

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

3rd Quarter 2007

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Third Quarter 2007

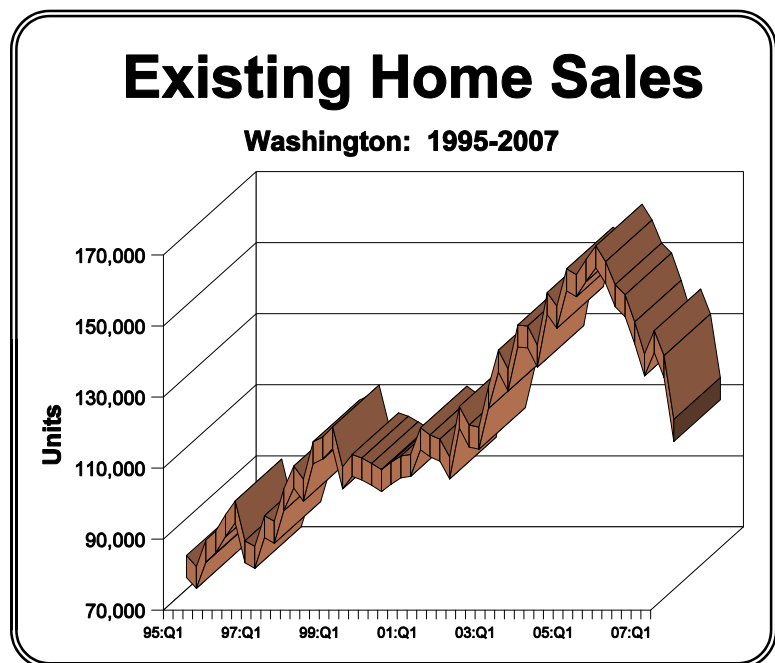
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Cooling housing markets prevail throughout the country as turmoil in the subprime mortgage segment has spread to other parts of the housing market. While Washington is not immune to these market disruptions, so far the primary impact has been reduced levels of home sales and increases in the absolute numbers of homes available for sale. Although media stories in the national press have been painting a picture of home prices declining sharply, to date Washington home price changes have been limited to slower increases in medians. It seems that some segments of the Washington market are experiencing modest declines, but other areas continue to report multiple offer situations for homes which are well located and competitively priced. Sellers who insist on listing homes for sale at prices well above what would have prevailed last year are experiencing extended marketing times and the prospect of repeated price reductions.

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) represented a seasonally adjusted annual rate of 114,750 across the state of Washington. This is a sales rate 5.0 percent below the second quarter and 11.4 percent lower than a year ago. On a not seasonally adjusted basis, a total of 31,160 homes sold during the July-September period.

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.



Sales rates were consistently lower in all parts of the state, with only two counties (Lewis and Walla Walla) reporting an increased sales rate compared to the second quarter and only four counties (Benton/Franklin, Lewis and Kittitas) registering higher sales than during the third quarter of 2006.

Among the large urban areas the strongest market was the Tri-Cities with a sales decline of only 1.8 percent compared to the second quarter and an increase of 5.1 percent compared to a year ago. The weakest major market was Pierce County, which saw sales decline 18.9 percent compared to second quarter and 32.2 percent compared to last year. In the second-tier micropolitan areas the strongest market was Lewis County (Centralia) which increased 1.7 percent compared to last quarter and stood 9.9 percent above a year ago in terms of units sold. At the other extreme, Mason County (Shelton) was 25.0 percent below the second quarter and down 34.2 percent compared to third quarter 2006.

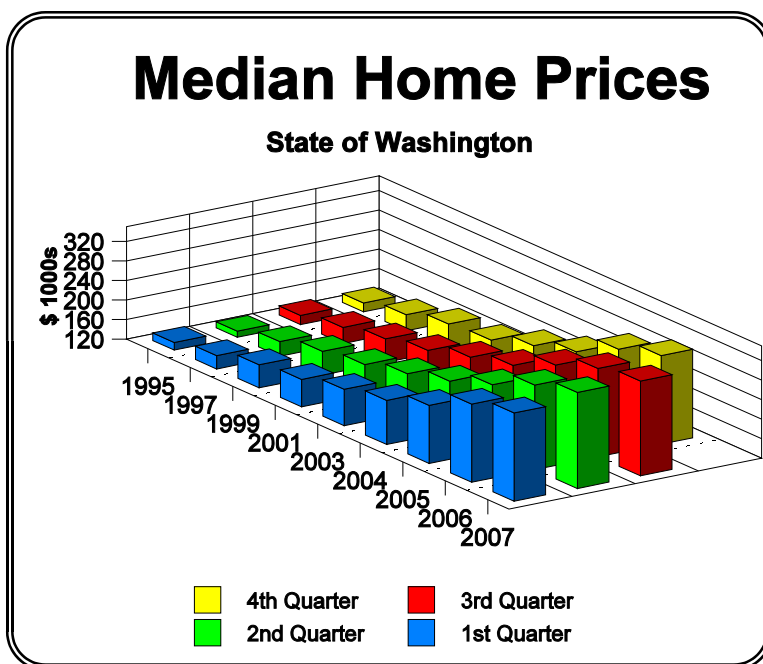
Housing Construction

Construction activity, as measured by building permits, followed the national trend toward weakness, with total permits declining 17.3 percent statewide, led by an 18.8 percent decline in single-family construction compared to a year ago. Multifamily permits, typically the most volatile component, declined 15.3 percent, continuing the recent trend to relatively stronger multifamily markets. This represents both construction of units for sale as condominiums and as new rental units. The permit data is provided by the U.S. Bureau of the Census which receives reports directly from many permit issuing jurisdictions (cities and counties). More than 1,000 building permits were issued in only three counties during the second quarter: King County jurisdictions issued 4,483 permits, 13.2 percent fewer than last year; Snohomish County communities issued 1,217 permits, a decline of 6.5 percent; and Pierce County localities authorized 1,089 new units, but saw a reduction of activity of 29.1 percent.

Home Prices

The median selling price for a resale home in the state of Washington during the third quarter of 2007 continued to advance, reaching \$314,000, a level 4.4 percent above last year at this time. While the median price was lower than in the second quarter, since these values are not adjusted for seasonality nor balanced geographically, no conclusions can be drawn from that fact.

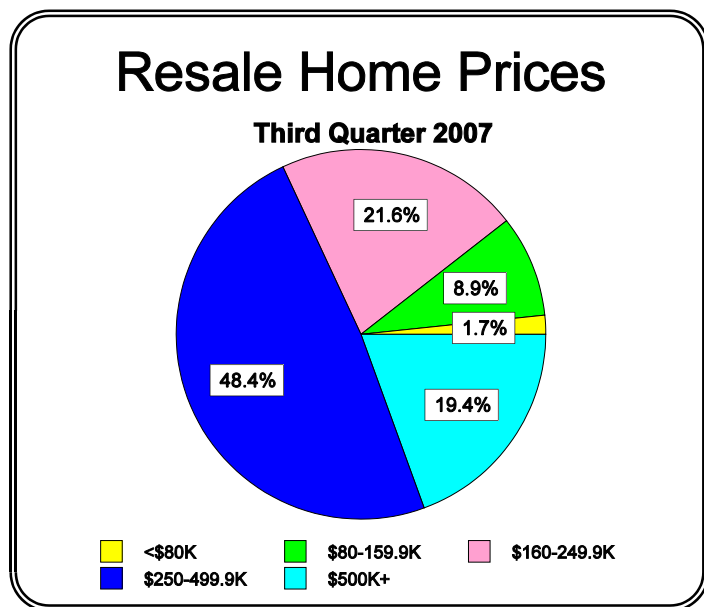
The question often arises regarding why price increases (particularly from quarter to quarter, if not from year to year) persist during periods of declining sales activity. Consumer behavior is the primary factor. When potential homebuyers enter the housing market, they have two preconceived notions



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. The depth and duration of the slowdown coupled with the number of listings on the market will determine whether Washington will see the year-to-declines in median prices which have recently been observed in many parts of the country.

Local area median prices ranged widely around the \$314,000 statewide median, from a low of \$104,300 in Adams County to a high of \$585,000 in the San Juan County resort market. Among metropolitan areas the range was slightly narrower, with King County’s \$472,000 the high and Asotin County’s \$154,100 the low. For the smaller city micropolitan areas, the range was even smaller, from \$169,100 in Grant County to \$320,000 in Island County.

Third quarter median prices were higher than a year ago in 36 of the 38 counties for which data is available (the Pacific County median price declined 8.3 percent and Jefferson County’s median slipped 3.0 percent). The extent of the increases varied from a 0.7 percent increase in Skagit County to a 35.0 percent jump in Okanogan County. Among the metropolitan counties the increases ranged from the low of 0.7 percent in Skagit County (Mount Vernon) to 15.0 percent in Yakima County. For the micropolitan areas the range was from 1.6 percent in Island County (Oak Harbor) to 22.5 percent in Grant County (Moses Lake).

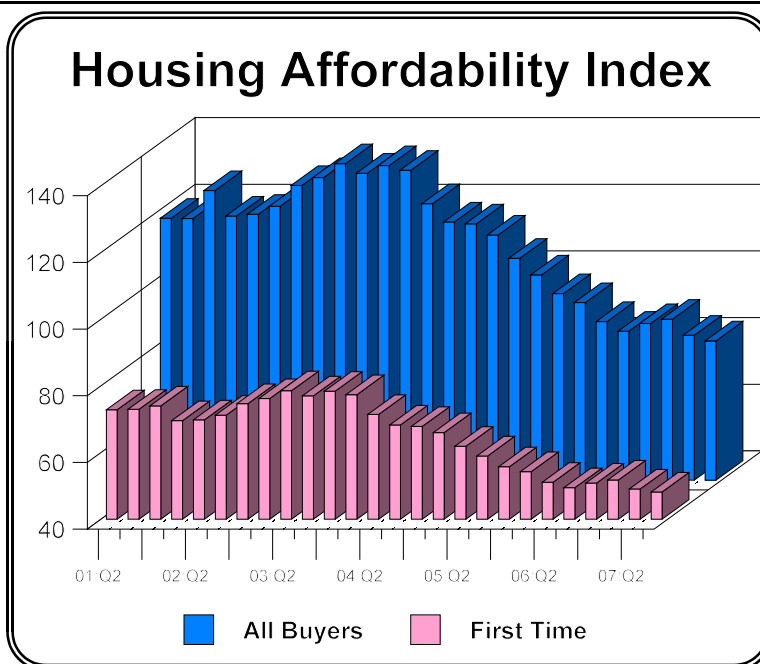


Measures of central tendency, like median prices (half the homes sold were more expensive, half less) which use a single number to represent a distribution of home prices, tend to confuse some prospective buyers into believing there is nothing less expensive than the median in the marketplace. While 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” 1.7 percent of the single-family homes sold during the third quarter were priced no

higher than \$80,000, this represents about 560 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 (6.75 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 amortizing 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 parent) 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 slightly to its lowest level since WCRER began calculating the measure in 1994. The 81.8 value for the third quarter means that a median income family had 18.2 percent less income than the bare minimum required to qualify for a mortgage on the median price home. A troubling as this value seems, it is consistent with the national affordability index which prevailed throughout the 1980s, and represents a much higher level of affordability than prevailed during the last major real estate downturn of the early 1980s when the all buyer index was below 70.

The all-buyer affordability index indicated that a median income family could still afford to purchase the median price home in 17 of the 38 counties for which the statistics are calculated – four fewer than in the second quarter. Locally, housing affordability indexes ranged from a low of 39.1 in San Juan County to a high of 160.3 in Adams County. Again, the higher the index, the more affordable the housing. Among metropolitan areas, affordability indices ranged from a high of 154.6 in Benton County to a low of 64.7 in King County. Meanwhile, all-buyer affordability in micropolitan areas ranged from 73.5 in Island County (Oak Harbor) to 110.6 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 48.2. 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) only in Adams county. At the other extreme, first-time buyer indexes were below 60 in 22 counties indicating a continuing affordability crisis, especially since many large urban areas are on the list. Housing was most affordable for first-time buyers in Adams County (108.1) and least affordable in San Juan County (23.1). Among urban areas the range was from 36.1 in King County to 92.9 in Benton County. The micropolitan range was from a low of 42.1 in Kittitas County (Ellensburg) to a high of 69.7 in Grant County (Moses Lake).

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% (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
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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 \$64,005, and ranged from a low of \$40,155 in Ferry County to \$76,023 in King County. Household incomes were predictably lower than family incomes, ranging from \$33,431 in Whitman County to \$60,150 in Snohomish County. The statewide median household income was \$52,865. 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, 2007

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	5.6	40.0	70.7	94.9
Benton/Franklin	7.5	44.5	80.6	97.6
Chelan/Douglas	1.0	6.8	31.4	78.3
Clallam	2.8	8.7	30.1	84.3
Clark	0.6	1.7	22.7	76.9
Cowlitz	3.1	28.2	64.4	90.3
Ferry/Pend Oreille/Stevens	2.8	27.8	58.4	91.3
Grant	5.0	26.8	56.8	93.1

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County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Grays Harbor	3.2	29.0	59.5	93.1
Island	0.0	1.3	13.2	66.7
Jefferson	0.2	3.8	14.5	66.5
King	0.0	0.1	2.0	49.5
Kitsap	0.1	1.9	21.6	71.7
Kittitas	0.2	4.3	32.1	74.9
Klickitat	3.2	18.9	41.4	82.9
Lewis	1.3	16.8	49.9	92.2
Mason	1.2	14.3	49.9	87.9
Okanogan	5.4	27.1	56.5	87.0
Pacific	1.7	17.8	50.3	83.3
Pierce	0.0	1.7	21.4	76.3
San Juan	0.0	0.0	1.0	25.6
Skagit	0.9	3.6	22.8	77.4
Skamania	0.9	13.0	44.4	82.4
Spokane	0.6	18.5	52.2	88.3
Snohomish	0.1	0.5	4.9	71.2
Thurston	0.0	2.2	26.7	78.9
Walla Walla	3.0	23.4	60.1	90.8
Whatcom	0.9	3.6	22.8	77.4
Whitman	3.9	35.0	68.9	98.3
Yakima	9.8	45.2	75.9	96.9
Statewide	1.0	7.8	25.5	73.5

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 7.8 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 significant increase in the number of homes on the market, frequently described as record high levels of homes available for sale. As illustrated in the table below, many Washington counties do, in fact, have record numbers of homes on the market. Record levels of inventory are presented in bold. The number of homes listed for sale increased by 41.8 percent compared to the end of the third quarter last year. On a local level, listings more than doubled in the past year in the Wenatchee market (Chelan and Douglas counties), and increased by more than 50 percent in Grant, Kittitas and Snohomish counties. Conversely, listings were unchanged in the Tri-Cities (Benton/Franklin 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 20 of the 25 counties or county groups for which WCRER has consistent listings data for most of the years. All third quarters with higher inventory levels are shaded in the table.

Listings Available for Sale – 3rd Quarters

County	2001	2002	2003	2004	2005	2006	2007	%ch 2006-07
Asotin	703	483	403	341	337	381	450	18.1%
Benton/Franklin	889	1,091	1,371	1,755	1,575	1,436	1,436	0.0%
Chelan/Douglas	675	558	541	393	376	348	710	104.0%
Clark	1,282	n/a	1,750	1,729	1,916	3,789	4,421	16.7%
Cowlitz	558	546	488	405	336	536	742	38.4%
Ferry/Pend Oreille/Stevens	411	458	366	332	260	288	320	11.1%
Grant	437	379	364	379	301	348	537	54.3%
Grays Harbor	559	625	561	404	424	601	770	28.1%
Island	668	684	590	583	468	809	1,070	32.3%
Jefferson	n/a	n/a	n/a	323	289	401	490	22.2%
King	7,602	9,274	7,163	5,924	5,135	7,136	10,555	47.9%
Kitsap	1,350	1,234	1,105	930	964	1,649	2,269	37.6%
Kittitas	n/a	236	242	263	245	343	558	62.7%
Lewis	570	n/a	309	379	351	567	768	35.5%

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County	2001	2002	2003	2004	2005	2006	2007	%ch 2006-07
Mason	656	532	431	373	395	560	834	48.9%
Okanogan	n/a	n/a	n/a	n/a	n/a	225	313	39.1%
Pierce	4,054	3,758	3,278	3,050	2,975	5,259	7,582	44.2%
San Juan	178	188	212	189	195	210	308	46.7%
Skagit	756	748	707	487	480	800	1,066	33.3%
Snohomish	3,386	3,651	3,239	2,842	2,582	3,565	5,570	56.2%
Spokane	3,784	3,913	1,875	1,835	1,942	2,942	3,607	22.6%
Thurston	1,091	833	785	748	799	1,774	2,075	17.0%
Walla Walla	n/a	n/a	n/a	n/a	364	347	534	53.9%
Whitman	144	189	115	132	140	162	180	11.1%
Yakima	888	847	738	718	742	1,045	1,161	11.1%
State	30,641	30,227	26,633	24,514	23,591	35,521	50,333	41.7%

Listings alone, however, only tell part of the story. They need to be linked to prevailing sales rates to determine how the current availability might influence aggregate housing markets. Accordingly, 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 seasonally adjusted annual rate of sales for the quarter is compared to the end-of-quarter listing inventory to determine the months supply. This prevents higher sales rates in previous quarters for producing unrealistically optimistic estimates of market activity. As expected, the months' supply statistics are increasing in most markets, with a statewide inventory of 7.3 months currently available. This is significantly above the 4.3 months recorded a year ago, and nearly triple the 2.5 months inventory which prevailed in September 2005.

A 5-7 month inventory is considered normal or balanced. Accordingly, the overall state market can be characterized as being at the high end of balanced. 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 close to 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.

Over the course of the last several months a number of markets in Washington have joined the ranks of places nationally with an oversupply of homes available for sale, with months' supply statistics greater than 10 months. Those markets should anticipate some price instability in the near term, unless the current owners of properties who do not have an immediate need to sell allow listings to expire, allowing the market to return to a stable equilibrium. No market in the state would currently

be characterized as having a shortage of homes available for sale. Accordingly, the reported rates of increase in median prices should be moderating in all parts of the state.

**Months' Supply of Housing by Price Range
September, 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	4.4	5.9	7.7	14.2	40.5	7.7	5.0
Benton/Franklin	6.7	5.4	5.3	4.5	10.4	5.3	5.5
Chelan/Douglas	2.7	4.2	4.8	8.4	20.4	7.4	2.9
Clark	4.6	6.0	6.4	10.8	24.8	10.5	6.4
Cowlitz	3.1	6.8	6.8	15.0	60.6	9.6	4.5
Ferry/Pend Oreille/Stevens	2.4	6.1	17.1	11.3	25.6	9.7	6.0
Grant	5.7	5.2	8.0	14.7	15.7	8.5	4.1
Grays Harbor	4.5	8.9	8.1	16.7	29.9	10.4	6.1
Island	n/a	5.1	5.2	11.4	17.0	10.9	6.3
Jefferson	1.1	4.7	7.7	12.1	37.1	13.2	8.4
King	1.7	5.7	3.9	5.1	6.2	5.6	2.9
Kitsap	3.5	4.3	7.0	8.7	13.1	8.9	4.8
Kittitas	n/a	7.3	7.3	9.4	33.5	10.4	6.0
Lewis	5.6	6.2	8.7	12.6	33.7	9.9	6.4
Mason	6.2	7.5	11.4	14.4	25.0	12.2	5.0
Okanogan	5.1	6.2	10.3	11.4	45.6	9.6	6.6
Pierce	6.8	4.9	6.4	8.7	23.6	9.3	4.0
San Juan	n/a	n/a	n/a	15.6	27.6	22.5	9.9
Skagit	21.4	6.6	5.0	7.7	17.8	7.8	5.1
Snohomish	8.6	3.4	4.6	6.4	9.6	6.9	3.0
Spokane	n/a	4.1	5.2	7.2	20.0	6.0	4.1
Thurston	0.0	7.6	4.5	6.2	19.6	6.5	4.5
Walla Walla	3.3	7.4	8.6	10.2	21.3	8.8	4.9
Whatcom	3.2	5.7	5.7	7.3	15.5	7.6	6.6

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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
Whitman	5.9	10.3	5.2	6.6	12.6	6.8	5.1
Yakima	6.6	8.8	8.0	9.2	25.2	8.5	7.2
Statewide	4.5	5.7	6.0	7.2	10.0	7.3	4.3

The statewide market now shows a months' supply which increases linearly across price ranges, with the least expensive homes showing the greatest appreciation potential. This is consistent with the affordability challenges described earlier.

In summary, while responding to the national slowing of the housing market and disruption of mortgage markets, the Washington housing market is one of the brighter spots. Inventories have increased enough to provide greater consumer choice and to stabilize prices, but not enough to force prices into steep declines. Employment remains strong. Overbuilding was never the problem in Washington as it was in markets without growth management restrictions. Interest rates remain affordable, but after the rapid increases in prices in the last two years overall housing affordability remains a significant challenge, especially in the largest urban communities in Western Washington. Affordability, coupled with the inability to predict how consumers will react to national media allegations that the housing market is in a prolonged free fall, creating an atmosphere there panic decision making could reinforce instability. Time will tell. Crystal balls are too cloudy to accurately forecast.