

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

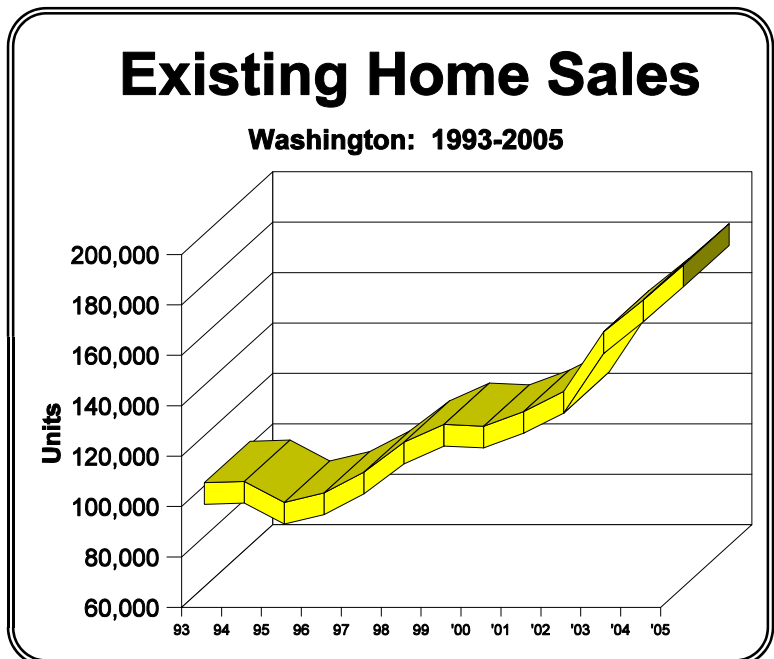
Fourth Quarter 2005

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Sales records were set during 2005 for existing homes at the national, regional and state level for the fifth consecutive year. Nationally, 6,176,000 resale transactions for single-family homes were recorded, 3.6 percent more than 2004, as the overall economic activity remained strong. The entire West (13 states, Rockies to the Pacific) recorded 1,473,000 single-family sales, an increase of 2.3 percent. Washington alone recorded sales totaling 183,320 units, an increase of 8.1 percent compared to the prior year, significantly besting the performance nationally and in the broader region, reflecting the belated start to the general economic recovery in the state. Housing market performance in 2005 is attributed to a continuation of the low mortgage interest rates in the face of continued pressure by the Federal Reserve Board to make borrowing more costly. The investment motive also was a factor as home prices continued to outpace gains achieved by other financial assets. Single-family construction, measured by either building permits or housing starts achieved new records again in 2005 both nationally and in the West (there is no state-level housing start data, and permit data for states is not yet final). Total permits and starts were at their highest levels since 1978 even though apartment construction remains limited by significant vacancies in many places. WCRER research reported separately has indicated apartment vacancies in Washington remain well below national averages, resulting in a more robust multifamily construction market in Washington than elsewhere in the nation.

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) increased 2.9 percent from the fourth quarter of 2004, reaching a total of 43,750 units sold between October 1 and December 31. These statistics show a typical seasonal decline in actual sales compared to the third quarter. This was the smallest increase in sales activity compared to a year earlier observed in 2005, and is some evidence that the real estate market



may be slowing somewhat. Media pundits have been searching for a chink in the armor of the real estate expansion, and believe they have found it, but experience teaches that a single observation does not represent a trend.

Twelve of the 39 Washington counties reported fewer home sales in late 2005 than a year earlier, with several reporting double-digit percentage declines. Again, these experiences must be viewed cautiously because shortages in inventory available for sale can also depress the sales statistics. Meanwhile, ten counties reported sales jumps of more than ten percent compared to late 2004. Among metropolitan counties the strongest market was in Cowlitz county (38.5 percent increase), while the weakest was in Kitsap County (11.4 percent decline). Six of the 17 metropolitan counties reported fewer sales than a year ago.

Note: This report uses the 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 nine micropolitan areas.

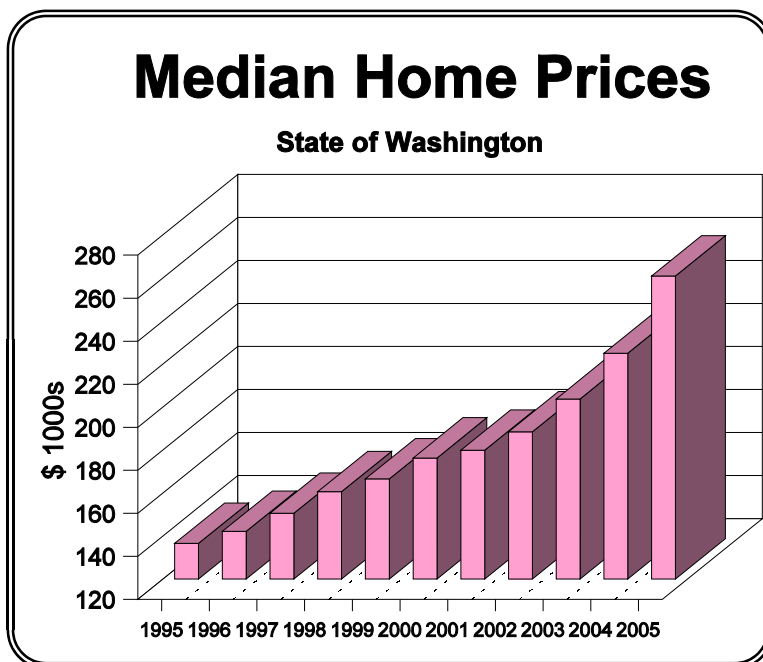
Housing Construction

Construction activity, as measured by building permits, increased 3.5 percent compared to the fourth quarter of 2004. During the closing months of the year single-family building permits increased more than multifamily construction. Single-family building permits were 3.9 percent higher than last year, with 8,090 new homes authorized for construction. Far more complete data on 2005 building permits will be included in the next issue of **Washington State's Housing Market**, since the Census Bureau typically releases final annual permit numbers in April.

At the local level, total housing construction declined compared to late 2004 in 16 counties and increased in the other 12 where the Census Bureau releases monthly statistics. A 29.8 percent jump in building permits in King County was responsible for turning the statewide number positive. Kitsap County showed the greatest construction increase (84.6%) while Pacific and Stevens Counties had declines of more than 90%. Lewis County had the greatest increase in single-family construction. The 5-county Central Puget Sound region represented nearly two-thirds of the state's building permits in late 2005.

Home Prices

The median selling price for a resale home in the state of Washington during the fourth quarter of 2005 was \$275,700. This is \$44,000 (19.0%) higher than last year's fourth quarter median. Median prices during the fourth quarter are usually a little lower than the third quarter, but in 2005 (as in 2004) an increase was observed. This \$6,400 surge was even more striking than a year earlier. The median price



for full year 2005 was \$260,900, an increase of 16.0 percent compared to 2004. The median price in Washington was \$68,400 above the national median and \$38,000 below the median in the West. The national median increased 12.6 percent during 2005, while in the West the increase was 18.0 percent.

Local area prices in the fourth quarter ranged from a low of \$81,700 in Adams County to a high of \$462,500 in San Juan County. Only Adams County reported a median price less than \$100,000, while 13 counties now have medians of at least \$200,000. Of those, San Juan, King, Jefferson and Snohomish counties have medians in excess of \$300,000.

Twenty counties recorded increases in median prices of at least 20 percent compared to the fourth quarter of 2004, while only Adams County experienced a lower median price. Among metropolitan counties, price changes ranged from a 4.6 percent increase in Yakima County to a 32.9 percent jump

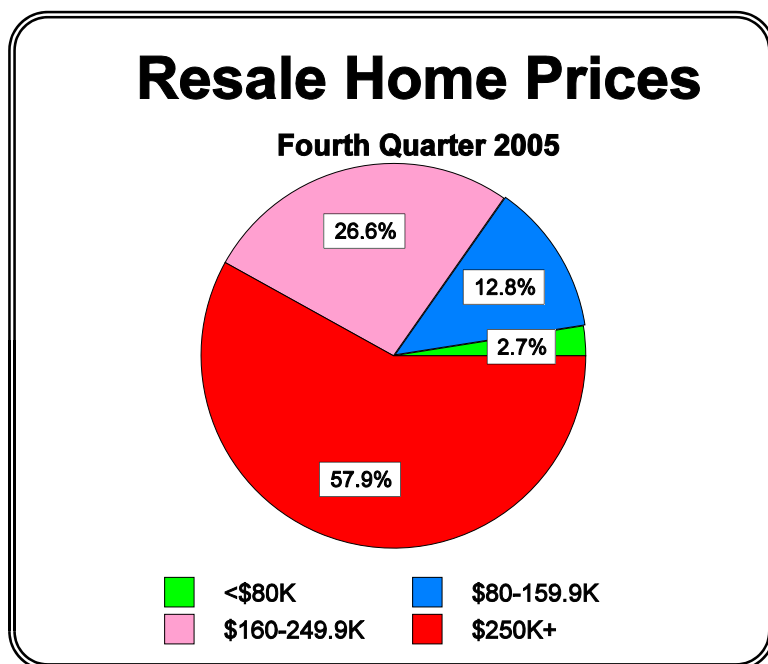
in Chelan/Douglas counties. Among the micropolitan markets, the range was from Walla Walla's 7.3 percent increase to Mason's 32.4 percent jump.

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 consumers 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 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" 2.7 percent of the single-family homes sold during the fourth quarter were priced no higher than \$80,000, this represents about 610 homes. It should be noted that the price ranges illustrated in the accompanying graph were updated just a year ago, another revision will be required shortly. 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 these reports is always the statistics 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 for each county in the state where price data is available. These affordability calculations depend on statistics from a variety of sources. The effective mortgage rate on loans closed during the quarter (national



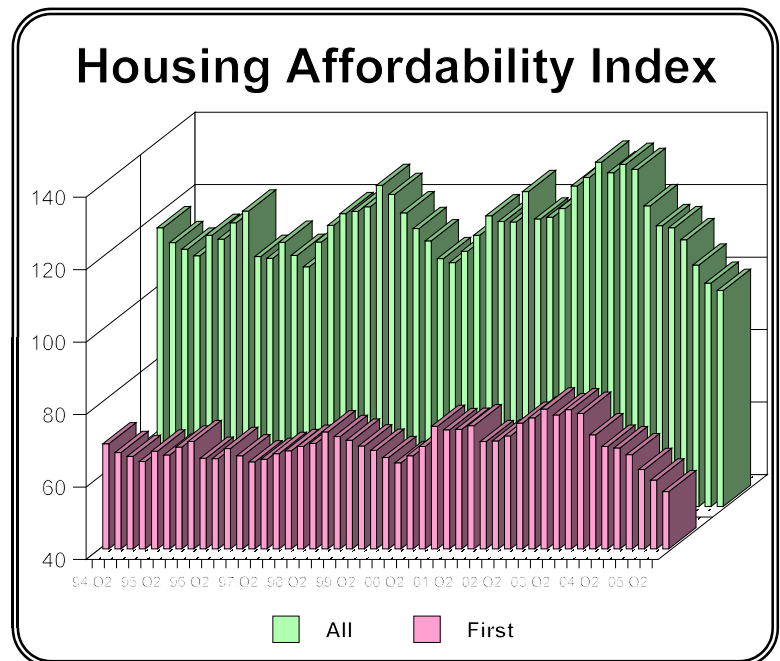
average, 6.21 percent) is used in this calculation. While the average downpayment on home purchases is 25 percent, the most frequently encountered downpayment is 20 percent. Accordingly, that percentage is used in the calculation of the all-buyer index. A 30-year term is assumed for paying off the loan.

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 individuals sharing a housing unit (roommates). 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 fourth quarter of 2005 stood at 96.0, meaning that a median income family had 4.0 percent less income than the bare minimum required to qualify for a mortgage on the median price home. This represents a sharply diminished affordability condition than the index of 116.9 which prevailed a year ago, or the 134.4 from two years ago. Affordability has declined consistently throughout 2005 as prices and interest rates have both increased more rapidly than prevailing income levels. The current index represents the first time in the 12 years WCRER has been computing the statistic that the statewide value has been less than 100, meaning the state's median income family could not afford to purchase the median price

(typical) home – although a higher downpayment would probably make the sale possible. Locally, housing affordability indexes ranged from a low of 50.9 in San Juan County to a high of 213.9 in Adams County. Among metropolitan areas, affordability indices ranged from a high of 173.6 in Benton County to a low of 80.1 in King County. Among the smaller urban areas the range is from a low of 87.0 in Island County to a high of 163.3 in Grant 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 first-time buyers index for the fourth quarter of 55.8. Again, this is the lowest affordability measurement in the last 12 years, and presents a real challenge for a state endeavoring to achieve economic success in conjunction with a high quality of life.

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, all east of the Cascades. Unfortunately, this is down sharply from 19 affordable counties two short years ago. Only three additional counties had an index above 90, indicating a small 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 60 in ten counties, indicating the affordability crisis is becoming more severe. In Jefferson County the would-be first time homebuyer had less than 40 percent of the income required to purchase the typical "starter" home, and in San Juan County the value was less than 30! If households cannot afford to purchase their first home, the homeownership rate will begin to decline, and high levels of homeownership have been demonstrated to be consistent with many desirable features of communities.

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 will be assumed that these buyers will be able to find mortgages for their purchases at an interest rate of 6.25% (approximately the same as 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	\$ 84,616	\$ 4,454	\$ 89,070
\$ 45,000	\$ 1,042	\$169,234	\$ 18,803	\$ 188,037
\$ 70,000	\$ 1,563	\$253,850	\$ 63,463	\$ 317,313
\$125,000	\$ 2,604	\$422,921	\$ 227,727	\$ 650,648

This table clearly illustrates how income growth coupled with ownership of homes with increasing values moves a household up the ownership housing ladder. When reviewing these statistics it is

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important to remember that the median family income in the state during the quarter was \$62,304, and ranged from a low of \$38,734 in Okanogan County to a high of \$73,569 in King County. Household incomes were predictably lower, ranging from \$32,040 in Whitman County, with its large student population, to \$59,434 in Snohomish County. The statewide median household income was \$50,801. This means the lower two price ranges are most relevant for 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 December, when inventories are typically at their seasonal low (fewer people attempt to sell their homes over the holidays). 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 – December, 2005

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	13.1%	57.1%	78.0%	96.6%
Benton/Franklin	7.1%	45.2%	81.2%	98.7%
Chelan/Douglas	2.1%	24.3%	57.6%	92.2%
Clark	2.4%	4.8%	27.6%	77.5%
Cowlitz	9.0%	40.8%	69.7%	100.0%
Grant	16.7%	62.8%	82.3%	97.5%
Grays Harbor	11.3%	42.2%	65.5%	95.7%
Island	0.6%	4.6%	20.7%	69.7%
Jefferson	0.5%	6.9%	18.6%	70.1%
King	0.1%	0.6%	4.9%	50.1%
Kitsap	0.0%	4.9%	26.6%	72.3%
Kittitas	0.6%	6.7%	41.7%	88.3%
Lewis	5.8%	33.4%	65.6%	92.5%
Mason	3.0%	28.3%	59.6%	92.0%
Pierce	0.2%	4.2%	29.4%	82.1%

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	Home Price Maximum			
County	\$80,000	\$160,000	\$250,000	\$500,000
San Juan	0.0%	0.7%	2.0%	33.6%
Skagit	2.0%	8.4%	30.5%	72.7%
Spokane	4.8%	35.5%	63.6%	91.9%
Snohomish	0.6%	2.4%	13.4%	71.6%
Thurston	0.2%	4.3%	34.9%	89.6%
Walla Walla	11.9%	38.5%	67.6%	93.9%
Whatcom	1.1%	4.7%	25.4%	81.0%
Whitman	14.3%	34.7%	72.4%	98.0%
Yakima	15.7%	58.4%	80.4%	97.1%
Statewide	3.0%	15.3%	35.4%	77.7%

These statistics make it clear that in most parts of the state first-time home buyers still face extremely limited choices in the housing market, while trade-up buyers have a wide assortment of homes from which to choose in all communities. Significantly, virtually no homes in King County have asking prices below \$80,000, while over half have an asking price in excess of \$500,000. Virtually no (less than 1 percent) lower cost housing is available in Island, Jefferson, Kitsap, Kittitas, Pierce, San Juan, Snohomish or Thurston counties.

It should be pointed out that the \$25,000 income level is now somewhat below the income used to calculate the statewide first-time buyer affordability index. This means if those households were actively in the home purchase market, they would be competing for the lowest-priced 3.0% of the available statewide inventory. These lower-cost homes, if they are in reasonably good condition in stable neighborhoods, should 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

WCRER 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 full-year 2005 are compared to the end-of-year listing inventory, with the result multiplied by 12 to yield a month's supply. There was only a 2.4 month's supply of homes on the market at year-end, due primarily to the seasonal decline of listings. This represents an extremely tight listing inventory, suggesting that rapid increases in prices can be expected in the short term if interest rates remain low and no surge of new listings reaches the market. The 2005 year-end month's supply is virtually identical to that recorded a year ago. This suggests rapid price increases will continue into 2006, at least until inventory begins to accumulate.

Historically, balanced markets are characterized by a five to seven month's supply of homes on the market. Most markets in the state, in communities large and small, can be described as having a shortage of inventory, with the remainder balanced. No market has excess inventory as of year-end

2005. The most severe shortage of listings was in King County, with Chelan/Douglas and Snohomish counties close behind, each recording inventory levels of less than two months. The longest month's supply was in the balanced Tri-Cities market, with a listing inventory capable of sustaining sales at current rates for 5.6 months -- a balanced market on the verge of shortage.

The market is 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 units offered for sale which need substantial work – they are few in number but cannot attract the typical buyer. Unlike previous reports, nearly all markets had a least one sale above \$500,000 in 2005, but if there were several listings at that level, some local high-priced supplies could wait many months to sell, despite the active market. Homes priced above \$500,000 are in excess supply in most areas, but the Seattle metropolitan area, where most of the expensive homes are located, would be characterized as balanced to short supply. It is common for homes at this level to take longer to sell since they tend to be unique, and buyers in those price ranges have the ability to be more selective.

**Month's Supply of Housing by Price Range
December, 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	2.5	2.7	3.4	9.8	27.0	3.3
Benton/Franklin	5.4	4.5	6.2	7.7	8.1	5.6
Chelan/Douglas	0.5	1.2	1.7	3.4	6.7	1.9
Clark	5.1	0.9	1.5	4.1	11.4	3.1
Cowlitz	1.2	2.0	2.5	5.3	138.0	2.8
Ferry/Pend Oreille/Stevens	2.7	3.5	2.9	8.4	24.0	3.9
Grant	2.8	3.9	4.3	8.2	n/a	4.2
Grays Harbor	1.9	3.0	4.4	11.1	28.5	4.1
Island	2.3	1.3	1.3	3.8	8.5	3.1
Jefferson	0.8	2.1	1.9	4.3	9.0	3.9
King	3.0	1.1	0.5	1.2	3.0	1.5
Kitsap	0.0	1.1	1.3	2.6	5.5	2.2
Kittitas	1.0	0.8	2.7	5.4	9.0	3.1
Lewis	1.6	1.9	4.1	7.3	23.0	3.3
Mason	1.1	2.2	3.0	5.2	8.5	3.1
Pierce	0.6	0.9	1.3	3.0	7.7	2.2
Skagit	3.1	1.4	1.5	3.2	12.8	2.9
Snohomish	4.3	1.4	0.8	1.8	6.0	1.9

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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
Spokane	1.2	1.5	2.0	3.5	8.1	2.1
Thurston	0.6	0.9	1.6	4.0	7.4	2.5
Walla Walla	3.9	2.6	3.7	7.6	25.5	4.0
Whatcom	2.1	1.8	2.4	4.4	10.8	3.9
Whitman	4.0	1.8	2.8	4.2	8.0	2.9
Yakima	4.7	3.8	4.1	8.4	29.1	4.5
Statewide	2.4	2.1	1.6	2.4	4.7	2.4