2011 Missoula Housing Report

Current Knowledge, Common Vision: Growing a Missoula to Treasure

Released March 31, 2011

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, Farviews/Pattee Canyon, Rattlesnake, Bonner, East Missoula, Clinton, Turah, South Hills, 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, 2010 in most cases, but 2009 or even 2008 data are used 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, is the price of the one home, among all prices being considered, that has half of the other 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 houses will significantly raise the average, but have little effect on the median.

5. Research for this report was conducted principally by the Missoula Organization of REALTORS® (MOR) and the University of Montana Bureau of Business and Economic Research. 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®. It is a member-based service – administered, operated, a nd paid for by the REALTOR® members of a local real estate board –that indicates the cooperation among REALTORS® to share information about homes and real estate for sale or rent.

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Message From the Coordinating Committee

March 25, 2011

We are pleased to present our sixth annual report to the community on housing in the city and county of Missoula. The 2011 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:

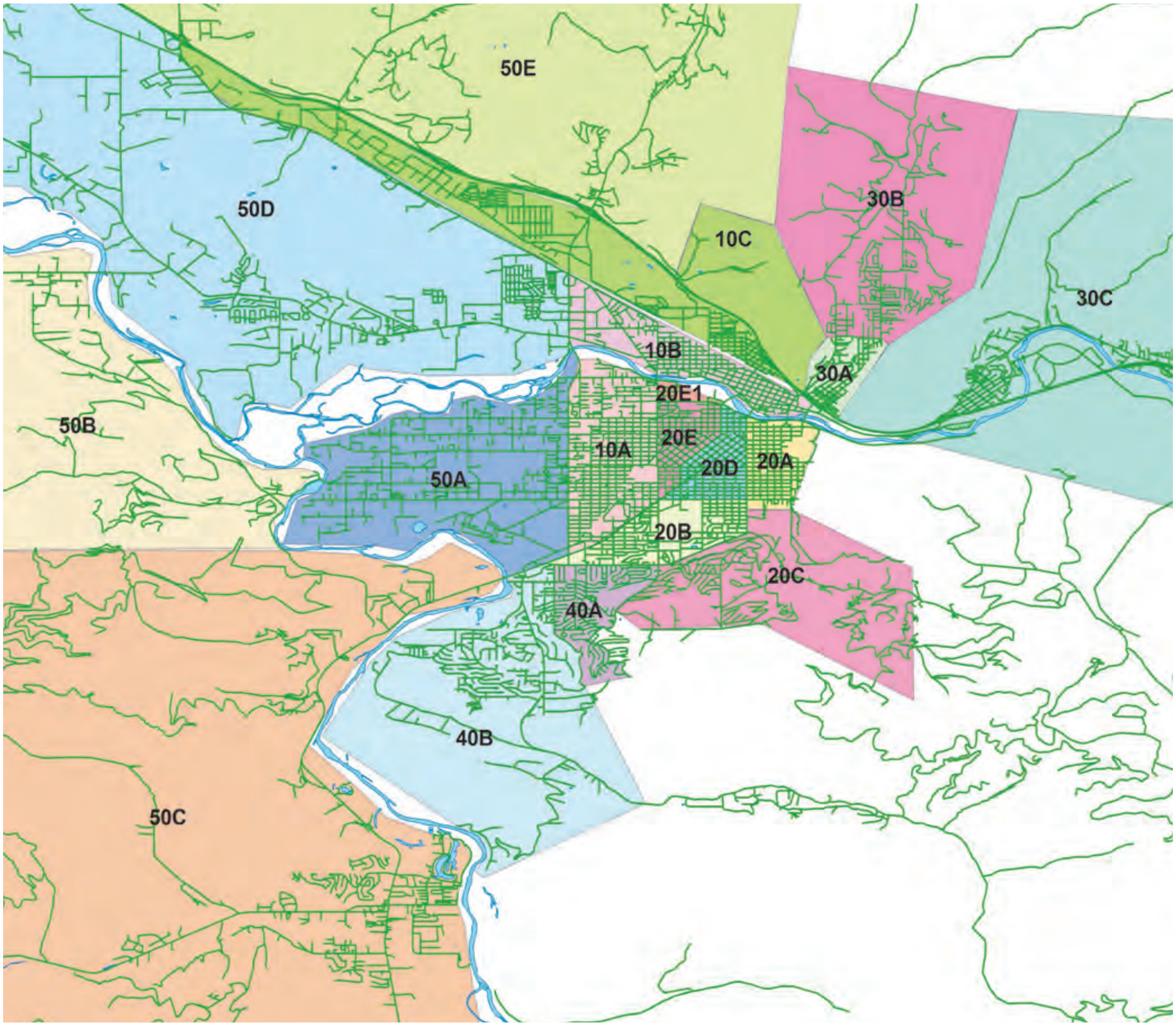
- consolidates data that aren't readily available to everyone in a single publication,
- provides a reliable gauge of the overall health of Missoula real estate,
- keeps Missoulians up to date on real estate trends and helps everyone in real estate better serve clients and customers,
- indicates real 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.

Map of Missoula and Lolo



Map of Missoula and Lolo
Highlighted areas show breakout as used in the Multiple Listing Service

Executive Summary

The Home Ownership Market

Missoula County's housing occupancy is made up of 56% owner occupied and 35% renter occupied. The vacancy level totaling about 10% 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.

Sales of existing homes in the Missoula area in 2010 declined both in number sold and in median sales price. This mirrors sales declines nationally. Home sales in 2010 were strongest early in the year and among "starter homes" that sold for $150,000 and less.

The number of homes sold in Missoula in 2010 decreased by 12%. The median price of the homes sold in 2010 dropped by 4%. Overall home sales prices since 2007 have dropped 8.7%.

Looking more closely at our local market's sales over the past two years, quarterly sales of homes show same-quarter declines in every quarter of 2010 except the first.

Missoula's 14 neighborhoods experienced widely varying sales results. Among the more notable are consecutive significant gains over the past two years for two neighborhoods: South Hills and Linda Vista/Maloney Ranch/Miller Creek. Sales have declined for five consecutive years in three neighborhoods: Central, Downtown, and University.

Sales in 2010 of condos and townhouses increased in the highest and lowest price ranges, but declined in three of the four middle ranges. The housing market decline of recent years has been more severe both in the US and in the West than in our local market. The housing decline nationally is unprecedented.

Real home equity has returned to the 1985 level and has been exceeded by the total US mortgage debt for the first time on record.

Days on market for Missoula has generally trended upwards since 2002, with a relatively steep climb in 2009, succeeded by a marked drop in 2010. The absorption rate for Missoula exceeded six months throughout 2010 and, as in the past, consistently exceeds the national rate.

Real Estate Finance Activity

Mortgage rates trended downward in the first and second quarters of the year, then dipped to their lowest levels in third and fourth quarters, before a late-year jump put rates where they were in the first quarter. Mortgage activity was up, in part, from the first-time home buyer tax credit, historically low interest rates, reduced sales prices, and an uptick in refinances.

In the near term, Fannie Mae and Freddie Mac play a critical role in advancing – or suppressing – revitalization of the housing market. Their March 2008 implementation of an "adverse market fee" and "loan level price adjustments" raised costs for almost all mortgage transactions, making homes less affordable. That effect is magnified by additional regulatory impacts on housing arising from the newly enacted Dodd-Frank Act.

The Home Affordable Refinance Program has restrictions that have prevented many consumers from eligibility for the program. The Home Affordable Modification Program had not nearly the beneficial impact envisioned by its proponents.

The first wave of foreclosures, in 2007 and through 2009, mostly involved homeowners who defaulted because they got mortgage loans they couldn't reasonably afford. In 2010, a larger share of defaults was attributed to unemployment and falling incomes. Even homeowners with traditional mortgages could no longer afford their homes, and many who could afford them walked away from underwater mortgages.

In 2010, Missoula's geographical market area was freed from enforcement of so-called declining market policies, as applied to investors and mortgage insurance companies. This had hampered some mortgage transactions with specific restrictions, now unnecessary as the mortgage market continues to stabilize.

Missoula foreclosures may have turned a corner in 2010, with the first year-to-year decrease in net foreclosures in five years. The key to the drop in net foreclosures was a 60% increase in notice of sale cancellations.

Residential Rental Market

Even in today's depressed housing market, rental rates in Missoula are relatively strong and vacancies average less than 5%. Missoula rental rates remain stable 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 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 through the District XI Human Resource Development Council (HRDC).

Reduced tenant incomes caused the per unit cost, or need for assistance, to increase by 4% in 2010, a reduction from the previous year's increase of 11%, but more than the 2% to 3% average of prior years. For the first time in more than a decade, the voucher and public housing programs were fully funded by Congress in 2010, allowing more movement on the waiting list than in recent prior years. With full funding, MHA provided Section 8 subsidies to almost three times as many new families as in 2009, adding more than 160 new voucher holders.

Unduplicated wait list numbers continue to increase in spite of full funding and the increase in number of new admissions. No new affordable units were added in 2010.

As part of the 2009 federal stimulus program, Missoula received $350,000 for the Homeless Prevention and Rapid Rehousing Program administered by the HRDC. The funding was used to prevent homelessness, and the full $350,000 was depleted by October 2010.

Lot Sales and New Construction

Sales of empty lots in 2010 were lower in number of sales, but up by 21% in median sale price, compared with prior year sales.

Building permits issued by the City of Missoula in 2010 increased from 182 to 302 in 2010. This gain was entirely accounted for in duplex and multi-family construction, as single-family permits declined for the fifth consecutive year. Missoula County building permits in 2010 increased for the first time in the past four years, with gains in all types of construction, including single family.

Population, Income, and Poverty

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. Net migration increases have declined sharply in recent years, with a moderate drop from 2006 to 2007 and a much steeper decline from 2009 to 2010. 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 of the county in recent years.

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 four years through 2009, but a substantial decline in 2010.

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.

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, until 2010 when it increased again. The 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 each of the past two years. Missoula County 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.

In 2010, for the first time in the past five years, Missoula's unemployment rate (at year-end) of 7.4% exceeded statewide unemployment of 7.2%, while both the county and state unemployment rates stood below the 9.4% national rate. Missoula's escalating unemployment seems clearly to stem from deepening recession, in which cyclic job losses have been exacerbated by permanent business closures and shutdowns.

About 18% of Missoula County households have incomes below the poverty threshold that corresponds to their household size and age. 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, as well as a greater share in the top category of over five times the poverty threshold.

Housing Affordability

The Housing Affordability Index (HAI) for Missoula shows that in 2010, the income needed for a HAI of 100% is $57,216 – 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 has approximately 75% of the amount of income needed to purchase a home priced at the 2010 median sale price.

The HAI shows that increases in median home prices significantly outstripped increases in median family incomes from 2002 through 2007. Then, consistent with bursting of the housing bubble, home prices have lost value for the past three years – making homes more affordable. For many of those who wish to buy a first or move-up home, incomes remain below thresholds of affordability. Missoula's improved affordability isn't as pronounced as it is for the US as a whole.

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.

In Missoula, a significant percentage of households, divided into four age groups, spends more than the recommended maximum 30% of income on housing.

About one in three homeowners in Missoula County pay more than 30% of their gross income for housing. The problem is especially acute for homeowners age 25 to 34; nearly 40% exceed the affordability threshold.

Renters in general pay an even greater share of their gross incomes on housing. Half of renters spend more the 30% of their income on housing. More than 60% of younger renters, many of who are students, pay more than 30% of their income in rent.

Conclusion and Outlook

We again will assert our belief that housing prices in the Missoula market have bottomed or, more precisely, that they will have bottomed by year-end 2011. Also, with somewhat more confidence, we believe our market will experience a gain in the number of existing home sales. Mortgage rates can, with somewhat more confidence, be predicted to increase in 2011.

A further decline in home prices would contribute to affordability gains, as it has for the past three years. A ray of hope in local rent affordability is offered by the significant 2010 increase in multi-family building permits issued. It's unlikely, though, that apartments will be constructed and offered at a pace that will boost supply enough to measurably reduce rental costs in 2011.

But we have reasons for optimism. US demographics in the next decade or so will powerfully increase housing demand. The baby boom generation is strengthening demand for senior housing. Meanwhile, the "echo boom" will create a strong demand for housing for at least the next 15 years. Locally, two years have elapsed since the recession's lowest point, and families and businesses are starting to adjust, and both are now positioned to spend more.

In our local community, we have other conditions working in our favor. We continue to have escaped the full extent of harmful impacts of the housing downturn experienced across the country. We also enjoy a diverse economy, and we are a historically resilient population that bands together more tightly when adversity strikes. These qualities will prove decisive in overcoming today's unprecedented challenges.

The Home Ownership Market

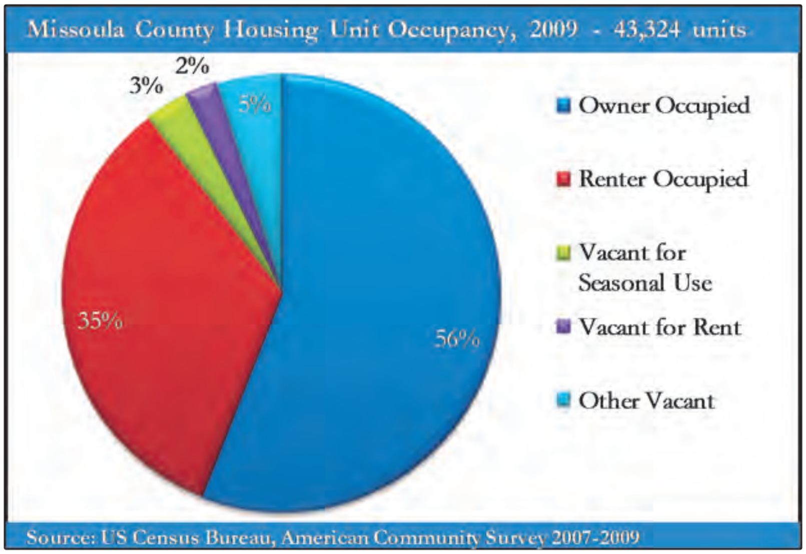
Housing Occupancy

Missoula County's housing occupancy is made up of 56% owner occupied and 35% renter occupied, as shown in Figure 1. In the city of Missoula, occupancy is split about 50/50 between owner and renter occupied.

Past data indicate that this represents a comparatively lower share of owner occupied homes and greater share of 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 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 10% 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

Sales of existing homes in the Missoula area in 2010 declined both in number sold and in median sales price. This mirrors sales declines nationally, which housing experts generally attribute in large measure to stricter mortgage underwriting standards, continued high unemployment, and – more broadly – a historically weak economic recovery.

Home sales in 2010 were strongest early in the year and among "starter homes" sold for $150,000 and less –indicating heavy influences of the federal first-time home buyer and existing home buyer tax credits, which was available in the year's first four months.

Homes sold in Missoula decreased by 12%, with 903 sales in 2010, down from 1,023 in 2009. The median price of the homes sold in 2010 dropped by 4%, from just under $209,000 in 2009 to just over $200,000 last year. The number of homes sold in the Missoula Urban Area in 2010 reversed a year-earlier gain, while the median price of homes sold in 2010 declined for a third consecutive year, and at a slightly steeper rate than in 2008 and 2009.

The number of homes sold in the Missoula Urban Area in 2010 reversed a year-earlier gain, while the median price of homes sold in 2010 declined for a third consecutive year, and at a slightly steeper rate than in 2008 and 2009. Overall home sales prices since 2007 have dropped 8.7%.

Nationally, as reported by the National Association of REALTORS® (NAR), existing home sales numbered 4,908,000 for 2010, a decrease of nearly 5% from sales of 5,156,000 in 2009 and about the same number of transactions as recorded in 2008. Median price declined nationally from $173,500 in 2009 to $172,492 in 2010.

State of the Nation's Housing for 2010, a yearly release from the Joint Center for Housing Studies of Harvard University, reported that median US home prices, as measured by NAR, were down in more than 85% percent of metro areas in 2009. In March 2010 the median existing house price stood 26% lower than in October 2005. The only other time in the past 40 years that this measure had fallen was from November 1989 to December 1990, when the dip was just 2%.

Looking more closely at our local market's sales over the past two years, quarterly sales of homes show same-quarter declines in every quarter of 2010 except the first (January through March), when the federal first-time home buyers tax credit was available. Sales in the fourth quarter of 2010 indicate a possible strengthening of the local housing market, as median price increased markedly and the number of homes sold was only slightly below year-earlier sales, when the first-time buyer tax credit was available. The original tax-credit legislation ended the credit on December 1, 2009, so buyers rushed to purchase before that deadline – which Congress then extended into 2010.

Table 1: Missoula home sales declined in number and median price ...

Year	Missoula Annual Sales	Median Price	% Change in Median Price
2001	1,211	$138,000	n/a
2002	1,119	$149,500	7.7%
2003	1,150	$163,000	8.3%
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	1,025	$208,775	-3.0%
2010	903	$200,500	-4.1%

Source: MOR Multiple Listing Service

Congress extended the first-time home-owner tax credit into 2011

Figure 2: … marking three years of price declines after five years of gains.

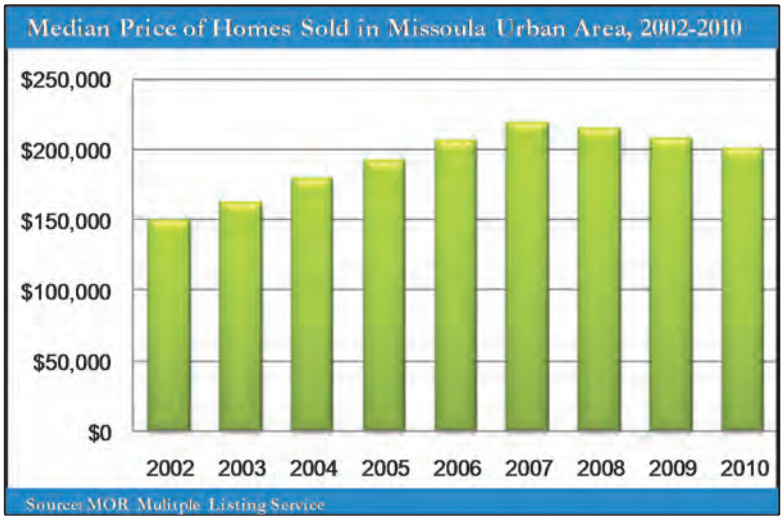


Figure 3: ... although the median in 2010's fourth quarter spiked upward.

Figure 4: The number of homes sold in 2010 was the least in the past decade ...

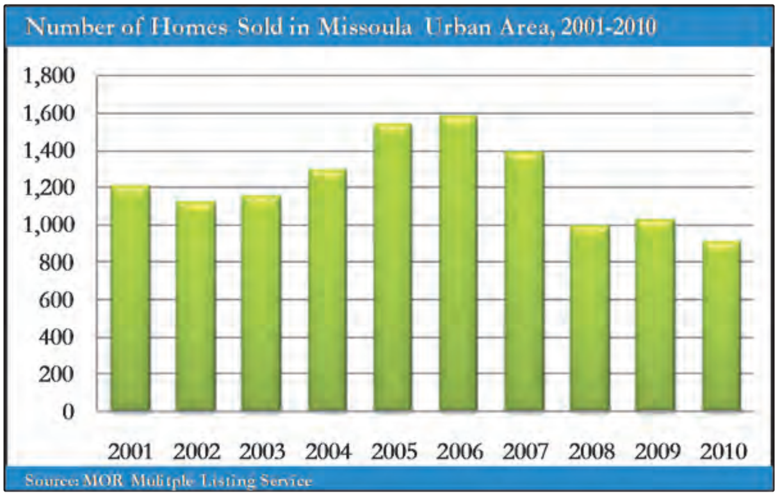


Figure 5: … and exceeded 2009 sales only in the first quarter. of the year...…

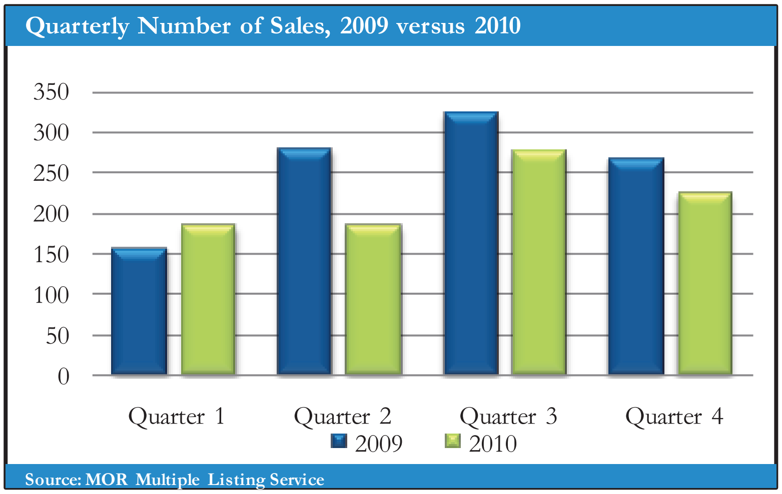
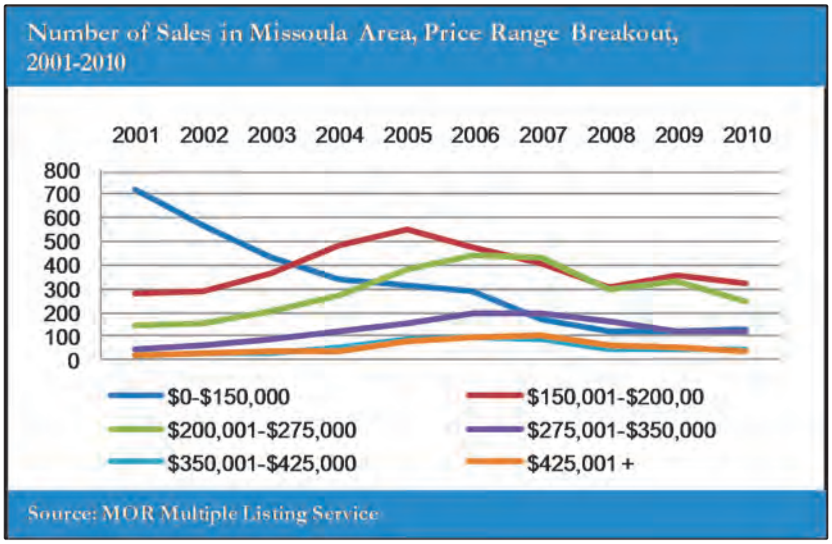


Table 2 and Figure 6: ...and sales increased only for homes in the lowest price range.

Number of Sales in Missoula Urban Area per Price Range, 2001-2010

Price Range	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
$0-$150,000	715	569	432	338	311	289	170	121	122	131
$150,001-$200,000	276	292	366	478	553	472	405	301	355	323
$200,001-$275,000	146	153	202	269	383	439	429	297	327	247
$275,001-$350,000	41	59	87	124	151	197	199	166	124	120
$350,001-$425,000	18	31	30	52	83	96	87	47	48	42
$425,001 +	18	31	33	40	77	93	102	64	49	40
TOTAL	1,214	1,135	1,150	1,301	1,558	1,586	1,392	996	1,025	903

Source: MOR Multiple Listing Service



Trends in Neighborhoods

Missoula's 14 neighborhoods experienced widely varying sales results for 2010. Among the more notable are consecutive significant gains over the past two years for two neighborhoods: South Hills and Linda Vista/Maloney Ranch/Miller Creek.

Sales have declined for five consecutive years in three neighborhoods: Central, Downtown, and University.

Figure 7: 2010 gains or losses in home sales varied widely by neighborhood range.

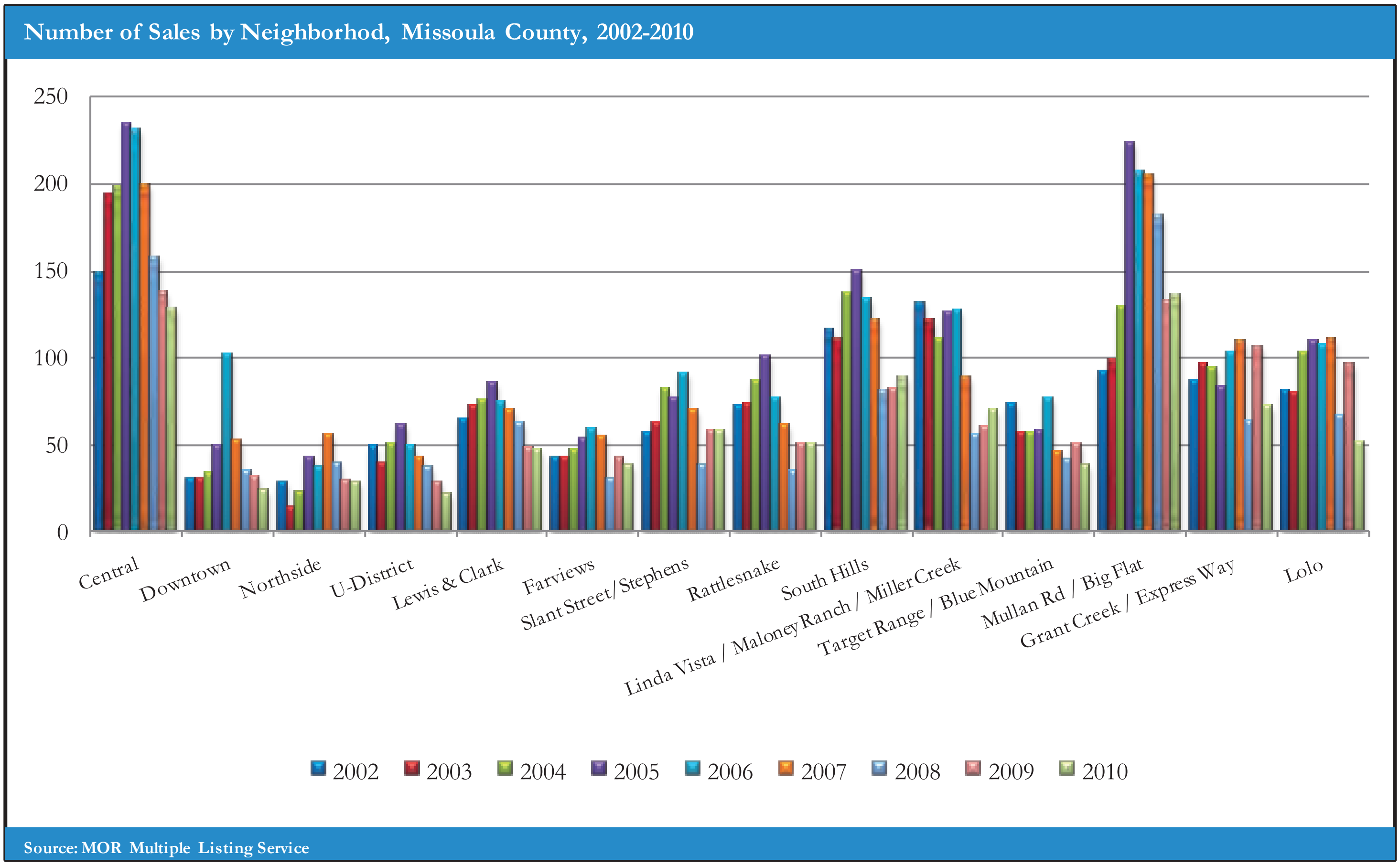
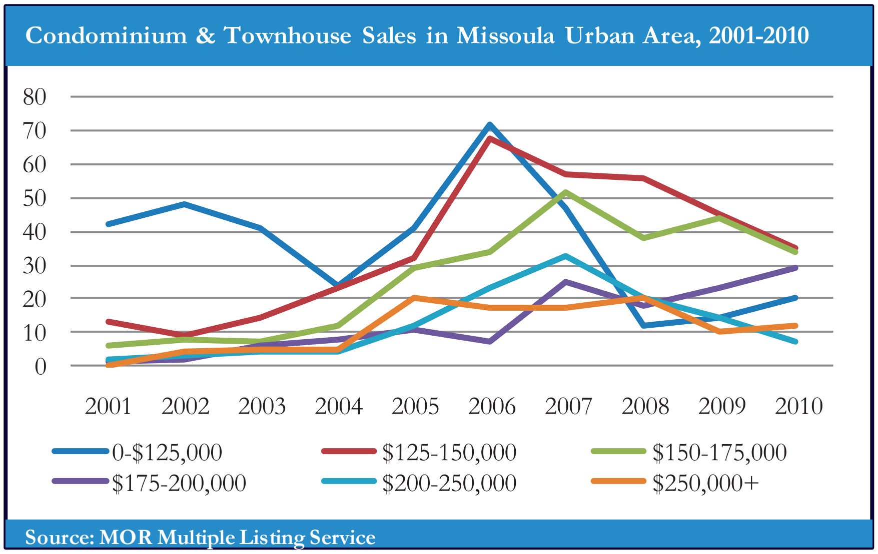


Figure 8: Sales of condos and townhouses increased in the highest and lowest price ranges, but declined in three middle ranges.



Condominiums and Townhouses

Sales in 2010 of condos and townhouses declined in three price ranges and increased in the other three.

The longer term trend of declining sales in condos and townhouses sold for $200,000 or less continued. This trend appears attributable at least in part to difficult financing for condominiums.

Comparative Trends in Home Prices

The housing market decline of recent years has been more severe both in the US and in the West 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.

The housing decline nationally is unprecedented. Real home equity has returned to its level of 1985 and has been exceeded by the total US mortgage debt for the first time on record. Home equity declined from a peak of $14.5 trillion in 2005 to $6.3 trillion in 2009, erasing 57% of all US housing wealth.

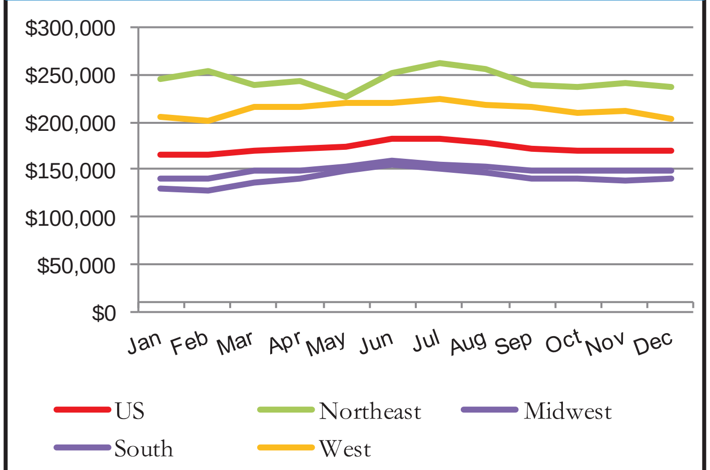
Nationally, as in Missoula, the first-time home buyer tax credit of late 2009 and early 2010 appears to have spurred a recovery in sales of low to moderately priced homes, but with no apparent effect on still-declining sales of more expensive homes.

Figures 9 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 11 traces a measure called the Housing Price Index for the decade of the 2000s. 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.

Figure 9: ... while median prices generally rose early in the year, but then fell back.

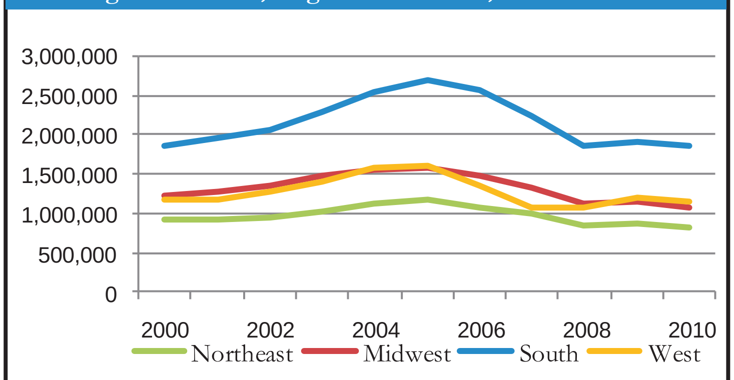
Median Price of Existing Homes, Regional Breaakout, 2010



Source: National Association of REALTORS®

Figure 10: US home sales declined slightly in every region of the country.

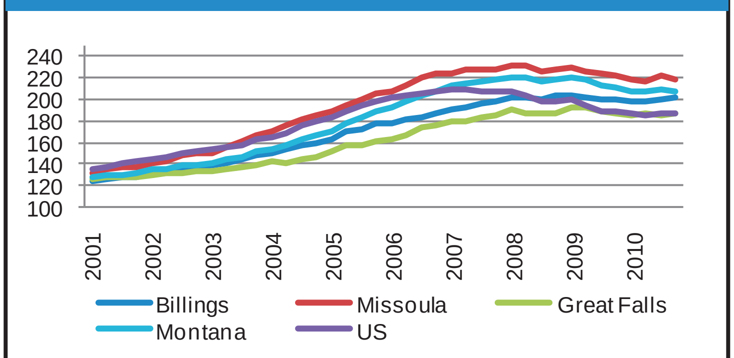
Existing Home Sales, Regional Breakout, 2000-2010



Source: National Association of REALTORS®

Figure 11: Missoula housing prices have gained and held sales value more strongly than in Billings, Great Falls, and the state as a whole.

FHFA Housing Price Index, 1st Quarter, 2001 through 4th Qtr 2010



Source: Federal Housing Finance Agency

Local effects of the tax credit are reflected as well in national home sales. Individuals who planned on buying did so early in 2010, which caused the summer months to be unusually slow.

Pace of Home Sales

One of two common measures of housing market vitality is days on market. Figure 12 shows, as one might expect in our northerly climate, that days on market 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 in 2009 succeeded by a marked drop in 2010.

A second housing vitality indicator is the absorption rate. It is measured 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.

Figure 13 shows that the absorption rate exceeded six months throughout 2010 and that the rate for Missoula, as in the past, consistently exceeds the national rate. The month-to-month absorption rate for Missoula in 2010 shows the apparent impact of the first-time home buyer tax credit that was available until the end of April. The year's early months were marked by a declining absorption rate. Then the rate climbed steeply in the summer months – normally the period of quickest sales – likely due to the tax credit's no longer being available.

Figure 12: After trending upward for several years, local days on market noticeably declined in 2010.

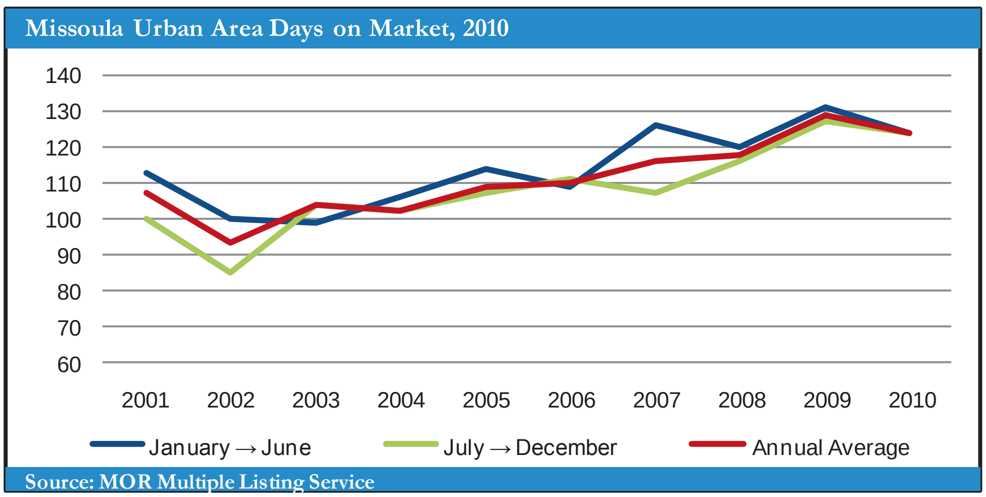
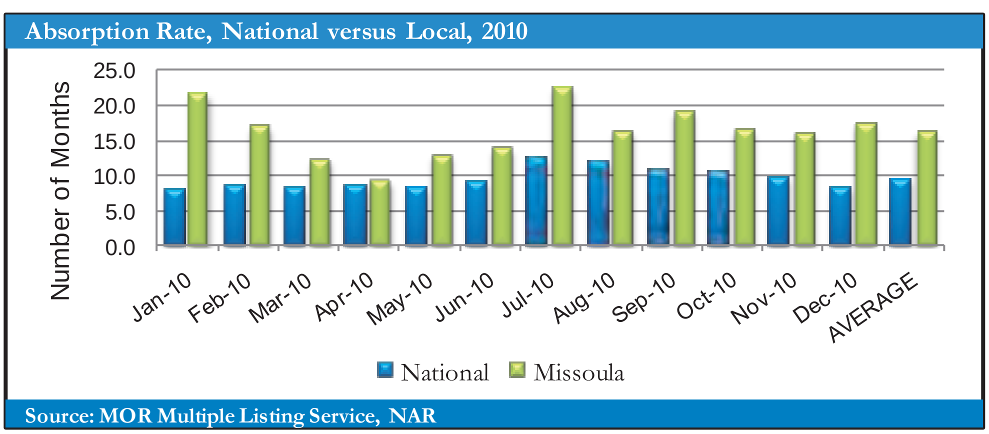


Figure 13: The federal first-time buyer tax credit appears to have distorted the usual absorption rate in 2010's early months and in summer.



Real Estate Finance Activity

Mortgage Loans

Mortgage activity was up, in part, from the first-time home buyer tax credit, historically low interest rates, reduced sales prices, and an uptick in refinances. Among numerous regulatory changes implemented in 2010 was the Real Estate Settlement Procedures Act (RESPA), intended to provide borrowers with a more accurate accounting of closing costs incurred for processing and origination of mortgage loans.

The extraordinarily and persistently low levels of interest rates in 2010 confounded experts, who in effect asked, “How low can they go?”

Rates trended downward in the first and second quarters of the year, then dipped to their lowest levels in third and fourth quarters, before a late-year jump put rates where they were in the first quarter. Meanwhile, the refinance market heated up to record highs, but purchase transactions only moderately increased.

Table 3: Historically low mortgage interest rates prevailed in 2010 …

Mortgage Interest Rates, 2010					
MORTGAGE TYPES	**Q1**	**Q2**	**Q3**	**Q4**	**YEAR -END**
30 Year Fixed	4.875%	4.750%	4.000%	4.375%	4.750%
15 Year Fixed	4.250%	4.125%	3.750%	3.750%	4.000%
FHA/VA	4.875%	4.750%	4.250%	4.250%	4.750%
5/1 ARM	3.875%	3.625%	3.250%	3.250%	3.625%
MBOH	5.125%	5.125%	4.375%	4.375%	4.375%

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… as conventional rates declined for the fourth consecutive year.

Conventional Mortgage Rates, Year-End, 2010										
Year – End	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
	7.250%	5.750%	5.750%	5.625%	6.125%	6.250%	6.000%	5.375%	5.500%	4.750%
Source: First Security Bank										

Figure 14: Conventional Mortgage rates continued to fall.

The now infamous government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac were placed in conservatorship two years ago, but as of year-end 2010 were still in place, under control of their regulator, the Federal Housing Finance Agency (FHFA). "Fan and Fred" currently play a critical role in advancing – or suppressing – revitalization of the housing market. Their March 2008 implementation of an "adverse market fee" and "loan level price adjustments" raised costs for almost all mortgage transactions. More seriously dampening recovery is the growing impact of the GSEs' loan-buyback policies on the loan guidelines of mortgage originators. Buybacks could discourage prudent lenders from taking reasonable risks.

Additional regulatory impacts on housing arise from the newly enacted Dodd-Frank Act. This legislation gave the federal government its new Consumer Financial Protection Bureau (CFPB), principally intended to protect consumers regarding certain credit products such as mortgages and credit cards. It also addresses and restricts predatory lending.

Dodd-Frank has given regulators more authority to police risk. More risk assessments are being performed at every level of lending, and some investors have introduced overlays above Fannie and Freddie underwriting guidelines to mitigate their risks. One consequence is that fewer borrowers will qualify to purchase or refinance their homes.

The program introduced to help financially squeezed borrowers re-set their current mortgages, known as The Home Affordable Refinance Program (HARP), has restrictions that have prevented many consumers from eligibility for the program. Nationally, through March 2010, HARP had completed 291,600 mortgage refinancings.

The federal government's $75 billion Home Affordable Modification Program (HAMP) – tailored to help borrowers who hadn't yet fallen into delinquency – had not nearly the beneficial impact envisioned.

Many homeowners continued to be past due on their mortgages, and relatively few have received permanent modifications through HAMP. As of April 2010, HAMP had made 1.5 million offers nationwide, and the US Treasury Department estimated that 40% of homeowners with HAMP modifications would re-default by its proponents.

The past year was also one of fundamental change and challenges to existing business processes. The "robo-signing" and foreclosure process was investigated, with a temporary moratorium imposed until the process could be reviewed. The first wave of foreclosures, in 2007 and through 2009, mostly involved homeowners who defaulted because they got mortgage loans they couldn't reasonably afford. In 2010, a larger share of defaults was attributed to unemployment and falling incomes. Even homeowners with traditional mortgages could no longer afford their homes.

Availability of jumbo loans continued to be a challenge in 2010. Jumbo interest rates increased significantly when the meltdown in the mortgage market began, because investors and funding resources for these types of loans dried up. Rates declined in 2010, and the secondary market for jumbos eased. Nonetheless, consumers seeking jumbos are still likely to endure a long, arduous underwriting process.

The Federal Housing Administration (FHA) restructured both the Upfront Mortgage Insurance Premium (UFMIP) and the Monthly Insurance Premium (MIP) in 2010. The UFMIP was decreased and the monthly premium was increased. The UFMIP is typically financed and the monthly premium is paid with the regular monthly payment.

Legislation introduced and passed in 2007 allowed borrowers to deduct the cost of mortgage insurance based on specific household adjusted income on their federal tax return. Congress has extended this legislation, making mortgage insurance tax deductible for many Americans.

The Secretary of Housing and Urban Development (HUD) changed the premiums so FHA was in a better position to address the increased demands of the marketplace and return the Mutual Mortgage Insurance (MMI) fund to congressionally mandated levels without disruption to the housing market

Veterans Administration (VA) loans have become more appealing as a viable mortgage product, especially with more service men and women being discharged from active or reserve duty. It is one of the few remaining mortgage products that allow 100% financing for purchase transactions.

In 2010, Missoula's geographical market area was freed from enforcement of so-called declining market policies, as applied to investors and mortgage insurance companies. This had hampered some mortgage transactions with specific restrictions, now unnecessary as the mortgage market continues to stabilize, with more pervasive use of prudent underwriting standards and processes.

Down Payments

Down payments are similar with most loan program types, including FHA and conventional loan products, as they have been in the past. FHA remains at a minimum requirement of 3.5% down, while some conventional products are being offered with 3% down payment. A more typical down payment would be a minimum of 5% or more.

The Wall Street Journal reported that the median down payment in nine major US cities rose to 22% in 2010 on properties purchased through conventional mortgages. That percentage doubled in three years and represents the highest median down payment since the data were first tracked in 1997.

Table 5: Foreclosure notices increased 27% in 2010, but cancellations jumped by 60% …

Foreclosures Notices and Cancellations			
	Notice of Sale	Cancellation of Notice of Sale	Net Foreclosures
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
2010	719	486	233
Source: First Security Bank			

Foreclosures and Short Sales

Foreclosures may have turned a corner in 2010, with the first year-to-year decrease in net foreclosures in five years. This is in spite of a 27% increase in foreclosure notices of sale. The key to the drop in net foreclosures was a 60% increase in notice of sale cancellations. Also possibly having an impact in reducing net foreclosures was a nationwide moratorium on foreclosure processing during the year by some large financial institutions.

Table 6: … so net foreclosures were lower in 2010 than in 2009 in three of the year's four quarters.

Missoula County Foreclosure Notices and Cancellations, 2010				
Year	Qtr	Notice of Sale	Cancellation of Sale	Net Foreclosures
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
2010	Q1	164	113	51
	Q2	156	110	46
	Q3	247	153	94
	Q4	152	110	42
Source: First Security Bank				

Missoula's notices of foreclosure sale increased by more than 300% over the past five years. In the same period, net foreclosures rose by more than 400%, but these large percentage increases start from a low base number and are not numerically very large. Historically, foreclosures have been relatively rare in the Missoula market, amounting to well below 0.5% of the total owner occupied stock. In contrast, according to the NAR, more than one-third of all US existing home sales in 2009 — about 1.8 million units — were short sales or foreclosures.

For the entire country in 2010, according to online foreclosure marketer RealtyTrac, one of every 45 US housing units received a foreclosure filing in 2010. Montana's 2010 foreclosure rate placed the state far below most others, with only about 10 to 15 states recording a lower rate, depending on how foreclosures are measured.

Short sales, in which the mortgage lender accepts proceeds from a sale for less than the total amount due on a home, are not a common device in our market. In the last half of 2010, Missoula's short and REO sales numbered 32, representing about 16% of all home sales in that period.

Residential Rental Market

Rentals are 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 Rentals

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 our 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 15, 16, and 17 depict median monthly rents and vacancy rates for various types of rental property in the fourth quarter of 2010.

Even in today's depressed housing market, rental rates in Missoula are relatively strong and vacancies average less than 5%. As the later section on Housing Affordability demonstrates, Missoula rents remain stable 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 15: Median costs of rent in 2010 essentially held at levels recorded in 2009 …

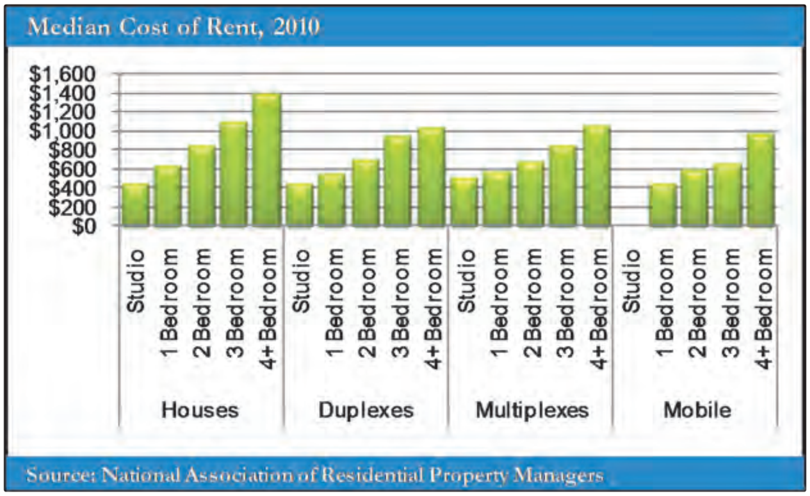
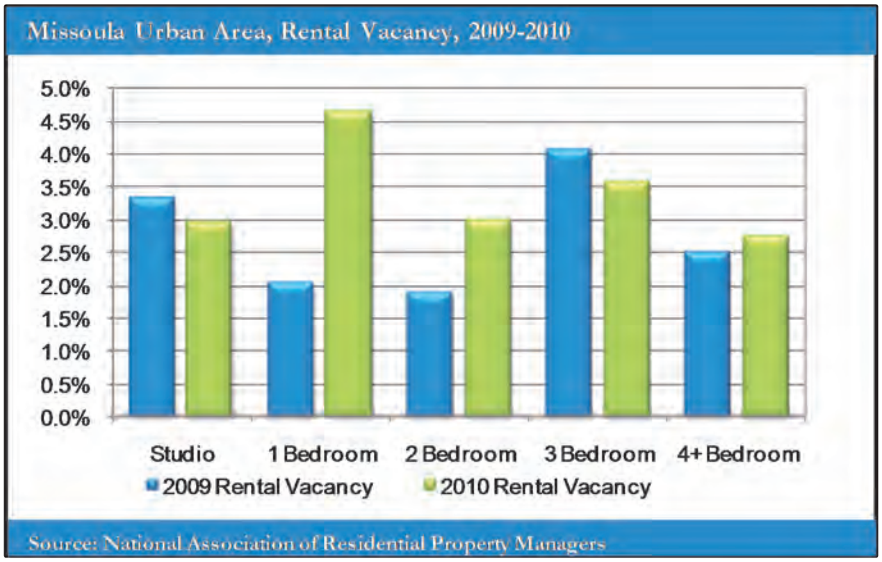


Figure 16: … as vacancy rates by size of home stayed below 5% ...

Figure 17: ... with a mix of vacancy rate increases and decreases from 2009 to 2010.



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 through the District XI Human Resource Development Council (HRDC). 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 by lack of jobs or reduction in number of hours worked.

Reduced tenant incomes caused the per unit cost, or need for assistance, to increase by 4% in 2010, a reduction from the previous year's increase of 11%, but more than the 2% to 3% average of prior years.

**Photo of Equinox courtesy of Julie Stitler at HomeWORD*

For the first time in more than a decade, the voucher and public housing programs were fully funded by Congress in 2010, allowing more movement on the waiting list than in recent prior years. With full funding, MHA provided Section 8 subsidies to almost three times as many new families as in 2009, adding more than 160 new voucher holders.

Unduplicated wait list numbers continue to increase in spite of full funding and the increase in number of new admissions. No new affordable units were added in 2010.

The numbers on two of the wait lists dedicated to homeless households were 156 and 114.

As part of the 2009 federal stimulus program, Missoula received $350,000 for the Homeless Prevention and Rapid Rehousing Program (HPRP) administered by the HRDC. The funding was used to prevent homelessness by providing families with an infusion of cash to pay rent, arrears, and deposits, as well as housing relocation/stabilization services. The full $350,000 was depleted by October 2010.

Table 7: Vacancies in 2010 remained essentially at zero for rent-restricted and subsidized units ...

Missoula Rent Restricted and Subsidized Units, Vacancy Rates, 2010									
									# Units Surveyed
	Dec-03	Dec-04	Dec-05	Dec-06	Dec-07	Oct-08	Nov-09	Oct-10	
Tax Credits	1.4%	5.5%	1.0%	0.7%	1.7%	0.8%	0.5%	0.5%	786
Subsidized	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.5%	0.0%	578
Source: Missoula Housing Authority									

Note: Rates are point-in-time numbers gathered as part of periodic market studies.

When calculating the total MHA wait list, households are consolidated into an "unduplicated list" to provide a clearer picture of need. Many families are on multiple lists, so that they might obtain housing sooner. The number of unduplicated households on MHA wait lists in December 2010 was 1,944, up from 1,824 last year and 1,410 in 2008.
The number on the Section 8 waiting list was 1,653, almost equal to the prior year (1,669).

Table 8: .... as waiting lists didn't grow as much in 2010 as in recent prior years.

Waiting Lists	**2007**	**2008**	**2009**	**2010**
MHA Unduplicated	1,079	1,410	1,829	1,944
MHA Section 8 Voucher	1,063	1,315	1,669	1,653
MHA Homeless Project 1	112	103	136	156
MHA Homeless Project 2	59	159	118	114
Source: Missoula Housing Authority				

Lot Sales and New Construction

Sales of empty lots in 2010, as shown in Table 9, were lower in number of sales but up by 21% 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.

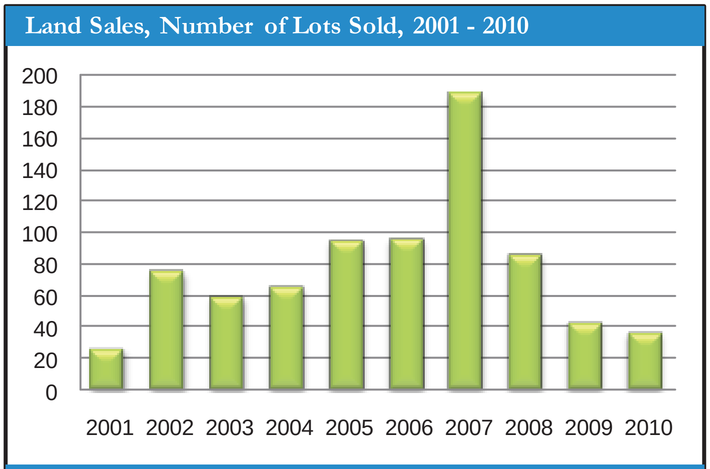
Lot sales through the first years of the decade were limited by availability of too few lots to meet demand. Since then, lots have nearly always been readily available, but demand has plummeted.

Table 9: 2010 Lot sales strengthened in median price and days on market …

Year	Lot Sales	Median Price	Median Days on Market
2001	28	$43,450	114
2002	74	$79,900	117
2003	58	$75,900	297
2004	65	$89,500	119
2005	95	$82,200	116
2006	96	$84,950	147
2007	188	$68,000	213
2008	84	$79,950	247
2009	43	$72,000	325
2010	36	$87,000	269

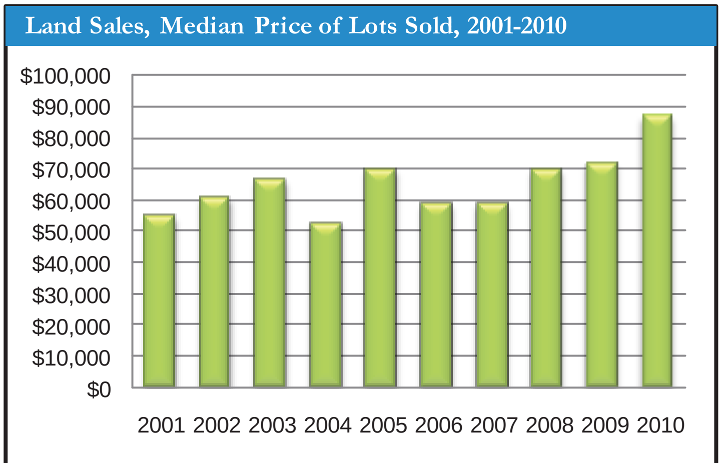
Source: MOR Multiple Listing Service

Figure 18: … while the number sold declined for the third consecutive year …



Source: MOR Multiple Listing Service

Figure 19: … and median price jumped to its highest level of the past decade.



Source: MOR Multiple Listing Service

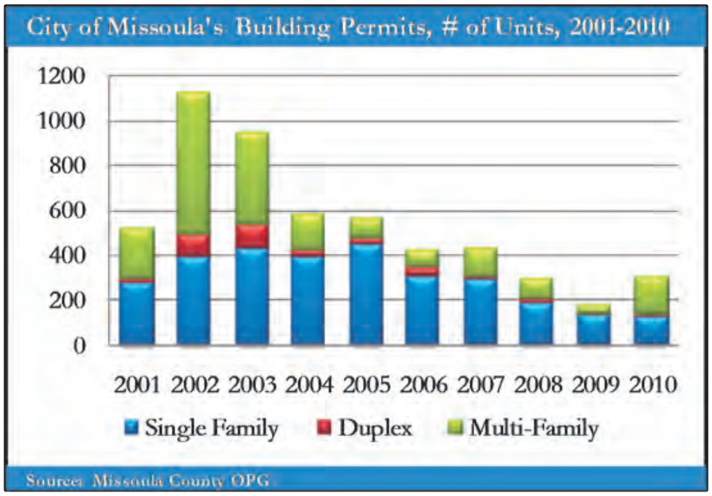
Pace of Development

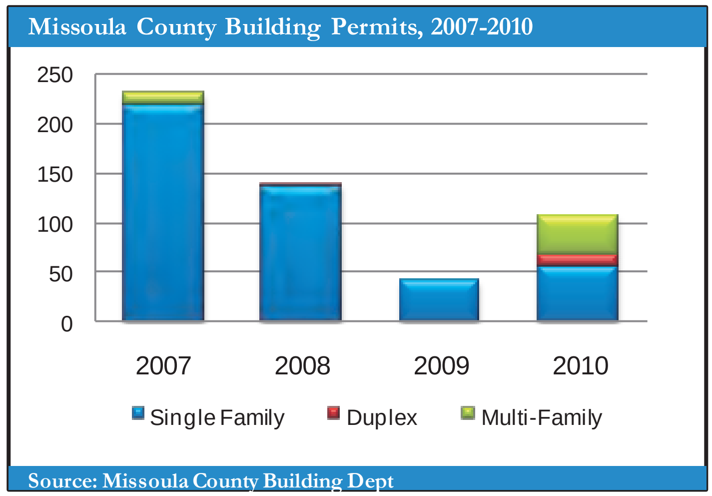
Building permits issued by the City of Missoula in 2010 increased by 66% over the 2009 number. This gain was entirely accounted for in duplex and multi-family construction, as single-family permits declined for the fifth consecutive year. Single-family permits for 2010 stood 72% below their record-high year of 2005. In contrast, multi-family permits increased to their highest level in seven years.

Missoula County building permits in 2010 increased for the first time in the past four years, with gains in all types of construction, including single family.

Nationally, as reported in *State of the Nation's Housing for 2010*, the US Census Bureau estimated that permits totaled just 583,000 in 2009, compared with 2.16 million at the 2005 peak of permit issuance and an annual average of 1.32 million in the 1990s. This was the first time ever that annual permits nationwide numbered less than 900,000. The sharp cutback in permits extended across the US, with 57 of the 100 largest metropolitan areas posting record lows in 2009.

Figures 20 and 21 and Table 10: Building permits issued in 2010 increased in both Missoula City and County.





Missoula Residential Building Permits, 2001-2010

	Number of Units in Missoula			
Year	**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
2010	128	12	162	302
	Number of Units in County			
	Single family	Duplex	Multi-family	Total
2007	220	0	12	232
2008	137	2	0	139
2009	42	0	0	42
2010	55	12	40	107

Source: US Census Bureau Construction Statistics, Missoula City /County Building Departments

Population, Income and 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 22). Missoula County population increased from 95,802 to 109,299 between 2000 and 2010; an increase of 14.1 percent. 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).

Components of Population Change

For many years, as Figure 23 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 2010. This decline may be attributed to people leaving for 'greener pastures' after major industrial closures in Missoula.

Figure 22: Despite a slowed economy, county population continues to grow.

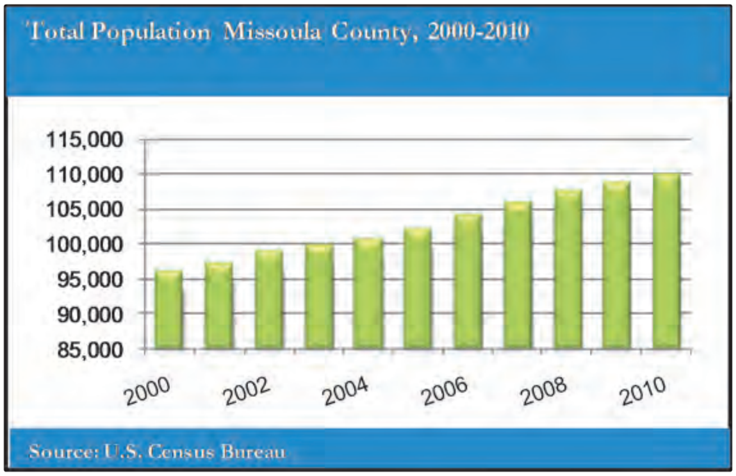
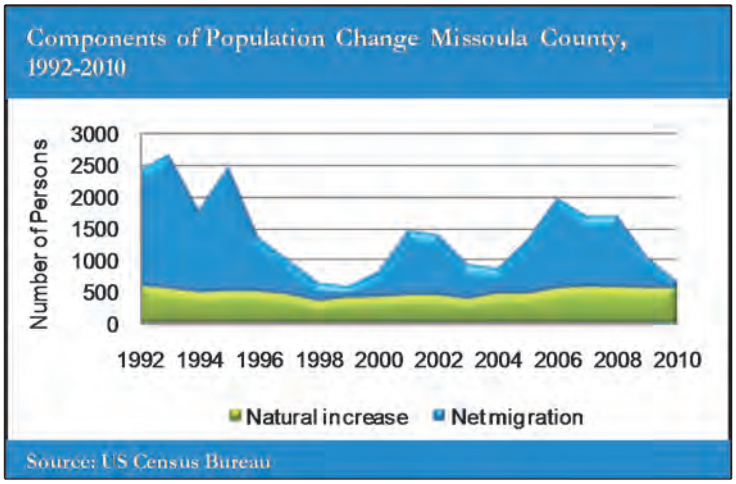


Figure 23: County population gains are steady in natural increase and lower in net migration.



Migration

Figures 24-26 present 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 of the county 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.

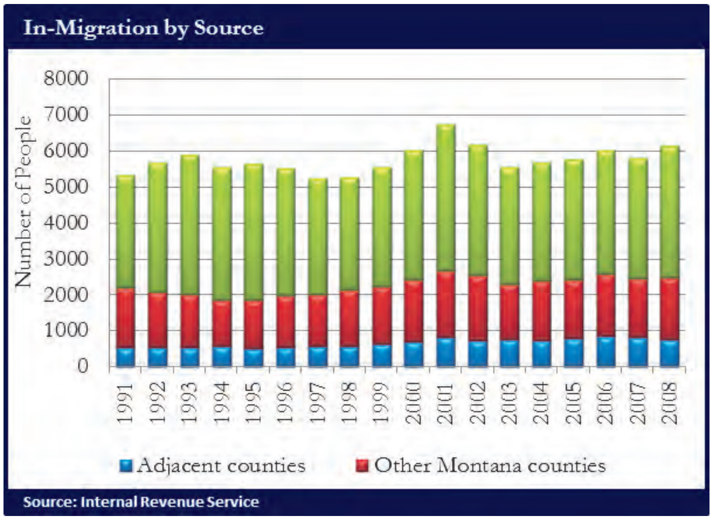
Net migration of out-of-state migrants was strongly positive between 1992 and 1996. Since then, net migration has usually been less than 500, with a noticeable upturn in the four years through 2009, but a substantial decline in 2010.

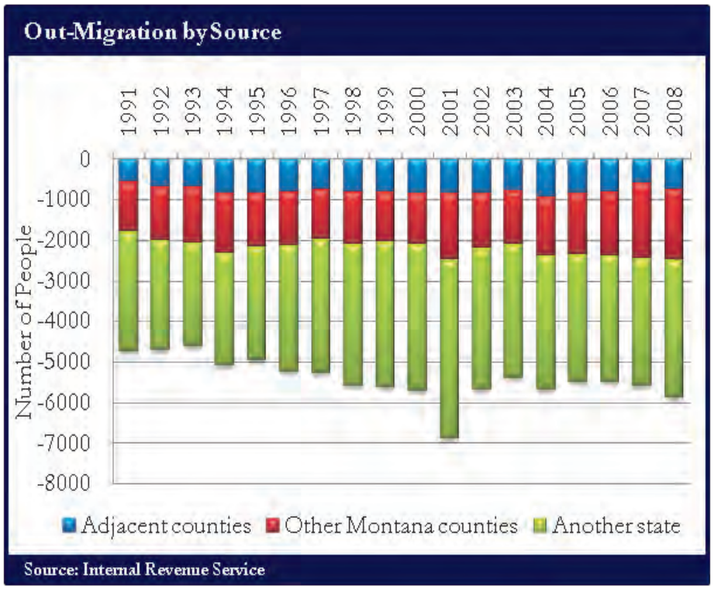
Income and Employment

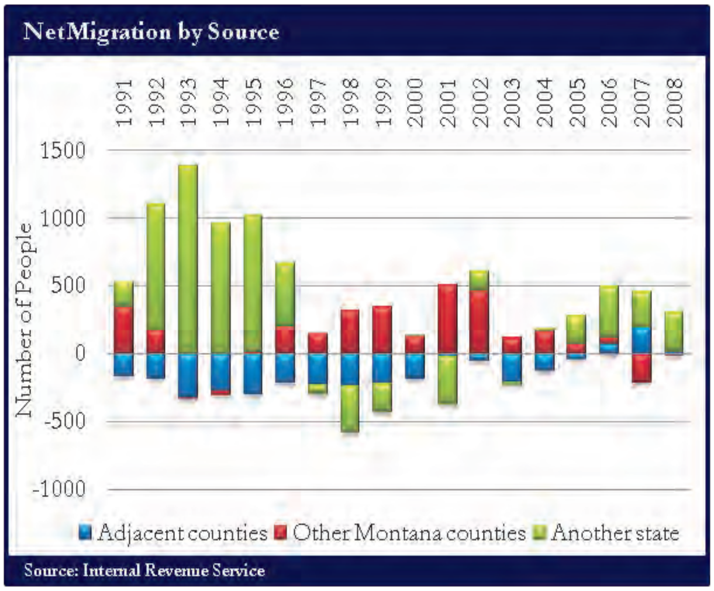
The types and prices of houses demanded by consumers are determined largely by whether would-be buyers are employed and, if they are, how much they earn in their jobs.

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.

Figure 24, 25, and 26: County migration is mostly from and to other states.







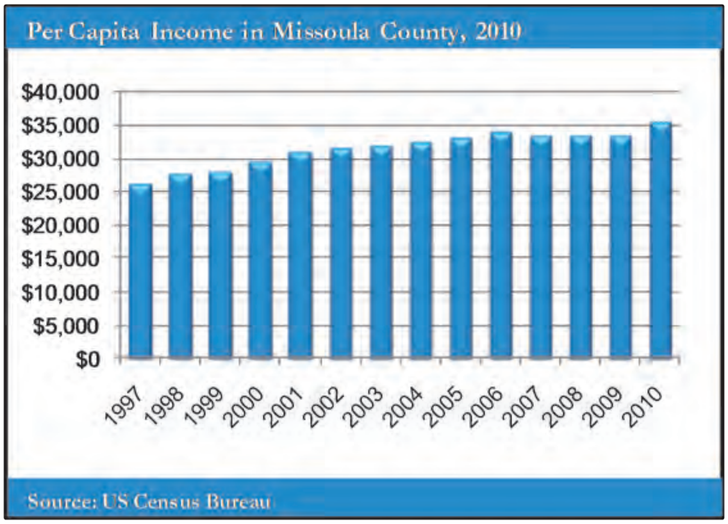
Income Measures

Figure 27 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 until 2010 when it increased again.

Figure 28 shows median income in 2008 for homeowners, renters, and overall in Missoula County and the US. (Remember that median is the point at which exactly half of all incomes are greater and the other half is less.) Median income in Missoula County shows a markedly extreme disparity for 2009 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.

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 27: 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).

Lagging income gains are a significant barrier to improved housing affordability. As stated in *State of the Nation's Housing for 2010*, "Making up for [income] losses may take time. Housing demand must, therefore, build upon a lower real income base than a decade ago."

Figure 28: Missoula homeowner household income greatly exceeds that of renters.

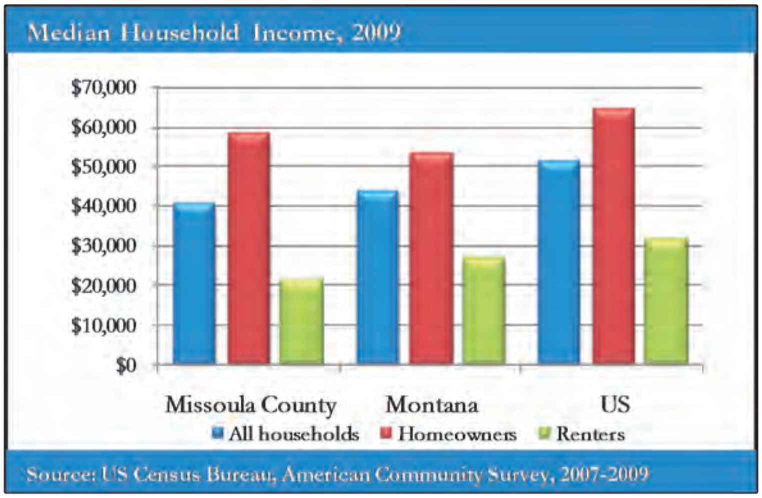
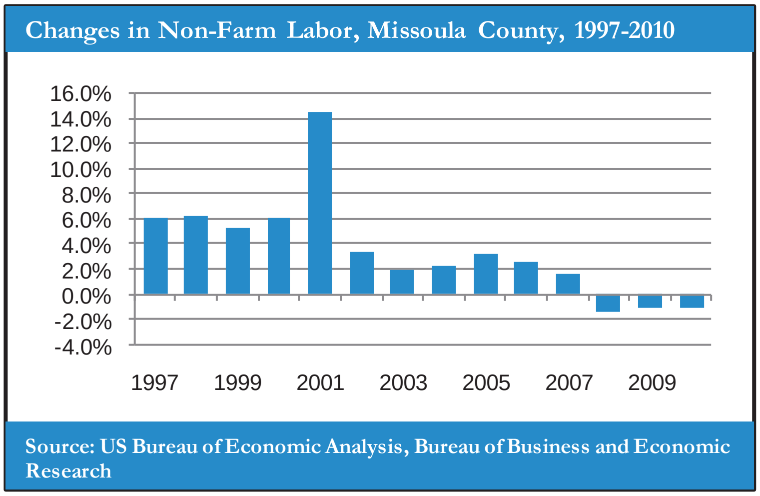


Figure 29: After gains for 12 years, non-farm labor income decreased in 2008, 2009, and 2010.



Income Distribution

The Census Bureau measures family and household income by the various income groupings shown for Missoula County in Figure 30. The figure shows 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.

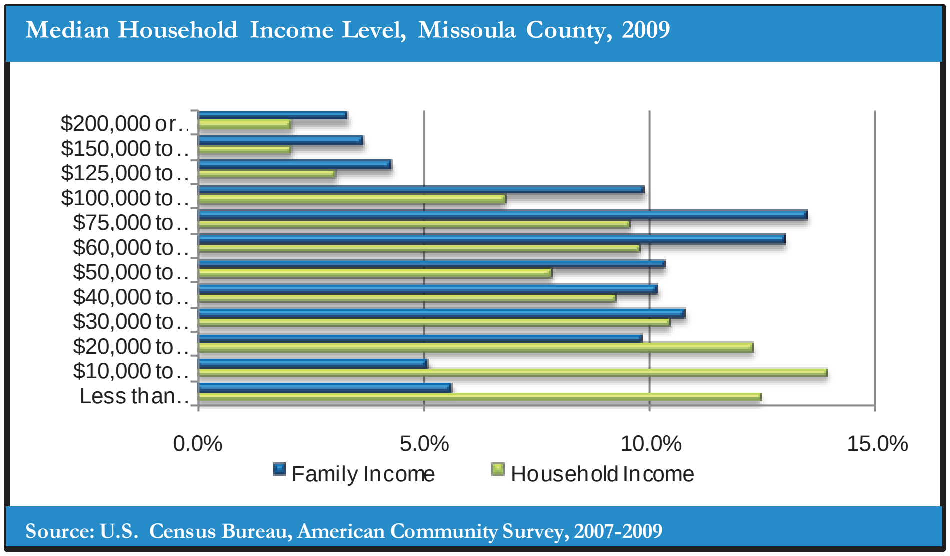
These concentrations appear to correspond to county employment patterns, with professional workers represented in the higher income category and retirees and students mostly composing the households with lower incomes. (Note: The chart's individual income bands span a wider dollar range at higher incomes, so a casual glance at the chart would suggest more than the actual number of people at lower incomes.)

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 31 shows that Missoula County unemployment increased in 2010 for the fourth consecutive year, after staying below 4% for nine consecutive years.

In 2010, for the first time in the past five years, Missoula's unemployment rate (at year-end) of 7.4% exceeded statewide unemployment of 7.2%, while both the county and state unemployment rates stood below the 9.4% national rate. Missoula's unemployment rate is significantly below that registered by each of its seven bordering counties, where year-end unemployment rates range from 10.0% to 17.8%.

Figure 30: Family Income is concentrated at middle levels while household income is predominately at lower levels.

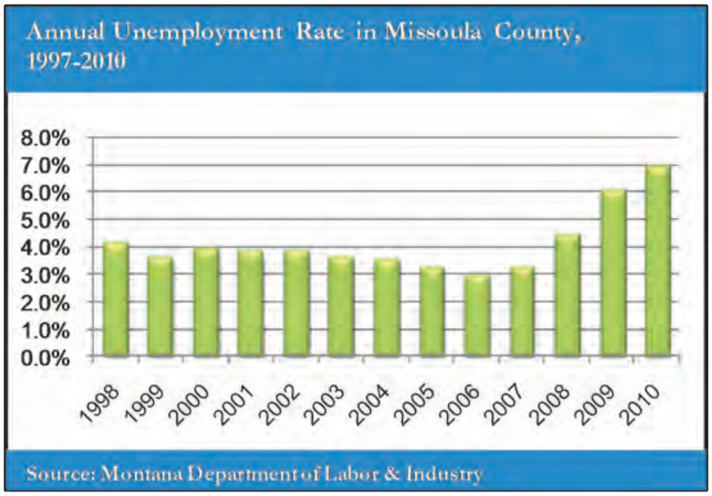


Note: Families are defined as two or more persons living together that are related by blood or marriage. Households include families as well as persons living alone and two or more unrelated individuals who share living quarters.

Missoula's escalating unemployment seems clearly to stem from deepening recession, in which cyclic job losses have been exacerbated by permanent business closures and shutdowns. Missoula has experienced three years of economic declines.

The downward spiral began with the shutdown of the Bonner plywood plant in 2007 and was followed by the Bonner sawmill closure in 2008. The final shoe to drop was the closing of the Smurfit-Stone pulp mill in early 2010. Another 1,500 to 2,000 mill workers and related industry jobs were lost as a result of these closures. These permanent closures were accompanied by a sharp decline in construction employment caused by the drop in housing demand.

Figure 31: Missoula unemployment spiked in 2010 surpassing the statewide rate.



Poverty

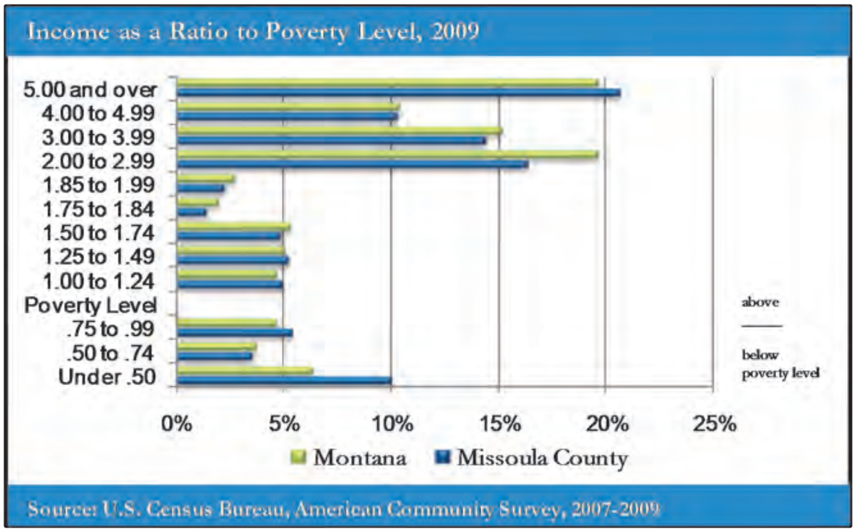
The Census Bureau computes so-called "poverty thresholds" each year – thresholds commonly known as the Federal Poverty Level. As Table 11 shows, poverty thresholds vary by the number of persons in the household and (for one and two-person households) by age.

Using the established poverty thresholds shown in Table 11 and measuring the income of Missoula households yields Figure 32, which shows where household income stands relative to the government-set poverty thresholds.

Table 11: The federal government sets poverty thresholds by household size and age.

U.S. Poverty Thresholds, 2010	
1 person	$11,136
under 65	$11,344
over 65	$10,458
2 people	$14,220
under 65	$14,676
over 65	$13,195
3 people	$17,378
4 people	$22,314
5 people	$26,417
6 people	$29,887
7 people	$33,919
8 people	$37,863
9+ people	$45,094
Source: U.S. Census Bureau	

Figure 32: 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 (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 (0.5) 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 earlier in 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.

Table 12: In 2010, homes became more affordable for the third consecutive year.

Missoula County Housing Affordability, 2002-2010									
	2002	2003	2004	2005	2006	2007	2008	2009	2010
Median Home Price (MOR)	$149,500	$163,000	$179,000	$192,000	$206,850	$219,550	$215,000	$208,775	$200,500
Down payment	10.0%	10.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Interest Rate	5.75%	5.50%	5.50%	6.75%	6.25%	6.00%	5.38%	5.25%	4.50%
Loan Term	30 years	30 years	30 years	30 years	30 years	30 years	30 years	30 years	30 years
Actual Loan Amount	$134,550	$146,700	$171,840	$184,320	$198,576	$210,768	$206,400	$200,424	$192,480
Monthly Payment on Loan	$786	$833	$976	$ 1,196	$1,223	$1,264	$1,157	$1,107	$975
Homeowners Insurance	$37	$41	$45	$48	$52	$55	$54	$52	$50
Taxes	$125	$136	$149	$160	$172	$183	$179	$174	$167
Total Monthly Payments*	$948	$1,010	$1,170	$1,404	$1,447	$1,502	$1,390	$1,333	$1,192
Median Family Income									
1 person	$30,000	$31,600	$34,200	$37,000	$37,400	$37,800	$38,800	$ 41,600	$43,000
2 person	$34,300	$36,200	$39,000	$42,200	$42,800	$42,800	$44,300	$ 47,500	$49,200
3 person	$38,600	$40,700	$43,900	$47,500	$48,100	$48,100	$48,600	$ 53,500	$55,300
4 person	$42,900	$45,200	$48,800	$52,800	$53,500	$54,000	$54,000	$ 59,400	$61,400
Housing Affordability Index	2002	2003	2004	2005	2006	2007	2008	2009	2010
1 person	66	65	61	55	54	52	58	65	75
2 person	75	75	69	63	62	59	66	74	86
3 person	85	84	78	70	69	67	73	84	97
4 person	94	93	89	78	77	75	81	93	107
Median Family Income Needed to Purchase Median Priced Home									
Income	$45,502	$48,460	$56,156	$67,392	$69,460	$72,089	$66,716	$63,992	$57,216

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

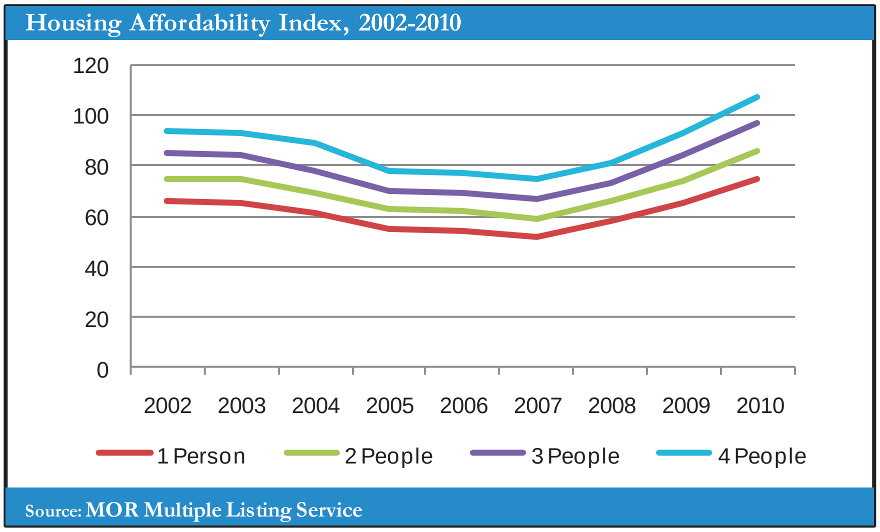
An affordability index of 100% indicates that, given all the factors that affect ability to purchase, a family with a median income has the income necessary to purchase a median priced home.

The NAR uses the HAI to quantify housing affordability. To figure the affordability of the payment, it's assumed that 25% of monthly income would go toward the mortgage payment. Table 12 ,on the previous page, shows the HAI for Missoula from 2002 through 2010. In 2010, the income needed for a HAI of 100% is $57,216 – 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 has approximately 75% of the amount of income needed to purchase a home priced at the 2010 median sale price.

The HAI shows that increases in median home prices significantly outstripped increases in median family incomes from 2002 through 2007. Then, consistent with bursting of the housing bubble, home prices have lost value for the past three years – making homes more affordable. But "more" affordable doesn't entail 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 a first or move-up home, incomes remain below thresholds of affordability.

Figure 33: Housing affordability has improved in the past three years …



For example, a 4-person family at the median Missoula income ($61,400) had 107% of the income required to qualify to purchase a median priced home (at $200,500). But families of this size at the median income are the only ones for whom the purchase of a median priced home would be affordable in 2010. Families of one, two, or three persons with median incomes would still be unable, as in every year of the past decade, to qualify for purchase of a median priced home

Missoula's improved affordability isn't as pronounced as it is for the US as a whole. According to *State of the Nation's Housing for 2010*, lower home prices and interest rates in 2010 pushed mortgage payments on a newly purchased median-priced home (assuming a 10% down payment) below 20% of the US median household income — to the lowest ratio on records dating back to 1971. The improvement in home purchase affordability was widespread, as more than 80% of US metro areas reported payment-to-income ratios for 2010 that were below their average levels of the 1990s.

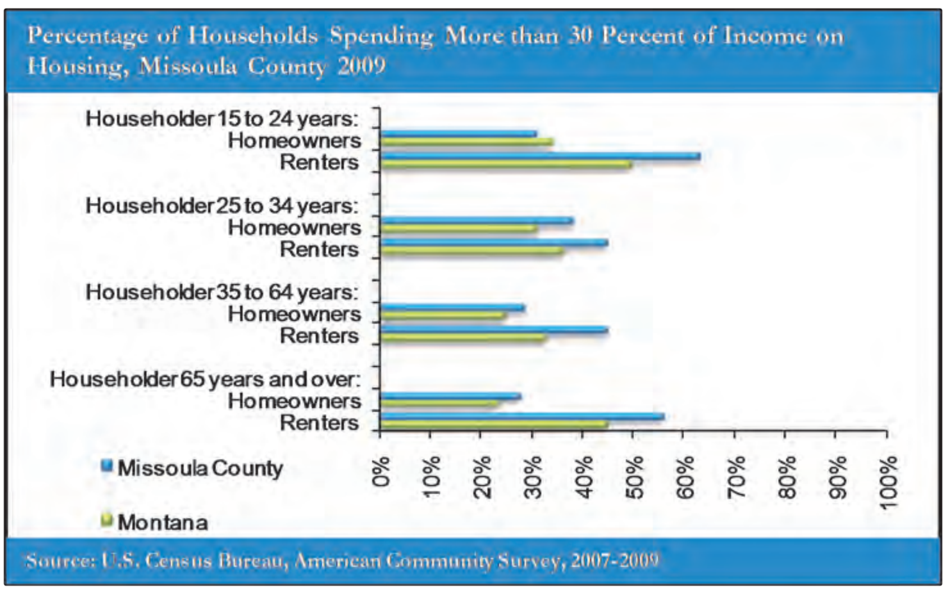
Share of Income Spent on Housing

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 34 shows that a significant percentage of households, divided into four age groups, spends more than the recommended maximum 30% of income on housing.

The national scene is similar. According to the *State of the Nation's Housing for 2010*, "After holding steady at 12% in both 1980 and 2000, the share of severely burdened households (spending more than half their incomes on housing) jumped by a third, to 16%, in 2008. A record 18.6 million households faced these high cost burdens that year — up from 13.8 million in 2001. Nowhere in the country is the HUD fair market rent for even a one-bedroom apartment at or below $372, a level affordable at 30% of the median income of households in the bottom quartile ($14,868).

About one in three homeowners in Missoula County pay more than 30% of their gross income for housing. The problem is especially acute for homeowners age 25 to 34; nearly 40% exceed the affordability threshold.

Figure 34: … but a significant share of homeowners and most renters still spend more than 30% of income on housing.



Renters in general pay an even greater share of their gross incomes on housing. Half of renters spend more the 30% of their income on housing. More than 60% of younger renters, many of whom are students, pay more than 30% of their income in rent.

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 2000s, with many of them having paid down most or all of their mortgages.

State of the Nation's Housing for 2010 reports that nationally – despite falling home prices, loan modifications, and softening rents – the housing downturn did not reduce the number of households spending half or more of their income on housing — 18.6 million in 2008. Instead, the share with such severe housing cost burdens climbed to a new record.

Conclusion and Outlook

The housing downturn of the past several years may qualify as one of the most confounding economic events in US history. It seems that most forecasts issued by economists and housing experts proved wrong.

Events of 2010 illustrate the string of mistakes:

Example: As 2010 dawned, expert consensus held that the year would be one of increased home sales in the US, with median price holding or possibly increasing. Result: fewer home sales and lower median price.

At the year's outset, expert consensus held that mortgage rates would stay level or increase. Result: Mortgage rates went lower through most of the year, before trending up at year end.

In last year's report, we cited a prediction by the National Association of Home Builders' senior economist that new home sales in 2010 would increase by 25% over their 2009 total. Result: new home sales dropped by 14%.

At the local level, our outlook in last year's Housing Report fared only a little better than the national experts' forecasting. We observed, for example, that "home prices, except at the top-most ranges, appear to have bottomed." Result: median home price once again declined.

So we approach this year's Conclusion and Outlook with perhaps more caution than in the past.

Nonetheless, we again will assert our belief that housing prices in the Missoula market have bottomed or, more precisely, that they will have bottomed by year-end 2011. Also, with somewhat more confidence, we believe our market will experience a gain in the number of existing home sales – with the important caveat that our greater confidence stems in part from anticipating a greater number of foreclosure and short sales.

Mortgage rates can with somewhat more confidence be predicted to increase in 2011, resulting from a number of trends that include an uptick in the US inflation rate, stricter mortgage loan standards, and increased costs of meeting the regulatory requirements of recently enacted legislation, such as the Dodd-Frank Act and the Real Estate Settlement Procedures Act.

If we do experience this 1-2-3 punch in 2011, median sales prices would be very unlikely to increase, and rather more likely decline for the fourth year in a row.

Nationally, further price declines are forecast by many expert observers, some of whom have shifted in the first months of 2011 from seeing a housing market poised for a recovery to forecasting a renewed downward drift. "This looks like a double-dip [in housing] is pretty much on the way, if not already here," according to Standard & Poor's executive David Blitzer. Joining the chorus, Wells Fargo & Co. projects home prices will drop 8% in 2011's first half, consistent with other analysts' expectations that home prices will decline 5% to 10% by mid-year or late summer.

Such a decline, were it to occur, would contribute to affordability gains, as it has for the past three years. However, affordability is threatened by a February 2011 report by the Obama administration on redesigning the government's role in housing finance. Each of three alternative ideas for dissolving Fannie Mae and Freddie Mac would raise the cost of mortgage loans and push homeownership beyond the reach of some families.

As for rents, affordability gains in 2011 are also unlikely in our local market. The real estate market in Montana typically lags that of the US by about a year, and nationwide rents spiked significantly in 2010, owing mostly to additional demand by 1) former homeowners who were foreclosed or who walked away from underwater mortgages and 2) would-be homeowners who can't meet the stricter standards of today's mortgage loans.

A ray of hope in local rent affordability is offered by the significant 2010 increase in multi-family building permits issued. It's unlikely, though, that apartments will be constructed and offered at a pace that will boost supply enough to measurably reduce rental costs in 2011.

The national affordability outlook in *State of the Nation's Housing for 2010* is equally unenthusiastic, noting that, "with federal budget deficits looming, the resources necessary to make a noticeable dent in the nation's widespread housing affordability problems are unlikely to appear anytime soon."

Given this cavalcade of dreary assessments for 2011, it wouldn't be unreasonable to hope that expert consensus will be just as consistently incorrect now as it was in last year's forecasts.

But we do have at least a little substance, not just hope, on which to pin our prospects for the near future. For example, US demographics in the next decade or so will powerfully increase housing demand. The baby boom generation is reaching senior and retired and empty-nest status by some ten thousand every day, strengthening demand for senior housing.

Meanwhile, the generation of boomer offspring – the "echo boom" – is even larger than the baby boom contingent and will create a strong demand for housing for at least the next 15 years.

Locally, "the climate for growth has improved significantly," according to Pat Barkey, an economist and director of the University of Montana's Bureau of Business and Economic Research. "Two years have elapsed since the recession's lowest point, and families and businesses are starting to adjust, and both are now positioned to spend more."

In our local community, we have other conditions working in our favor. For the most part, we continue to have escaped the full extent of harmful impacts of the housing downturn experienced across the country. We also enjoy a diverse economy, ranging from a renowned university to natural resources production to nearby scenic attractions that draw national and international travelers. And we are a historically resilient population that bands together more tightly when adversity strikes. These qualities will prove decisive in overcoming today's unprecedented challenges.

Notes

Coordinating Committee and Contributing Resources

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First Security Bank

Missoula Housing Authority

Missoula Organization of REALTORS®

Western Montana Chapter of National Association of Residential Property Managers

WGM Group

First Security Bank

Thank You First Security Bank of Missoula!
Your contribution provided hard copies of this report to Missoula's citizens.

IT MATTERS HOW WE

LiveMissoula!

You're Invited to Missoula's Front Porch!

- **What is the Front Porch?**
-
    - **The Front Porch is a virtual celebration of neighborhoods.**
    - **A place for community members to have discussions.**
    - **To introduce visitors to our community as a whole and the unique characteristics of each neighborhood.**

- **Why do Neighborhoods Matter?**
    - **Where we live impacts our lifestyle and activities.**
    - **The culture of each neighborhood offers something for everyone; from events and block parties, to just borrowing a cup of sugar.**
    - **Neighborhoods offer stability in communities which creates opportunities for economic development and support of local businesses.**

For those who want to glimpse what life is like here, there's no better view!

the front porch

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