

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

4th Quarter 2007

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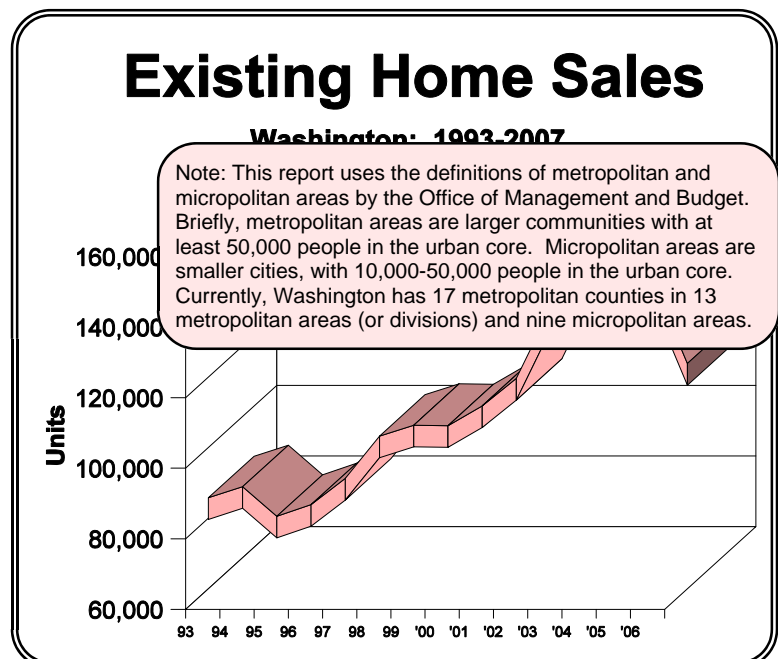
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The decline in Washington home sales which began in 2006 accelerated a bit in 2007. The home resale market retreated significantly in terms of unit sales volume during the year. The 120,760 single-family homes sold last year were 16.1 percent fewer than in 2006 and 24.3 percent below the 2005 peak. Although sales in 2007 were below each of the last four years, they still represented a very active market by the standards of the last decade. Annual statistics on resale housing markets prepared by the National Association of REALTORS® indicated a decline in home sales activity of 12.8 percent nationwide and 19.5 percent throughout the West. Factors contributing to the softer housing market were the collapse of the subprime mortgage market, coupled with resets of many of the innovative mortgage products to higher mortgage rates and amortization. In addition, news stories about declining home prices in some markets caused many potential buyers to remain on the sidelines waiting for “bargains” while many owners listed their home for sale in hopes of cashing out before the fall. This resulted in a move toward a “buyers market”, as will be discussed later. Like the resale market, the new construction market moved to a lower level of activity as builders faced cancelled sales and cut back on speculative construction. While reports of declining home prices have prevailed in the media, annual median sales prices in virtually all Washington counties in 2007 were above 2006 medians, and many were at least 10 percent higher. The statewide median rose 5.4 percent compared to 2006. Although this was the smallest percentage increase in medians since 2002, it should be noted that the statewide value rose by more than the inflation rate.

Home Resales

Statistics collected from multiple listing services and from organizations which monitor deed recordings in areas where multiple listing coverage is less complete, indicate that sales of single-family homes (excluding most new construction) declined 13.7 percent from the third quarter at seasonally adjusted annual rates, recording a pace of 99,120 units sold during the October-December quarter. Unfortunately, this represents the first time since early 1998 that the annual sales rate has dipped below 100,000 homes sold.



Five of Washington's 39 Washington counties reported a higher sales rate during the fourth quarter than the prior quarter, and six reported a higher sales rate than a year ago. Walla Walla and Columbia counties reported more home sales than either prior period. The sharpest decline in home sales was recorded in tiny Wahkiakum County where the sales rate was at least 40 percent below either prior period. Among the metropolitan counties the range of sales declines compared to the third quarter ranged from 1.1 percent in Cowlitz County to 19.8 percent in Spokane County. In the micropolitan markets the range was from a 28.1 percent jump in sales in Walla Walla County to a 31.1 percent decline in Island County.

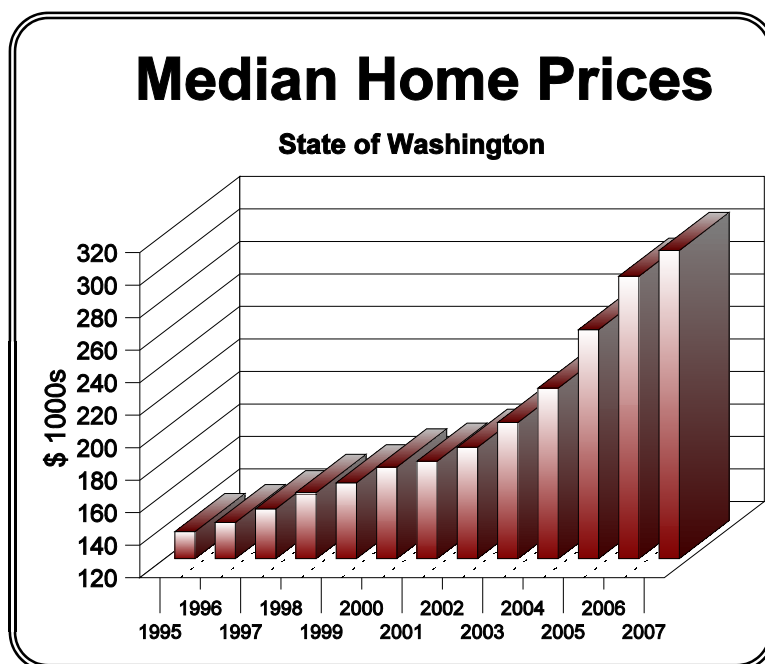
Housing Construction

Construction activity, as measured by total building permits, declined 2.8 percent compared to the fourth quarter of 2006. Single-family permits slid by 28.2 percent while authorizations for multifamily construction rebounded by 52.5 percent. This represents, in part, a belief that the challenges in the single-family marketplace will result in a long-term increase in renters. A total of 7,582 housing units were authorized for construction during the quarter, with 3,830 of those being single-family homes. Far more complete data on 2007 building permits will be included in the next issue of **Washington State's Housing Market**, since the Census Bureau typically releases final annual permit numbers in April.

At the local level, total housing construction increased compared to late 2006 in only three counties where the Census Bureau releases monthly statistics. Single-family permit activity in the fourth quarter was higher than that reported a year ago in Douglas and Skagit counties. The 5-county Central Puget Sound region represented nearly 75 percent of the state's building permits in late 2007, making the region even more dominant than a year ago.

Home Prices

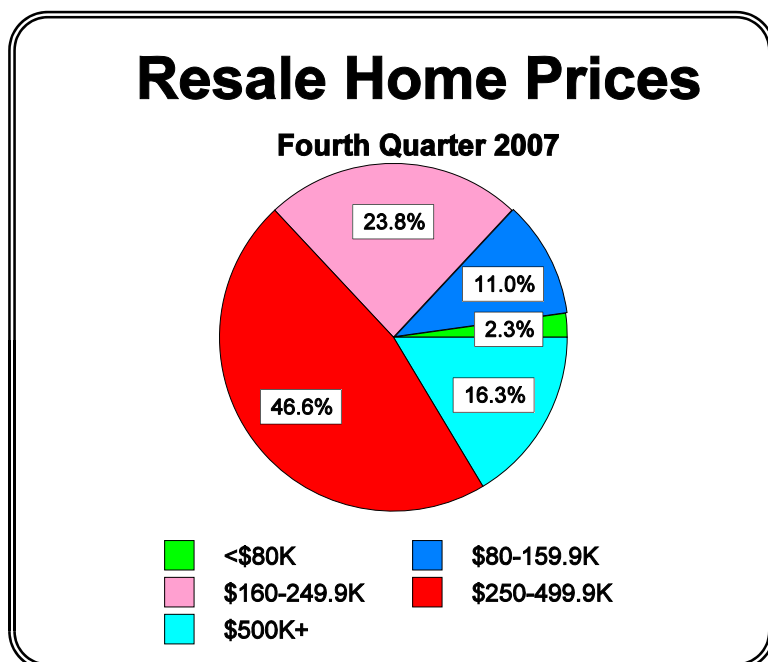
The median selling price for a resale home in the state of Washington during the fourth quarter of 2007 was \$293,900. This is \$7,500 (2.5%) lower than the fourth quarter median in 2006. Median prices during the fourth quarter are typically a little lower than the third quarter, and in 2007 a decline was observed. The median price for full year 2007 was \$309,600, an increase of 5.4 percent compared to 2006. This was the smallest year-to-year increase in median price in Washington since 2002. To put the Washington price experience into perspective, the national median declined by 1.8 percent in 2007 and the West region experienced a 2.3 percent annual decline. While the Washington market exhibited less price strength in 2007, it remained stronger



than either the national or regional markets.

Local area prices in the fourth quarter ranged from a low of \$110,000 in Adams County to a high of \$693,800 in San Juan County. A total of 17 counties now have medians of at least \$200,000. Of those, San Juan, King, Snohomish and Jefferson counties have medians in excess of \$300,000.

At the peak of the sales market in the last quarter of 2005, 20 counties recorded increases in median prices of at least 20 percent compared to the fourth quarter of 2004. By contrast, in late 2007 only Grant County had such an extreme increase in median. Twelve counties had lower median prices than a year earlier, twice as many as reported declines in late 2006. Among metropolitan counties, price changes ranged from a 3.1 percent decline in Asotin County to an 18.4 percent jump in Chelan County. This is consistent with federal data indicating the Wenatchee market has the highest



appreciation in the country. Among the micropolitan markets, the range was from Grant County's (Moses Lake) 20.6 percent increase to Inland County's (Oak Harbor) 4.7 percent slide. This was the only decline among the smaller urban communities. Among the rural counties the extremes of changes in median prices were a 14.3 percent increase in Columbia County and a 22.9 percent decline in Wahkiakum county. Significantly, these were the two smallest housing markets in the state in terms of number of sales.

Measures of central tendency, like median prices (half the homes sold were more expensive, half less) which use a single number to represent a distribution of home prices, tend to confuse some consumers into believing there is nothing less expensive than

the median in the marketplace. While there were significant numbers of homes which sold for prices well below the statewide median, the largest concentration of less costly housing is outside a reasonable commuting distance from major population centers. However, even in urban areas, lower cost housing is often available, especially if the buyer is willing to invest some hard physical labor improving the home. In fact, while "only" 2.3 percent of the single-family homes sold during the fourth quarter were priced no higher than \$80,000, this represents about 560 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.

Housing Affordability

A central feature of these reports is always the statistics 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 for each

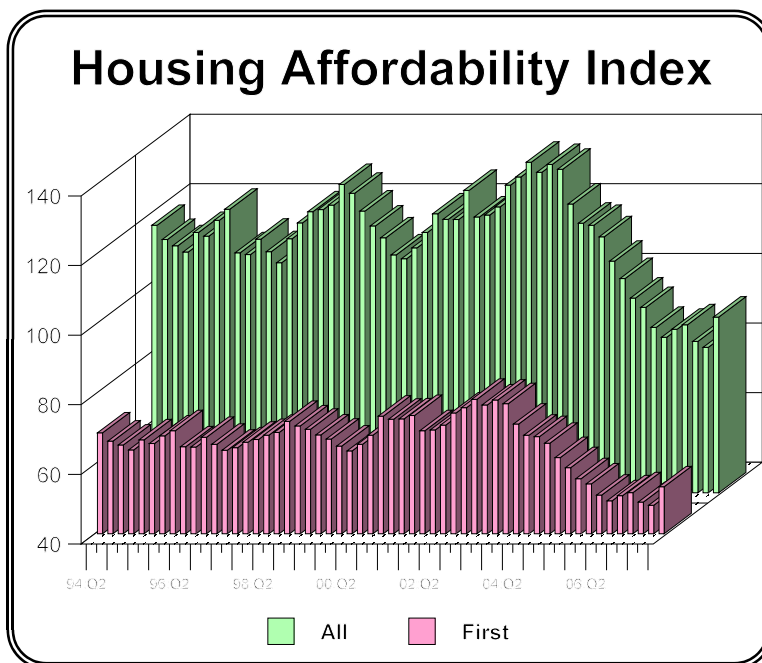
county in the state where price data is available. These affordability calculations depend on statistics from a variety of sources. The effective mortgage rate on loans closed during the quarter (national average, 6.42 percent) is used in this calculation. While the average downpayment on home purchases 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 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 individuals sharing a housing unit (roommates). 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 fourth quarter of 2007 stood at 90.5, meaning that a median income family had 9.5 percent less income than the bare minimum required to qualify for a mortgage on the median price home. This represents a somewhat improved affordability condition than the index of 87.0 which prevailed a year ago, but remains well below the index value of 134.4 from four years ago. Affordability increased in the fourth quarter compared to the third quarter as the median price and mortgage rates both eased a bit while incomes continued to advance. Locally, housing affordability indexes ranged from a low of 33.6 in San Juan County to a high of 159.4 in Benton County. Among metropolitan areas, affordability indices ranged from Benton County's high to a low of 72.4 in King County. Among the smaller urban areas the range is from a low of 81.9 in Island County to a high of 122.0 in Grays Harbor County.

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 current renters (potential buyers) 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 first-time buyers index for the fourth quarter of 53.5. Again, this reflects an improvement in affordability compared both last quarter and 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) only in Adams County. Unfortunately, this is down sharply from 19 affordable counties four years ago. Only one additional county (Benton) had an index above 90, indicating a small increase in the down payment or purchasing a home slightly below the assumed price would result in an affordable purchase. At the other extreme, first-time buyer indexes were below 60 in 14 counties (one less than a year ago), indicating the affordability crisis is still severe. In King County the would-be first time homebuyer had about 40 percent of the income required to purchase the typical "starter" home, and in San Juan County the value was less than 20! If households cannot afford to purchase their first home, the homeownership rate, which has already begun to decline through foreclosure and fear, will continue to slip. Since high levels of homeownership have been demonstrated to be consistent with many desirable features of communities, the affordability crisis is truly a community problem.

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 will be assumed that these buyers will be 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 moves a household up the ownership housing ladder. When reviewing these statistics it is

important to remember that the median family income in the state during the quarter was \$64,030, and ranged from a low of \$40,479 in Ferry County to a high of \$76,691 in King County. Household incomes were predictably lower, ranging from \$33,554 in Whitman County, with its large student population, to \$59,836 in King County. The statewide median household income was \$53,015. This means the lower two price ranges are most relevant for 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 December, when inventories are typically at their seasonal low (fewer people attempt to sell their homes over the holidays). 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. 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, they are reflective of housing market access in these communities.

Percentage of Homes on Market Below Specified Price – December, 2007

County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Asotin	4.6%	38.9%	67.3%	95.2%
Benton/Franklin	7.5%	44.5%	80.6%	97.6%
Chelan/Douglas	1.4%	6.4%	31.9%	80.0%
Clallam	2.9%	10.0%	34.6%	85.4%
Clark	0.8%	2.2%	26.7%	79.0%
Cowlitz	3.0%	29.7%	66.6%	90.8%
Ferry/Pend Oreille/Stevens	5.8%	32.6%	58.9%	88.8%
Grant	4.9%	29.4%	56.4%	90.5%
Grays Harbor	5.0%	31.9%	62.5%	93.4%
Island	0.0%	0.9%	16.7%	70.4%
Jefferson	0.3%	4.9%	19.0%	73.6%
King	0.0%	0.1%	2.7%	49.4%
Kitsap	0.1%	2.5%	23.8%	71.8%
Kittitas	0.0%	5.4%	39.4%	75.6%
Klickitat	4.8%	21.6%	41.3%	85.6%

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County	Home Price Maximum			
	\$80,000	\$160,000	\$250,000	\$500,000
Lewis	1.0%	16.5%	53.3%	94.2%
Mason	1.2%	14.5%	50.2%	89.9%
Okanogan	4.0%	26.3%	54.7%	86.7%
Pacific	1.4%	20.3%	55.0%	83.8%
Pierce	0.0%	2.3%	25.1%	80.4%
San Juan	0.0%	0.0%	1.6%	23.4%
Skagit	0.7%	3.8%	29.1%	77.8%
Skamania	0.0%	21.8%	50.9%	80.0%
Spokane	0.5%	18.9%	50.8%	87.3%
Snohomish	0.2%	0.5%	6.1%	72.3%
Thurston	0.1%	2.9%	29.1%	84.2%
Walla Walla	10.7%	25.3%	63.5%	89.5%
Whatcom	0.9%	5.3%	24.8%	77.1%
Whitman	1.9%	24.1%	56.5%	96.3%
Yakima	9.9%	47.9%	75.6%	96.2%
Statewide	1.3%	8.8%	27.8%	74.9%

These statistics make it clear that in most parts of the state first-time home buyers still face extremely limited choices in the housing market, while trade-up buyers have a wide assortment of homes from which to choose in all communities. Significantly, virtually no homes in King County have asking prices below \$160,000, while over half have an asking price in excess of \$500,000. Virtually no lower cost housing (less than 1 percent of listings) is available in 15 of the 34 counties identified above, clear evidence of a continuing affordability problem for first-time buyers.

It should be pointed out that the \$25,000 income level is now somewhat below the income used to calculate the statewide first-time buyer affordability index. This means if those households were actively in the home purchase market, they would be competing for the lowest-priced 1.3% of the available statewide inventory. These lower-cost homes, if they are in reasonably good condition in stable neighborhoods, should 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. Communities in Eastern Washington generally 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. Certainly most parts of the state of Washington have higher levels of listings available for sale than they have seen historically.

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However, the inventory levels have generally declined a bit over the last three months. Whether this is a seasonal decline, or a move toward a stabilizing market cannot yet be identified.

As illustrated in the table which follows, the number of listings available for sale at the end of the fourth quarter was at the highest level this decade (and probably ever) in 19 of the 24 counties or county groups for which WCRER has consistent listings data for most of the years. Whitman county alone had a higher inventory for sale a year ago than at the end of 2007. All fourth quarters with higher inventory levels than those at the end of 2007 are shaded in the table. Peak inventories are shown in bold type.

Listings Available for Sale – Year-end

County	2001	2002	2003	2004	2005	2006	2007	%ch 2005-06
Asotin	510	406	349	308	268	350	416	18.9%
Benton/Franklin	779	1,071	1,254	1,412	1,435	1,436	1,436	0.0%
Chelan/Douglas	514	446	417	315	243	336	590	75.6%
Clark	1,042	2,071	1,657	1,502	2,090	3,064	3,917	27.8%
Cowlitz	454	580	467	337	346	505	691	36.8%
Ferry/Pend Oreille/Stevens	360	328	299	238	221	223	258	15.7%
Grant	349	382	311	324	317	290	473	63.1%
Grays Harbor	574	577	473	334	443	504	702	39.3%
Island	620	597	513	426	498	661	876	32.5%
Jefferson	n/a	n/a	n/a	192	204	279	368	31.9%
King	6,233	6,820	5,742	4,405	4,101	5,137	8,589	67.2%
Kitsap	1,166	1,138	868	681	845	1,352	1,969	45.6%
Kittitas	n/a	195	206	204	180	294	464	57.8%
Lewis	492	404	344	349	308	551	617	12.0%
Mason	560	460	370	304	361	530	671	26.6%
Pierce	3,809	3,701	2,843	2,521	3,010	4,597	6,246	35.9%
San Juan	n/a	161	182	162	149	164	256	56.1%
Skagit	706	673	594	437	488	705	937	32.9%
Snohomish	3,038	3,370	2,957	2,330	2,289	3,044	4,708	54.7%
Spokane	3,230	3,683	1,486	1,553	1,573	2,350	2,652	12.9%
Thurston	874	759	731	631	938	1,441	1,712	18.8%
Whatcom	1,343	994	n/a	569	988	1,289	1,292	0.2%

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Whitman	122	197	104	112	98	124	108	-12.9%
Yakima	845	878	749	829	774	1,253	1,255	0.2%
State	27,620	29,891	22,916	20,475	22,167	30,479	41,203	35.2%

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 from producing unrealistically optimistic estimates of market activity. As expected, the months' supply statistics are increasing in most markets, with a statewide inventory of 7.2 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 hover near their current levels, 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 further 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 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.

**Month's Supply of Housing by Price Range
December, 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	Total Market 2006
Asotin	5.0	4.9	7.1	19.3	n/a	7.5	5.7
Benton/Franklin	5.3	5.8	6.0	5.0	5.5	5.6	5.9
Chelan/Douglas	4.0	2.9	4.4	7.7	14.6	6.4	4.3
Clark	6.9	5.2	6.8	12.2	23.9	10.9	6.1

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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	Total Market 2006
Cowlitz	3.7	5.0	7.5	15.1	46.8	9.0	5.2
Ferry/Pend Oreille/Stevens	6.5	4.5	7.1	14.6	88.2	7.8	5.4
Grant	4.0	5.3	5.7	11.8	32.9	7.2	3.9
Grays Harbor	4.5	7.5	9.9	20.2	27.4	10.5	6.0
Island	n/a	3.0	8.3	12.4	25.0	12.9	5.9
Jefferson	1.8	5.6	11.7	19.1	17.5	15.3	6.4
King	2.9	1.7	3.6	4.5	7.2	5.5	2.4
Kitsap	0.4	3.6	5.7	8.8	17.8	8.6	4.6
Kittitas	n/a	15.1	11.1	10.4	26.2	12.7	6.2
Lewis	2.2	4.9	10.1	18.0	52.9	10.4	7.5
Mason	8.2	6.3	8.8	17.3	17.4	10.9	6.0
Pierce	1.0	4.6	6.0	8.8	21.7	8.7	4.2
San Juan	n/a	n/a	3.8	16.0	24.3	20.3	10.0
Skagit	5.0	3.8	5.8	7.0	21.2	7.5	5.3
Snohomish	22.7	2.5	4.7	6.5	10.5	7.0	2.9
Spokane	1.0	3.4	4.5	8.4	14.0	5.5	3.3
Thurston	5.8	4.3	3.8	6.7	20.6	6.1	3.9
Walla Walla	12.5	8.6	8.7	12.3	48.7	10.8	5.1
Whatcom	2.5	5.4	4.1	5.6	13.4	5.9	5.6
Whitman	1.3	3.4	3.3	8.4	7.9	4.3	3.9
Yakima	5.4	9.0	7.3	10.5	22.9	8.4	6.3
Statewide	4.0	5.0	5.8	7.3	11.1	7.2	4.0

Occasionally a situation arises where a market has very few listings or sales in a low price range, creating a perception of a significant inventory. This statistical anomaly resulted in the estimated 22.7 months supply for homes under \$80,000 in Snohomish County, even though there were only eight of the 3,044 properties in the MLS as of year-end which were priced that low. During the final three months of the year only one home sold for less than \$80,000 (and very possibly other homes listed for less actually sold for more). Such is the nature of statistics where the number of observations are small.

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 continued

disruption of mortgage markets, especially more restrictive lending standards, the Washington housing market is one of the brighter spots in the country. Increasing inventories available for sale provide greater consumer choice and opportunities to negotiate price and terms, as is typical in real estate. At present, inventories are not so large that significant price declines would be anticipated throughout the market (although price reductions on high-end homes where the month's supply is much greater may become common). Employment remains strong, but is growing less rapidly than in previous quarters, and is subject to national trends in the event of a widespread recession. Overbuilding has not been the problem in Washington it is in markets without growth management restrictions, but those homes built on speculation are now offered with significant incentives. 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. The wide card remains the consumer. Owners who believe prices may fall like they have in Las Vegas may flood the market with listings while buyers remain on the sideline, creating a significant imbalance between demand and supply, becoming a self-fulfilling prophecy of lower prices. If, however, owners choose to hold-er while qualified buyers recognize that the current low interest rates probably cannot last as talk of stagflation reappears, deciding that buying at the lower rates today will be better in the long run than waiting for a decline in home prices at a time when rates are higher (with mortgage payments at or above current levels).

Households who can afford their mortgage payments, even if they owe more for the home than they could sell it for today, need to recognize that real estate markets have always been cyclical, with prices generally increasing and occasionally declining. Housing is not a short-term investment, it is primarily shelter, with an investment kicker. At the end of every cycle of wild housing inflation it is necessary to remember these fundamentals. While the current market is scary, it is reminiscent of the boom of the late 1970s followed by the collapse of housing in the early 1980s. With patience, and avoiding panic, the market will regain its strength.