**How Supply & Demand Affects Housing Prices**

*Written by Kathy Adams; Updated December 09, 2018*

As with commodities traded on the market, housing prices continually fluctuate, sometimes with drastic changes over a short period of time. Availability is a huge factor affecting prices within a set region, such as in a specific suburb of a metropolitan area. Likewise, demand for homes in that market also plays into that price, which is why two nearly identical homes in different cities may sell for vastly different prices.

**Tip**

When buying a home in a seller's market, limit your contingencies and make your offer as favorable to the seller as possible.

**Grasping Supply and Demand Basics**

For houses and virtually anything else available for purchase, supply and demand play into the ultimate selling price. When an item is in short supply and many people want it, prices tend to rise. When the market is flooded with an item or there's no demand for it, prices fall. Sporting event ticket prices tend to rise when a team reaches the championship level, yet tickets to the same team's events a few years later, when the team isn't doing well, cost far less. Prices on holiday decor are another great example: At the peak of any holiday's shopping season, some shoppers are willing to pay a premium for the decor. Three days after the holiday, the leftover stock of these items is marked down to clearance prices due to little demand.

**Applying Supply and Demand to Housing**

Housing supply and demand works in exactly the same way. Sometimes there are so many single-family homes available in the same region that there aren't enough buyers for all of them. In this housing oversupply, prices drop to draw more attention from potential buyers. A lowered price may influence an interested buyer to choose one home over a similar house in the same general area. Without a lowered price, a house may sit on the market for months due to the abundant number of similar homes for sale nearby at the same time.

The opposite also happens. In a hot market, such as a neighborhood with large waterfront lots or a city with great schools and high-paying jobs, houses sell quickly due to high demand. There aren't enough homes for sale to meet the demand of interested buyers. Housing prices rise since buyers are willing to pay more to live in the neighborhood they desire. The houses in such a neighborhood may be virtually identical to those in the low-demand market, but with significantly higher selling prices.

The San Francisco area has experienced the effects of supply and demand for years. Due to the shortage of newly built homes and the influx of highly paid employees, prices of homes have skyrocketed. What was a million-dollar home ten years ago is now a two-million dollar home. Owners are staying put and enjoying their increasing equity while people who can afford a high down payment are at a loss for finding a home to buy. The trickle down effect of San Francisco's lack of housing supply has also led to a costly renter's market, one of the highest in the nation.

**Defining a Buyer's Market**

Instead of mentioning the laws of supply and demand, most real estate agents label a market as either a buyer's market or a seller's market. A buyer's market is exactly the same as a housing oversupply. Numerous houses are available for sale; some may have been on the market for quite a while. The buyer has the upper hand when negotiating the price or conditions of the sale since so many other homes are up for grabs. In this market, sellers often offer to pay closing costs or add a bonus to the real estate agent's commission if they bring them a buyer.

To determine if an area is a buyer's market, check real estate listings that mention how long a house has been on the market, or ask your real estate agent for a market analysis. If several homes on the same street have been for sale for a year or more at reasonable prices for the region and the homes are in relatively good shape, it's likely a buyer's market.

**Seller's Market Defined**

A seller's market means conditions favor the seller. Buyers are willing to pay top dollar for even the most basic home since there aren't enough homes for sale to meet the demand. If the houses seem overpriced for the neighborhood and they still sell quickly, it's likely a seller's market.

Sellers often wait for multiple offers during a seller's market, sending the price even higher than the market should be. Buyers need to come in with offers accompanied by high deposits and expect to pay more cash out of pocket at closing if the home doesn't appraise for the purchase price.

Economic conditions can also change the same market from one favoring buyers to one favoring sellers over several years. As incomes and employment levels rise, more people are willing to buy homes. Houses that once sat on the market for months start to sell. Demand rises, and so do home prices.

**Questions:**

1. Why are homes in Marin County in high demand? Explain
2. What affect did the fires in Sonoma County last year have on supply and demand?
3. What are the challenges with changing the supply of housing in this area?
4. How do “Income Effect” and “Substitution Effect” apply to the housing market in Marin?
5. What do you think of the Law of Demand as it relates to the housing market in Marin specifically? Does it apply? 100%?