

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

First Quarter 2006

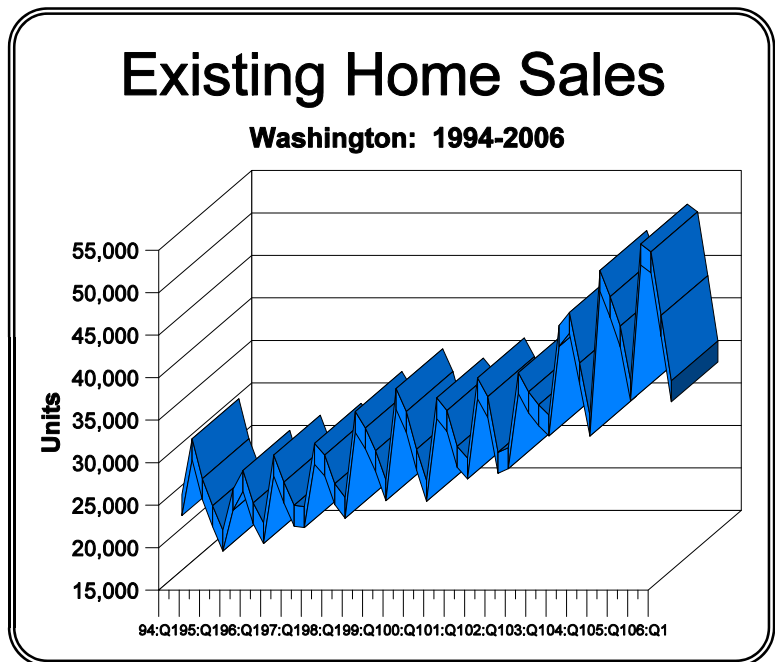
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Early 2006 has been marked by news stories of softening homes sales, often characterized as the bursting of the “housing bubble”. Markets in high cost areas – especially California, Florida and the Washington, DC region were especially in the limelight. Since the extraordinary housing market arrived in Washington State a bit later than other areas because the local recession was longer and deeper than in many places, it also seems to have a bit more resilience. Home sales in the first part of the year have remained on pace with the 2005 record, and home prices are still significantly above a year ago.

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) were basically unchanged from the opening months of 2005. The 36,050 single-family homes sold statewide between January 1 and March 31, were only 70 fewer (0.3 percent) than a year ago. The “sawtooth” pattern of home sales illustrated in the adjacent graph points out the highly seasonal nature of the housing market in Washington, but clearly illustrates the continued upward trend.

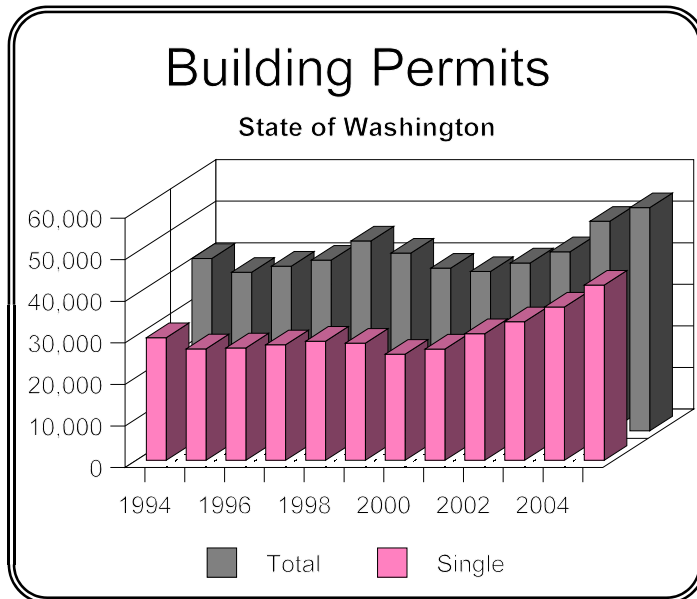
Home sales declined in 24 of Washington’s 39 counties. The sharpest drop was 68.8 percent in tiny Wahkiakum County, while the largest gain was 51.2 percent in Kittitas County (Ellensburg). Among the metropolitan counties, the



greatest improvement in sales was 18.4 percent in Cowlitz County (Longview/Kelso), while the greatest decline was 11.2 percent in Clark County (Vancouver). For the smaller micropolitan areas, existing home sales activity ranged from the 51.2 percent jump in Kittitas County to a 22.9 percent reduction in Clallam County. Rural areas ranged from a 43.6 percent increase in sales in Columbia County to the 68.8 percent sales decline in

Note: This report uses the definitions of metropolitan and micropolitan areas by the Office of Management and Budget. Briefly, metropolitan areas are 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 and eight micropolitan areas.

Wahkiakum County. King County reported 8,520 sales during the first quarter, while Ferry, Garfield and Wahkiakum counties had ten sales apiece.



Housing Construction

Construction activity, as measured by building permits, slipped 3.7 percent from last year's strong pace, with 9,601 permits issued during the first three months in those jurisdictions which report monthly statistics. Multifamily permits (duplex units through rental or ownership apartments) increased by 4.7 percent from a year ago, while single-family permits declined 6.0 percent. In part this reflects improving conditions in the rental market where vacancies are already declining, and demand for rental housing may well increase due to reduced ownership affordability.

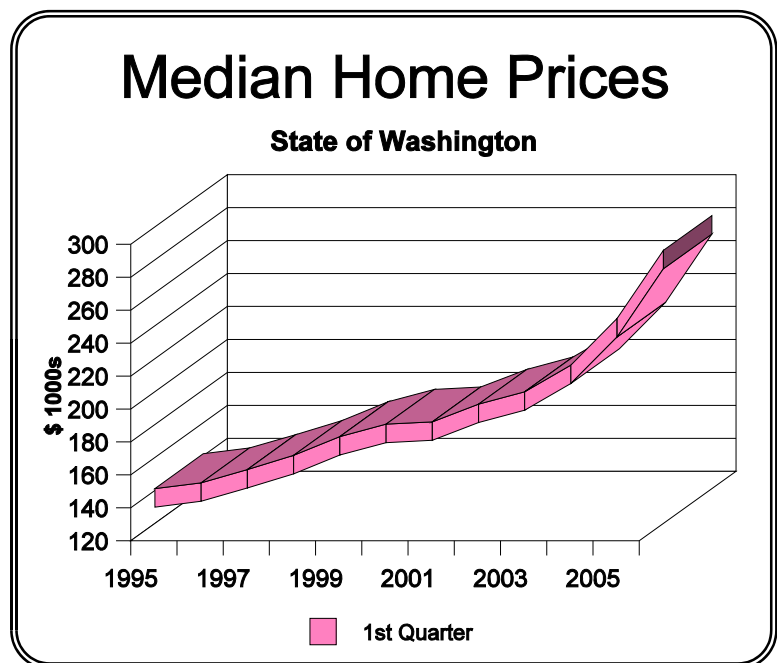
This report also includes the complete information on building permits and housing inventory for 2005. Total building permits for residential construction reached 53,716 units, presumably a record level, and 6.5 percent ahead of 2004. Single-family permits issued in 2005 surged 12.6 percent to a record 42,123 homes

authorized for construction. Annual multifamily construction in 2005 stood 14.8 percent below the 2004 level across the state. While the state's overall residential construction was exceptionally strong, the pace of new home building was actually lower in 2005 than it was in 2004 in nine counties, including five metropolitan communities.

Home Prices

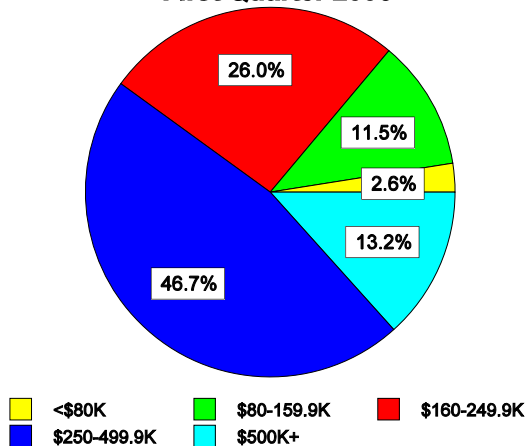
The median selling price for a resale home in the state of Washington during the first quarter of 2006 increased 17.1 percent from the first quarter of 2005, to a record \$280,200. This continues the classic demand pull inflation in housing prices when exceptionally strong demand meets a very short supply of listings available for sale. By way of comparison, overall inflation in metropolitan Seattle, as measured by the Consumer Price Index was 3.0 percent in the last year.

Local area median prices ranged from a low of \$99,300 in Columbia County to a high of \$625,000 in San Juan County. King County remained the highest cost metropolitan market with a median of \$399,500, 15.5 percent higher than a year ago. Last year seven counties reported medians above \$200,000, but in early 2006 that number nearly doubled to 13! No



Resale Home Prices

First Quarter 2006



county for which data was available joined Columbia with a median price below \$120,000.

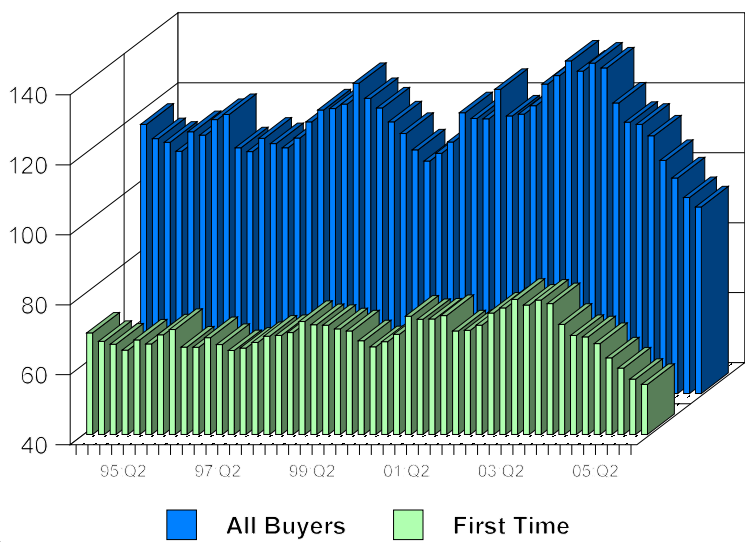
Reported prices in 34 of the 36 counties for which WCRER can compute data were above the opening months of 2005, (Grant and Yakima reported marginally lower prevailing prices). While there was consistent direction, the pace of price increases varied widely – from 3.1 percent in Walla Walla County to 36.6 percent in Pacific County. Among the metropolitan markets the range was from a 2.2 percent decline in Yakima to a 26.4 percent jump in both Clark and Spokane counties. Similarly, price performance in micropolitan areas ranged from a 0.2 percent decline in Grant County to a 23.5 percent increase in Clallam County (Port Angeles/ Sequim). A total of 12 counties reported median price increases of at least 20 percent over the last year, a clear sign of widespread strength in the housing market throughout the state.

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” 2.6 percent of the single-family homes sold during the first quarter were priced no higher than \$80,000, this represents about 940 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. Four times as many homes, however, sold during the first quarter at prices in excess of \$500,000, illustrating the depth and strength of the luxury housing market.

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 (6.39 percent) is used in this calculation. While the average downpayment on home purchases is 25 percent, the most

Housing Affordability Index



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 defined as 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, therefore, 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 first quarter stood at 93.3. This value indicates that a median income family had only 93.3 percent of the income to marginally qualify for a mortgage on the median price home. This was the second consecutive quarter where the median income family could not afford the typical home under the assumed conditions. This represents a fairly typical value for the all-buyer index in a national historical context, but represents a significant deterioration of affordability conditions over the last year – a loss of 20.3 points. Since mortgage rates have increased by about 75 basis points over the last year (substantially less than the rate of increase in the Federal Funds Rate), some of the reduction in affordability must be attributed to financing costs, but most must be attributed to the increasing price level of homes.

The all-buyer affordability index indicated that a median income family could afford to purchase the median price home in 27 of the 36 counties for which the statistics are calculated. Locally, housing affordability indexes ranged from a low of 37.1 in San Juan County to a high of 198.7 in Columbia County. Among metropolitan areas, affordability indices ranged from a high of 177.9 in Benton County to a low of 77.1 in King County.

While statistically representative of the total housing market, 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 was 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 first quarter of 54.3. Again, this is a typical value by long-term standards, but represents a significant loss of affordability during the last year.

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 (compared to six a year ago and 17 two years ago), including both urban and rural areas. At the other extreme, first-time buyer indexes were below 60 in 10 counties. The first time buyer index was only 21.9 in San Juan County, 39.3 in Jefferson County and 43.1 in King County, highlighting the extreme challenges faced by potential first-time buyers in Washington's largest urban area.

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 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
\$ 50,000	\$ 1,042	\$169,234	\$ 18,803	\$ 188,037
\$ 75,000	\$ 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 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 \$89,070 today. This 17.7 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 \$62,755, and ranged from a low of \$39,069 in Okanogan County to \$73,886 in King County. Household incomes were predictably lower, ranging from \$32,315 in Whitman County to \$59,898 in Snohomish County. The statewide median household income was \$51,172. This illustrates that the lower two price ranges remain most relevant for most residents of Washington state.

This leads to the question of 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.

The calculations were based on those homes available for sale as of the end of March, when inventories and demand both typically begin to increase. 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. Because these are offering prices, actual sales may occur below or above these prices, depending on local market conditions, and the motivations of buyers and sellers. Nevertheless, they are reflective of housing market access in these communities.

Percentage of Homes on Market Below Specified Price – March, 2006

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	6.7%	47.9%	76.8%	95.6%
Benton/Franklin	7.3%	45.1%	80.6%	98.2%
Chelan/Douglas	3.8%	29.2%	58.5%	88.7%
Clark	2.2%	3.5%	20.1%	74.8%

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Cowlitz	8.2%	33.0%	62.9%	100.0%
Grant	16.0%	53.4%	78.3%	94.4%
Grays Harbor	10.5%	38.0%	66.5%	95.2%
Island	0.3%	1.6%	14.1%	63.0%
Jefferson	0.0%	4.1%	19.3%	64.6%
King	0.0%	0.3%	3.4%	46.3%
Kitsap	0.0%	3.9%	21.6%	69.9%
Kittitas	0.0%	5.3%	37.6%	88.1%
Lewis	3.3%	23.8%	51.8%	89.4%
Mason	3.2%	21.6%	57.5%	92.9%
Pierce	0.1%	2.9%	23.0%	80.4%
San Juan	0.0%	0.5%	1.9%	32.5%
Skagit	1.8%	7.3%	24.9%	72.2%
Spokane	2.9%	27.1%	56.9%	91.3%
Snohomish	0.6%	2.2%	9.1%	66.4%
Thurston	0.1%	3.6%	31.4%	88.9%
Walla Walla	19.2%	76.1%	68.6%	91.1%
Whatcom	1.5%	5.5%	23.1%	80.8%
Whitman	9.7%	27.0%	65.3%	97.4%
Yakima	14.8%	58.1%	80.8%	96.6%
Statewide	3.0%	14.1%	32.3%	76.1%

These statistics demonstrate 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. There were effectively no homes in the 5-county Central Puget Sound region with asking prices below \$80,000 while at least a third have an asking price in excess of \$500,000. Significantly, fewer than one in 100 homes in seven counties carry asking prices less than \$80,000.

The income used to calculate the statewide first-time buyer affordability index is halfway between the assumptions for the two lower categories. This means that if those households were actively searching for a home to purchase, they would be competing for the lowest-priced 14% of the available statewide inventory. These lower-cost homes, if they are in reasonably good condition in stable neighborhoods, would be expected to sell quickly, while higher priced homes may wait awhile for the right buyer. There are more units available and relatively few qualified buyers for the more expensive homes. All communities in Eastern Washington offer far greater choices of lower-cost homes.

Available Inventory

To meaningfully represent the inventory of homes available for sale, WCRER computes estimates of the month's supply of housing by price range. This 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-March listing inventory, with the resulting statistic multiplied by 12 to yield a month's supply. There was only a 2.7 month's supply of homes on the market at the end of the quarter. This represents a continued shortage of homes available for sale. However, some improvement toward balance was observed since a scant 2.2 months' supply prevailed a year ago.

A 5-7 month inventory is considered normal or balanced. Accordingly, the overall state market can be characterized as a "very 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 outpace inflation, both statewide and in most individual communities.

Month's Supply of Housing by Price Range March, 2006 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	1.5	2.9	5.5	9.7	42.0	3.9
Benton/Franklin	7.2	5.3	7.0	8.6	12.0	6.5
Chelan/Douglas	1.0	1.3	1.5	2.7	7.8	1.8
Clark	5.3	0.9	1.4	5.0	14.6	3.8
Cowlitz	0.9	1.4	1.8	6.7	56.0	2.5
Ferry/Pend Oreille/Stevens	3.1	2.9	4.2	8.8	38.4	4.1
Grant	3.0	3.2	5.3	9.4	n/a	4.3
Grays Harbor	2.4	3.2	6.7	11.8	42.9	5.0
Island	2.2	0.6	1.3	4.1	11.4	3.7
Jefferson	0.0	1.8	3.1	4.4	12.0	4.8
King	0.9	0.7	0.5	1.2	3.2	1.6
Kitsap	0.0	1.2	1.2	3.0	6.8	2.6
Kittitas	0.0	0.9	2.8	6.4	11.2	3.7
Lewis	1.0	1.4	3.2	8.4	34.9	3.2
Mason	1.3	1.9	3.8	6.1	7.9	3.5
Pierce	0.2	0.8	1.1	3.3	8.4	2.4
San Juan	0.0	4.0	4.0	9.1	18.1	13.1
Skagit	3.3	1.6	1.4	3.9	12.9	3.2

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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
Snohomish	4.2	1.5	0.6	1.6	5.9	1.8
Spokane	1.0	1.4	2.2	4.4	8.9	2.3
Thurston	0.3	1.2	1.7	4.4	8.2	2.9
Walla Walla	11.6	5.7	5.5	11.8	44.6	8.0
Whatcom	4.3	2.9	2.6	5.6	11.8	4.9
Whitman	5.4	3.3	5.5	9.5	30.0	5.7
Yakima	5.4	4.3	4.6	8.9	44.0	5.1
STATE	3.0	2.3	1.7	2.6	5.3	2.7

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. Homes priced above \$500,000 are in excess supply in most areas. However, a 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 less than four months, and stories of bidding wars over properties priced in excess of \$1,000,000 are still being heard. Based on statewide data, the only price range which would be described as "balanced", rather than a "seller's market" is for very expensive homes.

It must be pointed out that evidence of increasing inventories in some markets is beginning to be seen. Coupled with sales rates which are running even a little behind last year can quickly turn these statistics from a shortage of listings available for sale to a balanced market, or even to a modest excess supply. It appears the remainder of 2006 will bear careful attention.