

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

Third Quarter 2006

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Sales of homes, both new and resale, have declined compared to a year ago in most areas of the country, and Washington State is no exception. However, the reduction in activity has merely changed the character of the housing market from white-hot to very strong. Despite national media stories to the contrary, the increase in homes available for sale in Washington does not constitute a glut. The month's supply of homes on the market remains modest throughout the state. The current situation is not a "buyers market," rather, the market is approaching balance. Median home prices remain significantly higher than a year ago, and mortgage rates, whose increases were expected to hasten the market softening have once again hit a plateau – less than one percent above a year ago.

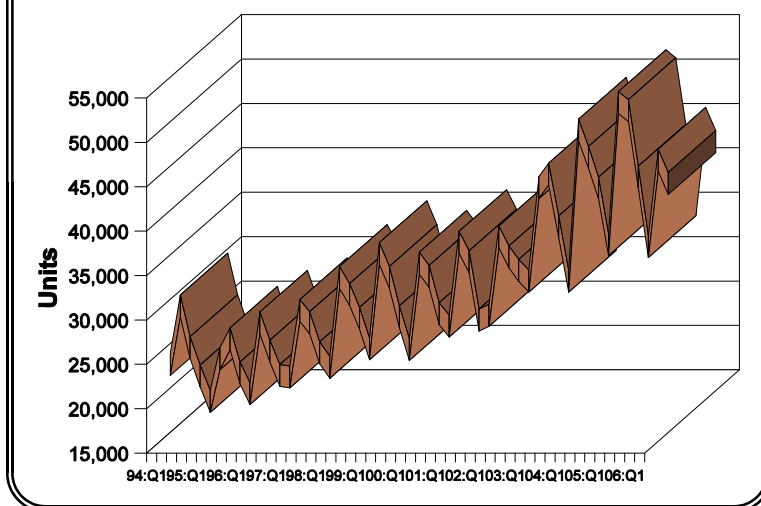
Home Resales

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 existing single-family homes (excluding most new construction)

totalled 43,050 units during the third quarter, fewer than the third quarters of the last two years, but still above any other year since WCRER began monitoring home sales in 1994. Reported sales were

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.

16.0 percent lower than the third quarter of 2005. Three counties (Yakima, Grant and Thurston) actually bucked the downward trend, reporting increases of 13.8, 9.7 and 1.6 percent, respectively. As in the second quarter, 11 of Washington's 39 counties experienced sales declines of at least 20 percent.

Among the large urban areas the strongest market was the 13.8 percent increase in Yakima County, while the largest decline was the 31.8 percent slide in Snohomish County. In micropolitan areas sales activity ranged from an increase of 9.7 percent in Grant County (Moses Lake) to a decline of 32.6 percent in Lewis County (Centralia/ Chehalis). Rural markets all reported fewer sales than a year ago, with most reporting 10-20 percent fewer sales.

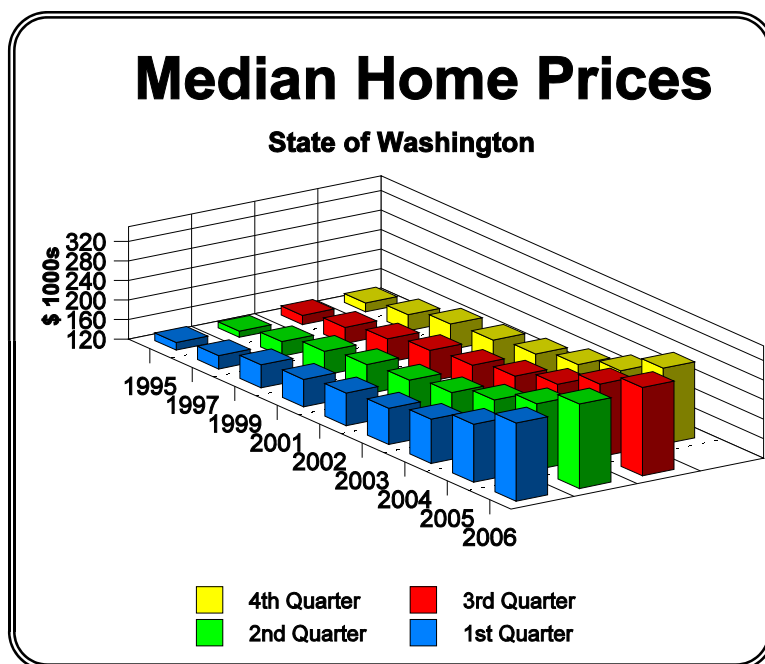
Housing Construction

Construction activity, as measured by building permits, remained strong, with 12,804 units approved for construction, a 0.9 percent increase from a year ago. Single-family permit activity was 20.6 percent below last year, with only five counties reporting increased single-family construction to the Census Bureau. Apartment construction was once again sharply ahead of the year-ago pace, this time increasing 60.2 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, consistent with national assessments that the apartment market is back.

Home Prices

The median selling price for a resale home in the state of Washington during the third quarter of 2006 soared to \$300,900, 11.7 percent higher than a year ago. While an impressive increase in a national market reporting many lower median prices, it reflects continued reductions in median price increases. This may mean that inflationary pressure on housing is 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. This appears to represent the current market.

Local area median prices ranged widely around the \$300,900 statewide median, from a low of \$98,800 in Adams County to a high of \$438,000 in the San Juan County resort market. Among metropolitan areas the range was slightly narrower, with King County’s \$432,600 the high and Yakima County’s \$139,100 the low. For the smaller city micropolitan areas, the range was even smaller, from \$138,000 in Grant County to \$315,000 in Island County.

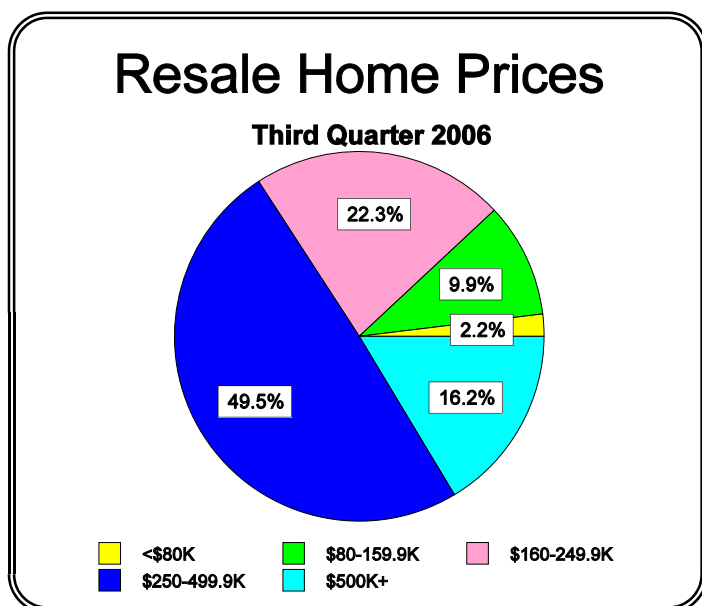
Third quarter median prices were higher than a year ago in 35 of the 36 counties for which data is available (the San Juan County median price declined 7.8 percent), but the extent of the increases varied from a 3.1 percent increase in Adams County to a 30.8 percent jump in Lewis County. Four counties had median prices at least 20 percent above last year (compared to 11 similar jumps last quarter). Among the metropolitan counties the increases ranged from a low of 5.8 percent in Benton/Franklin counties (Tri-Cities) to 26.4 percent in Chelan/Douglas counties (Wenatchee). For the micropolitan areas the range was from 10.0 percent in Clallam County (Port Angeles/Sequim) to 30.8 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 homes 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 in construction materials and physical labor to improve the home. While “only” 2.2 percent of the single-family homes sold during the third quarter were priced no higher than \$80,000, this represents about 950 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.

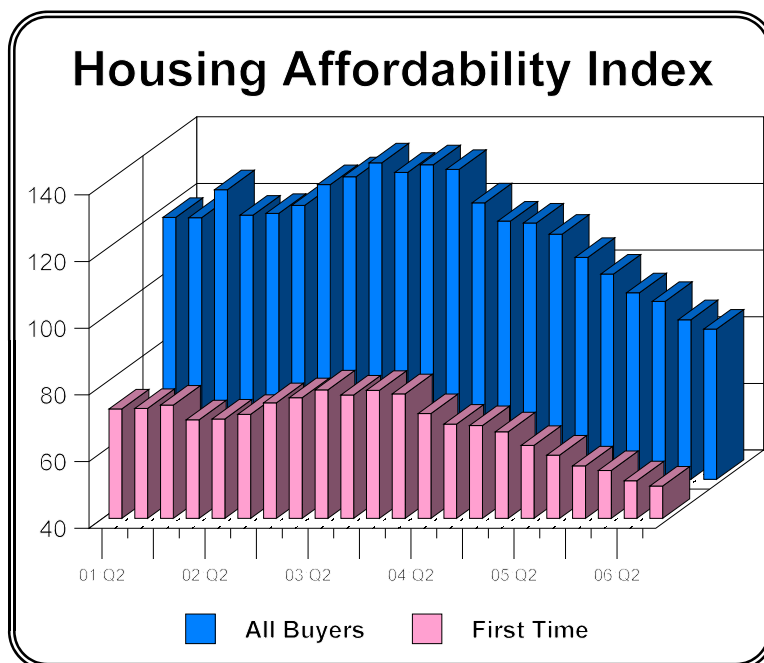
Housing Affordability

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 (6.76 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 Claritas, a demographics 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. A value of 100 means the median income family can just afford the median price home. Higher values represent greater affordability.



The Housing Affordability Index for Washington State declined for the tenth consecutive quarter to 85.1, meaning that a median income family had 14.9 percent less income than the bare minimum required to qualify for a mortgage on the median price home. This represents a another record low for the index since it was begun in 1994. Nevertheless, the all-buyer affordability index remains within normal ranges, based on long-term 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 21 of the 36 counties for which the statistics are calculated – two fewer than in the second quarter. Locally, housing affordability indexes ranged from a low of 53.6 in San Juan County to a high of 185.1 in Columbia County. Again, the higher the index, the more affordable the housing. Among metropolitan areas, affordability indices ranged from a high of 160.4 in Benton County to a low of 69.2 in King County. Meanwhile, all-buyer affordability in micropolitan areas ranged from 76.1 in Island County (Oak Harbor) to 136.3 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 49.7. As in the case of the all-buyer index, the level recorded during the third 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 two counties (one fewer than three months ago). At the other extreme, first-time buyer indexes were below 75 in 28 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 Adams County (113.6) and least affordable in San Juan County (31.8). Among urban areas the range was from 38.8 in King County to 96.4 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 6.75% (about 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	\$ 80,327	\$ 4,228	\$ 84,555
\$ 50,000	\$ 1,042	\$160,654	\$ 17,851	\$ 178,505
\$ 75,000	\$ 1,563	\$240,981	\$ 60,246	\$ 301,227
\$125,000	\$ 2,604	\$401,481	\$ 216,183	\$ 617,664

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 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 \$84,555 above. By the second quarter of 2003 the mortgage rate had declined to 5.50 percent, and the household could have afforded a home priced at \$96,558. However, increasing interest rates since late 2003 have reduced the affordable home price for a household earning \$25,000

by over \$10,000. It is noteworthy that the \$25,000 income will still support a home price higher than the 1999 value. When reviewing these statistics it is important to remember that the median family income in the state during the quarter was \$63,860, and ranged from a low of \$39,642 in Ferry County to \$74,593 in King County. Household incomes were predictably lower than family incomes, ranging from \$33,011 in Whitman County to \$61,244 in Snohomish County. The statewide median household income was \$52,289. Remember, also, that calculations regarding first-time buyers use incomes 70 percent of the household estimates. This means the lower two price ranges remain most relevant for most residents of the state.

How much opportunity is there 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 different income/asset groups, 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 sales seasonally begin to slow and inventories typically stagnate. 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 – September, 2006

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	7.9%	47.8%	71.7%	95.3%
Benton/Franklin	7.5%	44.5%	80.6%	97.6%
Chelan/Douglas	4.6%	17.2%	38.8%	80.2%
Clark	1.2%	1.8%	20.3%	76.2%
Cowlitz	2.8%	28.4%	63.2%	90.5%
Ferry/Pend Oreille/Stevens	8.3%	37.5%	61.8%	91.3%
Grant	7.5%	43.7%	67.0%	94.3%
Grays Harbor	3.7%	27.1%	58.1%	94.7%
Island	0.2%	1.5%	17.1%	70.5%
Jefferson	0.6%	5.0%	18.7%	69.8%
King	0.0%	0.2%	2.0%	46.9%
Kitsap	0.0%	1.6%	18.7%	72.5%
Kittitas	0.0%	3.2%	27.1%	81.0%
Lewis	2.5%	22.2%	49.4%	92.1%

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Mason	1.6%	14.1%	48.4%	89.1%
Pierce	0.1%	2.1%	21.3%	81.8%
San Juan	0.0%	0.0%	1.4%	21.9%
Skagit	1.0%	5.1%	23.8%	75.3%
Spokane	1.3%	21.8%	53.7%	89.6%
Snohomish	0.0%	0.9%	5.4%	65.9%
Thurston	0.1%	2.8%	27.3%	86.4%
Walla Walla	3.2%	25.4%	61.4%	91.9%
Whatcom	1.4%	4.8%	21.5%	79.0%
Whitman	11.7%	30.2%	75.9%	100.0%
Yakima	16.3%	56.7%	77.3%	97.8%
Statewide	1.6%	9.8%	26.9%	74.9%

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 in 11 counties no more than five in 100 homes currently for sale 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 home price categories. This means if those households were actively in the home purchase market, they would be competing for the lowest-priced 9.8 percent 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

Much of the media attention in recent months has focused on the apparent surge of homes on the market, frequently described as record high levels of homes available for sale. While that may be true on some high-profile national markets in California, Florida, the mid-Atlantic and even Las Vegas, the situation in Washington is strikingly different. Certainly listings available for sale have increased significantly – more than doubling in Thurston County, nearly doubling in Clark County and increasing by 50 to 80 percent in most urban counties.

As illustrated in the table which follows, the number of listings available for sale at the end of the third quarter was at the highest level this decade in eight of the 22 counties or county groups for which WCRER has consistent listings data for most of the years. The first three years of the decade had

higher levels of listing inventory in 12 counties. All third quarters with higher inventory levels are shaded in the table.

Listings Available for Sale – 3rd Quarters

County	2000	2001	2002	2003	2004	2005	2006	%ch 2005-06
Asotin	575	703	483	403	341	337	381	13.1%
Benton/Franklin	835	889	1,091	1,371	1,755	1,575	1,436	-8.8%
Chelan/Douglas	684	675	558	541	393	376	348	-7.4%
Clark	n/a	1,282	n/a	1,750	1,729	1,916	3,789	97.8%
Cowlitz	547	558	546	488	405	336	536	59.5%
Ferry/Pend Oreille/Stevens	380	411	458	366	332	260	288	10.8%
Grant	426	437	379	364	379	301	348	15.6%
Grays Harbor	578	559	625	561	404	424	601	41.7%
Island	690	668	684	590	583	468	809	72.9%
King	6,447	7,602	9,274	7,163	5,924	5,135	7,136	72.0%
Kitsap	1,566	1,350	1,234	1,105	930	964	1,649	71.1%
Kittitas	n/a	n/a	236	242	263	245	343	40.0%
Lewis	609	570	n/a	309	379	351	567	61.5%
Mason	763	656	532	431	373	395	560	41.8%
Pierce	3,871	4,054	3,758	3,278	3,050	2,975	5,259	76.8%
San Juan	n/a	178	188	212	189	195	210	7.7%
Skagit	766	756	748	707	487	480	800	66.7%
Snohomish	3,484	3,386	3,651	3,239	2,842	2,582	3,565	38.1%
Spokane	3,810	3,784	3,913	1,875	1,835	1,942	2,942	51.5%
Thurston	1,253	1,091	833	785	748	799	1,774	122.0%
Whitman	229	144	189	115	132	140	162	15.7%
Yakima	981	888	847	738	718	742	1,045	40.8%
State	28,494	30,641	30,227	26,633	24,191	22,938	34,548	50.6%

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-September listing inventory, with the resulting statistic multiplied by 12 to yield a month's supply.

Accordingly, there was a 4.1 month's supply of homes on the market at the end of the quarter. This represents some inventory buildup compared to the 3.5 months supply which prevailed at the end of the second quarter or the 2.6 month supply from the third quarter of last year.

A 5-7 month inventory is considered normal or balanced. Accordingly, the overall state market can be characterized as having a "somewhat 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 somewhat above the inflation rate, but as inventories continue to build in the face of slowing sales, the available inventory may move into an oversupply situation, leading to price discounting on individual homes and, over time, to stability or even reductions in the median prices.

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
September, 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	3.5	3.7	4.9	10.8	216.0	5.0	4.3
Benton/Franklin	5.5	4.7	5.8	6.7	12.4	5.5	6.5
Chelan/Douglas	3.0	1.4	1.5	4.6	16.2	2.9	3.0
Clark	4.5	1.2	3.0	7.6	18.3	6.4	2.8
Cowlitz	0.8	2.5	3.3	10.8	23.5	4.5	3.0
Ferry/Pend Oreille/Stevens	2.9	4.0	6.4	12.3	60.0	6.0	4.5
Grant	1.9	3.0	4.0	13.1	48.0	4.1	4.1
Grays Harbor	1.2	3.6	7.5	13.6	34.9	6.1	3.9
Island	3.0	1.6	3.7	6.4	12.2	6.3	2.8
Jefferson	3.0	5.2	6.2	8.0	13.9	8.4	4.3
King	1.2	1.3	0.8	2.2	4.7	2.9	1.9
Kitsap	0.0	1.3	2.4	5.6	10.0	4.8	2.5
Kittitas	0.0	1.4	3.5	8.3	25.2	6.0	4.4
Lewis	2.3	3.2	5.1	15.1	49.1	6.4	4.0

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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
Mason	1.1	2.2	4.7	9.0	12.8	5.0	3.5
Pierce	0.6	1.5	2.2	4.7	10.2	4.0	2.3
San Juan	0.0	0.0	3.0	4.7	15.3	9.9	8.7
Skagit	3.7	2.5	2.5	6.0	13.2	5.1	2.8
Snohomish	0.3	2.0	0.9	2.7	7.1	3.0	2.1
Spokane	1.1	2.3	3.8	6.6	14.4	4.1	2.7
Thurston	0.7	2.2	2.5	5.9	11.9	4.5	2.2
Walla Walla	1.4	3.4	5.1	7.4	17.7	4.9	5.7
Whatcom	6.7	4.3	3.9	6.9	13.2	6.6	1.5
Whitman	6.3	4.1	5.4	5.1	0.0	5.1	3.9
Yakima	8.1	6.2	5.6	13.7	18.4	7.2	5.9
STATE	2.7	3.0	2.9	4.2	7.2	4.1	2.6

The market remains tightest for homes selling for prices in the mid-range. 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 all markets have reported at least one home sale above \$500,000 in the last year. 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 general slowing of the housing market nationally, and throughout Washington, leading to generally increased month's supplies, four Central Washington communities (Tri-Cities, Walla Walla, Wenatchee and Moses Lake) have stable or 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.