

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

Second Quarter 2006

Washington Center for Real Estate Research
Washington State University
P.O. Box 644844
Pullman, WA 99164-4844
(800) 835-9683

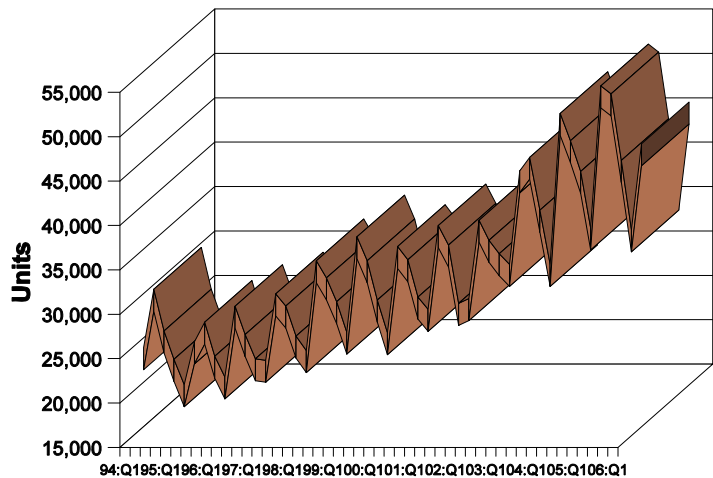
Housing markets in Washington, as elsewhere in the country were less robust during the second quarter of 2006 than they were a year ago. Despite the slowdown, the markets should still be characterized as very strong. Inventories of homes available for sale have begun to increase, providing buyers with an opportunity to locate homes which are well matched to their needs, and allowing a bit more negotiation on prices, but the median price of homes sold during the April-June period remained sharply high than a year ago. Higher mortgage interest rates, driven by continued efforts by the Federal Reserve to fight inflation, have combined with the high housing prices to reduce affordability and reduce the number of would-be homebuyers.

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 existing single-family homes (excluding most new construction) totaled 45,640 units during the second quarter, fewer than the second quarters of the last two years, but more than any other year since WCRER began monitoring home sales in 1994. Reported sales were 12.5 percent lower than the second

Existing Home Sales

Washington: 1994-2006



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 (or divisions) and eight micropolitan areas.

quarter of 2005. Only three counties (Grant, Thurston and Yakima) reported a higher level of sales than a year ago. Meanwhile, 11 of Washington's 39 counties experienced sales declines of at least 20 percent.

Among the large urban areas the strongest market was a 9.3 percent increase in Yakima

County while the largest decline was 25.6 percent in Whatcom County (Bellingham). In micropolitan areas sales activity ranged from an increase of 6.4 percent in Grant County (Moses Lake) to a decline of 32.9 percent in Island County (Oak Harbor). Rural markets all reported fewer sales than a year ago, with most reporting 10-20 percent fewer sales.

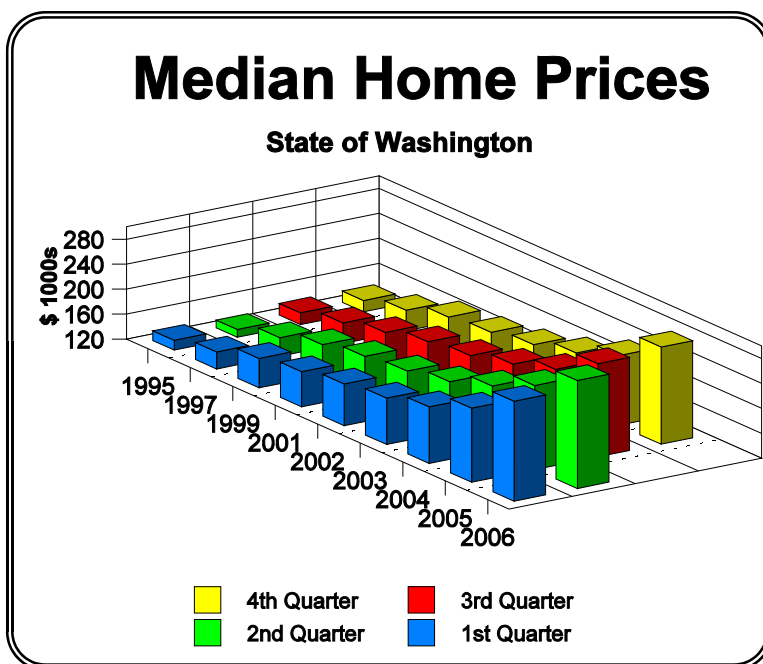
Housing Construction

Construction activity, as measured by building permits, remained strong, with 12,936 units approved for construction, a 6.7 percent increase from a year ago. Single-family permit activity was 10.0 percent below last year, with only six counties reporting increased single-family construction to the Census Bureau. Apartment construction was once again ahead of the year-ago pace, this time increasing 53.6 percent. These statistics include duplex and apartment units, and include both condominium and rental units. These statistics indicate that after a period where builders were concentrating almost exclusively on single family homes that multifamily housing as reemerged as a viable housing choice.

Home Prices

The median selling price for a resale home in the state of Washington during the second quarter of 2006 soared to \$293,000, 14.9 percent higher than a year ago. As impressive as this increase seems, however, the year-to-year percentage increases observed in recent quarters has been higher. This may mean that inflationary pressure on housing may be moderating somewhat as inventories rise and buyers bargaining opportunities increase.

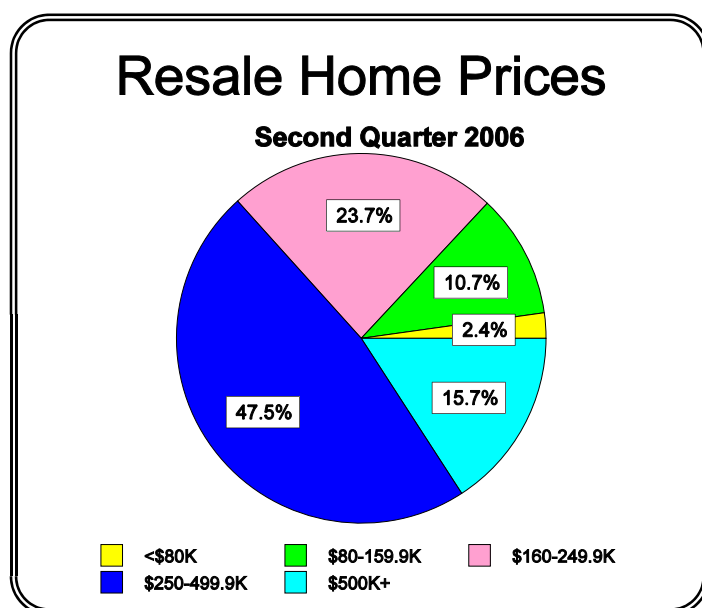
The question often arises regarding why price increases (particularly from quarter to quarter, if not from year to year) persist during periods of declining sales activity. Consumer behavior is the primary factor. When potential homebuyers enter the housing market, they have two preconceived notions about their search. First, they typically have a dollar figure in mind about how much they will have to spend on a home. Second, they have an image of what kind of house they are going to be able to afford. Once they begin their actual search, however, they learn that prices may be a bit softer than they imagined. They are then faced with a dilemma – do they spend the money they expected to spend, and buy a home with more features or space, or do they buy the kind of home they expected, and put the extra money back in their pocket (or take out a smaller loan)? Typically during the early stages of a housing slowdown they will choose to buy “up-market”. The result is continued high median prices and year-



to-year price increases.

Local area median prices ranged widely around the \$293,000 statewide median, from a low of \$99,000 in Adams County to a high of \$640,000 in the San Juan County resort market. Among metropolitan areas the range was slightly less, with King County's \$429,000 the high and Yakima County's \$133,500 the low. For the smaller city micropolitan areas, the range was even narrower, from \$130,200 in Grant County to \$291,000 in Island County.

Second quarter median prices were higher than a year ago in all 36 counties for which data is available, but the extent of the increases varied from a 2.9 percent increase in Benton/Franklin counties (Tri-Cities) to a 42.4 percent jump in San Juan County. Eleven other counties had median prices at least 20 percent above last year. Among the metropolitan counties the increases ranged from the Benton/Franklin low to 18.6 percent in Spokane County. For the micropolitan areas the range was from 12.6 percent in Whitman County (Pullman) to 25.8 percent in Lewis County (Centralia).



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 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"

2.4 percent of the single-family homes sold during the first quarter were priced no higher than \$80,000, this represents about 1,000 homes. 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 (6.63 percent) is used in this calculation. Although the average downpayment on home purchases is 25 percent, the most frequently encountered downpayment is 20 percent. Accordingly, the lower 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

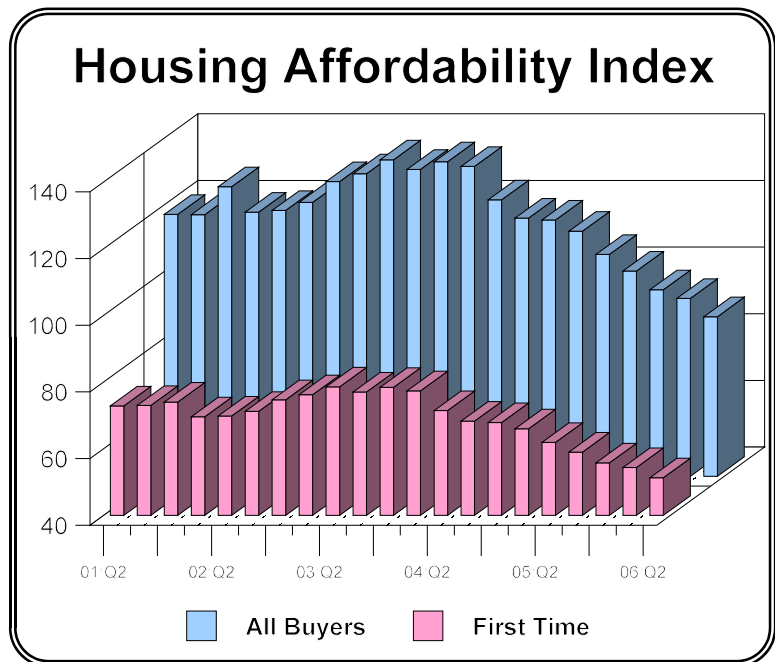
on family and household incomes from a consulting firm. In economic statistics, a family is two or more people related by blood, marriage or adoption who share a housing unit. Single adults with children or other dependent relatives (e.g. an aging aunt) are families. Household income includes all families 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 87.9, meaning that a median income family

had 12.1 percent less income than the bare minimum required to qualify for a mortgage on the median price home. This represents a decline of 5.5 index points compared to the first quarter, and a drop of 18.7 points compared to the second quarter of last year -- a very rapid deterioration in affordability. The all-buyer affordability level has dropped to its lowest level since WCRER began producing the statewide statistic in 1994. Nevertheless, the all-buyer affordability index remains within normal ranges, based on national data, 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.

The all-buyer affordability index indicated that a median income family could still afford to purchase the median price home in 23 of the 36 counties for which the statistics are calculated. Locally, housing affordability indexes ranged from a low of 36.5 in San Juan County to a high of 195.5 in Columbia County. Again, the higher the index, the more affordable the housing. Among metropolitan areas, affordability indices ranged from a high of 170.2 in Benton County to a low of 70.4 in King County. Meanwhile, all-buyer affordability in micropolitan areas ranged from 82.9 in Island County (Oak Harbor) to 144.8 in Grant County (Moses Lake).

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 51.3. As in the case of the all-buyer index, the level recorded during the second quarter is the lowest measure recorded since WCRER began computing the first-time buyer index in 1994.

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 (one fewer than three months ago). At the other extreme, first-time buyer indexes were below 75 in 24 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 (113.5) and least affordable in San Juan County (21.6). Among urban areas the range was from 39.4 in King County to 102.2 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 6.5% (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	\$ 82,428	\$ 4,388	\$ 86,766
\$ 50,000	\$ 1,042	\$164,856	\$ 18,317	\$ 183,173
\$ 75,000	\$ 1,563	\$247,284	\$ 61,820	\$ 309,104
\$125,000	\$ 2,604	\$411,981	\$ 221,836	\$ 633,817

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 \$86,766 above. However, increasing interest rates since late 2003 have reduced the affordable home price for a household earning \$25,000 by nearly \$10,000. When reviewing these statistics it is important to remember that the median family income in the state

during the quarter was \$63,342, and ranged from a low of \$39,703 in Okanogan County to \$74,252 in King County. Household incomes were predictably lower than family incomes, ranging from \$32,687 in Whitman County to \$60,641 in Snohomish County. The statewide median household income was \$51,793. 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 June, when inventories and demand typically are both high. 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, actual housing choices may differ somewhat from these estimates. Also, 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, list prices are reflective of housing market access in these communities.

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

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	6.7%	48.2%	75.9%	95.8%
Benton/Franklin	7.9%	41.7%	78.0%	97.9%
Chelan/Douglas	6.5%	24.8%	47.7%	79.7%
Clark	1.3%	2.0%	17.6%	73.6%
Cowlitz	5.1%	26.4%	63.9%	100.0%
Ferry/Pend Oreille/Stevens	9.5%	36.9%	63.4%	91.9%
Grant	9.8%	44.6%	64.2%	93.7%
Grays Harbor	6.3%	30.2%	61.5%	94.5%
Island	0.0%	1.0%	11.8%	64.4%
Jefferson	0.6%	4.1%	19.7%	66.2%
King	0.0%	0.3%	2.4%	45.5%
Kitsap	0.0%	2.1%	17.7%	70.1%
Kittitas	0.0%	5.5%	25.2%	83.8%
Lewis	3.2%	19.0%	45.4%	89.4%
Mason	2.9%	17.3%	49.3%	89.8%
Pierce	0.1%	2.6%	12.2%	73.3%

	Home Price Maximum			
County	\$80,000	\$160,000	\$250,000	\$500,000
San Juan	0.0%	0.0%	1.8%	28.5%
Skagit	1.4%	5.2%	19.0%	90.9%
Spokane	1.7%	21.0%	51.2%	88.5%
Snohomish	0.3%	1.1%	5.6%	67.1%
Thurston	0.3%	3.4%	27.1%	87.5%
Walla Walla	7.5%	30.8%	64.5%	91.3%
Whatcom	1.7%	5.3%	22.3%	78.6%
Whitman	5.4%	29.0%	66.7%	98.4%
Yakima	17.5%	59.4%	81.8%	97.7%
Statewide	2.1%	10.8%	26.5%	74.3%

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 fewer than five in 100 homes currently for sale in nine counties have asking prices below \$160,000 while over half have an asking price in excess of \$500,000 in King and San Juan counties.

Finally, it should be noted 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 11% 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

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 last 12 months are compared to the end-of-June listing inventory, with the resulting statistic multiplied by 12 to yield a month's supply. Accordingly, there was a 3.5 month's supply of homes on the market at the end of the quarter. This represents some inventory buildup compared to the 2.7 months supply which prevailed at the end of the first quarter or the 2.3 month supply from the second quarter of last year.

A 5-7 month inventory is considered normal or balanced. Accordingly, the overall state market can be characterized as a "tight" inventory. In a balanced inventory situation, neither rapid price increases nor significant price declines should be expected in the short term. Accordingly, it is likely that median prices will continue to evidence year-to-year increases above the inflation rate, but as inventories continue to build in the face of slowing sales the available inventory may move quickly into

an oversupply situation, leading to price discounting on individual homes and, over time, to stability or even reductions in the medians.

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. Many markets in the following table seem to be conducive to price inflation in the lowest price ranges, yet may be subject to even considerable price negotiation for the most expensive properties.

A current research priority at WCRER is to develop seasonally adjusted sales statistics, consistent with the data produced nationally by the National Association of Realtors®. This will lead to more time-sensitive measurements of month's supply where we would use only the relative sales experience of the current quarter rather than including sales from nearly a year ago in the current analysis.

**Month's Supply of Housing by Price Range
June, 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	Year ago
Asotin	2.2	3.4	5.9	9.4	90.0	4.5	4.7
Benton/Franklin	7.1	4.8	6.9	9.8	12.0	6.4	6.0
Chelan/Douglas	2.7	1.5	1.4	3.4	18.6	2.4	3.3
Clark	4.1	0.9	2.0	6.7	18.4	5.4	2.1
Cowlitz	0.7	1.7	2.9	8.9	36.0	3.5	3.1
Ferry/Pend Oreille/Stevens	2.9	3.4	6.6	13.3	72.0	5.7	5.4
Grant	1.9	2.7	3.4	14.3	120.0	3.8	5.4
Grays Harbor	1.9	3.6	8.1	15.1	45.3	6.3	4.0
Island	0.0	1.0	1.9	5.9	14.9	5.5	2.6
Jefferson	1.6	2.6	5.6	6.2	16.0	7.1	4.1
King	0.0	1.2	0.6	1.6	4.0	2.3	1.6
Kitsap	0.0	1.1	1.7	4.4	9.3	3.8	2.1
Kittitas	0.0	1.5	2.2	8.3	18.2	4.7	3.8
Lewis	1.7	1.6	4.0	12.1	37.6	4.5	4.8
Mason	1.6	2.1	4.2	8.5	13.0	4.6	3.6
Pierce	0.6	1.3	0.8	4.2	13.5	3.3	2.0
San Juan	0.0	0.0	4.0	6.7	14.2	10.4	8.2
Skagit	4.9	2.1	2.0	9.6	5.8	5.5	2.6

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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	Year ago
Snohomish	2.6	1.2	0.6	2.2	6.2	2.4	1.1
Spokane	1.0	1.6	3.0	6.1	13.7	3.3	2.4
Thurston	1.4	1.8	2.0	5.6	10.8	3.9	1.9
Walla Walla	3.5	4.1	5.9	8.9	23.4	5.9	6.0
Whatcom	7.7	4.1	3.7	6.8	15.1	6.5	2.3
Whitman	2.7	5.1	4.9	7.8	18.0	5.4	5.2
Yakima	8.3	5.6	5.8	10.8	28.0	6.7	5.8
STATE	2.8	2.5	2.1	3.6	6.8	3.5	2.3

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.

Despite the apparent slowing of the housing market nationally, and throughout Washington, leading to generally increased month's supplies, the Wenatchee and Moses Lake markets seem to have more restricted choices in the market than prevailed a year ago, illustrated by a lower month's supply this year. Accordingly, price increases may actually become more prevalent in the short term in those communities..