Forces are arrayed against overbuilding in Seattle

CONDO SCENE

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"Home sales jump!" "Home sales slump!" "The sky's the limit!" "The sky is falling!"

With the recent proliferation of conflicting local and national real estate headlines, it's no wonder home buyers find themselves sidelined in confusion about the state of Seattle's housing market.

The national indexes that drive the headlines monitor the macroeconomic landscape and don't address our local housing market. Like the weather, real estate is regional and cannot be predicted accurately by interpreting national forecasts alone. What's happening in Miami's condo market, for example, has little relationship to Seattle. So while we may envy their weather, they'd trade their sunshine for our economy right now.

To fully understand the local market, one must compare real estate fundamentals, such as job, wage and population growth (demand) to the total number of housing permits and construction activity (supply). Now consider that the Puget Sound region consistently adds 25,000 jobs annually and attracts more than 40,000 new residents each year. Then contemplate that new housing permits are expected to scale back at least 15 percent in 2008. Also, thanks to a commercial credit crunch, actual construction starts will be just a fraction of what's been seen in prior years. That means more people and fewer new homes.

That's why mainstream media have identified Seattle as the most stable housing market in the country. Yet despite consistently positive assessments by experts, home sales have slowed during the last two quarters. With such optimism — why the cold feet?

Home buyers are emotional consumers, especially during uncertain times. The consumer psyche is easily influenced by sensational headlines and macroeconomic reports, which can lead to "analysis paralysis."

Ironically, would-be home buyers sidelined by this paralysis are creating a self-fulfilling prophecy. The reverse can also occur in bull markets where motivated buyers fuel a sense of urgency and buying sprees can artificially inflate market values. This begs the question: What's going to happen when six months of sidelined buyers suddenly decide that it's time to buy again?

Aside from the estimated 500 "wait and see" buyers who will eventually return to the market in downtown Seattle, demand has kept pace with supply, as new condominium deliveries for 2007, 2008 and 2009 are posting impressive presales of 88 percent, 66 percent, and 28 percent, respectively. The downtown Seattle submarket historically absorbs about 2,000 condos per year, which are nowadays split evenly between existing resale and new construction inventory. There's only about a five- to six-month supply in resale inventory today and already half of the 4,100 new units expected to deliver by 2010 have been presold. So Seattle's real estate glass is most certainly half full.

While other markets suffer from overbuilding, there's little chance of that happening here in Seattle. Development costs have risen 45 percent over the last 24 months, land prices have skyrocketed, and construction financing is now onerous if not impossible to obtain in many cases.

Not surprisingly, developers are shelving impending condo projects until increased market values will justify increased development costs and other projects will build out as apartments, which are easier to finance. It's now clear that condos aren't the only game in town, and it won't be long before other land uses, including offices, apartments, retirement high rises, retail and biotech facilities, represent the majority of the tower cranes in Seattle's skyline.

The total number of new condo units delivered each year will decrease through 2010, proving a challenge for those buyers timing a market correction in downtown Seattle. Unless job growth subsides and our regional traffic problems are resolved, patient home buyers are more likely to experience less choice and even higher prices for new condos ahead. So what explains median home prices that have fallen compared with a year ago?

First, the downtown population is growing faster than the surrounding areas as more buyers are choosing urban condominiums over single-family homes. This has a significant effect on median home prices because condos in King County are typically less expensive than their single-family alternatives. Second, condo presales are now commanding greater market share than resales, but less than 10 percent of this inventory is ever listed or represented by Multiple Listing Service reports. If these transactions were to be included in the data, the headlines would be singing a very different tune.

Ultimately, the national housing shake-up is a good thing for Seattle. It addresses growing pains that could have become detrimental if left unchecked. There's now little risk that demand projections will be based on speculation, that loans will be provided to buyers who cannot afford them, or that a project will be financed if it can't demonstrate success before it's built.

Seattle continues to exhibit the nation's best real estate fundamentals, and the simple principle of supply and demand suggests clearer skies ahead for our local housing market.

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