

Washington State's Housing Market: A Supply/Demand Assessment

Third Quarter 2005

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Media outlets are begging to hype the slowing housing market as we approach year-end 2005, and it certainly is possible that the peak of the cycles is behind us. However, home sales activity during the third quarter of 2005 in Washington remained in record territory. Of course, increases in mortgage interest rates have been concentrated in the time since the end of September, as have many of the monthly releases suggesting somewhat less robust levels of home sales or construction. Home prices also remained on a rapidly increasing path through the third quarter, while the combination of higher prices and modestly higher mortgage rates combined to produce continued reductions in the affordability of housing.

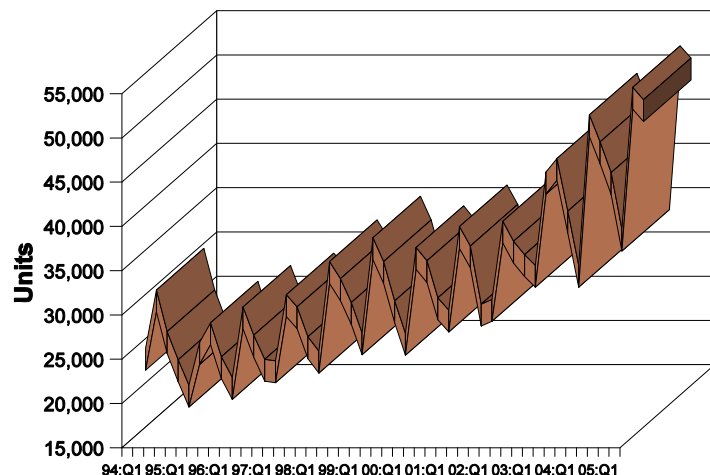
Home Resales

Statistics collected from multiple listing services (and from organizations which monitor deed recordings in areas where multiple listing coverage is less complete) indicate that sales of single-family homes (excluding most new construction) backed off from the record pace of the second quarter, but still recorded a level of activity never before seen so late in the year, as a total of 50,760 homes were sold between July and September. This represents an increase in activity of 10.4 percent compared to the third quarter of 2004, and only the second time that more than 50,000 homes have been sold in a single quarter. Only three counties reported fewer home sales than a year ago – San

Note: This report uses the new definitions of metropolitan and micropolitan areas as finalized by the Office of Management and Budget in July 2003. Briefly, metropolitan areas are, as before, larger communities with at least 50,000 people in the urban core. Micropolitan areas are smaller cities, with 10,000-50,000 people in the urban core. Currently, Washington has 17 metropolitan counties in 13 metropolitan areas (or divisions) and eight micropolitan areas.

Existing Home Sales

Washington: 1994-2005



Juan, Clallam and Skagit. Meanwhile sales were more than 20 percent above a year ago in 14 of Washington's 39 counties, including both urban and rural areas.

Among the urban areas, the greatest percentage increase was reported in Asotin County, where sales during the second quarter were 28.4 percent above the 2004 level. Spokane

was a close second, increasing 21.7 percent. Among the micropolitan areas (smaller cities), the most rapid increase in sales was observed in Lewis County (Centralia/Chehalis) where activity jumped 47.0 percent.

Housing Construction

Construction activity, as measured by building permits, remained strong, but was flat compared to last year, with 12,693 units approved for construction. This is 1.0 percent above a year ago. Single-family permit activity was 5.5 percent above last year, meaning multifamily construction was down somewhat. Construction activity, as reported to the Census Bureau was locally spotty, with 11 of the 28 counties responding indicating that permits had increased, while the larger group reported slightly fewer single-family homes approved for construction.

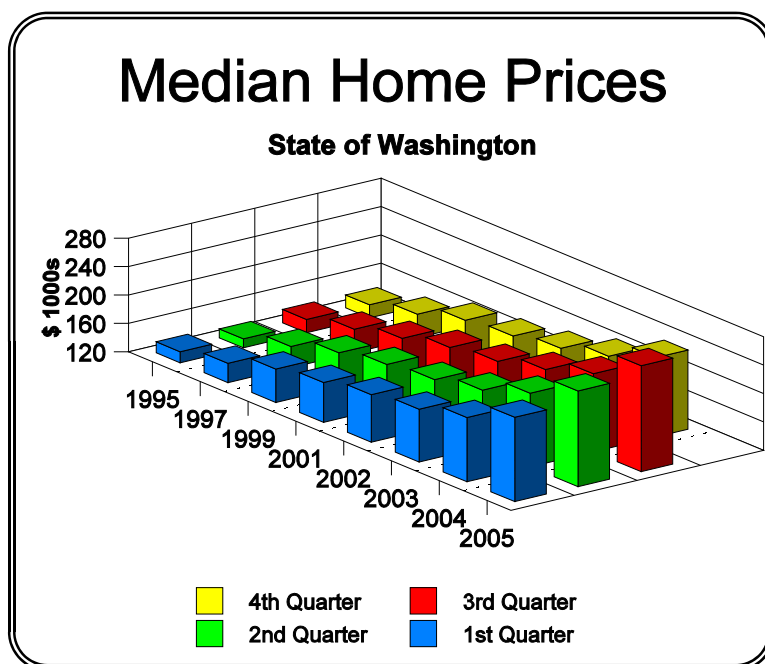
Home Prices

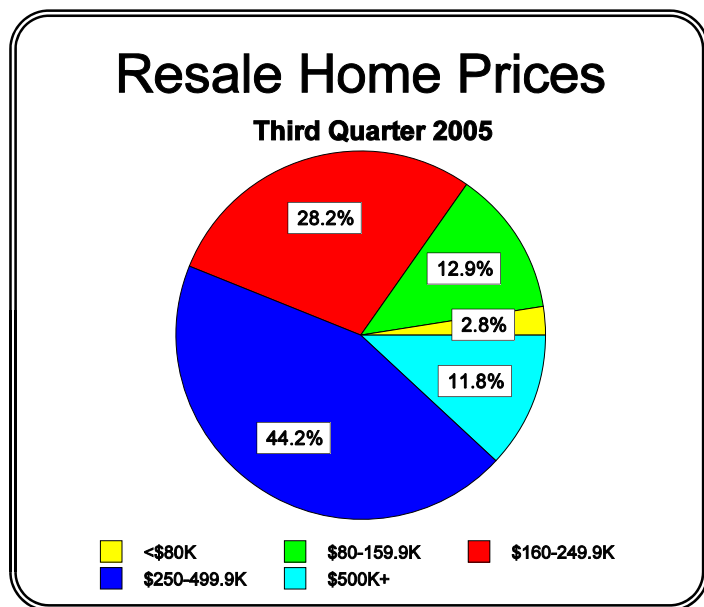
The median selling price for a resale home in the state of Washington during the third quarter of 2005 increased another \$15,000 from the previous quarter, reaching \$269,300. This represents an increase of 17.1 percent compared to a year ago. Three months ago the year-to-year advance was 13.9 percent indicating no slowing of home price inflation through September. Median prices ranged from a high of \$475,000 in San Juan County to a low of \$92,900 in Columbia County.

Urban areas also had wide-ranging median prices, from a low of \$134,100 in Asotin County to a high of \$380,000 in King County. Snohomish County also reported a median in excess of \$300,000. Among micropolitan areas, the range of median prices was a bit more limited, from a low of \$119,800 in Grant County to a high of \$266,500 in Island County.

Grant and Yakima counties reported median prices which were lower than a year ago, but all other communities from which WCRER receives price data were higher than last year. The most rapid increase was 36.6 percent in usually bargain priced Pacific County. Eleven other counties reported price jumps of at least 20 percent. Among the metropolitan markets, the price changes ranged from a 2.2 percent drop in Yakima County to 26.4 percent surge in Spokane County.

Measures of central tendency, like median prices (half the homes sold were more expensive, half less) which use a single number to represent a distribution of home prices, tend to confuse some prospective buyers into believing there is nothing less expensive than the median in the marketplace. While there were significant numbers of homes which sold for prices well below the statewide median, the largest concentration of less costly housing is outside a reasonable commuting distance from major population and employment centers. However, even in urban areas, lower cost housing is often





available, especially if the buyer is willing to invest some hard physical labor improving the home. In fact, while “only” 2.8 percent of the single-family homes sold during the third quarter were priced no higher than \$80,000, this represents about 1,420 homes. Clearly, affordable ownership housing is available and being purchased throughout Washington state. It should be stressed that these statistics represent only resale, single-family homes. Condominium apartments and manufactured homes represent other affordable ownership housing options.

Housing Affordability

A central feature of **Washington State’s Housing Market** is the data on housing affordability. Following the model developed in 1982 by the National Association of REALTORS®, the Washington Center for Real Estate Research calculates a housing affordability index for all buyers and for first-time buyers. These affordability calculations depend on statistics from a variety of sources. The effective mortgage rate on loans closed during the quarter (5.83 percent) is used in this calculation. While the average downpayment on home purchases is 25 percent, the most frequently encountered downpayment is 20 percent. Accordingly, that percentage is used in the calculation of the all-buyer index. A 30-year term is assumed for paying off the loan.

Income is the other key component of affordability analysis. WCRER obtains county-level data on family and household incomes from a consulting firm. In economic statistics, a family is two or more people related by blood, marriage or adoption who share a housing unit. Single adults with children or other dependent relatives (e.g. an aging aunt) are families. Household income includes all families as well as persons living alone or unrelated adults sharing a housing unit (roommates, etc.). Since the vast majority of home purchases (approximately 85%) are made by families, family income is used in the calculation of the all-buyer affordability index.

The Housing Affordability Index for Washington State in the second quarter stood at 101.6, meaning that a median income family had 1.6 percent more income than the bare minimum required to qualify for a mortgage on the median price home. This represents a another decline of five index points compared to the second quarter, and an drop of 15.9 points compared to the third quarter of last year -- a very rapid deterioration in affordability. The all-buyer affordability level has now dropped to its lowest level since WCRER began computing the statistic in the second quarter of 1994. Nevertheless, all-buyer affordability index remains within normal ranges of national experience since 1982, primarily because mortgage interest rates, while higher than in the most recent quarters are still very low by the standards of the last 40 years. Since the Federal Reserve Board continues a policy of higher interest rates, the mortgage rate will rise somewhat in the months ahead, putting additional pressure on housing affordability.

The all-buyer affordability index indicated that a median income family could still afford to

purchase the median price home in 30 of the 35 counties for which the statistics are calculated. Locally, housing affordability indexes ranged from a low of 51.4 in San Juan County to a high of 225.7 in Columbia County. Among metropolitan areas, affordability indices ranged from a high of 180.0 in Benton County to a low of 85.3 in King County.

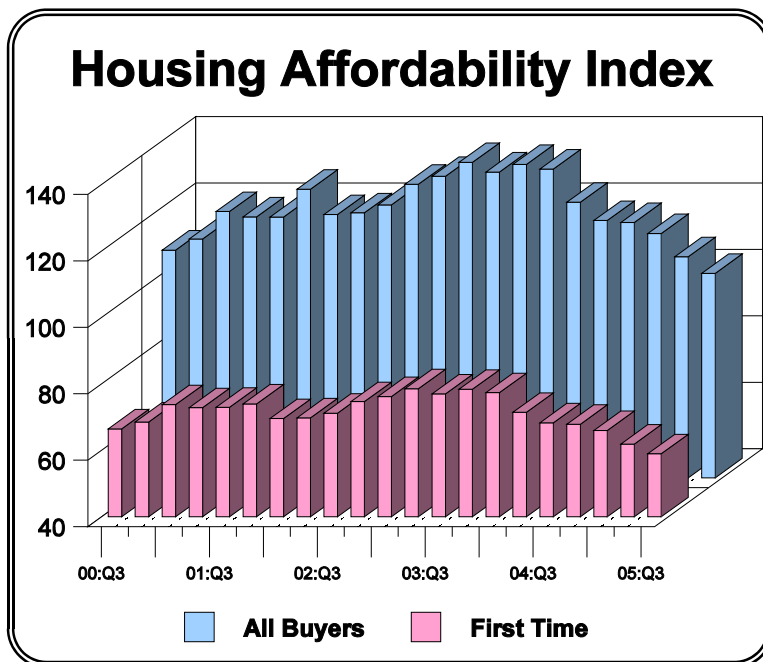
While statistically sound, the all-buyer index does not adequately describe the difficulty households have purchasing their first home and beginning the process of developing equity. Most first-time buyers are younger, less established in their careers and without the financial means for a large downpayment. Accordingly, a separate index which adjusts the assumptions has been developed, again patterned on the national methodology. It assumes a 10 percent down payment, even though many lower down payment programs are widely available. Less expensive homes are purchased by first time buyers, typically at prices 85 percent of the area median price. Because the assumed downpayment is less than 20 percent of the purchase price, mortgage insurance

must be carried, effectively increasing the mortgage rate by one-quarter point. Since most higher-income households have already purchased homes, the income measures for renters are lower. Household rather than family incomes are used because many more first-time buyers live alone. To account for the departure of the higher income group from the pool, the first-time buyer income is estimated to be 70 percent of the median household income in the area. Using these assumptions produces a statewide index for the third quarter of 59.0. As in the case of the all-buyer index, the level recorded during the third quarter is lower than last quarter and last year, recording the second consecutive all-time low for the series.

The first-time buyer index exceeded 100 (meaning the typical first-time buyer could realistically be able to afford the typical starter home in that community) in only three counties, including both urban and rural areas. Unfortunately, only one additional county had an index of at least 90, indicating a slight increase in the down payment or purchasing a home slightly below the assumed price would result in an affordable purchase. At the other extreme, first-time buyer indexes were below 75 in 15 counties indicating an expanding affordability crisis, especially since many large urban areas are on the list. Housing was most affordable for first-time buyers in Columbia County (128.6) and least affordable in San Juan County (30.1). Among urban areas the range was from 47.4 in King County to 107.9 in Benton County.

Affordable Housing Availability

The range of choices for several communities around the state is described for four household categories. In all cases it is assumed a household is willing to spend 25% of gross income on principal and interest payments and that overall debt levels are average. Household category groups are



defined by their income and their ability to make a downpayment. The groups studied are:

- \$ 25,000 income, 5% downpayment
- \$ 50,000 income, 10% downpayment
- \$ 75,000 income, 20% downpayment
- \$125,000 income, 35% downpayment

It is assumed that these buyers would have been able to find mortgages for their purchases at an interest rate of 5.75% (marginally below prevailing rates during the quarter).

Affordable Home Purchase Prices for Selected Income/Asset Groups

Income	Affordable Housing Expense (P&I)	Mortgage Amount	Downpayment	Home Purchase Price
\$ 25,000	\$ 521	\$ 89,249	\$ 4,697	\$ 93,946
\$ 45,000	\$ 1,042	\$178,498	\$ 19,833	\$ 198,331
\$ 70,000	\$ 1,563	\$267,747	\$ 66,937	\$ 334,684
\$125,000	\$ 2,604	\$446,245	\$ 240,286	\$ 686,531

This table clearly illustrates how income growth coupled with ownership of homes with increasing values can move a household up the ladder of homeownership. It is striking how the changes in interest rates in the last three years have changed this illustration. In WCRER's First Quarter 1999 report, using an assumed 8.0 percent mortgage rate, the \$25,000 income household could have purchased a \$75,679 home compared to \$93,946 above. This 24.1 percent jump is due solely to the effect of lower interest rates. When reviewing these statistics it is important to remember that the median family income in the state during the quarter was \$61,853, and ranged from a low of \$38,399 in Okanogan County to \$73,252 in King County. Household incomes were predictably lower, ranging from \$31,777 in Whitman County to \$58,970 in Snohomish County. The statewide median household income was \$50,431. This means the lower two price ranges remain most relevant for most residents of the state.

The next question is how much opportunity there will be in Washington to find a home which can be afforded under the assumptions? Using data reported by multiple listing systems around the state, the proportion of homes available for sale at the end of the quarter with prices at or below each threshold price indicates the degree of choice available to each group, and how difficult it will be to find suitable ownership housing.

One additional note is needed. The homes used in this calculation are those available for sale as of the end of September, when inventories and demand typically are both high, but poised for a seasonal decline. Since these MLS systems typically handle only about 80 percent of the market, and some areas were not able to report details about their listing inventory in the format WCRER uses, housing choices may differ somewhat from these estimates. Since these are offering prices, actual sales may occur below or above these prices, depending on local market conditions, and motivations of the buyers and sellers. Nevertheless, they are reflective of housing market access in these communities.

Percentage of Homes on Market Below Specified Price – September, 2005

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	13.4%	60.5%	83.4%	98.5%
Benton/Franklin	6.7%	45.3%	81.1%	98.2%
Chelan/Douglas	7.2%	29.5%	65.2%	92.3%
Clark	2.6%	5.5%	26.5%	77.3%
Cowlitz	10.7%	47.0%	76.8%	100.0%
Ferry/Pend Oreille/Stevens	15.0%	55.4%	75.0%	95.0%
Grant	16.9%	65.1%	84.4%	97.3%
Grays Harbor	12.0%	43.6%	71.2%	96.9%
Island	0.2%	5.1%	18.2%	67.5%
Jefferson	1.7%	6.8%	14.8%	71.3%
King	0.1%	0.7%	5.9%	50.7%
Kitsap	0.3%	6.5%	30.1%	73.4%
Kittitas	1.6%	10.2%	44.5%	89.4%
Lewis	5.1%	36.5%	66.7%	92.6%
Mason	5.1%	28.9%	58.7%	92.4%
Pierce	0.3%	6.4%	34.1%	81.5%
San Juan	0.0%	0.5%	3.1%	31.8%
Skagit	3.1%	9.8%	30.6%	72.7%
Snohomish	0.5%	3.0%	14.3%	73.0%
Spokane	4.2%	36.5%	63.1%	92.3%
Thurston	0.5%	7.8%	35.8%	88.1%
Walla Walla	10.5%	36.8%	66.9%	94.4%
Whatcom	1.8%	10.1%	27.5%	79.5%
Whitman	17.1%	36.4%	61.4%	98.6%
Yakima	13.5%	60.1%	83.3%	97.0%
Statewide	3.2%	17.2%	37.0%	77.3%

These statistics make it very clear that in most parts of the state first-time home buyers still face extremely limited choices in the housing market, whereas the trade-up buyers have a wide assortment of homes from which to choose in all communities. It is noteworthy that effectively no

homes in King or San Juan counties have asking prices below \$160,000 while half (or more) have an asking price in excess of \$500,000. Other communities in the Central Puget Sound also have virtually no homes for sale at prices below \$100,000.

It should be pointed out that the income used to calculate the statewide first-time buyer affordability index is halfway between the assumptions for the two lower categories. This means if those households were actively in the home purchase market, they would be competing for the lowest-priced 10% of the available statewide inventory. These lower-cost homes, if they are in reasonably good condition in stable neighborhoods, will be expected to sell quickly, while higher priced homes may wait awhile for the right buyer, since there are many units available and relatively few qualified buyers for those homes. All communities in Eastern Washington offer far greater choices of lower-cost homes.

Available Inventory

WCRES also computes estimates of the month's supply of housing by price range. A month's supply statistic measures how long it would take to sell all the homes currently available for sale if no new listings were added. The actual MLS sales during last 12 months are compared to the end-of-September listing inventory, with the resulting statistic multiplied by 12 to yield a month's supply. Accordingly, there was a scant 2.5 month's supply of homes on the market at the end of the quarter. This is marginally higher than the 2.2 month supply reported in March (and 2.3 months reported in June), but still reflects a much tighter inventory situation than prevailed a year ago. However, this modest movement in month's supply is the first consistent evidence we have seen in Washington that the housing market may be moving back toward balance.

A 5-7 month inventory is considered normal or balanced. Accordingly, the overall state market can still be characterized as a "tight" inventory. In a normal inventory situation, neither rapid price increases nor significant price declines should be expected in the short term, but current inventories suggest prices will continue to outstrip inflation. If an inventory level less than five months is considered a seller's market, 21 of the 25 markets reported separately are prone to rapid price increases in the months ahead, including most of the state's major population centers.

Even when the overall market appears balanced, there may be price ranges where the inventory is still very restricted, and rapid price increases may be observed for a subset of the overall market. For example, the 3.6 month's supply of homes priced no higher than \$80,000 in Grant County suggest less expensive listings may be subject to strong demand-induced price increases. Similarly, any property coming on the market in San Juan County for \$160,000 or less would be expected to generate inflationary offers, despite an overall inventory which is on the high end of balanced.

Month's Supply of Housing by Price Range September, 2005 Selected Washington Counties

County	Under \$80,000	\$80,000 - \$159,999	\$160,000 - \$249,999	\$250,000 - \$499,999	\$500,000 and above	Total Market
Asotin	2.8	3.8	4.8	11.5	20.0	4.3
Benton/Franklin	5.6	5.2	7.3	9.4	19.8	6.5
Chelan/Douglas	2.4	1.7	3.3	5.0	12.9	3.0
Clark	4.7	0.7	1.2	4.3	12.1	2.8

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County	Under \$80,000	\$80,000 - \$159,999	\$160,000 - \$249,999	\$250,000 - \$499,999	\$500,000 and above	Total Market
Cowlitz	1.5	2.1	3.1	6.0	87.0	3.0
Ferry/Pend Oreille/Stevens	3.1	4.0	4.1	10.6	17.3	4.5
Grant	2.6	4.0	4.7	7.4	n/a	4.1
Grays Harbor	1.7	2.9	5.1	11.0	26.0	3.9
Island	0.8	1.2	0.9	3.7	10.4	2.8
Jefferson	2.3	1.7	1.3	5.2	11.5	4.3
King	4.0	1.2	0.6	1.4	4.0	1.9
Kitsap	0.8	1.2	1.5	2.9	6.8	2.5
Kittitas	4.4	1.3	3.6	7.7	12.5	4.4
Lewis	1.5	2.5	5.1	9.8	39.0	4.0
Mason	1.7	2.0	3.6	6.6	11.3	3.5
Pierce	0.9	1.1	1.3	3.1	9.5	2.3
San Juan	0.0	2.0	3.3	5.4	13.5	8.7
Skagit	4.6	1.2	1.4	3.4	13.7	2.8
Snohomish	3.7	1.6	0.8	2.2	7.9	2.1
Spokane	1.1	1.9	2.5	5.2	11.3	2.7
Thurston	0.9	1.0	1.2	3.8	9.0	2.2
Walla Walla	5.1	3.4	5.4	13.8	28.0	5.7
Whatcom	1.0	1.3	0.7	1.8	5.4	1.5
Whitman	6.0	2.2	2.5	9.3	8.0	3.9
Yakima	5.0	5.2	5.9	9.4	44.0	5.9
STATE	2.5	2.4	1.6	2.6	5.7	2.6

The market remains tightest for homes selling for mid-range prices. The longer month's supply for homes in the under \$80,000 category may be due to many units offered for sale which need substantial renovation/repair. Previously, this table has often displayed "n/a" for the highest price range, suggesting no sales activity above \$500,000. It is noteworthy that very expensive homes have sold in the last year in all markets. Homes priced above \$500,000 remain in excess supply in most areas, and may be subject to some bargain seeking when market adjustments finally begin. The exception may be King, Kitsap, Snohomish, Whatcom and Whitman counties where the expensive inventory can sustain the market for only nine months or less. The shortage of inventory even at high prices is especially pronounced in King County where even homes priced at half a million dollars or more would sustain the market for roughly four months.