2010 Missoula Housing Report

Current Knowledge, Common Vision: Growing a Missoula to Treasure

Released March 25, 2010

A Community Service Provided by the Missoula Organization of REALTORS

Notes for Reading the Report

1. As in our past reports, we use data that are publicly available and statistically valid. Our interpretation of the data in some cases may lead to judgments that we believe are sound, but you may disagree with. If so, we invite your comments – that way we can continue to improve this yearly report.

2. Unless otherwise noted, data presented in the text and figures are for the Missoula Urban Area, which includes the City of Missoula and its neighborhoods and surrounding urbanized area, defined as: Downtown, Central Missoula, University, South Hills, Fairviews, Pattee Canyon, Rattlesnake, Bonner, East Missoula, Clinton, Turah, Linda Vista, Miller Creek, Lolo, Target Range, Orchard Homes, Big Flat, Blue Mountain, Mullan Road, and Grant Creek. Some data represent only the city or all of Missoula County, and are noted as such.

3. All data are the most recent available at the time we compiled the report. For calendar year data, that's 2009 in most cases, but 2008 or even 2007 when more recent figures aren't yet available.

4. "Median" is a term used often in this report and is an important term to understand. A median is the amount at which exactly half of the values or numbers being reported are lower and half are higher. A median can be more or less than an "average," which is the amount derived by adding the total of all values being reported and dividing by the number of individual values. So a median home price, for example, among all prices being considered, has half of the homes that are less in price and half that are more in price. In many instances, including reports of home prices, a median can be a more accurate representation than an average, because the sale prices of a very few extraordinarily expensive or inexpensive houses will significantly affect the average, but have little effect on the median.

5. Research for this report was conducted principally by the Missoula Organization of REALTORS® (MOR). Also contributing to the report were the University of Montana Bureau of Business and Economic Research and a consulting contributor to the *State of the Nation's Housing*, a yearly release from the Joint Center for Housing Studies of Harvard University. All of these contributors also served as sources of this report's data and information; other sources were the US Census Bureau, US Bureau of Economic Analysis (BEA), US Internal Revenue Service (IRS), US Department of Housing and Urban Development (HUD), US Office of Federal Housing Enterprise Oversight (OFHEO), Montana Department of Labor and Industry, Western Montana Chapter of the National Association of Residential Property Managers (NARPM), Missoula Housing Authority (MHA), and Missoula MLS® (see next note).

6. MLS refers to the Multiple Listing Service, a service for the orderly correlation and dissemination of listing information by participants. For this report, the MLS refers to the service operated by the Missoula Organization of REALTORS® for the REALTORS® who subscribe to the service.

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Message From the Coordinating Committee:

March 25, 2010

We are pleased to present our fifth annual report to the community on housing in the city and county of Missoula. The 2010 Missoula Housing Report, like its predecessors, results from a collaborative effort.

At the center of this collaboration is the Coordinating Committee for the Housing Report. The committee is structured to be highly inclusive. Its membership is drawn from the broad Missoula regional community, with members who represent a wide spectrum of businesses, organizations, agencies, and individuals concerned with our local housing market.

Our collaboration extends further, as we proactively solicit comment on our report from readers like you. This helps us make each successive report more useful and informative, as we add new measures each year and refine or drop others, always with the objective of providing a frank and trustworthy report that meets our purpose, which is . . .

> *To provide a comprehensive, credible, and neutral picture of Missoula housing that can be used as a tool by community members and policy makers as they seek to serve Missoula's needs.*

In adhering to this purpose, the housing report serves our community because it:

- *consolidates data that aren't readily available to everyone in a single publication,*
- *provides a reliable gauge of the overall health of Missoula real estate,*
- *keeps Missoulians up to date on real estate trends and helps everyone in real estate better serve clients and customers,*
- *indicates real estate's impacts on our overall local economy, which aids decisions by public agencies and officials and by economic development groups.*

While these and other contributions to the community are gratifying, we would like your help in making each year's housing report even better. So we invite you to read this report and let us know your thoughts on how we might improve it.

We also suggest you look into getting involved in meeting the housing needs of our community. Some of the public and private agencies engaged in local housing are mentioned in this report, others are listed on the website of the Missoula Organization of REALTORS® at www.missoularealestate.com. Click on the tab "Housing Resources" in the left-side column.

It takes concerned and caring citizens to make a community. We are blessed in Missoula to have what many people believe is an outsized share of such individuals. This housing report is a product of the efforts of many of these citizens, and we hope it will spur the concern and caring of many more.

Executive Summary

The Home Ownership Market

The number of homes sold in the Missoula Urban Area in 2009 reversed a two-year slide, with a gain of about 3%, from 994 sales in 2008 to 1,023 in 2009. However, the median price of homes sold in 2009 declined for a second consecutive year, from just under $215,000 in 2008 to just under $209,000 last year. That represents a drop of 3%, slightly steeper than the decrease from 2007 to 2008 of 2%.

In 2009, sales of homes at or under $275,000 increased by 12% over 2008 sales, while higher-end sales dropped another 20% -- for a two-year decline of 43%. A huge spur to sales in 2009 was the First-Time Homebuyers Tax Credit, which was extended at year-end into 2010.

Days on market for Missoula continued the upward trend of recent years, with a relatively steep climb from 2008 to 2009. Foreclosures climbed to the highest level since this report began. Net foreclosures rose to approximately 1% of owner occupied housing stock in 2009.

Interest rates were favorable for most of 2009, with year-end rates at a decade-low level. In mortgage finance, more restrictive underwriting requirements severely limited the availability of financing for some borrowers. Loans offered to borrowers by the Federal Housing Administration were instrumental in increasing the overall number of loans originated.

The Residential Rental Market

Even in today's depressed housing market, rental rates in Missoula are relatively strong, with vacancies averaging less than 5%. Missoula rents remain at levels that for many families consume a share of total income that leaves too little for other necessities, such as food, clothing, and health care. The widely respected *State of the Nation's Housing* for 2008 (issued in June 2009), from the Joint Center for Housing Studies at Harvard University, observes that, "High housing outlays cut deep into household budgets, leaving low-income families about $485 per month for everything else."

Availability of Section 8 vouchers in Missoula, which are inadequate to meet needs in a healthy economy, is further strained by the economic downturn. Reduced tenant incomes caused the per unit cost, or need for assistance, to increase by 11% in 2009, where previous years saw increases of 2% to 3%.

Amid a squeeze on supply of assistance, demand increased, as waiting lists added names and the wait time for those at the bottom of the lists has in some cases stretched past three years.

Lot Sales and New Construction

Sales of empty lots in 2009 were dramatically lower in their number and down by 10% in median sale price, compared with prior years.

Building permits issued by the City of Missoula in 2009 registered a low for the decade. Single-family permits for 2009 declined by 28% from 2008 and have declined by 71% since 2005. Multi-family permits declined by 56%, also a decade low number.

Missoula County building permits in 2009 declined from recent years by even more than in the city with only 42 issued for single-family construction, down from 137 in 2008.

Trends in Population, Income, and Poverty

Missoula's significant population increases have slowed as net in-migration have declined sharply in recent years.

Median income in Missoula County shows an extreme disparity for 2008 between homeowners and renters. This gap may be explained by Missoula's large population of college students. Missoula County's inflation-adjusted per capita income since 2006 has leveled off or declined slightly. Inflation-adjusted, non-farm labor income stayed positive in the early to mid 2000s, barely moved in 2008, and dropped by negative 2% in 2009.

Missoula County unemployment increased in 2009 for the third consecutive year, after staying below 4% for the preceding nine years. However, Missoula's 2009 year-end unemployment rate of 6.1% was less than Montana's 6.5% and 10.0% for the US.

About 18% of Missoula County households have incomes below the poverty threshold that corresponds to their household size and age. Missoula has a more pronounced income disparity than the state of Montana as a whole, with a greater share of households under half the poverty threshold, as well as a greater share in the top category of over five times the poverty threshold.

Housing Affordability

The Housing Affordability Index for Missoula shows that, consistent with bursting of the housing bubble, home prices have lost value for the past three years, making homes more affordable. However, "more" affordable doesn't mean widespread affordability, and for many families incomes remain well below thresholds of affordability.

In Missoula, homeowners in the 25 to 34 age group spend an average of some 42% of their gross incomes on housing, while homeowners in the youngest age group, on average, go beyond the recommended maximum to about 35%. For renters, the average percentage spent on housing significantly exceeds that of homeowners.

Conclusion and Outlook

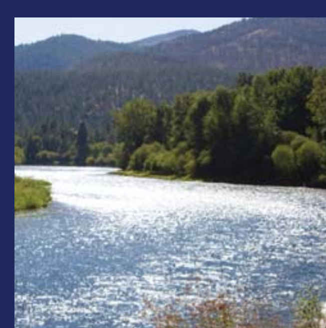
Amidst the recent downturn some genuinely good, or at least constructive, developments have taken shape. For example, houses have gotten more affordable, especially for first-time homebuyers. Nonetheless, much of the data presented in this report documents declines and difficulties that have imposed additional strains on families and households.

Fortunately, home prices in Missoula, except at the top-most ranges, appear to have bottomed, with entry-level homes showing some modest gains.

Yet not all signs are positive. A main concern is the ongoing and unprecedented liquidity crisis. And housing affordability has not improved locally to the extent it has improved nationally. Affordability arguably remains the greatest challenge in our local market.

The consensus forecasts of real estate and economic experts anticipate a slow recovery of the US economy and a likely even slower recovery of US housing. Locally, although a similarly slow progression is likely, our region benefits from starting its recovery from a hole that's not as deep, in many respects, as it is for much of the country.

Available data suggests that we are now at the beginning of a recovery, and that Missoula's economy and housing market will show renewed strength in the near future.



The Home Ownership Market

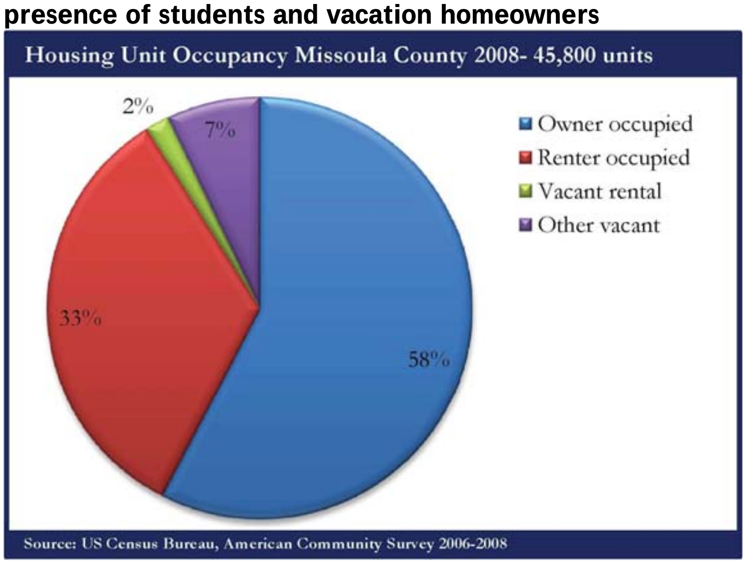
Housing Occupancy

Missoula County's housing occupancy is made up of 58% owner occupied and 33% renter occupied, as shown in Figure 1. In the Missoula Urban Area, occupancy is split about 50/50 between owner and renter occupied.

Past data indicate that this represents comparatively fewer owner occupied homes and more renter occupied homes than in the state of Montana as a whole or the entire US. The divergence of Missoula from state and national figures is not great, however, and may be explained mostly or entirely by Missoula's being the home of the University of Montana – as many students are renters and few are homeowners.

The vacancy level totaling about 9% is not entirely composed of units for rent, as total vacancies in our community include a significant number of residences that are used only seasonally or are temporarily vacant.

Figure 1: Missoula County's housing occupancy reflects presence of students and vacation homeowners



Sales Volume and Price Trends

The year 2009 was one of mixed results for the Missoula housing market. An increase in number of homes sold, coupled with the decrease in median sales price, is consistent with national trends for 2009, and reflects the potential emergence of a recovery in moderately priced to lower priced homes, which has not yet been seen in the market for more expensive homes.

More specifically, the number of homes sold in the Missoula Urban Area in 2009 reversed a two-year slide, with a gain of about 3%, from 994 sales in 2008 to 1,023 in 2009.

However, the median price of homes sold in 2009 declined for a second consecutive year, from just under $215,000 in 2008 to just under $209,000 last year. That represents a drop of 3%, slightly steeper than the decrease from 2007 to 2008 of 2%.

Nationally, as reported by the National Association of REALTORS®, existing home sales numbered 5.2 million for 2009, which is 4.9% higher than the 4.9 million transactions recorded in 2008—the first annual sales gain since 2005. But median price declined nationally far more than locally, as the median of $173,500 for 2009 is 12.4%less than the median of $198,100 in 2008.

Looking more closely at our local market's sales over the past two years, quarterly sales of homes show that year-over-year declines extended into the first half of 2009, while third quarter sales in 2009 matched those for the same quarter of 2008, and fourth quarter 2009 sales dramatically improved over the last quarter of 2008.

That outcome is not unexpected, as the national financial crisis peaked at the end of 2008, and the final quarter of

2009 benefitted from the first-time homebuyer federal tax credit. The original legislation ended the credit on November 30, 2009, so buyers rushed to purchase before that deadline (which Congress then extended into 2010).

Because few first-time homebuyers buy houses priced at the higher end of the market, the tax credit had no discernible effect on sales of more expensive homes. Higher-end sales probably suffered a double whammy, not only with the absence of a jolt from the tax credit, but also suppression of sales owing to mortgage lenders' employing much stricter lending standards.

This "bifurcation" of our market presents a stark contrast when the number of sales is divided into two categories: homes sold at or below $275,000 and those sold for more than $275,000. The percentage decline in sales from 2008 to 2009 was almost identical in both pricing levels (minus 28% at the lower end and minus 29% at the upper end).

But in 2009, sales of homes at or under $275,000 increased by 12% over 2008 sales, while higher-end sales dropped another 20% -- for a two-year decline of 43%. That dynamic largely explains the 2009 increase in number of sales, while median sales price continued to decline.

Table 1: 2009 Missoula home sales present a mixed bag ...

	Missoula Annual Sales	Median Price	% Change Median Price
2001	1,211	$138,000	n/a
2002	1,119	$149,500	7.7%
2003	1,150	$163,000	8.2%
2004	1,290	$179,000	8.9%
2005	1,536	$192,000	6.8%
2006	1,586	$206,850	7.2%
2007	1,385	$219,550	5.8%
2008	994	$215,000	-2.1%
2009	1023	$208,775	-3.0%

Source: MOR Multiple Listing Service

In 2009, sales of homes at or under $275,000 increased by 12% over 2008 sales, while higher-end sales dropped another 20%

Figure 2: ... with median price decreasing for the 2nd consecutive year ...

Figure 3: ... while the number of homes sold reversed a two-year slide ...

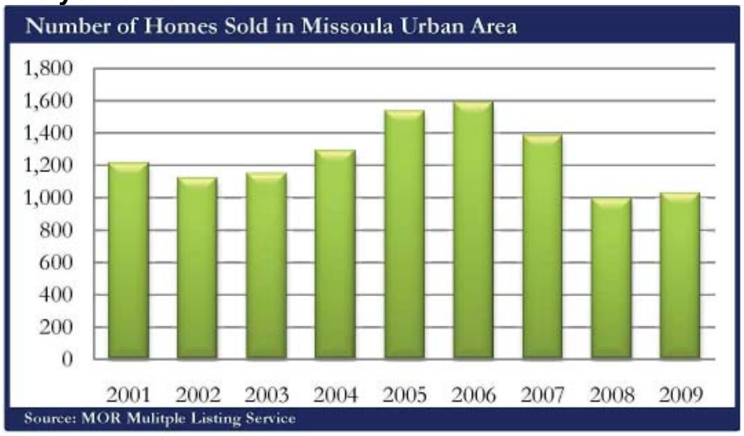


Figure 4: ... on the strength of sales in the last half of the year ...

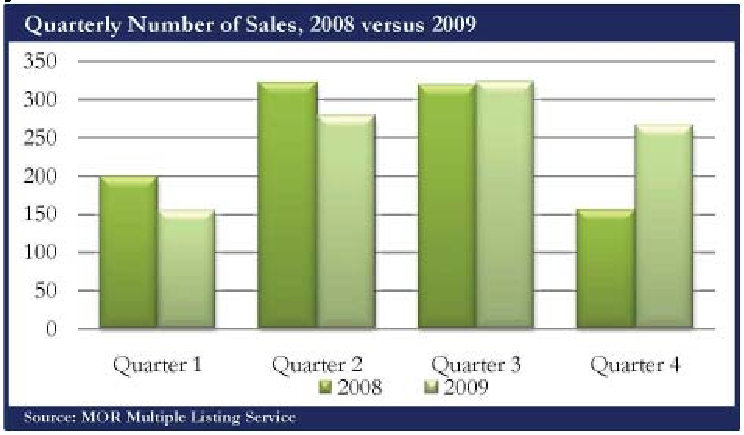


Table 2 and Figure 5: …that propelled sales of moderate to lower-priced homes.

Number of Sales per Price									
Price Range	2001	2002	2003	2004	2005	2006	2007	2008	2009
$0-150,000	715	569	432	338	311	289	170	121	122
$150,001-$200,000	276	292	366	478	553	472	405	301	355
$200,001-$275,000	146	153	202	269	383	439	429	297	327
$275,001-$350,000	41	59	87	124	151	197	199	166	124
$350,001-$425,000	18	31	30	52	83	96	87	47	48
$425,000 +	15	15	33	40	77	93	102	64	49
Total	1,211	1,119	1,150	1,301	1,558	1,586	1,392	996	1,025

Source: MOR Multiple Listing Service

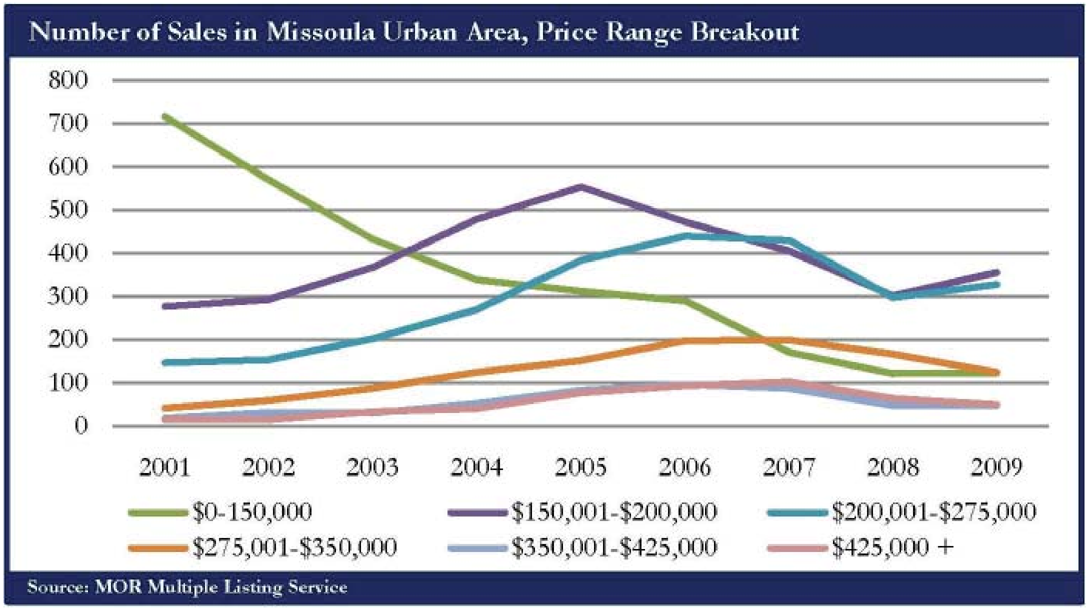
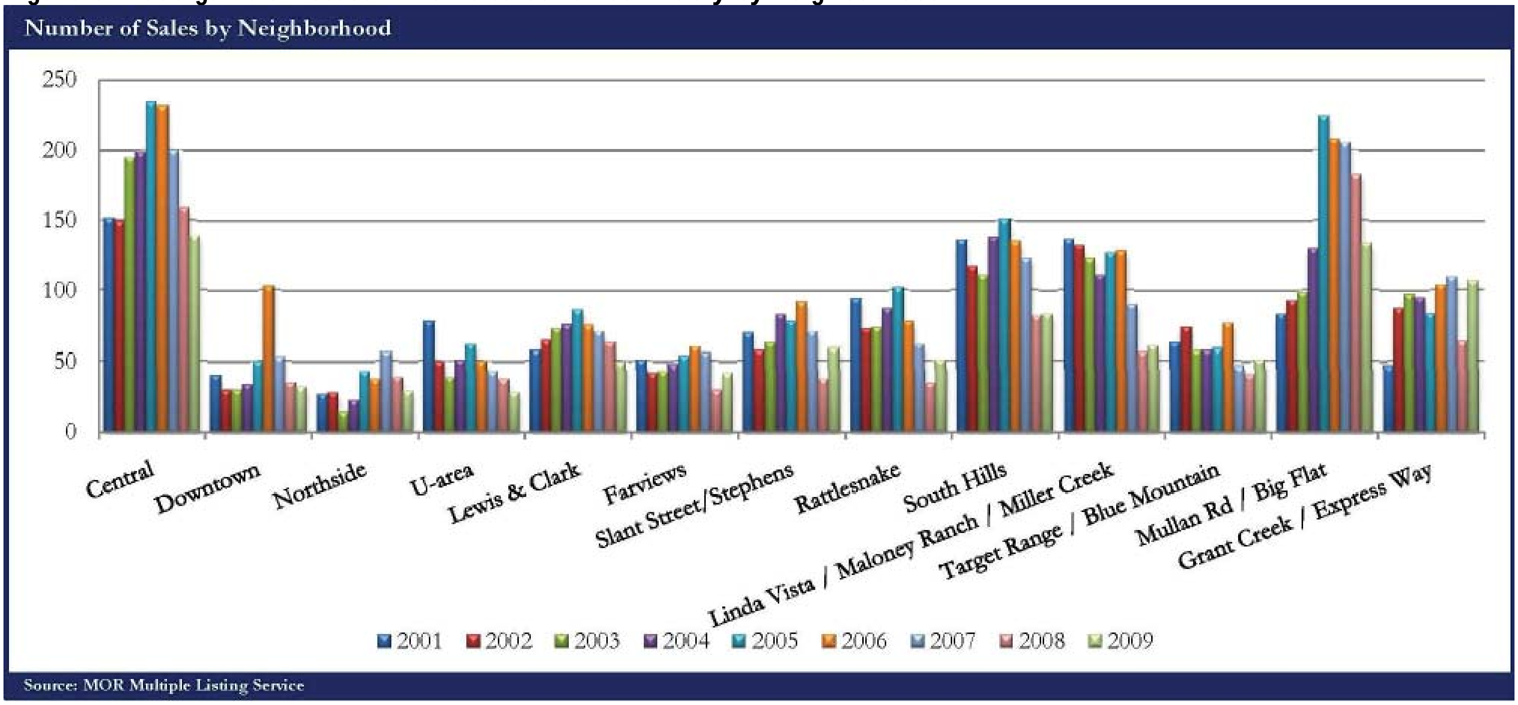


Figure 6: 2009 gains or losses in home sales varied widely by neighborhood



Trends in Neighborhoods

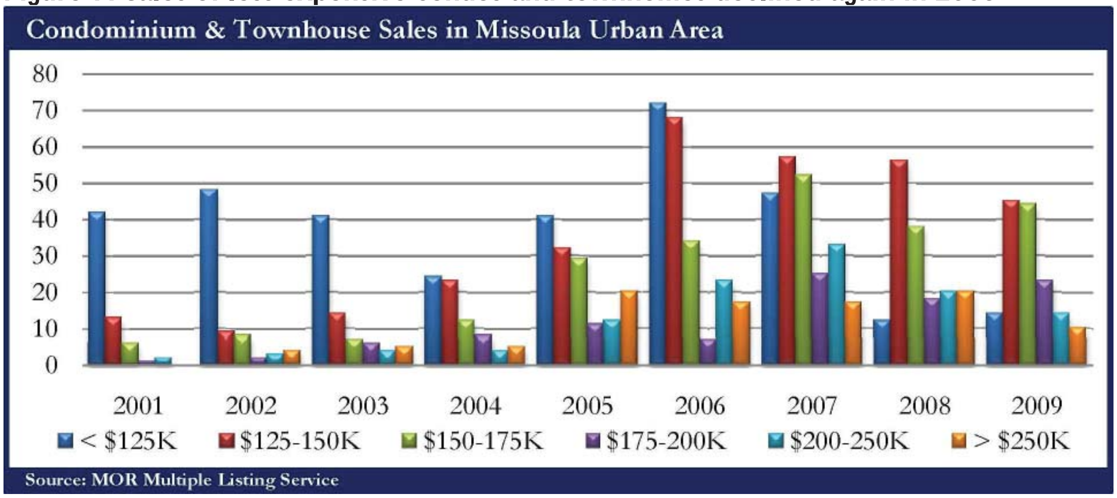
Home sales in 2009 bifurcated by neighborhood as well as by price range. Figure 6 shows that, while sales in every neighborhood declined from 2007 to 2008, sales in 2009 continued down in six neighborhoods while increasing in seven.

Those showing a rebound are Farviews, Slant Street/Stephens, Rattlesnake, South Hills, Linda Vista/Maloney Ranch/Miller Creek, Target Range/Blue Mountain, and Grant Creek/Expressway. Sales have declined for four consecutive years in four neighborhoods: Central, University, Lewis & Clark, and Mullan Road/Big Flat.

Condominiums and Townhouses

The gain in the number of homes sold was not realized in sales of condominiums and townhouses, as shown in Figure 7. A sales decline from 2008 to 2009 was registered in four of six price categories, with the other two categories essentially unchanged.

Figure 7: Sales of less expensive condos and townhomes declined again in 2009



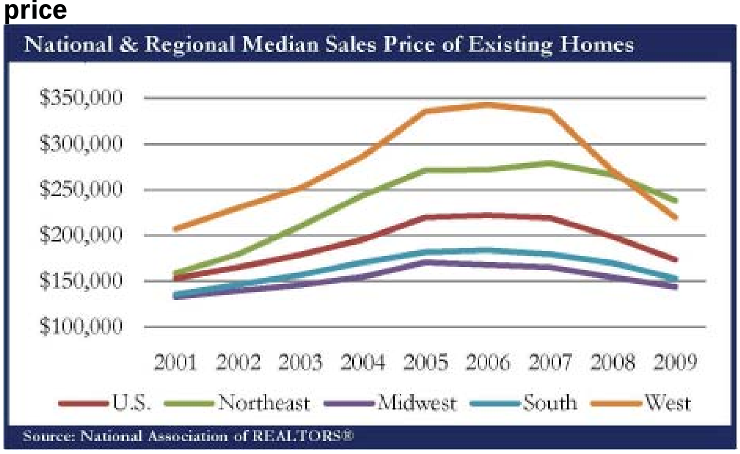
Declines in sales of condos and townhouses in the two lowest price categories; those sold for under $125,000 or for $125,000 to $150,000 is at least partly attributable to the greater challenge today of constructing units that can be priced in those ranges without selling at a loss.

Comparative Trends in Home Prices

Figures 8 and 9 indicate the greater severity of the housing downturn in the US, both nationally and regionally, than in our local market. The downturn also started sooner elsewhere in the US than in Missoula, with the number of homes sold dropping since 2005, a year earlier than in Missoula, and the median sales price declining since 2006, also a year earlier than in our market.

Figure 8: Home sales in the US by region in 2009 show an across-the-board uptick similar to that in Missoula ...

Figure 9: ... as well as a further decline in median sales price

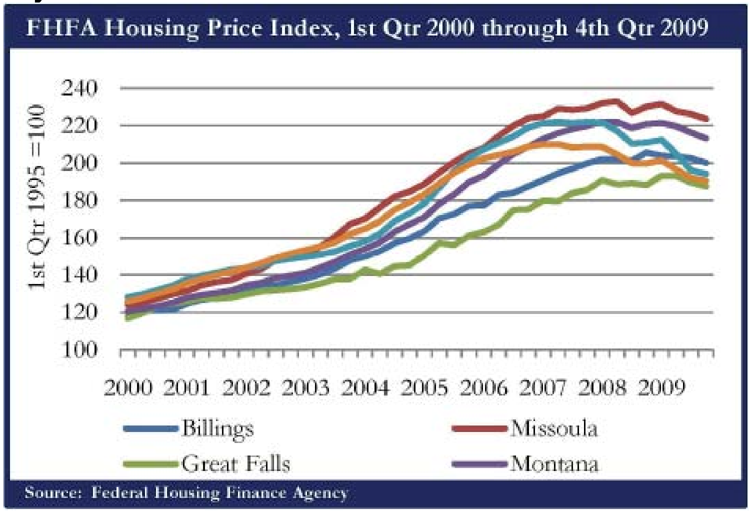


Elsewhere in the US, housing has declined to a devastating extent. As stated in Harvard's State of the Nation's Housing:

> From their quarterly peaks during the housing boom to the last quarter of 2008, real home equity was down 41%, existing median home prices 27%, new home sales 70% percent, and existing home sales 33%.

National impact of the first-time homebuyer tax credit was roughly the same as in our local market, as sales of low to moderately priced homes were spurred in the final months of 2009, while sales of higher-end homes languished.
Figure 10, shows the markedly different paths that housing prices have taken in the past several years in distinguishing Missoula's course not only from the mountain states region and the US as a whole, but also from Montana's largest cities.

Figure 10: Housing prices have held up better in Missoula and Montana than in the mountain states region or nationally



For all of the locations in the figure, housing prices generally The figure traces a measure called the Housing Price Index. Each line indicates the course of housing prices since the first quarter of 1995, when all price levels were set at 100. The index measures the average price changes in repeat sales or refinancing of single family properties through either of the government sponsored enterprises known as Fannie Mae or Freddie Mac. increased steadily, year after year, from 2000.

But the US registered a decline both earlier and steeper than the other locations, and the mountain states followed suit, although a little later than the US.

The indexes for the cities of Billings and Great Falls didn't accelerate at rates that kept up with the other locations, but those cities have, like Missoula, also escaped pronounced declines. As for Missoula, housing price increases significantly outpaced those for Billings and Great Falls through most of the current decade, with all three escaping the steeper drops seen in the mountain states and the entire US.

Pace of Home Sales

Another measure that can help indicate the health of a housing market is days on market (DOM). Figure 11 shows, as one might expect in our northerly climate, that DOM is generally greater in the first half of each year than in the second half, although this differentiation was largely absent in the past year. The figure indicates that days on market has generally trended upwards since 2002, with a relatively steep climb over the past year.

Figure 11: Local days on market measures have trended slowly upward

Housing market vitality can also be measured by absorption rate. It is calculated by dividing the total number of sales for the year by 12, then dividing that resulting number into the number of active listings, which yields the number of months that will likely be required to work through the listed inventory. A result greater than six (months) is generally defined as a buyer's market.

When considering absorption rate, it's important to note that it's calculated by using the number of active listings. That means the rate doesn't measure homes that have either been pulled off the market or not been listed at all, with would-be sellers waiting for cooling of the current buyer's market.

Figure 12 shows that the absorption rate, both nationally and locally, has stood at over six months for the entire 18 months depicted. In the US as a whole, according to the National Association of REALTORS®, total housing inventory amounted to a 7.2-month supply at the then-current sales pace at year-end 2009.

Figure 12: The time on market locally has reduced, but is still higher than the national average

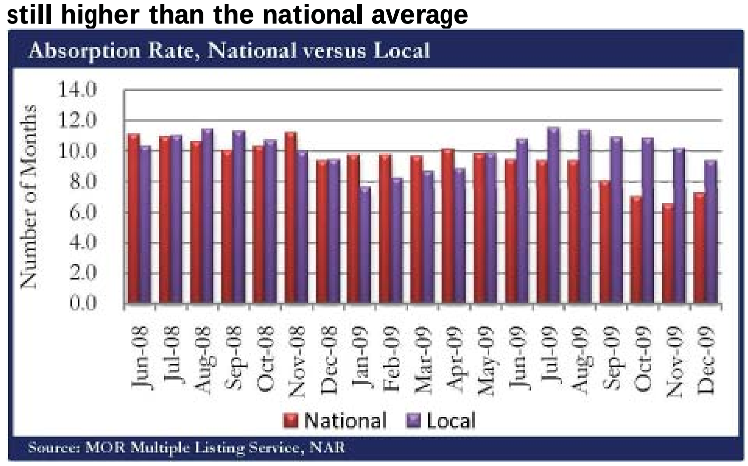


Table 3: Mortgage interest rates trended downward in 2009 until a year-end uptick ...

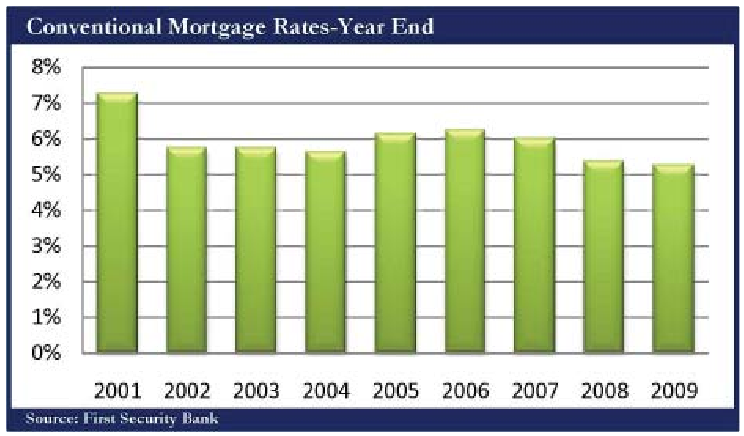
2009 Mortgage Interest Rates					
Mortgage Type	Q1	Q2	Q3	Q4	Year End
30 Year Fixed	5.375%	5.125%	5.125%	4.625%	5.250%
15 Year Fixed	4.875%	4.500%	4.625%	4.125%	4.625%
FHA / VA	5.500%	5.000%	5.125%	4.750%	5.250%
5/1 ARM	4.625%	4.250%	4.000%	3.500%	4.125%
MBOH	5.875%	5.875%	5.875%	5.500%	5.500%

Source: First Security Bank
FHA: Federal Housing Administration; VA: Veterans Affairs; MBOH: Montana Board of Housing; 5/1 ARM: A form of an adjustable rate mortgage that has a fixed period for five years. Once the mortgage has matured for five years the rate adjusts annually until it reaches a pre-determined limit.

Table 4 and Figure 13: ... but conventional rates stood at a decade low at year-end 2009 ...

Conventional Mortgage Rates, Year End									
	2001	2002	2003	2004	2005	2006	2007	2008	2009
YEAR - END	7.250%	5.750%	5.750%	5.625%	6.125%	6.250%	6.000%	5.375%	5.250%

Source: First Security Bank



Real Estate Finance Activity in 2009

Interest rates were favorable for most of 2009, excepting a brief June peak in 30-year fixed rates at 5.75%. Through the year, the federal government bought mortgage-backed securities to ensure that rates remained favorable. As the government reduces these purchases in 2010, interest rates may rise from recent lows.

Mortgage Loans

The pronounced changes in almost every aspect of the US home mortgage market seen in 2008 were extended through 2009. The most important of these changes was a continuance of more restrictive underwriting requirements, which severely limited the availability of financing for some borrowers.

Loans offered to borrowers by the Federal Housing Administration (FHA) were instrumental in increasing the overall number of loans originated. These loans were originated at a near-record pace for first-time homebuyers. The availability of FHA financing has been decisive in our current economic downturn, as it has been in past housing market declines.

According to Harvard's State of the Nation's Housing, "So complete was the shutdown of private mortgage lending that 73% of loans originated in 2008 … were bought, insured, or guaranteed by a federal agency or by Fannie Mae and Freddie Mac."

A huge spur to sales in 2009 was the First-Time Homebuyers Tax Credit. Sales declined in November, when the initial credit allowance expired. The extended tax credit requires that buyers have a signed contract by April 30, 2010 and close by June 30, 2010.

The financially precarious status of Fannie Mae and Freddie Mac has not abated in the past year, and those enterprises remain under indefinite federal government conservatorship. Their ultimate fate is still uncertain.

None of the major players in mortgage markets has escaped the financial and regulatory turmoil of the past two years. While some regulatory reform has helped to slightly clarify muddied waters, major decisions concerning the practices and players in the mortgage markets are yet to be established.

One significant change was implemented May 1, 2009, pertaining to reforms that apply to valuation mechanisms within the housing industry in both primary and secondary markets, which are aimed ultimately at protecting consumers. The Office of Federal Housing Enterprise Oversight (OFHEO), an independent agency in the Department of Housing and Urban Development (HUD) that oversees Fannie Mae and Freddie Mac, established a regulatory regime known as Home Valuation Code of Conduct (HVCC).

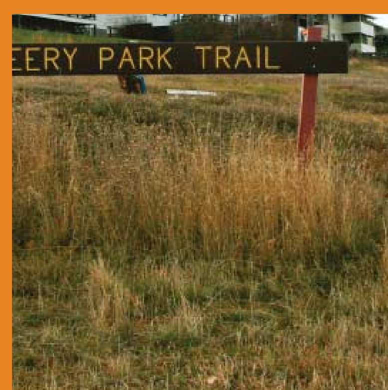
The code establishes requirements governing appraisal selection, solicitation, compensation, conflicts of interest and corporate independence. The intended goal of HVCC requirements is to construct a firewall between lenders and home appraisers, so appraisals aren't inflated to ensure that a home sale is completed. That effort appears to be thus far successful, but has also created many unforeseen problems. According to Bernard Markstein, senior economist at the National Association of Home Builders, appraisals continue to plague builders, many of whom have forfeited most or all profit by the time a valuation disparity crops up. "In most cases," Markstein said, "it scotches the deal."

HUD has implemented new regulations and overhauled requirements of the Real Estate Settlement Procedures Act (RESPA). HUD also has developed a standardized form, the new Good Faith Estimate of Closing Costs (GFE) that all lenders are required to use. It is intended to provide the borrower with a more accurate accounting of closing costs associated with originating a mortgage loan. The GFE is intended to be a tool the borrower can use to compare lenders and shop for a mortgage loan.

The cumulative effect of new regulations entails considerable costs to lenders. So, while fees should be more completely and accurately disclosed, they also will be somewhat higher as a direct result.

Down Payments

Although the Federal Housing Administration (FHA) is still offering loans with a 3.5% down payment to borrowers who qualify, the stricter lending standards applied in 2009 had the effect of limiting loans to prospective buyers who could pay 10% down on homes. As in the past, buyers could secure the best terms with 20% or more down.



Foreclosures

Historically, foreclosures have been relatively rare in the Missoula market, amounting to well below 0.5% of all owner-occupied homes. This is less than half the usual recent US rate before the housing bubble burst.

In the Missoula real estate market, foreclosures increased significantly in 2007, reached new highs in 2008, and climbed again to a housing report record in 2009, as shown in Table 5 and Figure 14 below. Notices of foreclosure sale increased by more than 80% from 2008 to 2009 and are up by 163% over the past three years.

Cancellation of notices of sale also increased significantly. Nonetheless, net foreclosures rose in 2009 by 106% over 2008. A break in this relentless climb may be foretold by net foreclosures in the fourth quarter of 2009, which declined to 71 from the 73 recorded in the same quarter of 2008.

As high as the rate of increase in foreclosures has been, the number of net foreclosures in Missoula represent only about 1% of our market's total owner-occupied stock. In contrast, Florida's nationally highest foreclosure inventory stood at 13.44% early in 2010. Montana is one of only five states with foreclosure rates less than 2%, the others are South Dakota, North Dakota, Wyoming, and Alaska.

Table 5: Foreclosure notices and cancellations both increased significantly ...

Foreclosure Notices & Cancellations			
Year	Notice of Sale	Cancellation of Sale	Net Foreclo-sures
2001	161	98	63
2002	206	122	84
2003	177	123	54
2004	174	106	68
2005	176	130	46
2006	215	142	73
2007	247	139	108
2008	313	186	127
2009	565	303	262

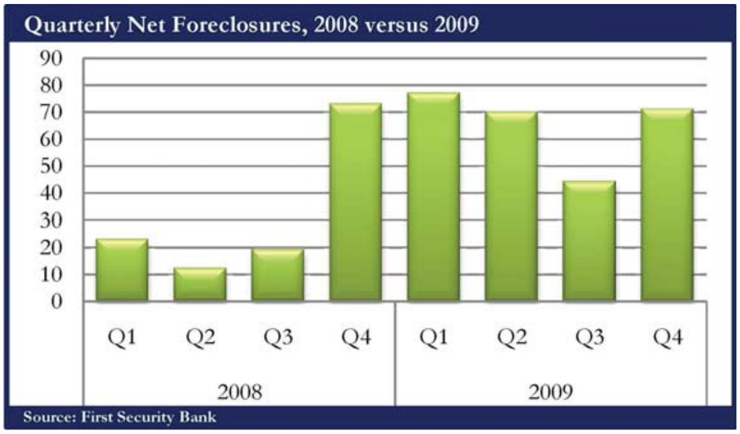
Source: First Security Bank

Figure 14: ... resulting in net foreclosures of double their decade-high level of last year ...

Table 6 and Figure 15: ... but provided a glimmer of hope in declining slightly in the 4th quarter of 2009 vs. the year-earlier 4th quarter

Missoula Quarterly Foreclosure Notices and Cancellations				
		Notice of Sale	Cancellation of Sale	Net Foreclo-sures
2008	Q1	69	46	23
	Q2	58	46	12
	Q3	67	48	19
	Q4	119	46	73
2009	Q1	147	70	77
	Q2	141	71	70
	Q3	127	83	44
	Q4	150	79	71

Source: First Security Bank



Residential Rental Market

The Residential Rental Market

Rental is an important segment of any housing market, but is especially vital in college towns such as Missoula, where a significant number of students create greater demand for rental housing. Surveys show that Missoula's rental market share is larger (vs. the owner-occupied housing market) than the rental market share in Montana or the US.

About half of rental units in the Missoula market area are owner managed. While comprehensive statistics on all rental units are not routinely gathered, the Western Montana Chapter of the National Association of Residential Property Managers (NARPM) gathers monthly information from its member property management firms regarding vacancy rate and rental rates for the units they manage.

Market Rate Rental

A normal vacancy rate for a healthy rental market in the US is in the range of 4% to 6%. ('Vacant' units are defined as currently unoccupied and ready to rent.) Missoula often has a lower rate, probably because the university population exerts continuing product demand, and also because Missoula seems to attract a significant share of young couples and singles at the outset of their working careers.

Figures 16 and 17 depict median monthly rents and vacancy rates for various types of rental property in the fourth quarter of 2008. Even in today's depressed housing market, rental rates in Missoula are relatively strong, with vacancies averaging well below 5%. This contrasts sharply with the national rental vacancy rate for 2008 of 10.0%, barely below the 10.2% record set in 2004.

As the later section on Housing Affordability demonstrates, Missoula rents remain at levels that for many families consume a share of total income that leaves too little for other necessities, such as food, clothing, and health care.

Rental information was provided by NARPM, which includes some of the major property management groups. Approximately 8,000 units were surveyed to gather the data presented in these figures.




Figure 16: Rents are burdensome for many families, particularly those in larger houses ...

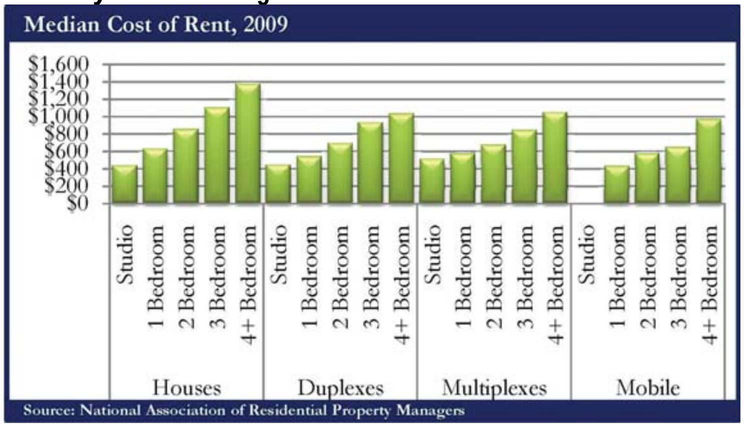


Figure 17: ... as vacancy rates remain below 5%

The Missoula Housing Authority only has the budget to support 730 to 740 of their 774 vouchers.

Status of Rental Assistance

The Missoula Housing Authority (MHA) has 774 available Section 8 vouchers that subsidize rent to private landlords for eligible program participants. Another 262 vouchers are provided in Missoula by the Montana Department of Commerce. Combined availability of these vouchers, which are inadequate to meet needs in a healthy economy, is further strained by the economic downturn, as tenant incomes are reduced and funding for vouchers has not been increased.

Reduced tenant incomes caused the per unit cost, or need for assistance, to increase by 11% in 2009, where previous years saw increases of 2% to 3%, roughly the cost of inflation.

MHA has only the budget to support 730 to 740 of their 774 vouchers. Additionally, during 2009, few families moved out. With this reflection of the poor economy, MHA was able to admit only about half as many families as in recent years.

Amid this squeeze on supply, demand increased. Often, in order to obtain housing sooner, households are placed on multiple waiting lists. When calculating the total MHA wait list, the households are consolidated into an “unduplicated list” in order to provide accurate figures. The number of unduplicated households on MHA waiting lists on December 15, 2009 was 1,824, up from 1,410 last year and 1,079 in 2007. The number on the Section 8 waiting list was 1,669; and the numbers on two of the waiting lists dedicated to homeless households was 136 and 118.

The US Congress relieved this extreme strain somewhat, by authorizing additional funding that restored the voucher program to its earlier funding level. But this was inadequate for expanding capacity to meet additional needs, and fewer families were being served at year-end 2009 than at the same time a year earlier. On the plus side, MHA and the Missoula and Billings-based homeWORD added a total of 72 units of affordable housing.

As part of the 2009 federal stimulus program, Missoula received $350,000 for the Homeless Prevention and Rapid Rehousing Program (HPRP) administered by the Human Resource Development Council (HRDC). The first HPRP application was taken on October 5, 2009, and resulted in 41 families being assisted with rent, arrears, and deposit, totaling about $45,000. More than 200 other individuals contacted HPRP staff seeking various services; they were assisted through phone consultations. HPRP is funded into 2010, but currently designed to cease in September.

Lot Sales & New Construction

Sales of empty lots in 2009, as shown in Table 7, were dramatically lower in number of sales and down by 10% in median sale price, compared with prior year sales. Price of sales can be misleading, however, because lot sizes are not reported. Average lot size is thought to be declining in recent years, owing to purchases of land for new subdivisions that offer smaller lots than those of 2006 and earlier.

Lot sales through the first years of the decade were limited by availability of too few lots to meet demand. That is not the case in 2008 and 2009, as lots are available but demand has plummeted.

Table 7: Lot sales continued to decline in 2009 ...

Missoula Urban Area Lot Sales		
	Lot Sales	Median Price
2001	28	$43,450
2002	74	$79,900
2003	58	$75,900
2004	65	$89,500
2005	95	$82,200
2006	96	$84,950
2007	188	$68,000
2008	84	$79,950
2009	43	$72,000

Source: MOR Multiple Listing Service

Figure 18: ... with the number sold sliding by nearly 50% ...

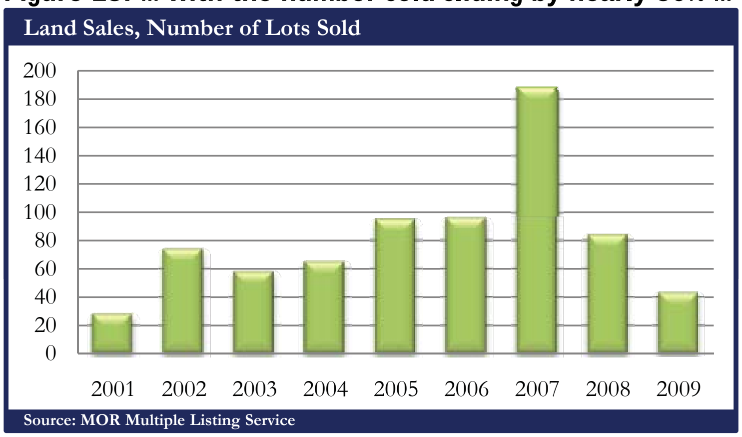
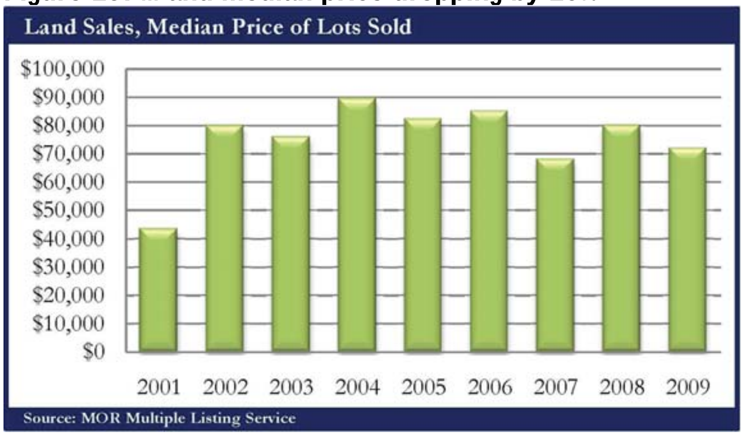


Figure 19: ... and median price dropping by 10%

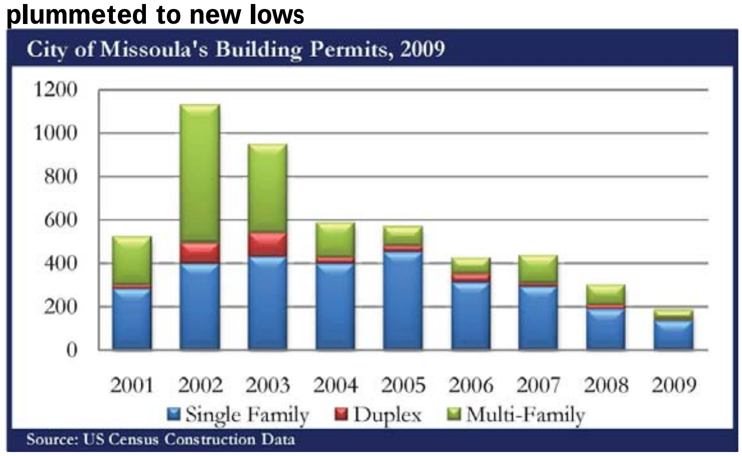


Pace of Development

Unsurprisingly, building permits issued by the City of Missoula in 2009 registered a low for the decade for both single-family and duplex construction and for all types of construction. Single-family permits for 2009 declined by 28% from 2008, and declined in number for the fourth consecutive year, with a 71% drop since the record-high year of 2005. Multi-family permits declined by 56%, also a decade low number.

Missoula County building permits in 2009 declined from recent years by even more than in the city, with only 42 issued for single-family construction.

Figure 20 and Table 8: The number of building permits issued in 2009 plummeted to new lows



Missoula County Residential Building Permits				
	Number of Units - City			
	Single Family	Duplex	Multi-Family	Total
2001	280	20	220	520
2002	396	98	633	1127
2003	428	110	409	947
2004	396	30	158	584
2005	451	28	87	566
2006	310	38	75	423
2007	293	14	128	435
2008	186	20	94	290
2009	133	8	41	182
	Number of Units – County, Unincorporated			
	Single family	Duplex	Multi-family	Total
2007	220	0	12	232
2008	137	2	0	139
2009	42	0	0	42
Source: US Census Bureau Construction Statistics				

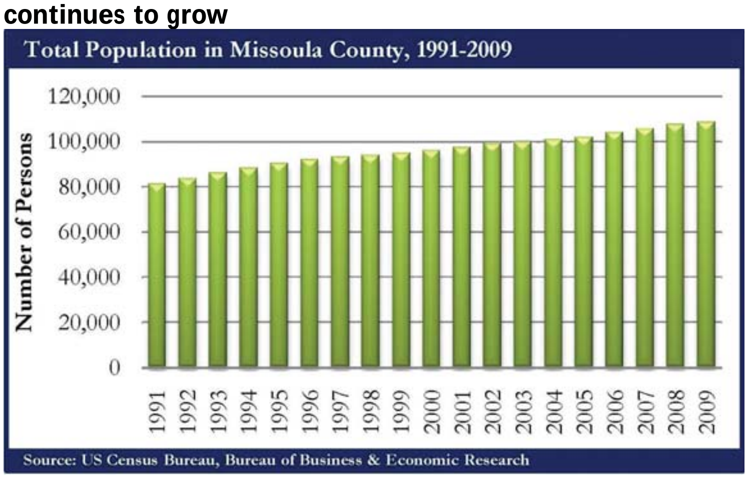
Population, Income, & Poverty

Population Dynamics

Of the various factors that influence demand for housing, population change often exerts the greatest impact. With our market's record of population growth, it's not difficult to understand why demand for housing, and consequently the costs of housing, have steadily increased in our market.

Missoula County population continues to grow, passing 100,000 persons in 2004 and gaining at about the rate of 500 to 1,000 each year (Figure 21). Population can increase or decrease by two mechanisms: natural (the net of births and deaths) and migration (the net of people moving in and moving out).

Figure 21: Despite a slowed economy, county population continues to grow

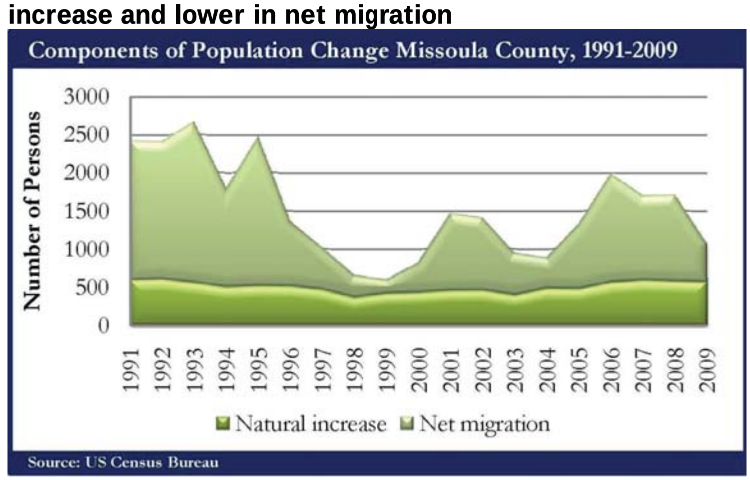


Components of Population Change

For many years, as Figure 22 shows, Missoula County's annual natural increase in population has hovered at a consistent positive level of plus 500 to 600. Over the same years, however, net migration has swung widely, with gains of as much as 2,000 in the early 1990s and as little as a few hundred in the late '90s.

Net migration increases have declined sharply in recent years, with a moderate drop from 2006 to 2007 and a much steeper decline from 2008 to 2009.

Figure 22: County population gains are steady in natural increase and lower in net migration



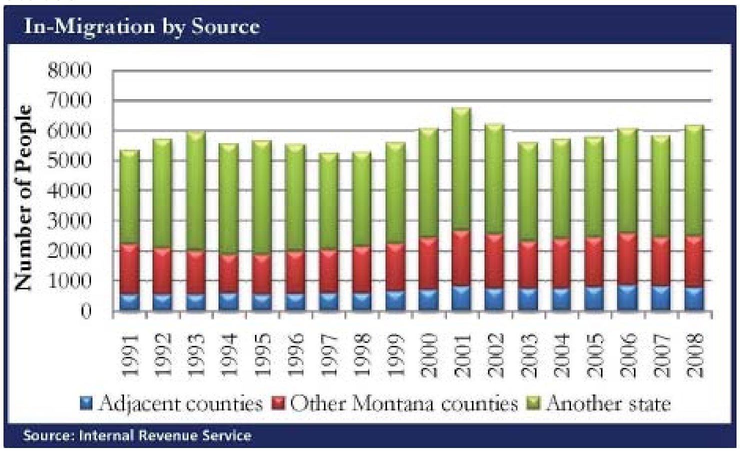
Migration

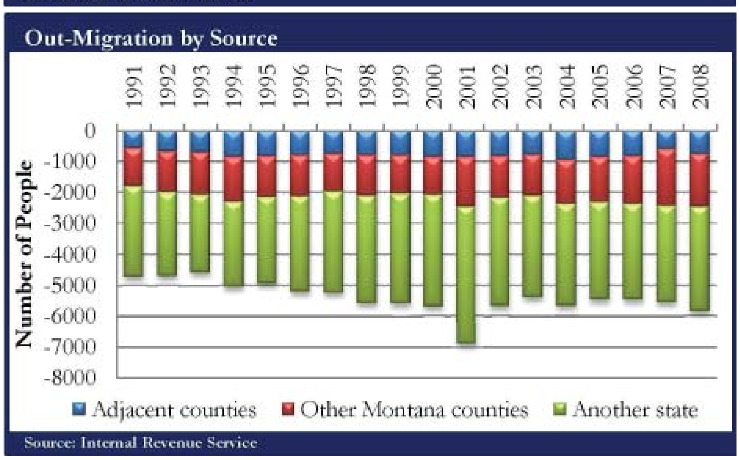
Figure 23 presents migration data as reported by the Internal Revenue Service. These data do not capture all migrants, as they include only those filing tax returns in Missoula County in at least one of two consecutive years. Nonetheless, they provide a reliable picture of migrants' moves.

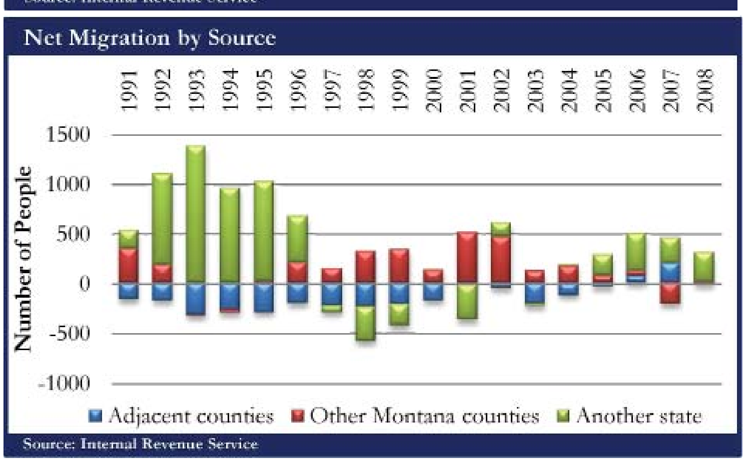
From these data, we can see that about 6,000 persons moved to Missoula County each year since 2000, with two-thirds from another state and one-third from other Montana counties. About 5,500 people annually have moved out in recent years, with just under two-thirds relocating out of state and more than one-third settling in another Montana county.

Subtracting out-migration from in-migration yields net migration and the conclusion that for many years Missoula County has been gaining population annually through net migration. Net migration of out-of-state migrants was strongly positive between 1992 and 1996. Since then, net migration has usually been less than 500, with a noticeable upturn in the most recent four years. In 2008, the county's net migration consisted almost entirely of those arriving from outside the state.

Figure 23: County migration is mostly from and to other states







Income and Employment

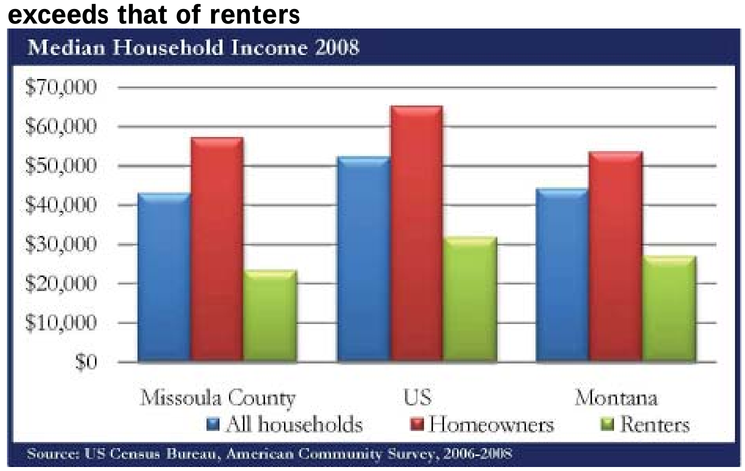
The types and prices of houses demanded by consumers are determined largely by whether would-be buyers are employed and, if they are, how much they earn in their jobs. Housing affordability for a population in any jurisdiction; city, county, state, or country, is principally a function of only three numbers: income, mortgage rates, and home prices. Average working families can only afford the monthly mortgage cost of homes if their incomes are sufficient.

Income Measures

Figure 24 shows median income in 2008 for homeowners, renters, and overall in Missoula County, Montana, and the US. (Remember that median is the point at which exactly half of all incomes are greater and the other half are less.)

Median income in Missoula County shows a markedly extreme disparity for 2008 between homeowners and renters. This relationship holds, but is less pronounced, both nationwide and for all of Montana. As in previous measures, this gap may be explained by Missoula's large population of college students, who tend to rent rather than own and have little or no income.

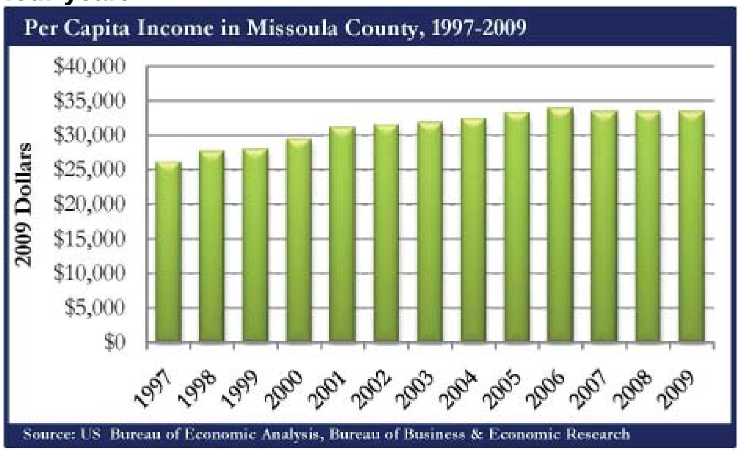
Figure 24: Missoula homeowner household income greatly exceeds that of renters



Another way to measure income is per capita (per person). Per capita income is regarded as a generally reliable measure of overall economic well-being. It is the average income of all individuals living in an area, derived by adding the total income earned by everyone in a given area or jurisdiction and dividing by the total population (regardless of age or employment status).

Figure 25 shows that Missoula County's inflation-adjusted per capita income increased steadily over the 10 years from 1997 through 2006, but since then has leveled off or declined slightly.

Figure 25: Per capita income has changed little in the past four years



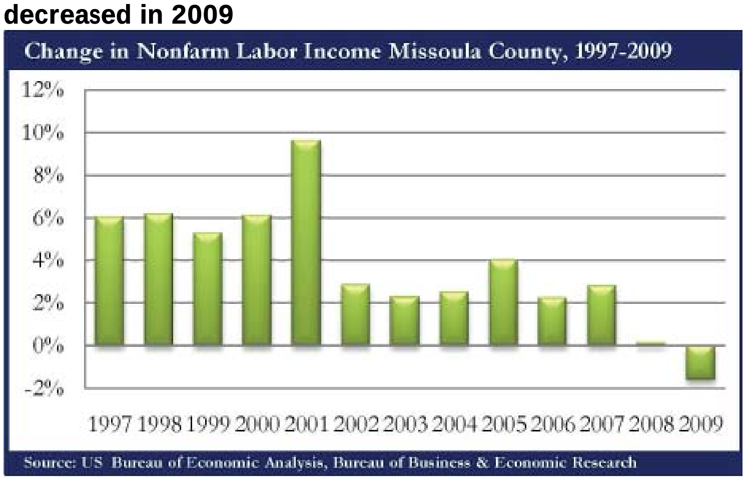
Income From Labor

Non-farm labor income is a proxy for economic activity at local levels, because it is highly correlated with gross domestic product (GDP – the sum of the value of all goods and services produced in a given area or jurisdiction).

As Figure 26 shows, Missoula County's inflation-adjusted, non-farm labor income increased rapidly from 1998 through 2001, retreated somewhat, though it stayed positive, in the early to mid-2000s, barely moved in 2008, and dropped significantly in 2009.

Lagging income gains are a significant barrier to improved housing affordability, according to Harvard's *State of the Nation's Housing*, "The possibility that households with low-wage workers can earn their way out of their housing affordability problems is small."

Figure 26: After gains for 12 years, non-farm labor income decreased in 2009

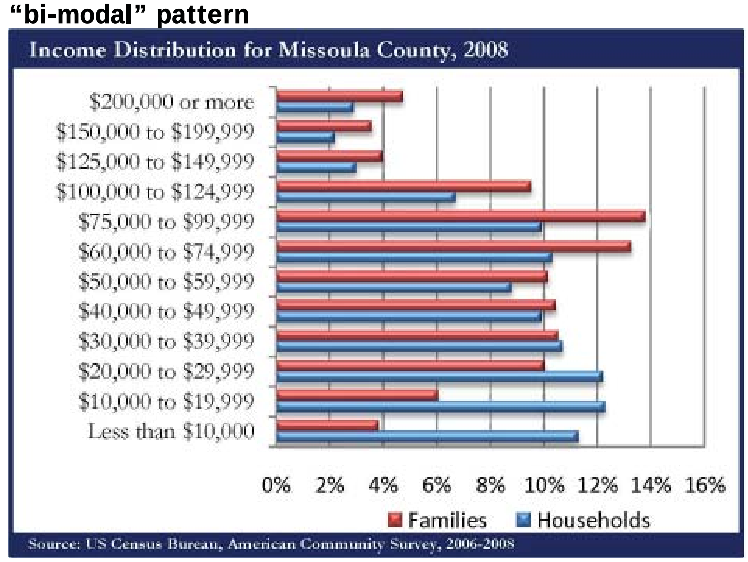


Income Distribution

The Census Bureau measures family and household income by the various income groupings shown for Missoula County in Figure 27. Families are defined as two or more persons living together that are related by blood or marriage. Households include families as well as persons living alone and two or more unrelated individuals who share living quarters.

The figure clearly indicates that the county's incomes are "bi-modal," that is, concentrated at two distinct levels: $40,000 and under for households and $30,000 to $100,000 for families. These concentrations appear to correspond to county employment patterns, with professional workers represented in the higher income category and retirees and students mostly composing the households with lower incomes. (Note: The chart's individual income bands span a wider dollar range at higher incomes, so a casual glance at the chart would suggest more than the actual number of people at lower incomes.)

Figure 27: Family and household income shows a distinct "bi-modal" pattern

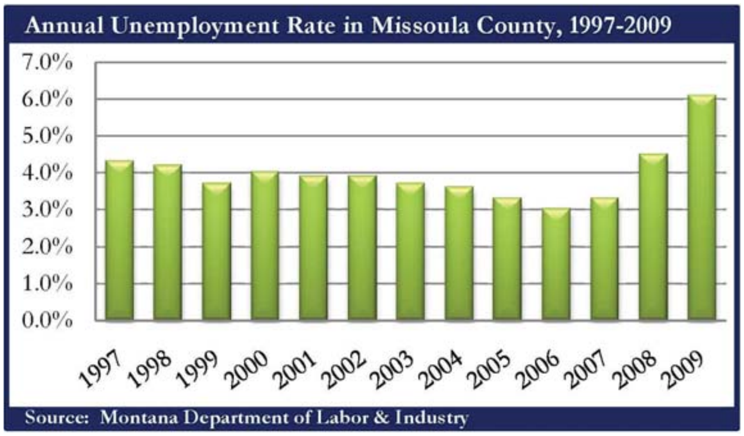


Unemployment

The unemployment rate measures the proportion of persons who are in the labor force (that is, seeking a job) but currently out of work.

Figure 28 shows that Missoula County unemployment increased in 2009 for the third consecutive year, after staying below 4% for nine consecutive years. Despite the recent increases, Missoula's 2009 year-end unemployment rate of 6.1% was less than Montana's 6.5% and 10.0% for the US. Also, Missoula's unemployment rate is significantly below that registered by each of its seven bordering counties, by about four percentage points or more.

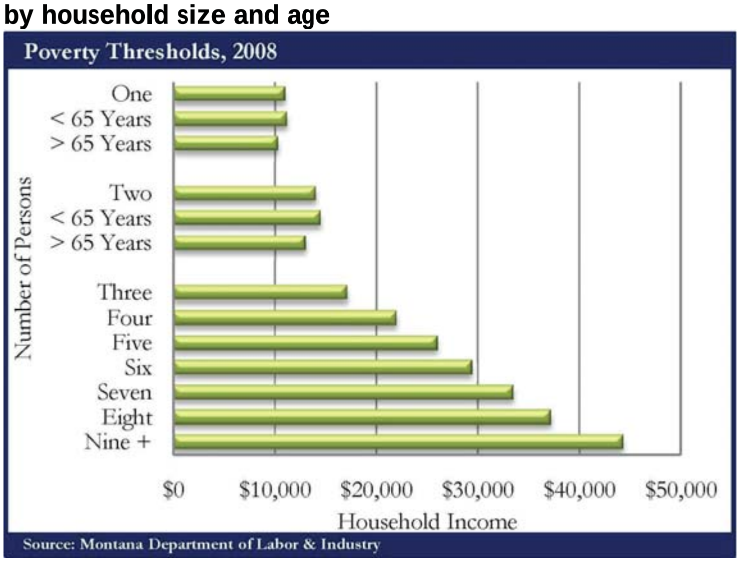
Figure 28: Unemployment spiked in 2009, but remains below the statewide and US rates



Poverty

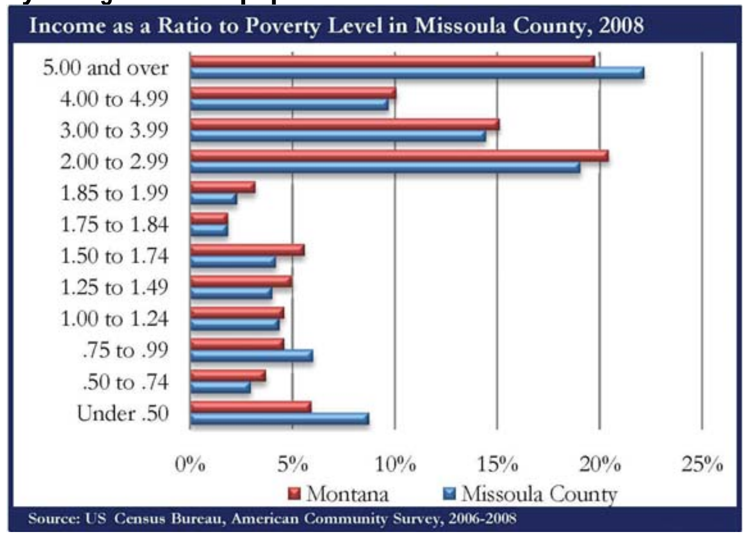
The Census Bureau computes so-called "poverty thresholds" each year – thresholds commonly known as the Federal Poverty Level. As Figure 29 shows, poverty thresholds vary by the number of persons in the household and (for one and two-person households) by age.

Figure 29: The federal government sets poverty thresholds by household size and age



Using the established poverty thresholds shown in Figure 29 and measuring the income of Missoula households yields Figure 30, below, which shows where household income stands relative to the government-set poverty thresholds.

Figure 30: Missoula County's poverty levels are influenced by a large student population



The figure indicates that about 18% of Missoula County households have incomes below the poverty threshold that corresponds to their household size and age (as represented by the lowest three bars on the chart, where 1.0 is equal to the income level established as the poverty threshold). The state of Montana as a whole has a smaller share of households in poverty. Again, however, Missoula's high number of college students, who tend to earn little or no income, probably exaggerates our local poverty rate.

A slightly higher percentage of county households has incomes that range from the poverty threshold (1.0) to double the threshold (2.0). More than 60% of county households have incomes of double the poverty threshold or higher.

Missoula has a more pronounced income disparity than the state of Montana as a whole, with a greater share of households under half the poverty threshold (0.50) as well as a greater share in the top category of over five times the poverty threshold (5.0).

Housing Affordability

The Housing Affordability Index

The Housing Affordability Index (HAI) is a comparison of the median price of a home (as discussed in Section 2 of this report) and the median income of households in the community (as discussed in the previous section) and how these factors are affected by mortgage interest rates. The HAI also includes estimation of taxes and homeowners insurance. The HAI is a way to indicate what the housing numbers mean to consumers who want to purchase in the local market. It reflects the fact that housing prices, interest rates, terms of loans, and amounts of down payments all affect a homeowner's ability to purchase a home.

An affordability index of 100% indicates that, given all the factors that affect ability to purchase, a family with a median income has the income necessary to purchase a median priced home.

The National Association of REALTORS® uses the HAI to quan-

Table 9: Homes became slightly more affordable in 2008 and 2009

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Median Home Price	$138,000	$149,500	$163,000	$179,000	$192,000	$206,850	$219,550	$215,000	$208,775
Down payment	10.0%	10.0%	10.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Interest Rate	6.3%	5.8%	5.5%	5.5%	6.8%	6.3%	6.0%	5.4%	5.3%
Loan Term	30 years	30 years	30 years	30 years	30 years	30 years	30 years	30 years	30 years
Median Family Income									
1 person	$30,000	$31,600	$34,200	$37,000	$37,400	$37,800	$38,800	$41,600	
2 person	$34,300	$36,200	$39,000	$42,200	$42,800	$43,200	$44,300	$47,500	
3 person	$38,600	$40,700	$43,900	$47,500	$48,100	$48,600	$49,900	$53,500	
4 person	$42,900	$45,200	$48,800	$52,800	$53,500	$54,000	$55,400	$59,400	
Housing Affordability Index									
1 person	68	69	71	66	55	54	54	62	65
2 person	78	80	80	75	64	62	61	71	74
3 person	88	89	91	85	71	70	69	80	84
4 person	98	99	101	94	79	78	77	89	93
Median Family Income Needed to Purchase Median Priced Home									
Income	$43,896	$45,502	$48,460	$56,156	$67,392	$69,460	$72,089	$66,716	$63,992

KEY: 100 - A median income family can marginally qualify for housing, , >100 - A median income family has xx% more income than minimum, <100 - A median income family has xx% of the income required to qualify

*Includes taxes and homeowners insurance on a 30 year fixed loan

Source: MOR Multiple Listing Service

tify housing affordability. To figure the affordability of the payment, it's assumed that 25% of monthly income would go toward the mortgage payment.

Table 9 shows the HAI for Missoula from 2001 through 2009. The income levels are set by HUD and for this report we are using the 2009 numbers because at the time of publishing the 2010 numbers had not been released. In 2009, the income needed for a HAI of 100% is $63,992, which means a family whose income is at that level could afford a median priced home (or any home priced lower than the median). The HAI shows that a one-person household in 2009 has approximately 65% of the amount of income needed to purchase a home priced at the 2009 median sale price.

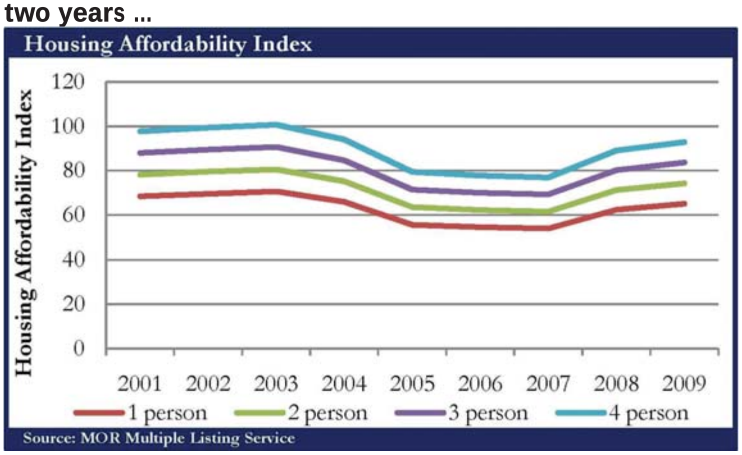
The HAI shows that increases in median home prices significantly outstripped increases in median family incomes from 2001 through 2006. Then, consistent with bursting of the housing bubble, home prices have lost value for the past three years – making homes more affordable.

However, "more" affordable doesn't mean widespread affordability. Those families and individuals who were at the cusp of affordability two or more years ago may since have been able to buy at today's moderated prices. But for far more of those who wish to buy that first or move-up home, incomes remain well below thresholds of affordability.

For example, a 4-person family at the median Missoula income ($59,400) had 93% of the income required to qualify to purchase a median priced home (at $208,775). Yet this family would fare better than families of one, two, or three persons – their median incomes provided even lower percentages of the incomes needed to qualify for purchase of a median priced home.

Missoula's improved affordability is far outstripped by startling gains nationwide. The typical American family earning the national median annual income of $64,000 could afford to buy 71% of all homes sold in the US during the last quarter of 2009, according to a report sponsored by the National Association of Home Builders and Wells Fargo.

Figure 31: Housing affordability has improved in the past two years ...

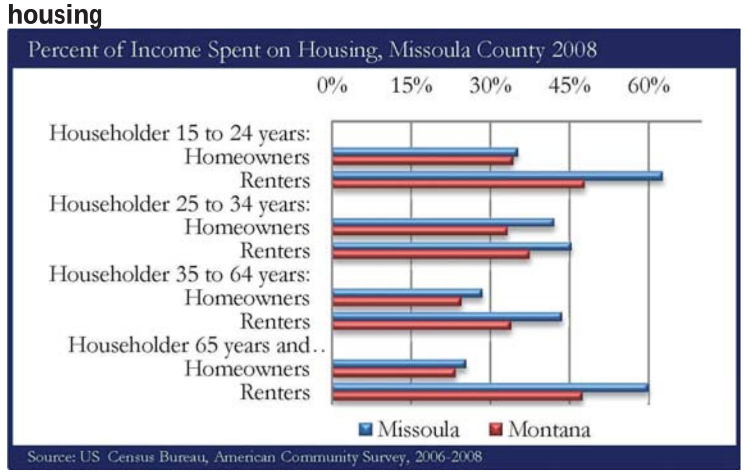


Share of Income Spent on Housing

Experts and professionals in real estate and financial planning generally agree that no more than 30% (and, more safely, 25%) of a family's gross monthly income should be spent on housing. Figure 32 shows that a significant percentage of households, divided into four age groups, spend more than the recommended maximum 30% of income on housing.

Here, too, the national scene appears to be significantly more troublesome than is our local market. According to the Harvard's *State of the Nation's Housing*, "In 2007, nearly three-quarters of severely cost-burdened households had low incomes. Fully 51% of low-income renters and 43% of low-income owners paid more than half their incomes for housing."

Figure 32: ... however, a significant share of homeowners and most renters still spend more than 30% of income on housing



In Missoula, homeowners in the 25 to 34 age group spend an average of some 42% of their gross incomes on housing, while homeowners in the youngest age group, on average, go beyond the recommended maximum to about 35%.

Fewer homeowners in the upper two age groups are burdened with excessive payments. This is attributable in part to members of the older generations having purchased their homes before prices began their steep advance in the 1990s and through 2007, with many of them having paid down most or all of their mortgages.

For renters, divided into the same age groups, the average percentage spent on housing significantly exceeds that of homeowners. Among renters, even those in the older age groups do not show the same low level of incomes going to housing as among homeowners. In fact, the profile of those in the oldest age group reveals that the percentage spent on housing is even greater than that spent by the youngest group.

The extent to which housing gobbles income is vividly captured in the Harvard Joint Center's *State of the Nation's Housing* finding that, "No household earning the equivalent of the full-time minimum wage ($11,500) can afford a modest two-bedroom apartment at the federal fair market rent anywhere in the US."

Conclusion & Outlook

Over the past few years, high-ranking federal government officials have warned us to "never waste a good crisis" or told us, in a variation of that warning, "it's a shame to waste a good crisis." Missoula seems to have taken heed of these admonitions, at least with regard to our real estate market.

How? Amidst the recent downturn some genuinely good, or at least constructive, changes have taken shape. For example, the Missoula housing market, partly as a result of not having home prices previously bid to the stratosphere, has not crashed in terms of homes sold, prices paid, or properties foreclosed. Also, houses have gotten more affordable, especially for first-time homebuyers.

Further, homeowners have been reminded that a house is a consumer good, not a tradable commodity or a cash-spewing ATM. Many of us, including leaders of our federal government, have learned through painful experience that some renters are not qualified or suited to be homeowners. Lenders have been reminded that mortgage loans carry risks, and risks must be properly assessed and priced.

This is not to say that the crisis that would be a shame to waste is not a crisis. Much of the data presented in this report document declines and difficulties that are all too real, imposing strains on families and households ranging from sleeplessness all the way to joblessness, divorce, and even homelessness.

With these impacts, the only thing about a "good crisis" that might truly be good is getting out of it. Fortunately, a variety of economic and real estate signals at national, state, and local levels have turned from blinding red to at least a weak shade of green, or a caution indicating yellow.

For example, home prices, except at the top-most ranges, appear to have bottomed, with entry-level homes showing some recent modest gains. December's increased home sales nationally were likely aided by mortgage interest rates hovering around 5%, the lowest level in decades.

Nationally, new home sales in 2010 are predicted to increase by 25% over their 2009 total, according to National Association of Home Builders senior economist Bernard Markstein. He says a share of this gain will result from a significant drawdown in housing inventory, which at the end of 2009 stood at 1971 levels.

More broadly, shoppers are again opening their wallets. Unemployment may have peaked. The current generation of Americans in the prime household-formation years of 25 to 44, the so-called Echo Boomers, exceeds the Baby Boomer generation in size by more than 5 million members, even without considering population-boosting immigration.

Yet some lights, especially those that influence housing, are still red. Missoula real estate shows signs of a bifurcated recovery: While homes sold for $275,000 and less recently registered gains in sales and price, those priced above $275,000 continue to show deterioration in number of sales and median price.

Also, an unknown number of properties are being held off the market until prices improve. If many of these are offered at about the same future date, prices may again retreat. Another factor is that the foreclosure rate, which ultimately dampens new home sales and prices, could potentially spike, as banks haven't yet dealt with all of the homes currently under water financially.

A main concern is the ongoing and unprecedented liquidity crisis. Fannie Mae and Freddie Mac were originally established to make sure there was always liquidity in the secondary markets. But they are now on federal life support, with billions of dollars being fed to them until their futures can be determined.

Lenders will continue to assess their risk, which may directly impact the availability of certain programs and underwriting guidelines. The direct impact to the borrower could be larger down payments, additional fees, and higher mortgage insurance premiums, depending on the type of financing.

Ironically, the relative strength of the Missoula housing market compared with the national picture means that housing affordability has not improved locally to the extent it has improved nationally. For the U.S. as a whole, the mortgage payment on a median priced U.S. home had fallen to about 17% of average family income by year-end 2008, from more than 25% two years ago. Affordability arguably remains the greatest challenge in our local market.

This catalogue of data seems all-in-all to send mixed messages about 2010 and the early years of our new decade. The consensus forecasts of real estate and economic experts anticipate a slow recovery of the US economy and a likely even slower recovery of US housing.

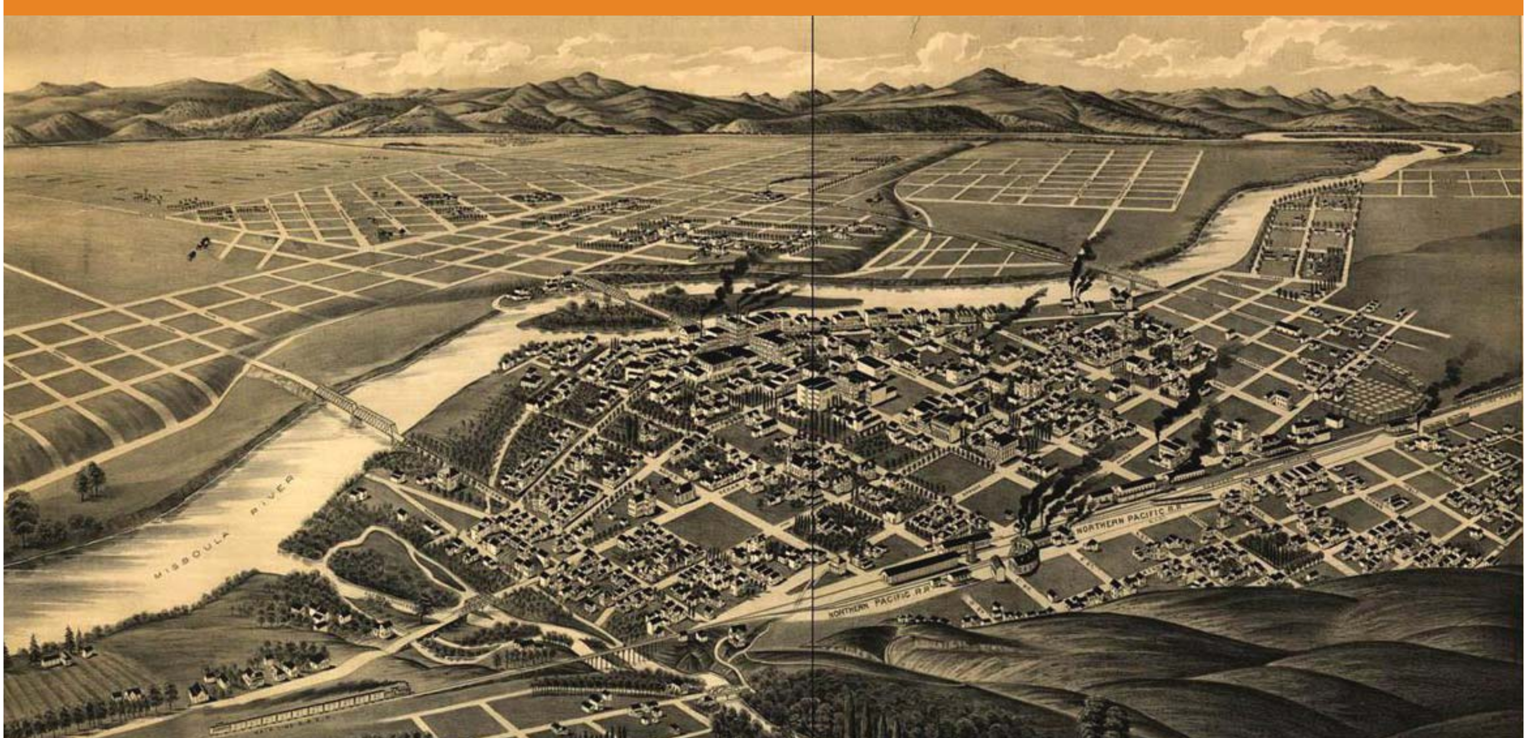
Locally, a similarly slow progression is likely, according to a many of the speakers at the Missoula Business Forum last December. But one of those speakers, University of Montana economist Larry Swanson, added that our region benefits from starting its recovery from a hole that's not as deep, in many respects, as it is for much of the country.

We concluded in last year's Housing Report that "Missoula's housing market … would be envied by most of the country. This state of affairs … provide[s] realistic potential for a stronger local housing market when the economy begins to rebound."

We were partially correct in this forecast, as a few important measures, such as number of homes sold and housing affordability improved in 2009. But other measures deteriorated further. As a result, strangely enough, we are left in early 2010 with the same conclusion as in 2009: "This state of affairs … provide[s] realistic potential for a stronger local housing market when the economy begins to rebound."

It is the economic rebound, nationally as well as locally, that remains elusive. The potential repercussions of the Smurfit Stone & Macy's closures are yet to be seen, but are likely to slow recovery. The question remains; are recent positive economic indicators, in such measures as home sales, gross domestic product, and unemployment signaling a resumed economic expansion? Or are these "false positives," with our economy headed for a dreaded "double-dip" or "w-shaped" recession, in which positive signals prove to be only a brief respite before the economy nosedives again?

With the data provided, it is our conclusion that we are likely at the beginning of a recovery, and that Missoula's economy and housing market will show renewed strength in the near future. Only time will tell if we're right about that. What we know for certain is that Missoulians will fight through adversity and celebrate the strengths we gain through community.



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