

U.S. STATE MONITOR

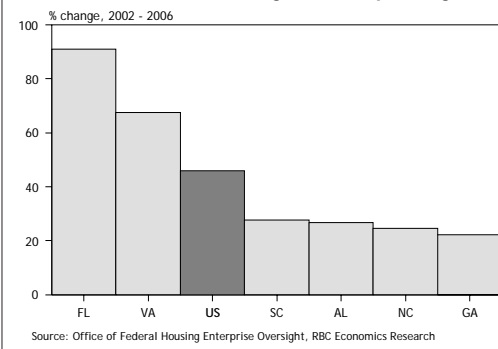
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States in focus



Southeast region: North Carolina, South Carolina, Virginia, Georgia, Florida, Alabama

CHART 1 Cumulative average house price gains



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Southeast housing correction bumpy through 2007

The housing market correction across the U.S. southeast continues to bottom out, with weakness expected to persist through the remainder of the year. New and existing home sales continue to trend down, inventories remain bloated and house price gains have moderated into the single-digit range. Many buyers have been able to reclaim some negotiating power because of high inventory levels but are now facing a hit from a higher mortgage rate environment. As markets bottom out and shake off their excess inventory through the remainder of the year, housing markets across the southeast are expected to start on a gradual recovery path in 2008. There is, however, significant intra-regional variation — markets in Florida and Virginia have been hit much harder by the housing correction compared to markets in North Carolina, South Carolina, Virginia and Alabama.

Strong housing run eroded affordability

During the course of the housing run, rapid growth in house prices outstripped income gains in many regions and led to a significant nationwide deterioration in affordability conditions. The affordability index in the southeast region, measured as the ratio of incomes to house prices, was no exception and underwent a significant erosion. The affordability index in both Florida and Virginia had the sharpest drop from 2002 to 2006, reporting declines of roughly 30%. The remaining southeast states witnessed much milder increases in house prices relative to incomes, translating into only modest affordability declines in the 5%-10% range during the four-year span.

House price gains proved unsustainable

From 2002 to 2006, average U.S. house prices rose a cumulative 46%. Across the southeast region, price gains varied significantly from the national average. Florida and Virginia booked the strongest price increases, with cumulative gains of 90% and 60%, respectively — a pace well above the national average. The cumulative gains booked in this same period in South Carolina, Alabama, North Carolina and Georgia, however, were well below the nationwide average and hovered in the 20%-30% range. Part of the disparity in gains can be explained by fundamental housing market drivers like employment and income gains. But rapid price escalations have not been entirely driven by fundamental supports. Speculation also drove up property values across many of these markets and, as conditions began to soften, these markets began to unwind rapidly. This unwinding process has been led by a combination of declining sales in both the new and existing home markets, a slower pace of price gains and higher mortgage rates, resulting in a significant retreat in residential construction activity.

Existing home market shows tentative signs of stability

As the lagged effects of higher interest rates began to filter through the economy in the late part of the housing cycle, homeowners began to feel the bite and the market began to pull off from its peak. Resale activity in the southeast region was hit hard through 2006 with existing home sales down roughly 12% in 2006. Again,

Florida and Virginia were the clear outliers acting as a drag on overall resale activity with declines of 20-30% in 2006. The remaining states all saw much more moderate declines in resale activity. There are tentative signs, though, that the market is now stabilizing. There was an uptick in resale activity in the first quarter of 2007 in all the southeastern states except Georgia. The increase in resale activity in Florida and Virginia in the first quarter was the first pick-up in six quarters.

### New home building still pulling off sharply

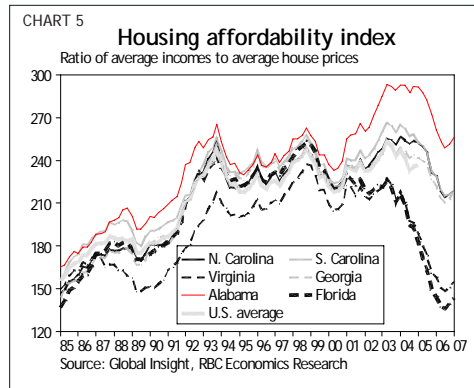
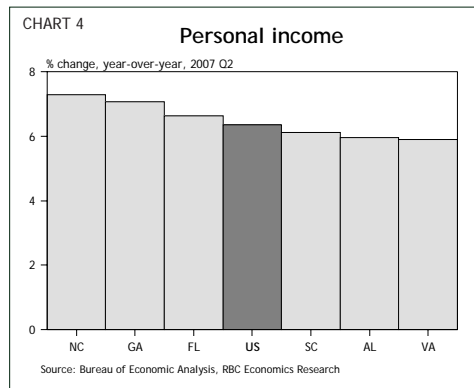
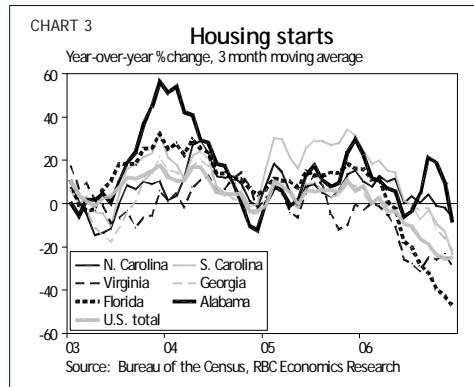
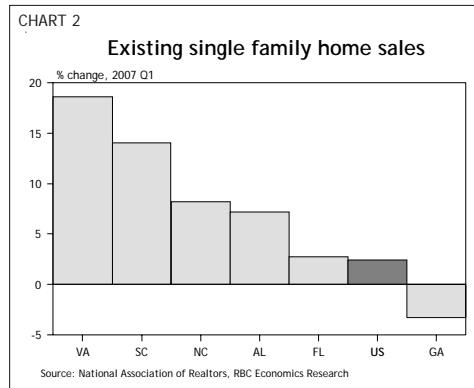
Construction activity has cooled right across the southeast region. Florida is leading the drop with a sizeable 50% annual rate of decline in activity in the first quarter of 2007 — a pace more than double the national rate of decline. Virginia is not far behind with annual declines in the 40% range. Housing starts in North Carolina and Alabama are holding up compared to the other states but are still undergoing annual declines in the 10% range so far this year. Furthermore, declines in residential permits are signalling more weakness in the pipelines for the new home market. Construction intentions in the Florida market are particularly weak with residential permits down on average 50% year-over-year so far in 2007. Housing starts are expected to continue to cool off through the remainder of the year in reaction to sharply weaker demand conditions. However, the magnitude of the drag from declining residential investment will gradually ease towards the end of the year.

### Key economic supports still intact

Job markets in the southeast reported a meaningful pick up beginning in 2004 with both Virginia and Florida leading the pace of gains. Employment gains have started to moderate right across the region but still remain at healthy levels. The pace of job growth so far in 2007 is tracking about one-half a percentage point below the pace clocked in 2006. However, even the current pace of gains is still supportive of a tight labour market and rising wages. Personal incomes continue to grow at healthy rates. North Carolina, Florida and Alabama are tracking a faster pace of income growth compared to the national average, while South Carolina, Virginia and Georgia are tracking a touch below. Healthy wages have provided a powerful offset to softer real estate markets and will help support the consumer in the coming year as housing markets remain soft.

### Affordability begins a modest improvement

Cooler housing markets have made way for a modest improvement in affordability across the southeast during the last few months. All six states that we track saw a second consecutive quarterly improvement in affordability. This trend is likely to continue as the market tilts in favour of buyers after a very strong run for sellers. Moderating house price growth combined with still healthy wage gains will support more favourable affordability conditions and gradually help tempt new homeowners back into the market. So, where do housing markets go from here? While part of the increase in house prices was driven by strong fundamentals in the economy, part is also attributable to a market that turned speculative towards the end of the cycle. While one quarter does not make a trend, there are some indicators signalling that the market is beginning to stabilize near the bottom after a fairly significant housing market correction. However, housing markets in Florida and Virginia are correcting off much higher levels and have significantly more downside potential compared to the rest of the region. While there is significant state-by-state variation playing out, we expect most markets to make a slow and gradual recovery into 2008.



## U.S. southeast current economic indicators

### REAL ESTATE PROFILE

		<u>North Carolina</u>	<u>South Carolina</u>	<u>Virginia</u>	<u>Georgia</u>	<u>Alabama</u>	<u>Florida</u>	<u>United States</u>
At seasonally adjusted annual rates, unless otherwise indicated								
Housing starts	March-07	95,884	43,499	36,738	88,680	27,344	133,984	1,491,000
Annual % change (3-month moving ave.)		-10.7%	-26.8%	-38.5%	-21.9%	-14.9%	-53.7%	-31.0%
Housing permits	May-07	97,332	58,020	49,428	95,184	27,144	130,284	1,707,600
Annual % change (3-month moving ave.)		-17.7%	-10.8%	-21.6%	-20.5%	-17.3%	-47.5%	-25.1%
Home prices (median)								
Existing homes	Q1 2007	\$137,156	\$121,839	\$229,565	\$142,462	\$109,348	\$208,608	\$212,300
Annual % change		7.9%	7.5%	5.3%	4.9%	6.9%	4.2%	-1.8%
New homes	Q1 2007	\$174,907	\$162,853	\$301,545	\$186,986	\$144,291	\$287,805	\$252,200
Annual % change		11.5%	10.5%	12.8%	9.3%	8.8%	11.5%	1.8%
Home price index (weighted repeat sales)								
Annual % change	Q1 2007	8.0%	7.6%	5.4%	5.0%	7.0%	4.3%	4.3%
Existing single family home sales <sup>1</sup>	Q1 2007	\$244,100	\$116,800	\$149,000	\$235,600	\$127,800	\$346,800	\$6,413,000
Annual % change		0.7%	-2.7%	-5.7%	-7.4%	-4.1%	-25.1%	-6.6%
Vacancy rates <sup>2</sup>								
Industrial	Q1 2007	11.1%	n/a	15.2%	19.8%	n/a	8.7%	9.7%
Office	Q1 2007	12.5%	n/a	9.9%	19.0%	n/a	9.9%	12.8%

1. Including apartments, condominiums, and cooperatives

2. Charlotte-Gastonia-Rock Hill, NC; Washington, DC-MD-VA-WV; Atlanta, GA; Ave of major MSA's, FL for office and Jacksonville for industrial.

### ECONOMIC PROFILE

		<u>North Carolina</u>	<u>South Carolina</u>	<u>Virginia</u>	<u>Georgia</u>	<u>Alabama</u>	<u>Florida</u>	<u>United States</u>
Employment	May-07	4,093,500	1,926,600	3,774,100	4,150,000	2,009,000	8,119,400	137,831,000
Annual % change (3-month moving ave.)		1.8%	1.2%	1.1%	1.4%	1.5%	1.5%	1.4%
Unemployment rate		4.8%	5.4%	2.9%	4.3%	3.5%	3.4%	4.5%
Labor force		4,525,719	2,145,299	4,049,775	4,838,099	2,214,412	9,173,427	152,762,000
Annual % change (3-month moving ave.)		1.9%	1.7%	1.9%	2.5%	1.8%	2.8%	1.3%
Personal income growth (annual % cl)	Q1 2007	6.1%	5.6%	4.5%	5.3%	6.3%	6.1%	5.8%

### EMPLOYMENT PROFILE

		<u>North Carolina</u>	<u>South Carolina</u>	<u>Virginia</u>	<u>Georgia</u>	<u>Alabama</u>	<u>Florida</u>	<u>United States</u>
July-07								
Employment (non-agricultural)								
Annual % change [share of employment]								
Total		2.7	2.7	0.9	1.4	1.3	0.4	1.1
Government		2.3 15%	2.5 16%	1.4 18%	2.1 16%	1.6 18%	2.6 13%	0.8 15%
Manufacturing		-3.3 13%	-1.1 13%	-3.4 7%	-3.9 10%	-2.5 15%	-4.1 5%	-2.0 10%
Professional & business services		4.7 12%	4.4 12%	2.6 17%	1.7 14%	2.4 11%	1.0 17%	1.9 13%
Education & health services		5.0 13%	5.6 10%	3.5 11%	3.7 11%	2.5 10%	2.9 13%	3.1 13%
Retail trade		2.8 11%	2.5 12%	1.2 11%	2.6 12%	3.5 12%	0.3 13%	1.0 11%
Wholesale trade		3.3 4%	5.1 4%	1.4 3%	1.9 5%	0.7 4%	1.2 5%	2.2 4%
Leisure & hospitality		3.5 10%	5.6 12%	1.8 10%	3.4 10%	2.2 9%	2.1 12%	2.6 10%
Transportation & utilities		-0.8 3%	4.2 3%	1.1 3%	2.3 5%	1.6 4%	0.5 3%	1.2 3%
Construction		2.6 6%	3.3 7%	-3.9 7%	0.0 5%	1.9 6%	-10.0 8%	-0.9 6%
Financial services		1.7 5%	3.8 6%	-0.5 5%	0.6 6%	1.6 5%	-0.9 7%	0.0 6%
Unemployment rate (%)								
July-07		4.7	5.8	3.0	4.4	3.6	4.1	4.7
July-06		4.7	6.2	3.0	4.5	3.5	3.4	4.7
Labor force								
y/y % change		1.0	1.3	1.5	1.8	0.9	2.3	1.1

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