset a price decrease in the Urban Core.

The decline in prices during the 4th quarter occurred despite exceptionally strong demand throughout 2016 and the resulting smaller inventory of homes for sale. The inventory at 4th quarter 2016 is at its lowest point since 4th quarter 2013.

Depending on how constrained inventory levels remain in the various sub-areas, coupled with the Trump administration's mixed employment impacts on the regional economy, home prices will most likely continue to rise slowly in the coming year.

Of note, the $471,333 metro area average sale price during 4th quarter 2016 was 98.39% of list price. This compares to the long-term annual average since 2002 of 96.62%. The ratio remains high even as

HIGHLIGHTS

4TH QUARTER PRICES
Up 1.1% from 4th quarter 2015.

SALES VOLUME
Up 5.6% from 4th quarter 2015.

DAYS ON MARKET
Down 5 days from 4th quarter 2015.

MONTHS OF INVENTORY
Down 0.3 months from 4th quarter 2015.

MARKET INDICATORS

Washington Metro Area | At Fourth Quarter 2016 | *Figure 1*

		CHANGE VS. Q3 2016	CHANGE VS. Q4 2015
Q4 AVG. SALES PRICE	$471,333	↓ 1.5%	↑ 1.1%
Q4 SALES (UNITS)	16,139	↓ 18.2%	↑ 5.6%
Q4 AVG. DAYS ON MARKET	54	↑ 7	↓ 5
MONTHS OF INVENTORY*	2 Months	↓ 0.8 Month	↓ 0.3 Month

Source: MRIS, Delta Associates; February 2017.
**Months of Inventory at Dec. 2016. Figure reflects number of listings divided by homes sold in one month.*

HOME PRICES BY SUB-AREA*

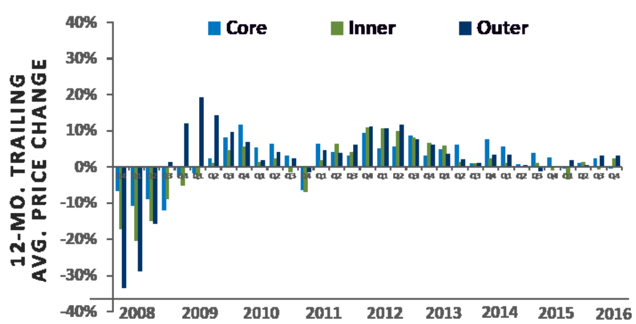
Washington Metro Area | At Fourth Quarter 2016 | *Figure 2*

SUB-AREA*		CHANGE VS. Q3 2016	CHANGE VS. Q4 2015
Core	$628,119	↓ 1.4%	↓ 0.4%
Units	*3,199*	↓ *13.2%*	↑ *2.7%*
Inner	$451,242	↓ 3.1%	↑ 2.3%
Units	*8,693*	↓ *18.2%*	↑ *4.7%*
Outer	$394,358	↓ 0.1%	↑ 3.2%
Units	*4,037*	↓ *21.2%*	↑ *10.6%*

*Source: MRIS, Delta Associates; February 2017. *Core: DC, Arlington, Alexandria. Inner: Fairfax, Montgomery, Prince George's, Fairfax City, Falls Church. Outer: Loudoun, Prince William, Frederick.*

HOME SALES AVERAGE PRICE CHANGE

Washington Metro by Sub-Area* | 2008 – 2016 | *Figure 3*



*Source: MRIS, Delta Associates; February 2017. *Core: DC, Arlington, Alexandria. Inner: Fairfax, Montgomery, Prince George's, Fairfax City, Falls Church. Outer: Loudoun, Prince William, Frederick.*

price growth has remained minimal in recent months. The spread between list and sold price may increase during 2017 if the available inventory increases.

The Washington area's **Core Jurisdictions** of the District of Columbia, Alexandria, and Arlington saw uneven price performance during the 4th quarter. The $628,119 overall average sale price in these jurisdictions is a 0.4% decrease since 4th quarter 2015, but only Alexandria and Arlington are responsible for this, as prices rose minimally in the District.

The **Inner Suburbs** of Fairfax (including the cities of Falls Church and Fairfax), Montgomery, and Prince George's counties experienced the second highest increase in home prices compared with 4th quarter 2015. Prince George's County saw the largest price increase of any jurisdiction in the region. The Inner Suburbs overall are up 2.3% from 4th quarter 2015 to an average of $451,242 in 4th quarter 2016.

Washington's **Outer Suburbs** of Prince William, Loudoun, and Frederick counties saw the largest increase in home prices during the fourth quarter of 2016, with prices rising 3.2% from 4th quarter 2015 to an average of $394,358. *See Figures 2 and 3.*

SALES PRICE ACTIVITY
WASHINGTON METRO AREA

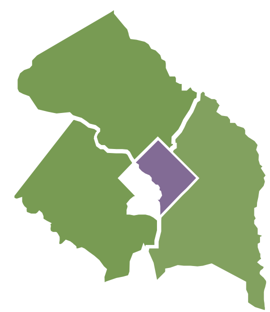
CORE JURISDICTIONS

The District
0.1% increase from Q4 2015

Arlington County
0.1% decrease from Q4 2015

Alexandria
1.5% decrease from Q42015

INNER RING JURISDICTIONS



Prince George's County
9.1% increase from Q4 2015

Montgomery County
2.0% increase from Q4 2015

Fairfax County
0.8% increase from Q4 2015

OUTER SUBURBS JURISDICTIONS

Frederick County
5.9% increase from Q4 2015

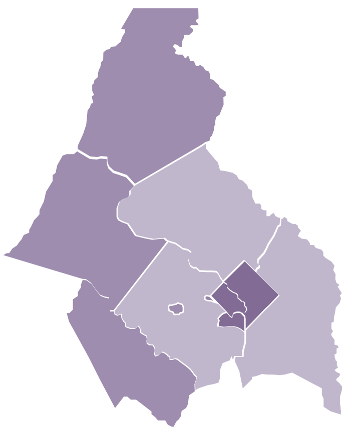
Prince William County
2.9% increase from Q4 2015

Loudoun County
1.1% increase from Q4 2015

SALES VOLUME GROWTH CONTINUES

Sales volume in the region continues its upward trend. With 16,139 closed sales during 4th quarter 2016, volume is up 5.6% from a year ago, marking the highest recorded 4th quarter total sales since 2005. The healthy sales volume is likely the result of homebuyers securing low mortgage rates before the December 2016 rate hike from the Federal Reserve. Sales volume will likely continue on its positive track in the short term.

AVERAGE DAYS ON MARKET



48 **Core:** Average DOM of 48 days, up one day from 4th quarter 2015

54 **Inner Suburbs:** Average DOM of of 54 days, down five days from 4th quarter 2015

57 **Outer Suburbs:** Average DOM of 57 days, down 10 days from 4th quarter 2015

AVERAGE DAYS ON MARKET DOWN

The average days on market (DOM) for homes sold in the Washington area at 4th quarter 2016 is 54 days. This is down five days from 4th quarter 2015 and significantly below the 10-year average of 68 days. The suburbs are responsible for this, as DOM in the Urban Core increased during the same period. Shrinking inventory, with active listings down by 17.1% in the 4th quarter, and strong sales volume have contributed to the decrease in average days on market. The Outer Suburbs have seen the sharpest improvement, with DOM decreasing by 10 days since 4th quarter 2015. *See Figure 4.*

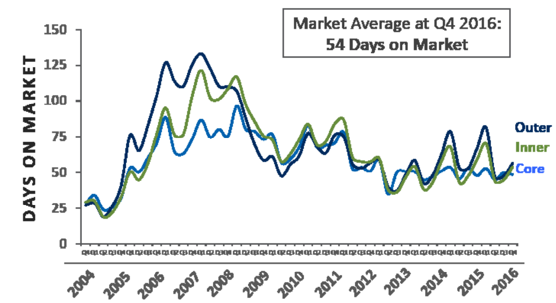
There are several explanations for the lower DOM level, including: a persistently tight inventory of homes for sale, continued low fuel prices which may enable buyers to move further into the outer suburbs where affordable inventory is more readily available, as well as the expected interest rate hikes in 2017.

AVAILABLE INVENTORY STILL TIGHT

The ratio of available listings to properties sold in one month remains below the 10-year historic average of 4.6 months. The metro area had two months of for-sale inventory at the end of 4th quarter 2016, which is down from the end of 3rd quarter 2016 and 4th quarter 2015.The current months of inventory figure is far below the post-recession peak of 6.9 months at the end of 2nd quarter 2010. Strong demand, made evident by the highest 4th quarter sales volume since

AVERAGE DAYS ON MARKET

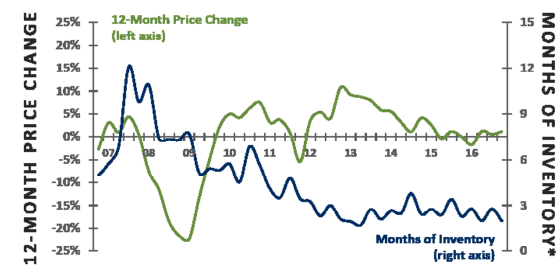
Washington Metro by Sub-Area* | Existing Homes | *Figure 4*



*Source: MRIS, Delta Associates; February 2017. *Core: DC, Arlington, Alexandria. Inner: Fairfax, Montgomery, Prince George's, Fairfax City, Falls Church. Outer: Loudoun, Prince William, Frederick.*

PRICE CHANGE AND INVENTORY

Washington Metro Area | 2006 – 2016 | *Figure 5*



Source: MRIS, Delta Associates; February 2017.
**Months of inventory at current sales pace for last month in each quarter.*

FOR-SALE LISTINGS

Washington Metro Area | Existing Homes | *Figure 6*

Source: MRIS, Delta Associates; February 2017.

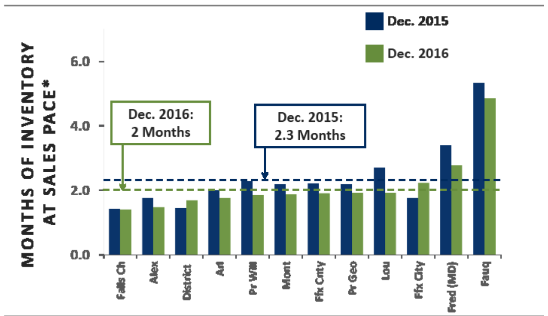
2005, has kept the months of available inventory from rising toward a more balanced level. *See Figures 5 and 6.*

In recent years, prices in the Washington area have tended to rise when there has been less than six months of inventory. The relatively low ratio during the past three years is attributable to fewer listings. During 2016, however, strong sales volume has also been a primary cause of the persistently low ratio. Demand is being driven by buyers who wish to take advantage of low interest rates, while also feeling more confident about Washington's regional economy. We expect this pattern to hold until the Federal Reserve implements more interest rate increases perhaps later in 2017.

Fauquier County, Virginia had the highest ratio in the region at 4.9 months of inventory at 4th quarter 2016. Meanwhile, Falls Church had the lowest available inventory relative to sales this quarter, at 1.4 months. *See Figure 7.*

MONTHS OF FOR-SALE INVENTORY

Washington Metro Area | *Figure 7*



Source: MRIS, Delta Associates; February 2017.
**Months of Inventory at Dec. 2016. Figure reflects number of listings divided by homes sold in one month.*

WASHINGTON AREA SLOWLY CATCHING UP WITH PEER REGIONS

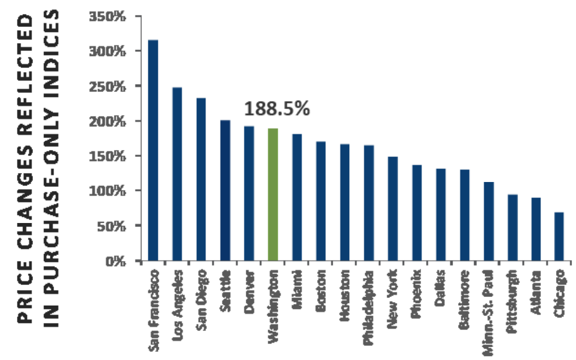
Although the past three years have seen the Washington area lose ground as one of the nation's strongest housing markets, the region's slow rate of price growth seems to be moderating and more on par with peer regions as of late. Between 1996 and 2016, prices rose 188.5% in the Washington region, according to the Federal Housing Finance Agency (FHFA), which ranks as the sixth highest long-term price growth rate among major metro areas. *See Figure 8.*

Over the past three years, price growth in many major U.S. metros surpassed the Washington market's rate of growth. The largest price gains are occurring in western and southern markets that are experiencing strong job and population growth or heavy foreign investment. These markets include Seattle, Portland, and Dallas. From October 2015 to October 2016, the Washington metro area ranked second to last among major metro areas in home price growth, with prices rising 3.4% over the year, according to S&P/Case-Shiller. Washington also underperformed the 20-city composite of the S&P/Case-Shiller Home Price Index, which saw an increase of 5.0% over the same period; however, the spread between Washington and the 20-city composite narrowed substantially during 2016. *See Figure 9.*

Of note, S&P/Case-Shiller's methodology is different from FHFA's in that it tracks "same-store" prices, or comparable unit sales.

PRICE CHANGES

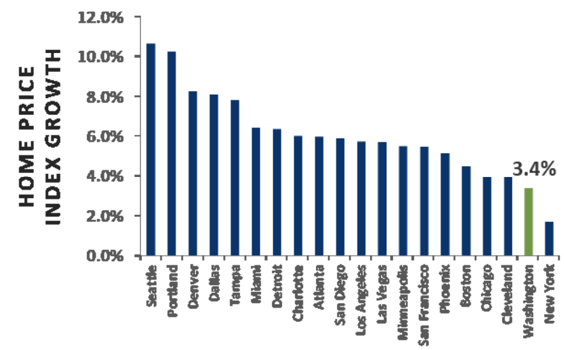
Selected Large Metro Areas | 1996 – 2016 | *Figure 8*



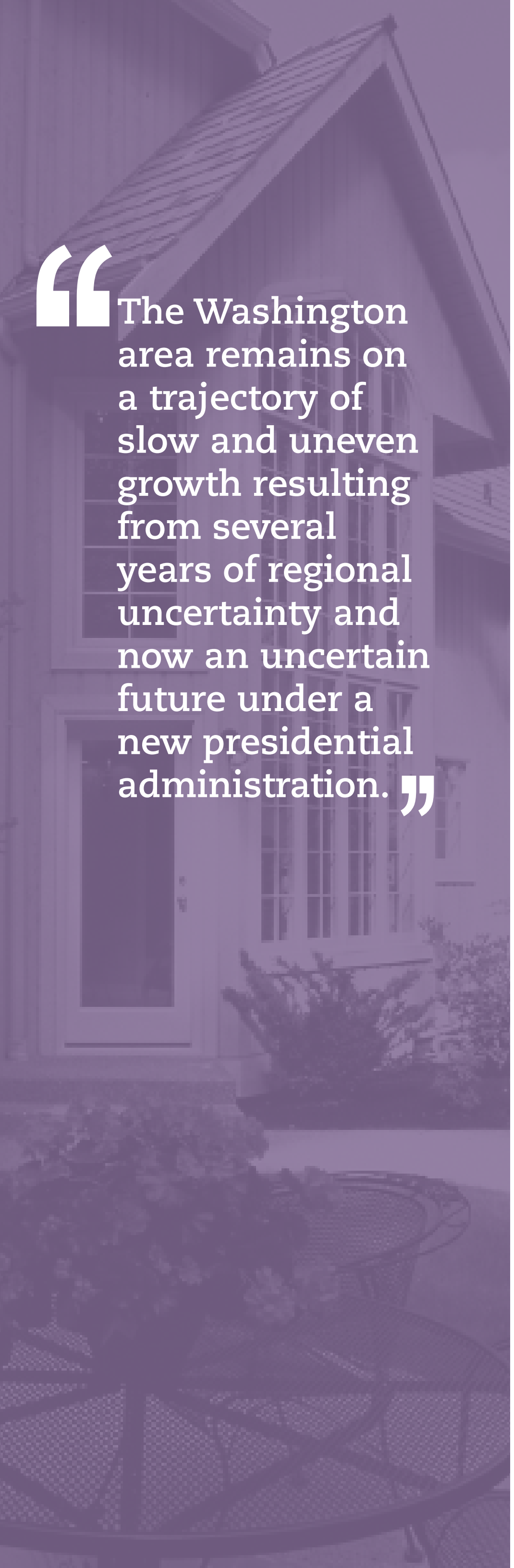
Source: FHFA, Delta Associates; February 2017.

PRICE CHANGES

Home Price Indices | October 2015 – October 2016 | *Figure 9*



Source: S&P/Case-Shiller, Delta Associates; February 2017.
Note: Seasonally adjusted purchase-only index.



"The Washington area remains on a trajectory of slow and uneven growth resulting from several years of regional uncertainty and now an uncertain future under a new presidential administration."

WASHINGTON AREA HOUSING OUTLOOK

The Washington area remains on a trajectory of slow and uneven growth resulting from several years of regional uncertainty and now an uncertain future under a new presidential administration. Major demographic shifts underway in urban and suburban areas with both Millennials and Boomers will continue to push the region into unfamiliar territory. Thanks to the suburbs, year-over-year prices rose during 4th quarter 2016, coupled with strong growth in sales volume.

The region's persistent shortage of homes for sale worsened during 2016. This may change in the next year if strong demand spurs more potential sellers to list their homes. However, with only a two month supply of homes, the Washington metro area still falls seriously short of the standard benchmark of six months for a balanced housing market.

The outlook for the regional housing market is generally mixed. The Washington metro area saw robust economic growth in 2016, with an unemployment rate that has dipped to 3.7%. The region was boosted by private sector growth as well as stabilization in Federal government employment and procurement activities after several years of cutbacks. Nevertheless, the new federal hiring freeze put in place by the Trump administration, as well as simmering legislative sentiments to relocate some federal agencies outside of the Washington region, casts a potential shadow over the region for 2017. Several factors will keep price appreciation at bay in the year ahead. These include:

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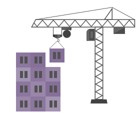
REGIONAL FACTORS
to consider

In addition to the December 2016 interest rate hike, additional increases may occur in the Federal Funds Rate during 2017, which will result in incrementally higher mortgage interest rates.



An inventory that remains tight and limits housing choices for buyers.

The presidential election results may fuel uncertainty over the regional economy; given the predominance of the Federal government in the region, this could affect the confidence of buyers and/or sellers.

A steady number of affluent, empty-nester suburban homeowners are retiring and leaving for either smaller, more affordable markets, or urban, amenity-rich areas, which may dampen performance among higher-priced single-family detached homes.

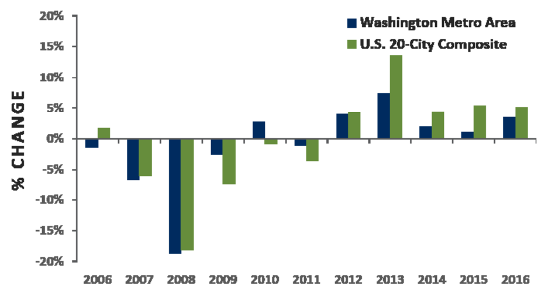
The limited buying power of younger homebuyers will likely lead to a shift in market share away from more expensive single-family detached homes and toward entry-level townhouses and condos in more affordable submarkets.

THE BIG PICTURE

Our Take: The Washington area saw a 3.4% increase in existing home prices for the 12 months ending October 2016, underperforming the S&P/Case-Shiller 20-city composite index of 5.0%. Washington outperformed its peer cities in previous years but currently ranks second to last among major metro areas. Still, most of the major markets included in the composite index continue to experience slower price growth, and the spread between Washington and the 20-city composite decreased over 2016.

PERCENT CHANGE IN HOME PRICES

Washington Metro Area vs. 20-City Composite | *Figure 10*

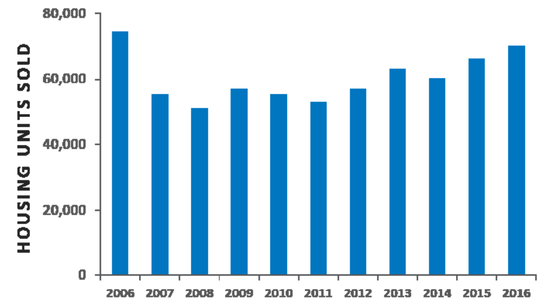


Source: S&P/Case-Shiller, Delta Associates; February 2017.
Note: Seasonally adjusted purchase-only index.

Our Take: The 4th quarter 2016 sales volume of 16,139 units is 5.6% higher than the 4th quarter 2015 sales volume. The sales volume for all of 2016 was 70,330 units – 6.1% higher than the sales volume for all of 2015. The region's for-sale market may continue its strong sales performance until the Federal Reserve implements additional interest rate hikes throughout 2017. The high sales volume will likely keep the region's months of available inventory figure very low.

RESALE VOLUME

Washington Metro Area | All Housing Types | *Figure 11*

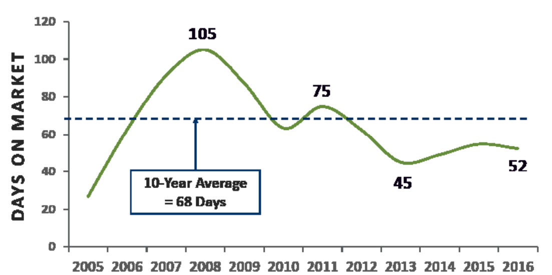


Source: MRIS, Delta Associates; February 2017.

Our Take: The average days on market (DOM) for 4th quarter 2016 is 54 days, five days less than a year ago and 19 days less than the 10-year average of 68 days. The 12-month trailing DOM average of 52 days is down three days from a year ago.

12-MONTH AVERAGE DAYS ON MARKET

Washington Metro Area | Existing Homes | *Figure 12*

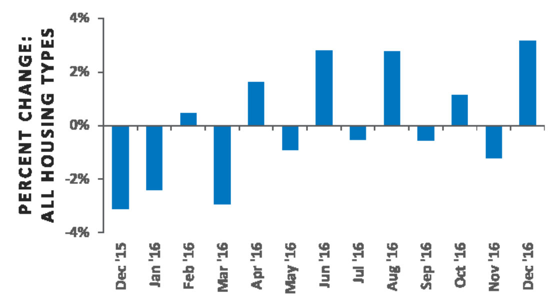


Source: MRIS, Delta Associates; February 2017.

Our Take: The Washington area's average resale price increased 1.1% from December 2015 to December 2016. Price growth will remain modest for 2017.

RESALE PRICE CHANGE

Washington Metro Area | 12-Month Change | *Figure 13*



Source: MRIS, Delta Associates; February 2017.

MILLENNIALS MAY LEAVE EXPENSIVE CITIES FOR SMALLER, CHEAPER MARKETS

Today's popular perception of a typical Millennial's lifestyle includes an amenity-rich rental apartment located in the urban core of a large, expensive and bustling metropolitan market. Experiential retail establishments, foodie hubs, and employment centers are conveniently accessible either by foot or public transit. In the Washington region, the District and Arlington are commonly associated with the signs of this demographic phenomenon.

This trend has been well-documented by Census figures, as a substantial number of young adults relocated to larger urban areas in the years immediately following the Great Recession. Considering the weak national job market at the time, large cities such as Washington, San Francisco, and New York offered relatively abundant employment opportunities. Unlike the suburban environs in which they were raised, these cities offered Millennials readily-available public transit, walkability, and an urban context that complimented their preference for authentic experiences.

Nevertheless, several factors now suggest America's largest demographic group since the Boomers may come to prefer a different lifestyle in the years ahead. Millennials may have simply been stuck in an urban lifestyle because economic conditions prevented them from buying homes and automobiles, according to William Frey, a demographer at the Brookings Institution. Furthermore, commercial real estate firm CBRE recently conducted a global survey that showed a slight majority of responding Millennials (55%) were open to living in a small or medium-sized town.

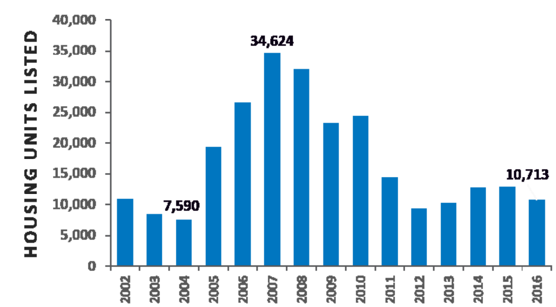
An improved national economy has opened up employment and homeownership opportunities beyond the high-cost cities to more affordable, mid-sized markets, including Raleigh, Austin and Colorado Springs. Although not smaller cities, the Dallas, Houston, and Atlanta metro areas offer similar opportunities. According to Lawrence Yun, chief economist at the National Association of Realtors, the housing price difference between the most expensive and cheapest metro areas is greater than it has been in the past two decades. If more Millennials marry and have children, a larger share may relocate to these types of lower-cost markets in search of better schools and more space.

Employers in the Washington region are also taking note of this potential wave and acting accordingly. In October 2016, the CoStar Group, a Washington-based real estate data firm, announced it was establishing a new research headquarters further south in Richmond and adding over 700 new jobs. Andrew Florance, CEO of CoStar, cited the ability to attract young professionals in a more affordable market as the top reason for the new division headquarters location. Kansas City and Charlotte were among the 20 other mid-tier markets CoStar explored before selecting Richmond.

In the long run, smaller cities or suburbs of large cities that offer employment opportunities, affordable housing, access to public transit, and quality schools will likely emerge as popular destinations for the evolving Millennial demographic. For the Washington region, this could mean Millennials settling in a Metro-accessible Loudoun County, or simply relocating altogether to more distant markets like Richmond, Raleigh, and Nashville.

ACTIVE LISTINGS

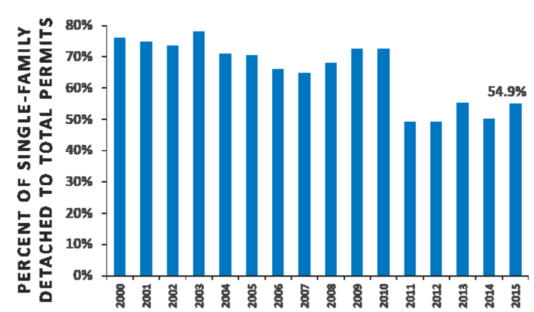
Washington Metro Area | All Housing Types | *Figure 14*



Source: MRIS, Delta Associates; February 2017.
Note: Listings at end of Fourth Quarter.

RATIO OF SINGLE-FAMILY DETACHED PERMITS

Washington Metro Area | 1-Unit Permits vs. Total Permits | *Figure 15*



Source: U.S. Census, Delta Associates; February 2017.
Note: Used annual data at metropolitan level.

WASHINGTON AREA ECONOMIC OUTLOOK

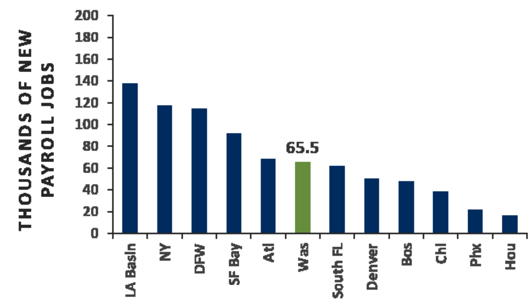
Looking ahead, there is a great deal of uncertainty surrounding the policies of the incoming presidential administration and their effects on the region's economy. Perhaps most importantly for the region is the effect on federal hiring. President Trump has frozen federal hiring and promised to reduce the size of the federal workforce through attrition. This would almost certainly have an adverse effect on the region, which is home to nearly 400,000 federal workers. However, at the same time, the new administration wants to increase federal infrastructure and defense spending, which would benefit the local economy. It is also possible that a reduction in the number of federal jobs would be offset by hiring in the private sector, as the government moves more work to contractors. Nevertheless, it will be at least a few months before we know for certain the effects of the new administration on the Washington area's economy, and even longer before those effects are felt.

Aside from the uncertainty, the Washington economy is poised to strengthen further in 2017. We predict that another 51,000 new jobs will be created in the region in 2017, with the pace of annual job growth slowly declining in subsequent years. Overall, we expect annual job growth in the metro area to average 43,600 over the next five years. The Washington metro area has a wealth of assets – a highly skilled workforce, access to international markets, high quality education, and vast cultural resources – that will continue to give it a competitive advantage over other large metro areas in the long run.

Regional economic growth will be driven primarily by the private sector. By 2020, the Federal government's contribution to Washington's GRP will have shrunk to

PAYROLL JOB GROWTH

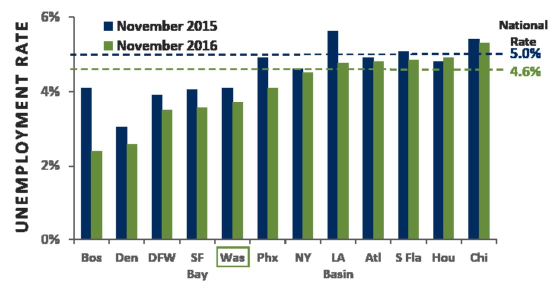
Large Metro Areas | 12 Months Ending November 2016 | *Figure 16*



Source: BLS, Delta Associates; February 2017.

UNEMPLOYMENT RATES

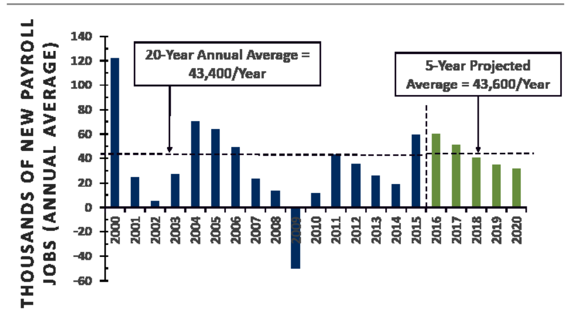
Large Metro Areas | November 2015 vs. November 2016 | *Figure 17*



Source: BLS, Delta Associates; February 2017. *Note: National rates are seasonally adjusted.*

PAYROLL JOB GROWTH

Washington Metro Area | 2000 – 2020 | *Figure 18*



Source: BLS, George Mason University Center for Regional Analysis, Delta Associates; February 2017.

approximately 27%, down from about 37% today. As a result, many jurisdictions in the Washington metro area have sought to reduce their reliance on the Federal sector by becoming more attractive to other industries.

The tech industry is shaping up to be a major source of growth for the Washington area's economy, with strong potential in the District, Maryland, and Virginia alike. During 2016, tech firms 2U, RainKing Software, Optoro, and Opower expanded their operations in the region and committed to hiring additional workers in the near future. Likewise, coworking firms, which cater to tech startups, have been on a path of rapid expansion in the Washington area. Coworking firms WeWork, MakeOffices, Eastern Foundry, Spaces, and Serendipity Labs all signed major leases for space in the region's core. In Montgomery County, life sciences firms including Novavax, AstraZeneca, GlaxoSmithKline, and United Therapeutics have doubled down on their economic investments in the region, adding to their workforces

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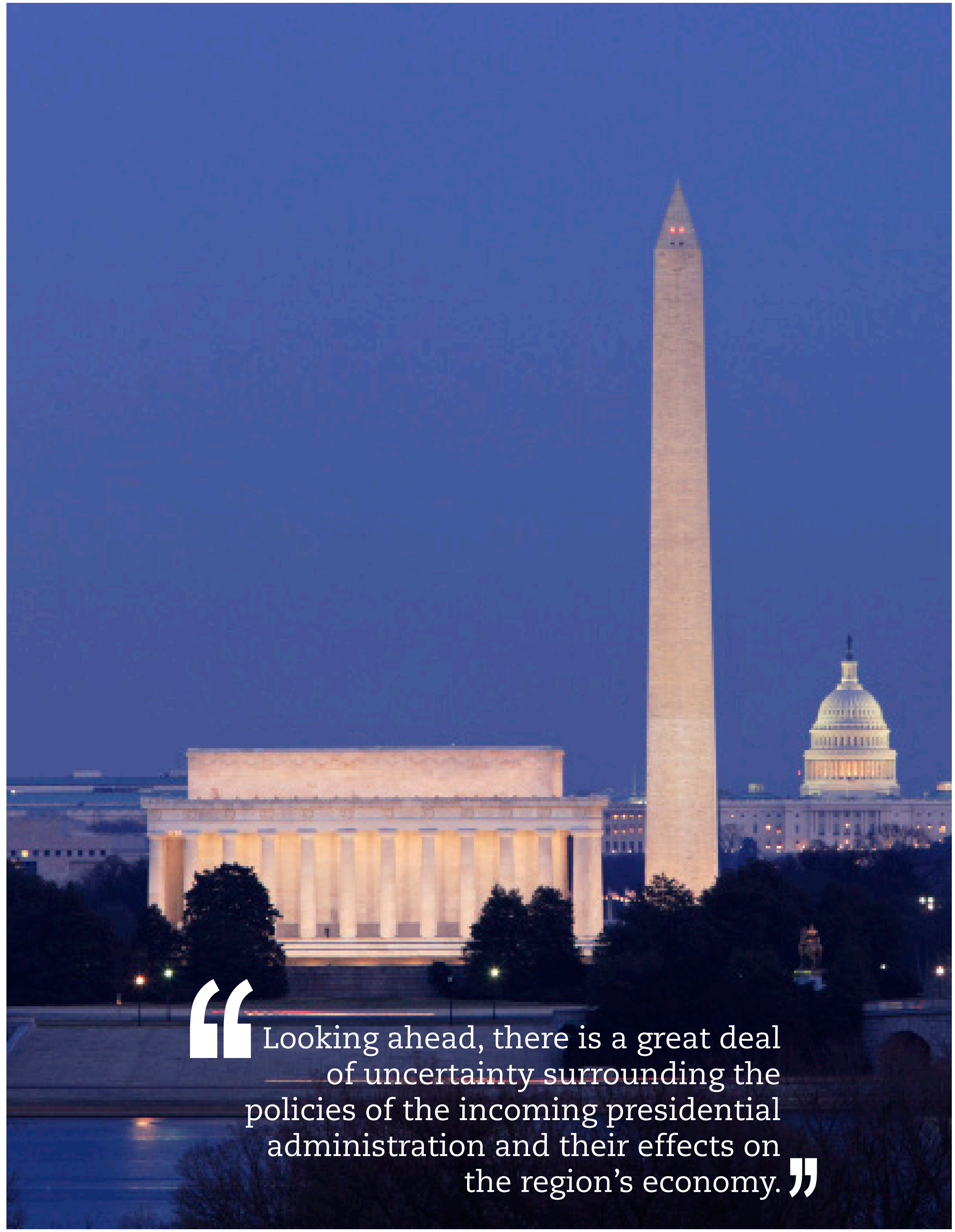

ABOUT DELTA ASSOCIATES

Delta Associates is a firm of experienced professionals serving the commercial real estate industry for over 35 years. The firm's main practice areas are:

1. Consulting, research, and advisory services for all property types throughout the United States (including market feasibility studies, highest and best use analysis, market entry strategies, asset performance enhancement studies, market due diligence, white papers on special topics, valuation analysis); and
2. Subscription publications for selected metro areas for the apartment, condominium, office, retail, and housing markets.

For more information on Delta Associates, please visit DeltaAssociates.com.

Delta's Washington Area Housing Outlook team includes:

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- David Parham, Senior Vice President

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Sources: Sources: GMU Center for Regional Analysis, Delta Associates, Federal Housing Finance Agency, Metropolitan Regional Information Systems, National Association of Homebuilders, NATIONAL ASSOCIATION of REALTORS®, RB Intel, S&P/Case-Shiller, U.S. Bureau of Labor Statistics, U.S. Census Bureau.

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