

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

Second Quarter 2007

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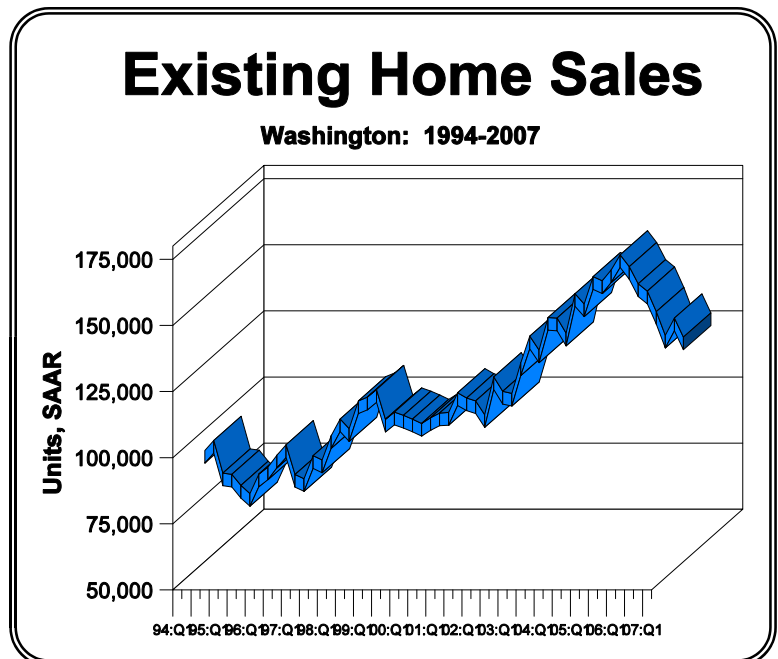
National housing market stories during the first half of 2007 have focused on the defaults in the subprime mortgage market spreading into the Alt-A and some prime loan markets; sharply slowing home sales (especially in the new construction market) coupled with record levels of homes available for sale; falling home prices; and increasingly restrictive lending policies by mortgage lenders. However, these national stories have often indicated that the Pacific Northwest, particularly Washington, was a bright spot in this gloomy picture. During the second quarter of the year Washington saw declining home sales on a par with national statistics (but better than the West region overall), but the median price continued to increase rapidly. Housing construction slowed, but unlike recent quarters, single-family construction was stronger than multifamily.

Home Resales

Since the beginning of 2007, **Washington State's Housing Market** has been reporting statistics at seasonally adjusted annual rates, consistent with most economic statistics on housing market activity. If the relative sales pace which prevailed during the second quarter were to continue for an entire year, there would be 132,560 resale homes sold throughout the state. This represents a decline of 5.2 percent from the sales pace during the first quarter, and 11.6 percent below the pace of a year ago. Putting this data into perspective, the national resale market declined 7.9 percent from the first quarter (10.8 percent from last year) and the sales in the West region (everything from the Rockies west) declines 9.8 percent during the quarter and 16.9 percent from a year ago. While the Washington market during the second quarter looked a lot like the national total, the real difference is the fact that the national market was sliding much more during early 2006 than the state was meaning Washington has not fallen as far from its peak level of sales.

Statistics on not seasonally adjusted sales activity will continue to be included in the tabular portion of this report, but the analysis will be limited to the seasonally adjusted annual rate data from now on.

Looking to the local detail, King County, of course, had the highest sales rate, 34,090 units, a decline of 4.5 percent from the first quarter and 7.7 from the second quarter of last year. At the opposite extreme, a sales rate of only 50 ho



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 nine micropolitan areas.

mes was reported in Garfield County, Washington's smallest county in terms of population. This sales rate was unchanged from last quarter, but 37.5 percent below a year ago. Eleven of Washington's 39 counties reported a higher sales rate in the second quarter than in the first, led by a 77.8 percent jump in Wahkiakum County (where small numeric changes translate into large percentage). Four counties reported no change in

home sales activity, while the remainder had a slower sales rate than earlier in the year. The biggest decline in sales activity was 38.5 percent in another small county, Adams.

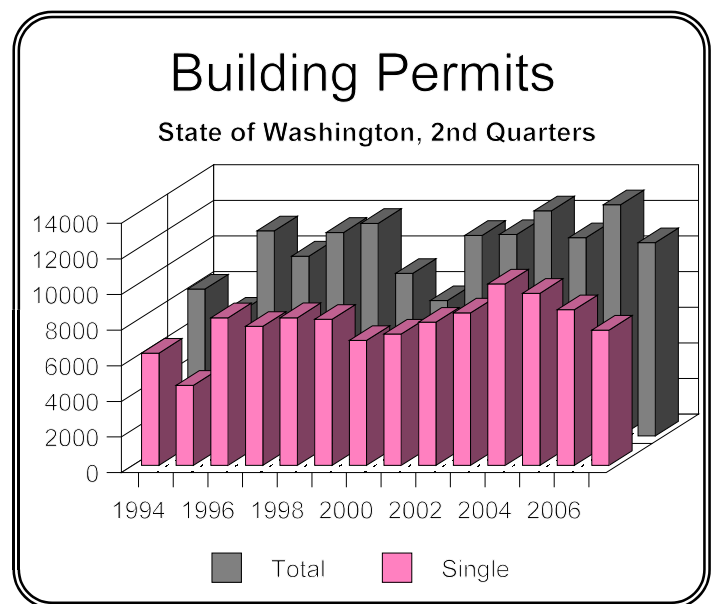
Home sales declined more consistently when compared to a year earlier with only four counties (Klickitat, Skagit, Wahkiakum and Yakima) reporting more sales. Among those, tiny Wahkiakum again reported the biggest gain, 14.3 percent. Among the counties with fewer home sales than a year ago, the largest percentage decline in activity was 37.5 percent in both Garfield and Pend Oreille counties.

In metropolitan areas, the strongest market measured in terms of change from a year ago was Yakima County which increased 2.7 percent. Benton/Franklin counties were unchanged and Spokane declined only 0.1 percent, indicating there are still markets in Washington resisting the national decline. The weakest metropolitan market was Cowlitz County, where sales were 34.8 percent below the second quarter of last year. The extremes in the second-tier micropolitan markets were declines of less than six percent in Grays Harbor, Walla Walla and Whitman counties on the positive end to a decline of 20.0 percent in Lewis County. These smaller population centers reflected the stability consistent with their typically more agricultural roots.

Housing Construction

After a strong start to the year, construction activity fell sharply compared to a year ago, mirroring national trends. According to building permit data collected by the Census Bureau, 10,850 permits were issued during the second quarter in those jurisdictions covered by the Census data efforts, a reduction of 16.1 percent compared to the second quarter last year. For the first six months of the year, a total of 22,429 residential units have been authorized by building permits, only 0.8 percent fewer than during the first half of 2006, but multifamily units contributed all the strength to first-half construction. During the first six months of 2007 only 14,204 single-family permits have been issued, a decline of 12.3 percent from a year ago. In Washington, as in other parts of the US, builders have an inventory of homes in the construction pipeline that does not justify starting new units at the current depressed state of the market.

Six counties indicated increased permitting activity in the second quarter. Four of those counties were in metropolitan areas – Cowlitz, Douglas, Skagit and Yakima counties all observed more residential building permit activity compared to a year ago.

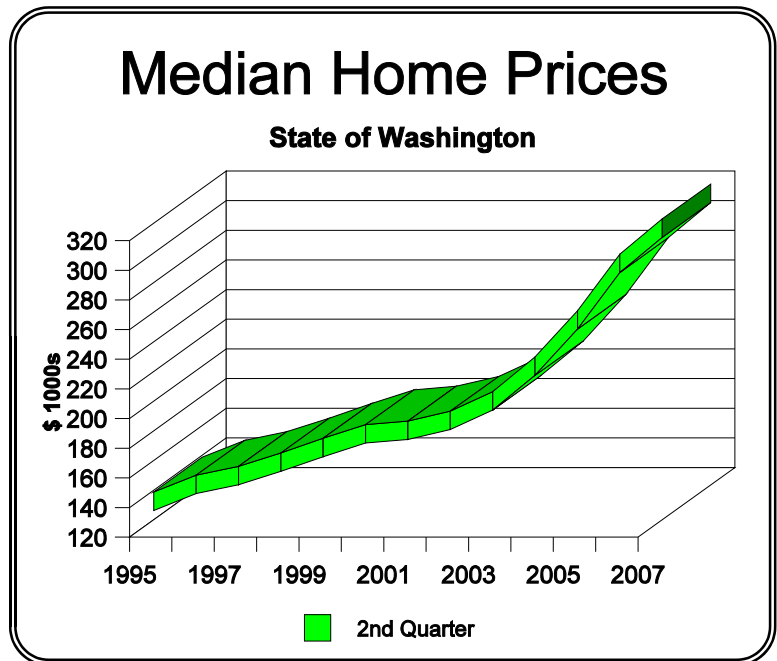


Home Prices

The median selling price for a resale home in the State of Washington during the second quarter of 2007 increased 8.1 percent from the second quarter of 2006, to \$316,700. While this increase in median prices remains double the inflation rate throughout the economy and a bit more rapid than during the first quarter, it should also be noted that the last two quarters show the slowest year-to-year increase in median prices statewide since late 2003.

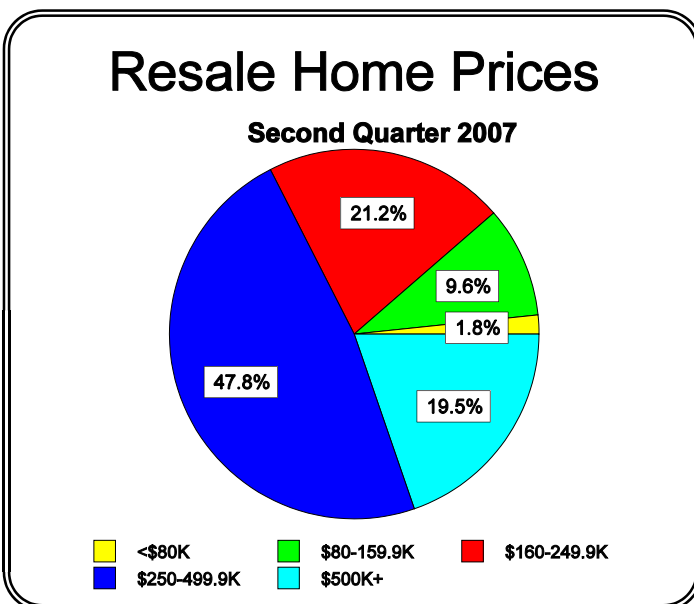
Local area median prices ranged from a low of \$104,400 in Adams County to a high of \$520,000 in San Juan County. King County remained the highest cost metropolitan market with a median of \$470,000, 9.6 percent higher than a year ago. During the second quarter over half of Washington's 39 counties reported median prices in excess of \$200,000. That is four more than three months earlier.

Only four counties reported price levels below a year ago, a sharp contrast to national reports. San Juan County showed an 18.8 percent decline. Extreme price movements are not uncommon in small, specialized resort markets. More modest declines in medians were reported in Adams, Jefferson and Wahkiakum counties. It should be noted, however, that simply because median prices are higher does not imply that the prices at which individual homes are selling are higher than the same home would have sold for last year. The median is a statistical measure where half the homes sold a higher prices, and half lower. It does not match the characteristics of the homes which sold. Typically in periods of declining sales activity and increasing inventories available for sale purchasers find that their home purchase dollar will go a bit



further than they expected. The result is the purchase of homes which have more amenities than prevailed in an earlier period. The homes may be larger or on larger lots. The buyers stretch their budgets to take advantage of the "bargains," resulting in an increasing median price at a time when the prices of individual homes is actually declining. It is a bit to early, however, to judge to what extent this is happening in the current market.

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



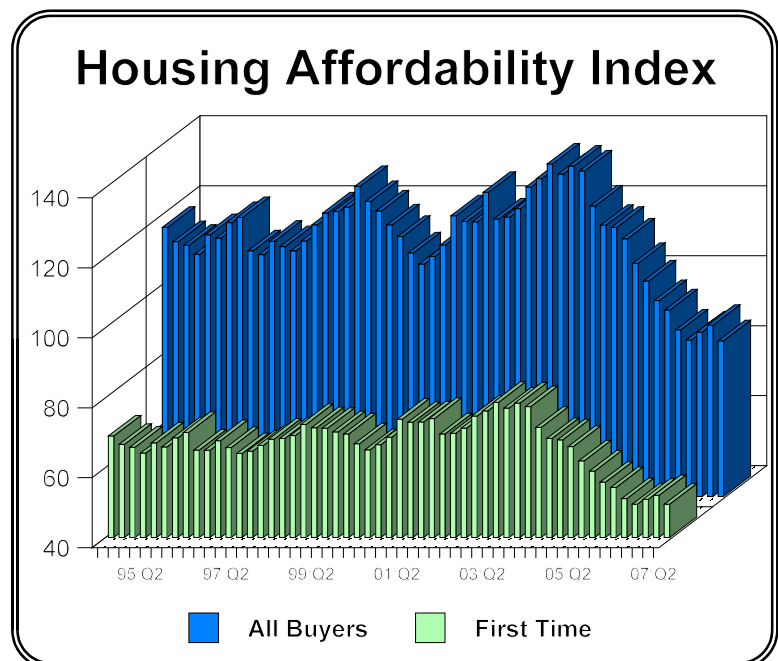
reasonable commuting distance from major population centers. However, even in urban areas, some lower cost housing is available, especially if the buyer is willing to invest some hard physical labor improving the home. In fact, while "only" 1.8 percent of the single-family homes sold during the second quarter were priced no higher than \$80,000, this represents annual sales of about 2,390 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. It is worth noting that almost twice as many homes sold during the second quarter at prices in excess of \$500,000 than sold for prices below \$160,000. This leads naturally to a discussion of the continuing challenge of affordability.

Housing Affordability

A central feature of **Washington State's Housing Market** is the data on housing affordability. Following the model developed 25 years ago 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 (6.47 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 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 second quarter stood at 84.5. This value indicates that a median income family had only 84.5 percent of the income to marginally qualify for a mortgage on the median price home. This was the seventh 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. After declining through mid-year 2006 as mortgage rates rose and sales prices soared, the affordability index has stabilized. After improving very modestly for two quarters, the higher prices and marginally higher interest rate pushed the index back down to the lowest level on record (since 1994). If a value of 100 determines counties which are affordable, the HAI indicates that housing is less than affordable in 17 of the 38 counties for which data is available. The most affordable urban area was Benton County (Kennewick/Richland) with an index of 171.0 while the least affordable metropolitan county was King at 66.1. San Juan County continued to have the least affordable housing overall.

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 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 49.5. This matches the record low affordability measure set in the third quarter of 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 (Adams, Benton and Columbia). At the other extreme, first-time buyer indexes were below 50 in seven counties. The first time buyer index was only 29.0 in San Juan County, 37.1 in King County and 39.7 in Jefferson County. First-time buyer affordability levels were generally higher in Eastern Washington.

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% (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	\$ 82,401	\$ 4,337	\$ 86,738
\$ 50,000	\$ 1,042	\$164,803	\$ 18,311	\$ 183,114
\$ 75,000	\$ 1,563	\$247,204	\$ 61,802	\$ 309,005
\$125,000	\$ 2,604	\$412,007	\$ 221,850	\$ 633,857

This table clearly illustrates how income growth coupled with ownership of homes with increasing values can move a household up the ladder of homeownership. When reviewing these statistics it is important to remember that the median family income in the state during the quarter was \$64,740, and ranged from a low of \$38,884 in Ferry County to \$75,143 in King County. Household incomes were predictably lower, ranging from \$32,908 in Ferry County to \$62,358 in Snohomish County. The statewide median household income was \$53,222. 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 these 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 June, when both sales and inventories are typically near their peak for the year. 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. 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 – June, 2007

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	6.5%	42.4%	71.1%	95.7%
Benton/Franklin	7.5%	44.5%	80.6%	97.6%
Chelan/Douglas	0.9%	7.2%	29.7%	81.0%
Clallam	0.0%	2.5%	26.4%	82.8%
Clark	0.6%	1.4%	18.9%	75.6%
Cowlitz	2.7%	25.3%	60.5%	89.0%
Ferry/Pend Oreille/Stevens	5.5%	29.2%	56.9%	91.4%
Grant	4.5%	26.1%	52.4%	91.2%
Grays Harbor	3.4%	28.0%	58.3%	92.8%
Island	0.0%	1.4%	12.5%	67.2%
Jefferson	0.7%	4.6%	14.2%	64.6%
King	0.0%	0.2%	1.4%	47.9%
Kitsap	0.0%	1.7%	19.8%	69.6%
Kittitas	4.0%	3.1%	25.9%	76.3%
Klickitat	3.9%	19.7%	39.5%	83.8%
Lewis	2.1%	14.0%	50.1%	92.9%
Mason	0.3%	13.1%	46.6%	87.7%
Okanogan	4.3%	23.6%	49.2%	83.9%
Pacific	0.6%	18.9%	52.6%	85.0%
Pierce	0.0%	1.2%	19.5%	79.3%

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
San Juan	0.0%	0.0%	0.9%	22.2%
Skagit	0.8%	3.1%	24.3%	72.4%
Skamania	0.0%	10.8%	37.8%	81.1%
Spokane	0.4%	15.1%	48.3%	88.7%
Snohomish	0.1%	0.8%	4.0%	68.7%
Thurston	0.0%	1.6%	26.8%	84.7%
Walla Walla	2.7%	24.8%	60.4%	91.8%
Whatcom	1.1%	3.7%	21.1%	78.3%
Whitman	3.2%	28.6%	61.9%	97.4%
Yakima	10.4%	46.1%	73.4%	96.9%
Statewide	1.0%	7.5%	24.7%	74.3%

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 16 counties carry asking prices less than \$80,000 (up from only seven counties a year ago).

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 8.5 percent 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, especially as lenders are enforcing more restrictive qualification standards. All communities in Eastern Washington offer far greater choices of lower-cost homes.

Available Inventory

Most communities in Washington, like their counterparts in the rest of the nation are seeing "For Sale" signs pop up like mushrooms after the rain. At the end of June there were 48,012 single-family homes for sale through the multiple listing services which contribute information for this report. That represents an increase of 45.8 percent compared to a year ago – roughly **15,100 more** homes on the market. Moreover, the vast majority of those listings are resale homes. Similarly, home builders have a much larger unsold inventory than they want, the result of fewer potential buyers in their model homes and a sharp rise in canceled orders for new homes. Unfortunately, the latter cannot be reported specifically for Washington State.

Listings Available for Sale – End of June

County	2001	2002	2003	2004	2005	2006	2007	%Ch 2006-07
Asotin	605	663	432	379	342	357	443	24.1%
Benton/Franklin	902	907	1,255	1,694	1,436	1,648	1,436	-12.9%
Chelan/Douglas	748	640	513	464	396	306	542	77.1%
Clark	1,588	1,197	1,966	1,676	1,414	3,414	4,206	23.2%
Cowlitz	590	555	483	469	326	432	671	55.3%
Ferry/Pend Oreille/Stevens	435	514	390	375	298	295	325	10.2%
Grant	438	437	367	407	372	316	441	39.6%
Grays Harbor	571	641	569	465	417	623	774	24.2%
Island	525	752	669	654	423	787	1,006	27.8%
Jefferson	n/a	n/a	217	286	221	340	452	32.9%
King	7,201	7,763	7,615	6,144	4,351	5,745	8,569	49.2%
Kitsap	1,416	1,335	1,243	1,008	820	1,388	2,199	58.4%
Kittitas	n/a	n/a	258	285	200	290	459	58.3%
Lewis	563	512	453	411	367	443	722	63.0%
Mason	774	702	512	465	385	521	796	52.8%
Okanogan	n/a	n/a	n/a	n/a	n/a	218	254	16.5%
Pierce	3,892	4,090	3,616	2,987	2,575	4,420	6,971	57.7%
San Juan	n/a	223	240	221	191	228	325	42.5%
Skagit	807	828	720	575	447	916	1,048	14.4%
Snohomish	3,333	3,450	3,436	2,936	2,133	2,944	4,906	66.6%
Spokane	4,181	4,168	1,811	1,676	1,644	2,401	3,236	34.8%
Thurston	1,157	929	810	755	690	1,524	2,122	39.2%
Walla Walla	n/a	n/a	n/a	n/a	372	425	512	20.5%
Whatcom	1,925	1,739	n/a	668	625	1,599	1,771	10.8%
Whitman	235	296	214	157	169	186	189	1.6%
Yakima	1,104	1,019	941	984	940	1,155	1,387	20.1%
Statewide	32,990	33,360	28,780	26,141	21,554	32,921	48,012	45.8%

The table above highlights those years where the inventory of homes available for sale at the end of June of

any year exceeded the inventory available this June. While in the aggregate it would be fair to say the inventory available statewide is a record, it is clear that there have been other years in some parts of the state where buyers have had more choices in the market. However, only six of the 26 markets identified in the table have had more homes on the market in a previous June than they had this year. Moreover, the absolute level of inventory only tells part of the story. The other component of the discussion is how long those units could sustain the market at current sales rates. Again, the conversion to seasonally adjusted annual rate data played a role in these calculations. Rather than minimizing supply by using data from the last four quarters when sales may have been above anticipated levels for this year, seasonally adjusted annual rate data for the current quarter was used to estimate month's supply.

A 5-7 month inventory is considered normal or balanced. Accordingly, the overall state market can be characterized as "balanced" with an inventory capable of sustaining the market for nearly six months, compared with a 3.7 months inventory a year ago as month's supply began to increase. 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 stabilize, with increases in median prices moving closer to the overall inflation rate. The month's supply of homes on the market increased in all communities except the Tri-Cities (Benton/Franklin counties) and Okanogan County markets.

Month's Supply of Housing by Price Range
June, 2007
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	6.3	5.5	6.4	10.2	32.8	6.9	4.6
Benton/Franklin	5.8	4.9	6.2	4.9	7.5	5.4	6.5
Chelan/Douglas	1.4	2.8	2.5	6.7	10.6	4.7	2.5
Clark	3.8	2.9	4.1	9.3	20.6	8.4	5.8
Cowlitz	4.0	4.4	5.9	12.6	82.1	8.0	3.7
Ferry/Pend Oreille/Stevens	3.0	6.4	7.5	20.9	88.7	9.1	6.0
Grant	3.5	2.7	5.3	10.4	21.4	5.4	3.5
Grays Harbor	2.6	5.9	8.5	15.4	36.1	8.7	6.8
Island	0.0	9.3	4.4	9.2	21.2	9.8	6.4
Jefferson	6.6	4.4	3.9	9.8	14.1	9.0	8.1
King	1.1	2.7	1.7	3.4	4.6	3.9	2.4
Kitsap	0.0	3.9	5.1	7.0	15.8	7.6	3.9
Kittitas	3.2	4.2	5.1	9.1	23.1	8.4	4.8
Lewis	7.9	3.8	9.2	16.0	16.1	9.6	4.6
Mason	1.0	4.7	7.4	12.5	25.0	8.9	4.8
Okanogan	4.6	4.2	8.1	13.4	27.4	8.4	8.8

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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	Year ago
Pierce	1.0	2.2	4.3	7.3	14.9	6.9	3.5
San Juan	n/a	n/a	3.1	8.3	23.4	16.2	9.0
Skagit	6.6	2.6	5.2	5.9	14.4	6.6	6.0
Snohomish	2.0	6.4	2.5	4.6	7.0	5.0	2.5
Spokane	0.8	2.3	4.1	7.0	12.9	4.6	3.4
Thurston	1.6	2.3	4.4	6.6	10.4	6.0	3.6
Walla Walla	3.4	6.6	7.4	14.5	14.4	8.6	6.7
Whatcom	3.2	6.0	5.0	7.6	16.2	7.6	6.6
Whitman	3.7	5.3	4.2	10.3	10.8	5.8	5.4
Yakima	5.4	6.0	5.9	12.1	13.7	6.8	5.8
Statewide	3.4	4.0	4.8	6.1	7.8	5.9	3.7

Unlike in previous reports, the months supply statistics now suggest longer marketing times as prices increase. In large part this is due to the absolute lack of homes available for sale at any price below \$100,000. Homes priced above \$500,000 are in excess supply in most areas.

Since inventory levels are increasing in most markets and the consensus is that sales activity is slowing, it is anticipated the month's supply statistics will continue to move toward balance in lower price ranges and a modest oversupply at higher prices in the months ahead, reducing demand pressure on home prices and reaffirming the stabilization of the market suggested throughout this report. The housing market around the country has softened substantially and declining prices have been observed more quickly than in previous cycles. While the Washington market continues to outperform the nation as a whole, the declining sales and rapidly increasing inventories available for sale suggest we may be approaching a tipping point. Stay tuned.