Home Price Analysis for Seattle Region

By the Research Division of the National Association of REALTORS®

Executive Summary

- Home prices in the region have significantly strengthened in recent months. After posting two straight years of double-digit gains, prices continued to move strongly with a 16% gain in the first quarter of 2006 from a year ago.

- Mortgage rates, which have risen roughly one percentage point since last summer, have not made an impact in the Greater Seattle-Tacoma region. Home prices, though high, are affordable when compared to those in California markets.

- Because of the strong increase in home prices over the past two years, mortgage debt servicing costs have risen significantly. Nonethless, the debt service cost relative to household income stood at 23% -- only a tad higher than the national average of 22%.

- A recent increase in new home construction reflects builders' response to the strong price gains. However, builders need to be mindful of not oversupplying the market.

- The share of adjustable-rate mortgages (ARMs) rose in the first quarter to 47% from 40% just a quarter earlier. Though ARMs are the best financing choice for some homeowners, they also carry interest-rate risk. An increase in ARM usage in the region is raising the regional risk of defaults and financial strain.

- The percentage of homebuyers who utilized sub-prime mortgages (those with rates more than 3 percentage points higher than the average market rate) was much lower in the region than it was for the nation as a whole. Also, a significantly lower percentage of mortgages was used to buy second/investor homes. Such conditions bode well for lowering risks associated with foreclosures and quick sales.

- Local job growth has been strong. The three-year job growth of 3.5% easily tops the national pace. Gains have been particularly strong in 2006. Not surprisingly, the mortgage delinquency rate in the first quarter for the state was well below the national average.

- Job growth attracts additional potential homebuyers to the market and limits the number of “forced-home sales” (as was the case in the early 1980s and 1990s). This suggests that any price decline will likely be short lived given the additional buyers ready to enter the market.

- However, the biggest risk is the drastic slowdown in home sales activity that could result from further measurable increases in interest rates. Should the 30-year average fixed rate approach 8% (from its current 6.8%) as a result of too much monetary tightening by the Federal Reserve, home prices in the region could well decline.

Summary of Activity

	Seattle	National Average	Comment
Price Activity			
Latest Appreciation (2006 Q1 vs 2005 Q1)	16.4%	10.3%	Strong
Last Year Appreciation	15.5%	12.0%	Strong
3-year Appreciation	38.2%	31.0%	Strong
Historical Average Annual Appreciation*	7.0%	5.0%	Neutral
Affordability			
Mortgage Debt Servicing Cost to Income Ratio** (2006 Q1)	22.9%	22.0%	Neutral
Historical Mortgage Debt Servicing Cost*	20.3%	22.0%	Neutral
Home Sales			
State Existing Home Sales (2006 Q1 vs 2005 Q1)	-1.2%	-2.1%	Neutral
Single-family Housing Permits (2006 Q1 vs 2005 Q1)	4.0%	-0.9%	Neutral
Mortgages			
Share of New Loans with ARMS (2006 Q1)	47.0%	28.0%	Unfavorable
Share of New Loans with LTV higher than 90%	3.0%	16.0%	Favorable
Percentage of Sub-Prime Mortgages	5.4%	10.1%	Favorable
Percentage of Mortgages for Second Home Purchase	9.7%	15.3%	Favorable
State Delinquency Rate (2006 Q1)	2.2%	4.0%	Favorable
Local Fundamentals			
3-year Job Growth	3.5%	2.4%	Favorable
Unemployment Rate (2006 Q1)	5.1%	4.7%	Favorable
Housing Permits to Total Employment (2005)	1.6%	1.6%	Neutral
Net Migration	15,900	0	Favorable

Risk Factor

The rising use of adjustable-rate mortgages, even as the spread between the short-and long-term rates have narrowed, is surprising. The strong price appreciation may have forced people into ARMs to enter the market. The mortgage debt service cost of buying a median priced home has increased in the past two years, though at a manageable level currently. The positive net migration (the net flow of U.S. residential movements, which excludes immigration) may partly reflect relative affordable conditions in relation to California markets. The very low share of loans with high LTVs implies minimal financial strain even if prices were to decline over the short term.

** Average ratio from 1980 to 2005*

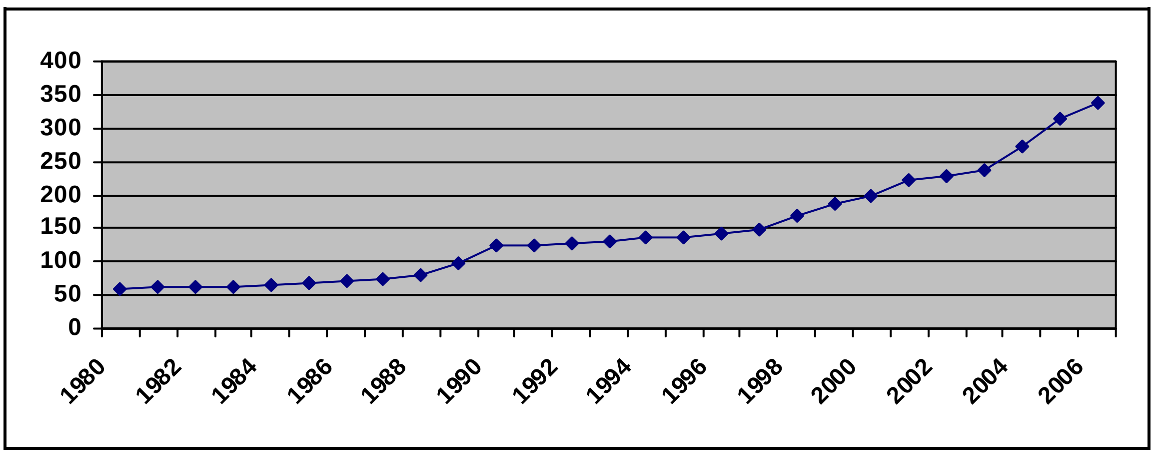
*** This ratio compares the monthly mortgage payment for a median-priced home financed at the prevailing mortgage rate to the median household income.*

Price Activity

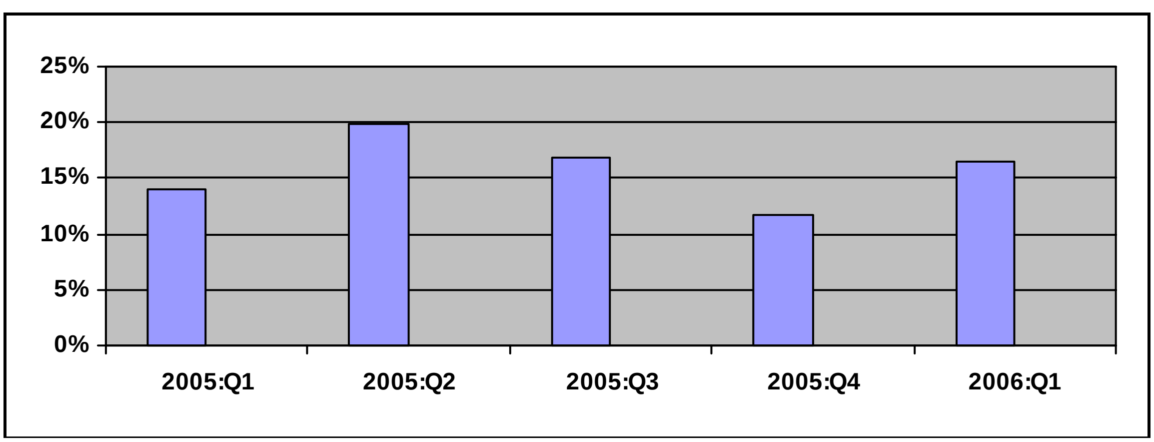
	Existing Home Price	Price Growth	Local to National Price	Per Capita Income	Mortgage Servicing Cost to Income	12 month Job Gain
2001	223,400	11.8%	1.4	37,808	19.0%	-18,200
2002	228,100	2.1%	1.4	38,229	18.0%	-46,800
2003	236,700	3.8%	1.3	38,447	17.0%	-11,300
2004	272,900	15.3%	1.4	41,634	18.0%	19,000
2005	315,300	15.5%	1.4	43,508	21.0%	48,100

- 2005 was another strong year, with the median home price rising 15.5% to $315,300.
- There were no signs of slowing in the first-quarter as prices rose 16.4%. (See chart below.)
- If history is a guide, the robust job gains of 64,800 net new jobs in the past 12 months will keep home prices from falling.
- Home prices are quite affordable in relation to those in California. So part of the recent years' increases are attributable to the "catch-up" effect.

Local Home Price (in $1,000)



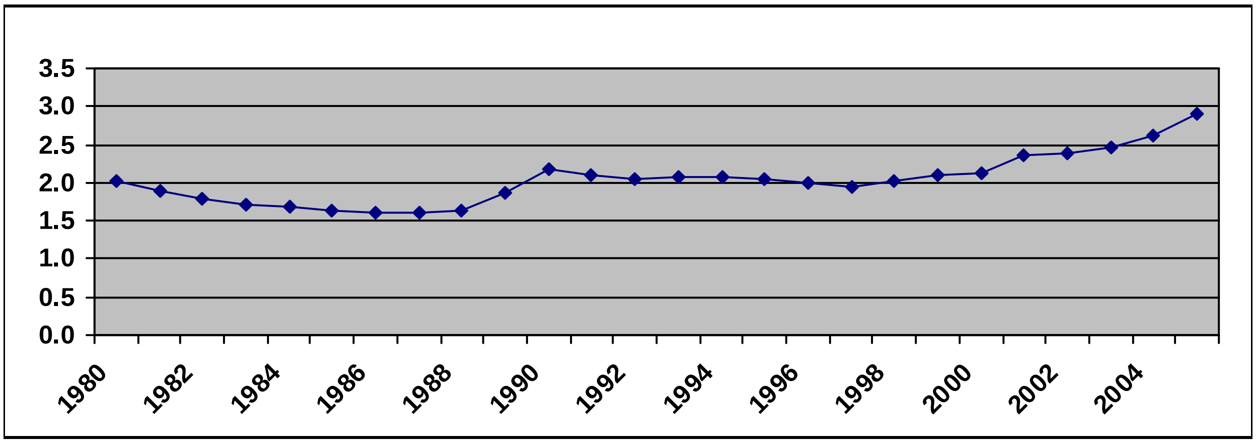
Recent Price Appreciation



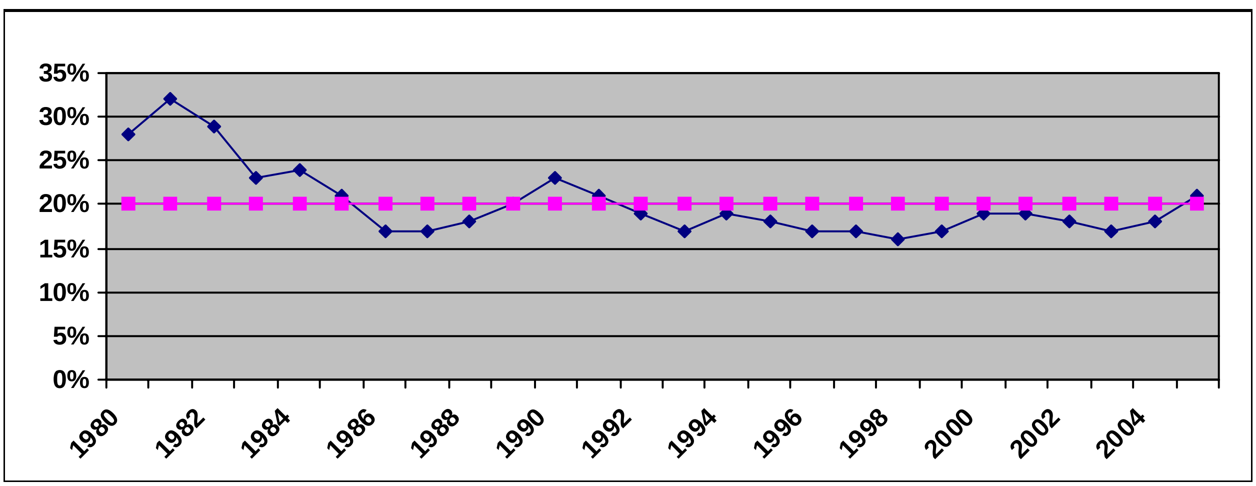
Affordability

- Because home prices have risen faster than income, the ratio of price-to-income is currently above the historical norm. This measure is frequently cited to imply that there is a housing market bubble.
- However, mortgage rates declining to historic lows have been a major force in boosting home prices in recent years. Recent higher rates are still at historically favorable levels. Lower rates allow homebuyers to obtain a larger loan without necessarily increasing monthly mortgage payments.
- A more relevant measure for assessing the risk of a home price bubble is the median mortgage servicing cost relative to the median income. This ratio is at near the local historical average. It implies no widespread financial overstretching to purchase a home in the region.

Price to Income Ratio



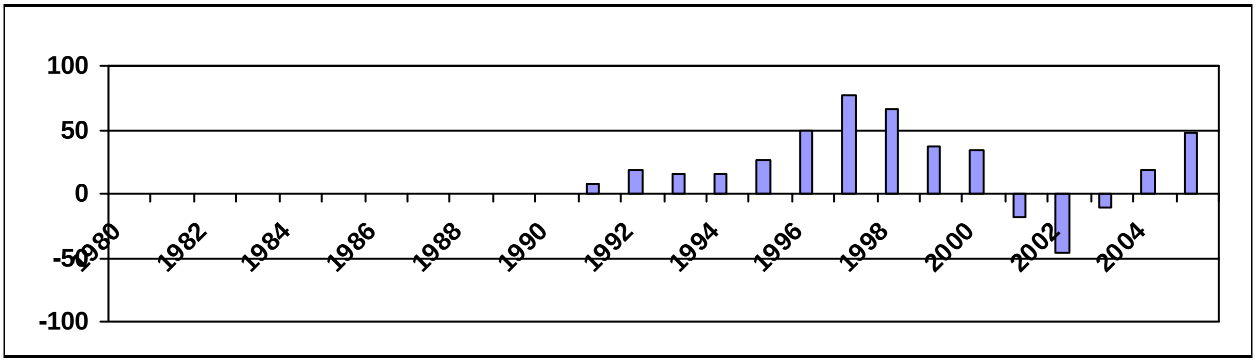
Mortgage Servicing Cost to Income Ratio
(Historical average shown as square boxes)



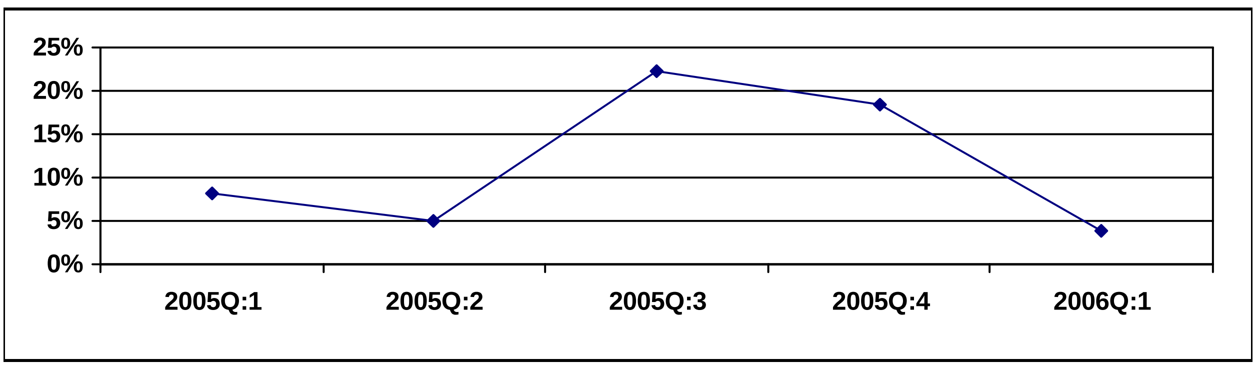
Local Fundamentals

- Job cuts were severe following the dot-com crash. But strong job gains of the past two years have recovered nearly all of the jobs that were lost in the early years of this decade.
- In the past five years the region added 122,000 new housing units, of which 83,900 were single-family units.
- New home construction was mostly higher in the prior four quarters. A supply increase can be troublesome should the job market take a turn for the worse.
- The ratio of five-year job gains to five-year new home construction shows the "hangover" impact of a housing shortage or housing surplus. Based on this measure, there were fewer new job additions than new housing additions.

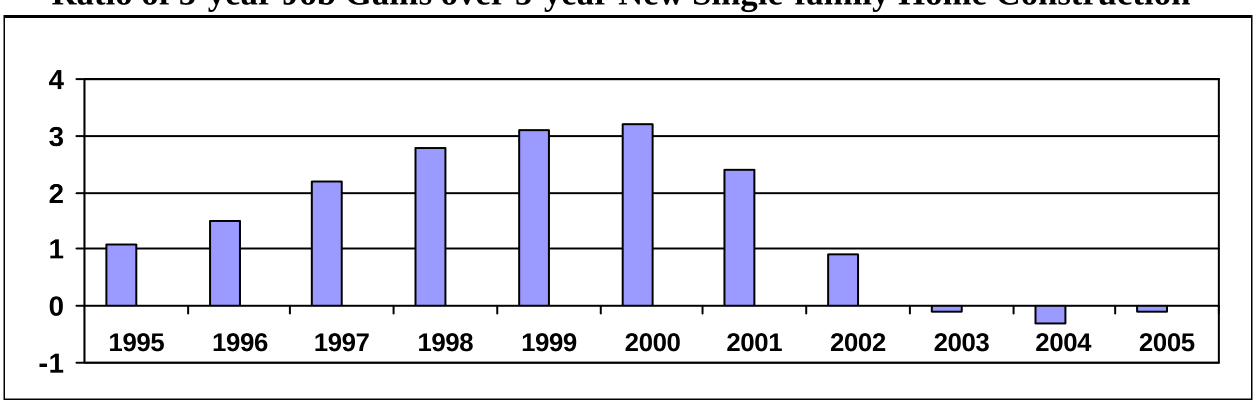
Job Gains (in Thousands)



Recent new Single-family Home Construction
(% change from a year ago)



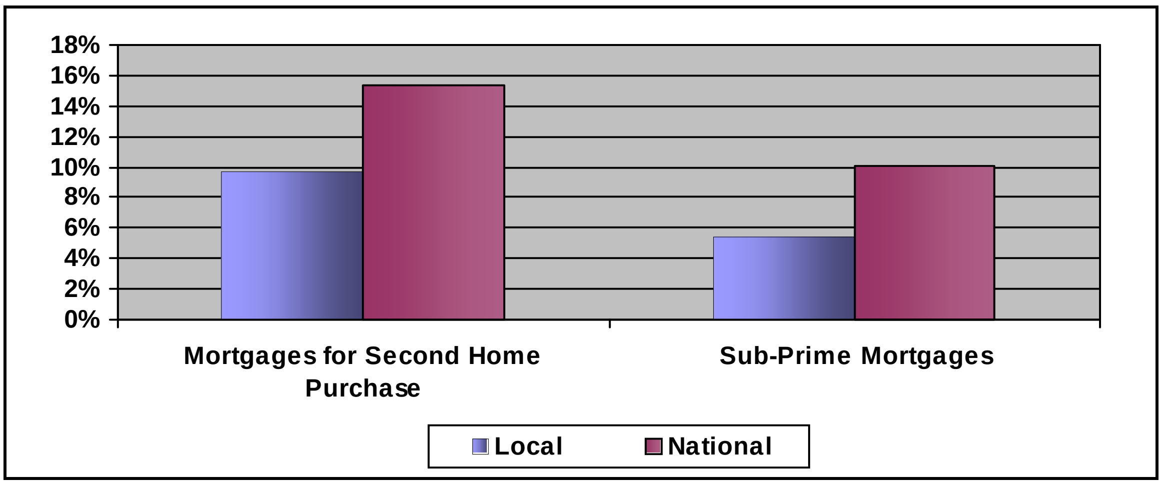
Ratio of 5-year Job Gains over 5-year New Single-family Home Construction



Mortgage Activity

- Mortgage lending in the region has been primarily to owner-occupied, credit-worthy borrowers who are least likely to quickly "dump properties" onto the market. The percentage of sub-prime loans (those carrying interest rates at least 3 percentage points higher than market rates) was 5% versus the 10% national average. Also, the share of loans for non-owner-occupied properties was only 10%.
- The share of adjustable-rate mortgages was 47% in the first quarter of 2006, an increase from 40% a year ago. Generally, ARM usage would decline in a rising interest-rate environment.
- Only 3% of new loans had a loan-to-value ratio of greater than 90%. Therefore, prices would have to decline by more than 10% to have a measurable impact on foreclosure rates.

Riskier Mortgages



Prevalence of Riskier Mortgages

(Unit: Percentage)

Quarter	Adjustable New Loans	Loans with LTV over 90%
2005:Q1	40	9
2005:Q2	38	8
2005:Q3	36	6
2005:Q4	42	4
2006:Q1	47	3

Price Scenarios

- Even in the unlikely event of prices declining by 5%, most homeowners will maintain sizable equity build-up in their homes. The table below shows the home equity gains if prices were to fall by 5% in 2006. A homebuyer who purchased in 2005 would suffer $11,700 in home equity loss. But homebuyers who had purchased in prior years would still retain significant housing equity gains.

Year of Purchase	Housing Equity after 5% Price Decline (Home price appreciation + principal payments on mortage)
1980	$274,700
1985	$254,200
1990	$203,000
1995	$182,400
2000	$112,500
2001	$89,800
2002	$83,000
2003	$72,700
2004	$33,900
2005	($11,700)

- A likely scenario is for home prices to rise, though at a much lower rate than in recent past years. The equity gains under different though conservative price growth assumptions are presented below.

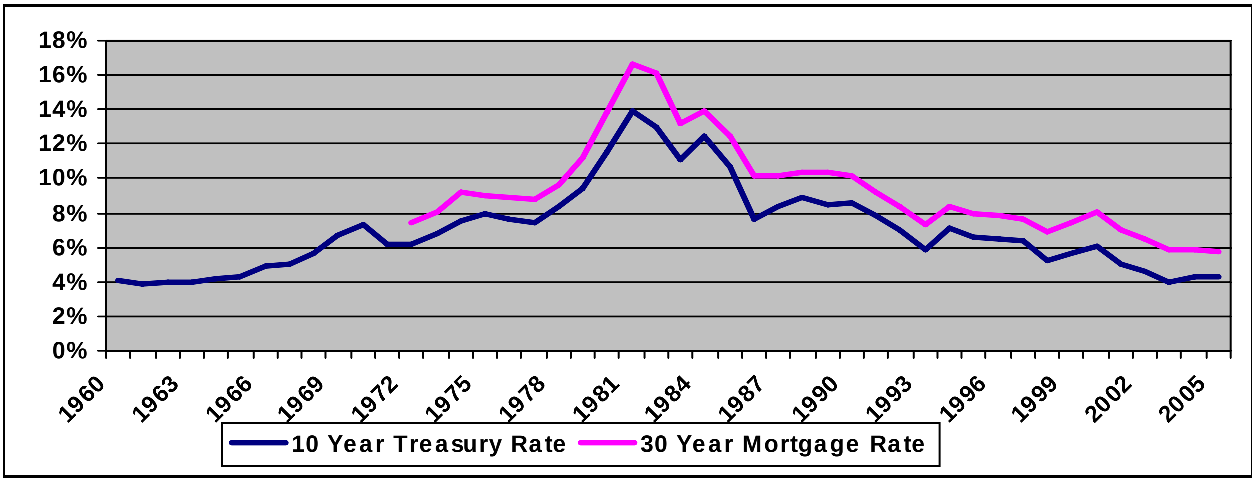
Housing Equity Gain				
Appreciation Rate	***1.5%***	***3.0%***	***4.5%***	***7.2%***
Conservative Scenarios	***Low***	***Middle***	***High***	*25-year average rate*
2010	$47,100	$72,900	$100,300	$153,600
2015	$101,800	$159,700	$225,600	$367,400
2020	$169,900	$266,900	$385,900	$669,300
2030	$359,500	$562,100	$849,600	$1,691,500
2040	$530,900	$887,200	$1,471,600	$3,583,900

Additional Discussion Points

- Home price declines are very rare. In fact, the national median home price has not declined since the Great Depression of the 1930s. Stock market collapses, OPEC oil crunch, economic recessions, and even wars have not negatively impacted national home prices since the 1930s.
- There have been few times when local prices declined. In nearly all these cases, the price declines were accompanied by sharp prolonged job losses. It is difficult to foresee a price decline in a job creating economy.
- Homes trade far less frequently than financial assets (about one home sale every 7 to 10 years for most homeowners). There are also larger transaction costs associated with selling a home due to the lengthy careful examination demanded by home buyers and sellers. Therefore, home prices are not prone to fluctuations as in the stock market. There are neither panic sells nor margin calls associated with homes.
- Many non-quantifiable factors could be important for this metro market in determining home prices. Access to cultural life, the quality of museums, nearby local and national parks, water views, exclusive neighborhoods, weather, the international airport, city vibrancy, restaurants, and a host of other non-quantifiable factors could have an important influence on the overall pricing.
- There are immense tax benefits to owning a home. These tax considerations were not considered in the analysis. For example, the 1997 law permitting primary owner occupants to trade down without having tax consequences. Also most home sales results in no capital gains tax. In addition, long-term capital gains tax rates were reduced in 2003, thereby providing higher return for home investors. These positive benefits, if accounted for in the analysis, would have shown an even stronger case for housing fundamentals in supporting home prices.

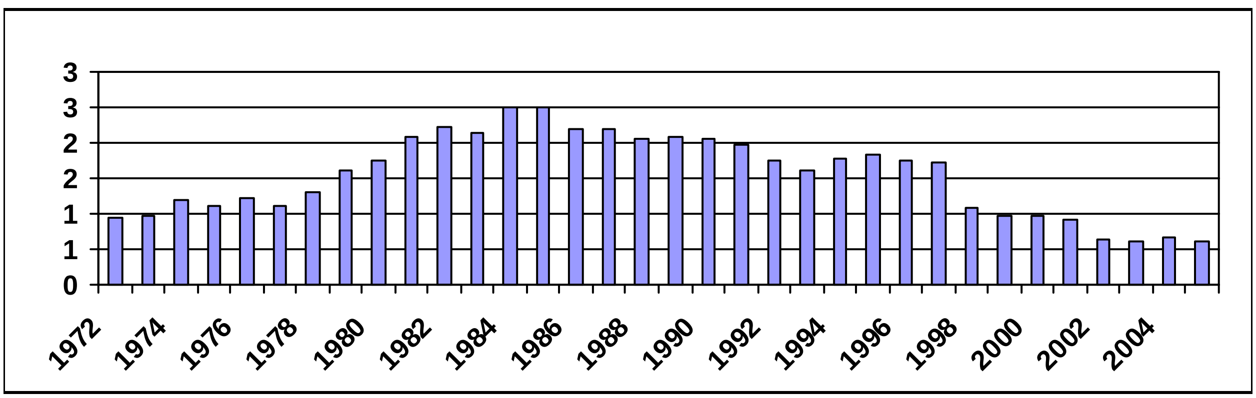
Additional Informative Charts

45-year Low Mortgage Rates



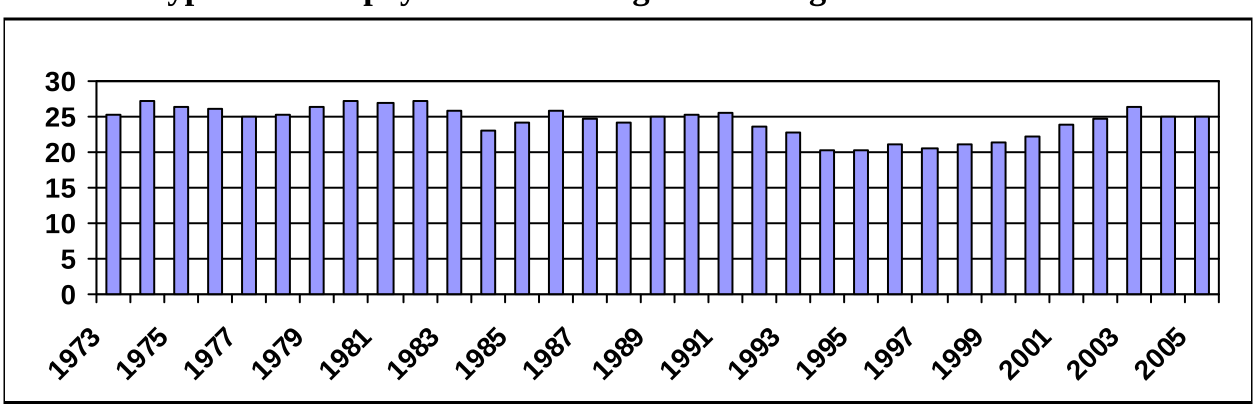
Source: Freddie Mac, Federal Reserve

Historic Low Fees and Points for Mortgage Origination



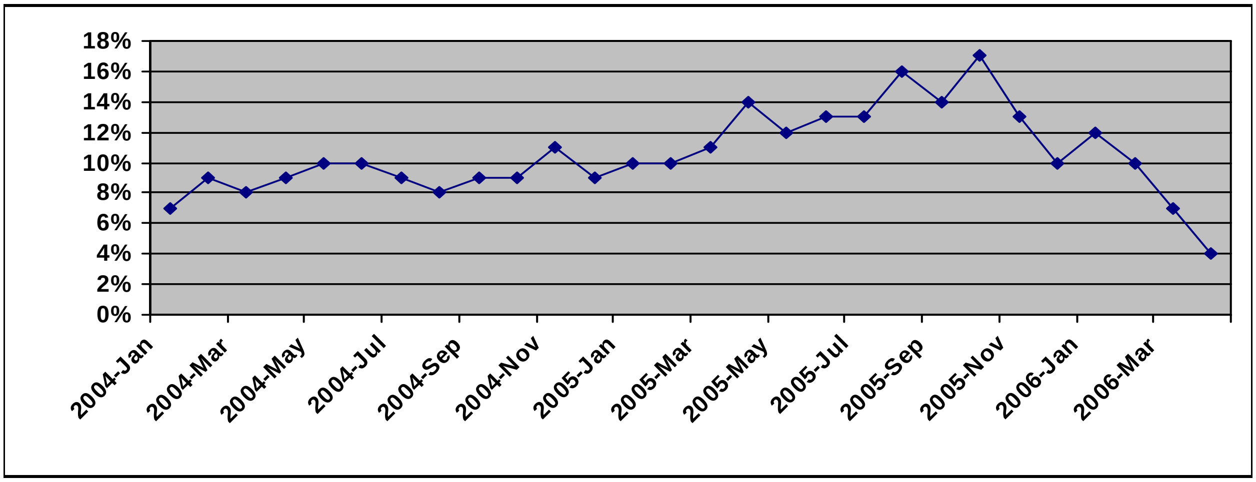
Source: Freddie Mac, Federal Reserve

Typical Down-payment Percentage Returning to Historic Norms



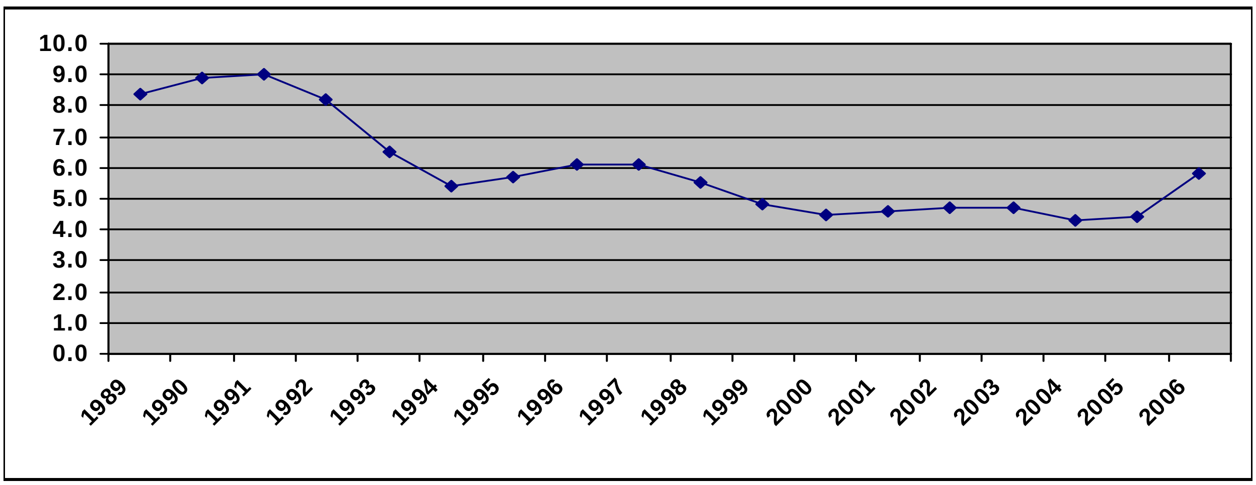
Source: Federal Housing Finance Board

Recent National Price Deceleration



Source: NAR

Historical National Months Supply of Homes on the Market



Source: NAR

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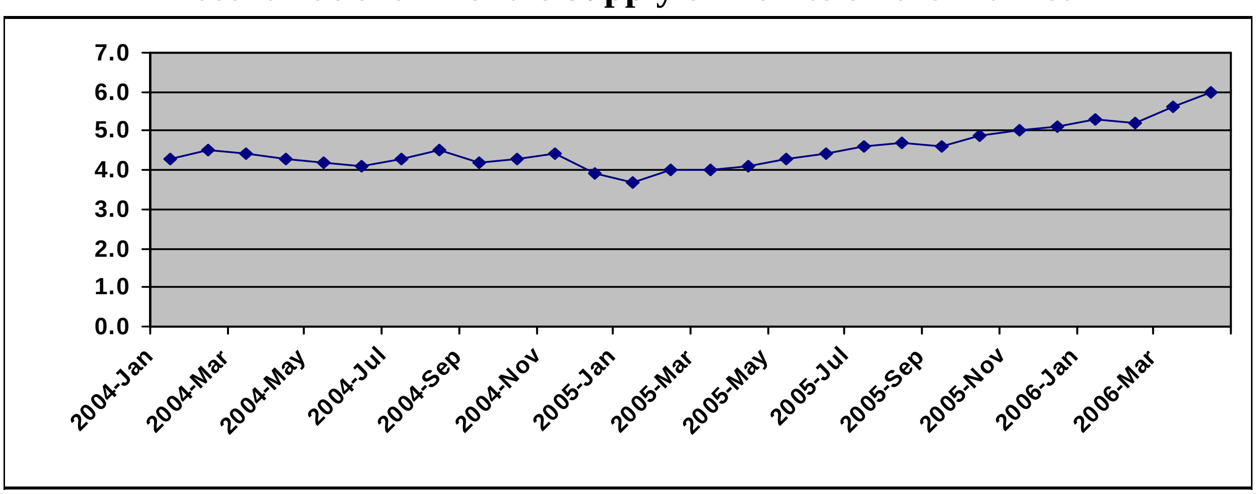

Source: NAR

NAR Research

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