2013 Missoula Housing Report

CURRENT KNOWLEDGE, COMMON WISDOM: GROWING A MISSOULA TO TREASURE

RELEASED MARCH 28, 2013

A COMMUNITY SERVICE PROVIDED BY THE MISSOLA 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 (email: comments@missoularealestate.com) – that way we can continue to improve this annual 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: Rattlesnake, Downtown, University, Farviews, South Hills, Pattee Canyon, Lewis and Clark, Miller Creek, Blue Mountain, Big Flat, Orchard Homes, Mullan Road, Grant Creek, Lolo, Bonner, East Missoula, and Clinton. Some data represent only the city or all of Missoula County, and are noted as such.

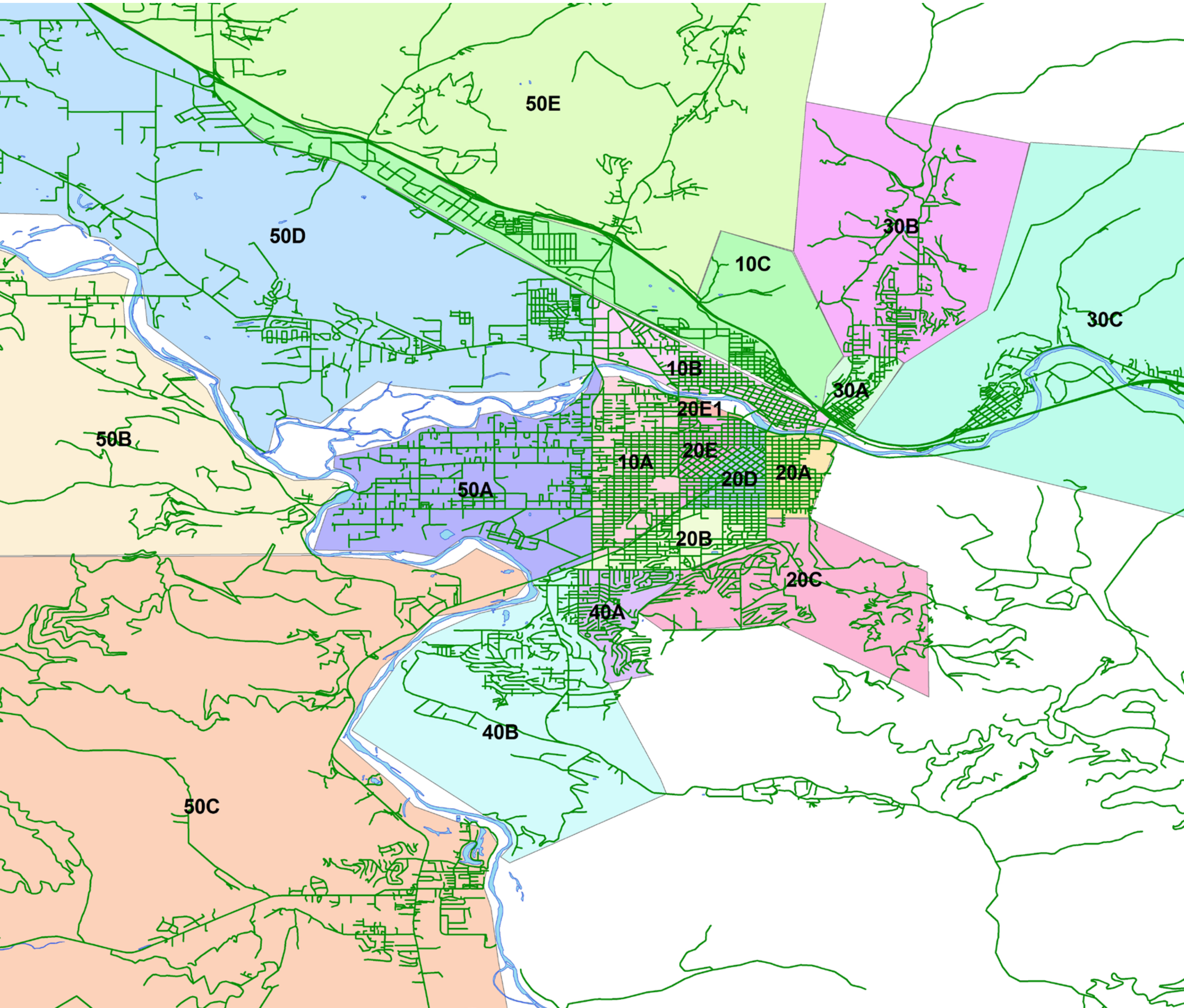
3. All data are the most recent available at the time we compiled the report. For calendar year data, that is 2012 in most cases, but 2011 or even 2010 when more recent figures are not yet available.

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. Data from the American Community Survey has a margin of error associated with it. This margin of error reflects the fact that there is always uncertainty involved in the process of creating estimates from a representative sample of the population. In other words, although estimates from the survey data may appear to be different, the difference sometimes falls within the margin of error for the estimates and therefore cannot be considered to be statistically significant. The charts with American Community Survey data portray the data in ranges with a lower and upper bound. The mean is the midpoint of the range. Statistical differences are visually apparent when the ranges do not overlap.

6. 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. 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 Finance Agency (OFHFA), Montana Department of Labor and Industry, Western Montana Chapter of the National Association of Residential Property Managers (NARPM), Missoula Housing Authority (MHA), Harvard's The State of the Nation's Housing 2012, and Missoula MLS® (see next note).

7. MLS® refers to the Multiple Listing Service®. It is a member-based service – administered, operated, and 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

We are pleased to present the 2013 Missoula Housing Report, our eighth annual report on housing in the city and county of Missoula. This year's report, as with previous reports, represents the collaborative efforts of the Coordinating Committee for the Housing Report. Committee membership is drawn from the Missoula regional community, with members who represent a wide spectrum of businesses, organizations, agencies, and individuals concerned with our local housing market.

The content of each year's report evolves based on:

- current trends
- available information
- feedback from readers like you

Our objective is always 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.

Changes to this year's report include discussions of low income housing and homelessness in our community. We also focus attention on distressed sales this year, which is currently a significant issue. In previous years we added neighborhood information and more detail on what is happening in housing finance. So please read this report and let us know your thoughts on how we might improve it.

If, after reading this report, you are interested in getting involved in meeting the housing needs of our community please contact any of the public or private agencies engaged in local housing mentioned in this report. Additional housing resources are listed on the Missoula Organization of REALTORS® website at www.MissoulaRealEstate.com.

Coordinating Committee:

Jim Sylvester

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Bureau of Business and Economic Research UM

Missoula Housing Authority

First Security Bank

WGM Group

Western Montana Chapter of NARPM

Professional Property Managment

Coldwell Banker Steinbrenner Real Estate

Windermere Real Estate

Executive Summary

Housing Supply: Development and Occupancy

Sales of empty lots increased slightly again in 2012, for the second year in a row. Median sales price was down by 25 percent, however, following a 23 percent decrease the year before.

The number of building permits issued by the City of Missoula decreased from 498 in 2011 to 254 in 2012, a difference of 49 percent. This loss is entirely attributed to a decline in duplex and multi-family permits, as single-family permits increased for the first time in seven years. While much of the multi-family building took place in 2012, the permits were issued in 2011. Missoula County building permits increased sharply in single-family with a modest increase in duplexes and a decline in multi-family units for the second year in a row.

Approximately 60 percent of Missoula County residents live in homes they own, and about 40 percent are renters. The percentage of renters increased slightly over last year.

Missoula continues to have a lower rental vacancy rate, at 3.5 percent, than the national average, which was at 9.5 percent in 2011. This trend is not uncommon in college towns. The fourth quarter of 2012 began to show dramatic increases as the result of several large multi family developments being completed and available for rent.

Housing Demand: Population and Income

The population in Missoula County grew a total of 14.5 percent between 2000 and 2011. Missoula City grew slightly faster, at 16 percent, than the unincorporated areas of the county. Growth in 2011 was approximately 0.6. The University of Montana, Echo Boomers, and Baby Boomers continue to figure prominently in the age distribution of the Missoula County population, with the two most pronounced age ranges at 20-29 years and 45-64 years. The median age of a Missoula resident is 34 years old.

Population increases in two ways, natural increase (births) and net migration. Natural increase in Missoula declined, as the number of births in 2011 was substantially lower than previous years. This is a reflection of the economy; households are hesitant to start or increase a family during uncertain times. Migration increased in 2011, following two years of sharp decline.

Median household income in Missoula County is about the same as the state level, but significantly below the US median.

Per capita income is a generally recognized measure of economic well-being. It is derived by dividing total personal income by total population. Per capita income in Missoula is approximately $35,000 per person, which is slightly below the Montana per capita of $36,000.

Nonfarm earnings are also a good indicator of economic vitality. After declines in 2008 through 2010, the Missoula economy appears to have turned the corner with positive growth in 2011.

Housing Sales and Prices

The number of homes sold in Missoula increased by 22 percent in 2012, with 1,068 sales compared to 878 in 2011. This is the first increase since 2009. The median home price increased by 2 percent, to $209,700, in 2012, following the same increase last year. Only two neighborhoods out of the 12 tracked, Lewis and Clark and Grant Creek, had fewer sales in 2012 than in 2011.

Sales of condominiums and townhouses in 2012 decreased slightly compared with 2011; however experienced minor increases in the $100,000-$150,000 and $200,000+ ranges.

Missoula's overall absorption rate spiked in late 2010 to almost 30 months. The market absorption rate has gradually been decreasing, suggesting a return closer to a desired equilibrium. However, if you consider the rule of thumb on over-supply versus normal supply, you see that the Missoula market has only moved into a more "normal" range in the last two quarters.

Missoula saw a decline in rental costs across almost every category in 2012 compared with 2011, partially due to a significant number of new apartments on the market in 2012 that led to an increase in supply over demand.

Housing Finance

Mortgage interest rates in 2012 continued downward, ending the year at 3.25 percent for a conventional loan.

The American Taxpayer Relief Act of 2012 allows mortgage insurance to be tax deductible for 2012 and 2013. This provides some nice relief, albeit temporarily, to homeowners.

Down payment requirements for most loan types remained unchanged in 2012. Typical down payments range from 3.50 percent to 5 percent.

Missoula saw an increase in distressed sales again in 2012, although at a lesser percentage than the past three years. 2012 saw a six percent increase in the number of net foreclosures in Missoula County, with 151 compared to 142 in 2011. This follows two years of decreases after hitting a high of 262 in 2009.

Home$tart was offered again in 2012. This grant program provides low and moderate income homebuyers with grant funds that offer $3 for every $1 of homebuyer funds up to $5,000.

New regulatory and legislative changes impacted the way the mortgage industry does business. One example is the new requirements for the industry to be especially diligent in making sure home appraisals are performed effectively.

Housing Affordability

The Housing Affordability Index (HAI) is an indicator that shows how much a family can afford; any HAI over 100 means that family can afford a median priced home. While the National Association of REALTORS® (NAR) assumes a 20 percent down payment, the down payments you will see in this report vary according to local trends and requirements. In 2012, most home purchasers did not have a 20 percent down payment in Missoula, which makes the actual HAI 101. For comparisons sake, if we assume a 20 percent down payment in Missoula, a family of four has an HAI of 133, significantly less than the national average of 193.5 in 2012.

Missoula County's unemployment rate declined to six percent in 2012 from its peak in 2010 of nearly seven percent. The national unemployment rate in December of 2012, by comparison, was nearly eight percent.

Between 6,500-10,000 households live below the federal poverty rate in Missoula County.

The Missoula Housing Authority has 774 available rent-subsidized Section 8 vouchers, with another 262 vouchers provided by the Montana Department of Commerce. Unfortunately this is inadequate to meet the need.

Homeword leased 35 new affordable units in 2012, and 115 new units built by Rocky Mountain Development Group, MHA, and the city of Missoula also began leasing.

In 2011, the City and County of Missoula and the United Way have sponsored a 10 year plan to end homelessness. The number of homeless individuals and families in Missoula increased in 2012. Last year we had 789 children in Missoula were homeless or at risk.

Conclusion and Outlook

Almost all measures point to a housing market that is finally rebounding, both locally and nationally.

The increase in income and decrease in interest rates has allowed homes in Missoula to be more affordable in 2012 despite an increase in median home prices. However with an actual HAI of 101 for a four person household, if median home prices continue to go up, Missoula will face the recovery still dealing with issues with housing affordability.

While low interest rates are helping homes sales, we must remember that not everyone is able to take advantage of the current rates to buy a home. Current lending standards remain tight and there have been instances where seemingly qualified buyers have come across issues obtaining financing.

The Missoula market has finally returned to "normal" absorption rates suggesting we are as close to what is expected to be a normal market in terms of absorption (supply and demand) than we have seen in over five years.

While the signs are pointing in the right direction, this economic recovery has been longer and more complicated than most of us hoped for. Missoula is still experiencing a higher median price than the average incomes can afford. But the economic conditions have closed the gap slighly. In addition, while the maket has improved, the number of distressed sales has as well. While the coming year shows the signs of a positve movement in Missoula, we have yet to see how some of these issues will effect recovery.

Housing Supply: Development and Occupancy

Lot Development

Lot sales in Missoula in 2012 were up slightly for the second year in a row (Table 1). However, the median sales price was down again last year, this time by 25 percent. While the economy has impacted the price of undeveloped lots, another factor has been at play as well. Prior to 2007 lots were larger and the supply of lots was limited. Since that time, a large quantity of land was subdivided, many of the lots are smaller than they had been previously. This increased supply coupled with decreased demand lead us to our current situation.

Figure 1: Number of lots sold increased for the second consecutive year

Table 1: 2012 median price of lots decreased and took almost three times as long to sell

Residential Lot Sales Missoula Urban Area				
Year	Lot Sales	Median Price	% Change	Median DOM
2001	26	$55,000		114
2002	75	$61,000	10.9%	117
2003	59	$66,750	9.4%	297
2004	65	$52,750	-21.0%	119
2005	95	$70,000	32.7%	116
2006	96	$59,000	-15.7%	147
2007	188	$59,000	0.0%	213
2008	86	$70,000	18.6%	247
2009	43	$72,000	2.9%	325
2010	36	$87,000	20.8%	269
2011	44	$67,400	-22.5%	130
2012	47	$50,000	-25.8%	381

Source: MOR Multiple Listing Service

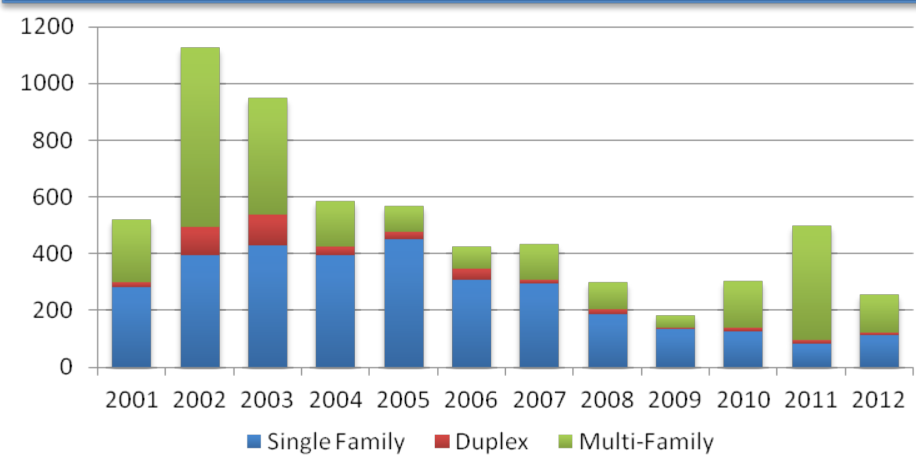
Figure 2: While median price dropped considerably for the second consecutive year

Pace of Development

The number of residential units permitted by the City of Missoula in 2012 decreased by 49 percent over the 2011 number (Figure 3). This loss was entirely accounted for in duplex and multi-family permitting, as single family permits increased for the first time in seven years, but still about three times less than the record high number of single-family permits issued in 2005. In contrast, multi-family permits decreased to a lower level than in the previous two years. While much of the multi-family building took place in 2012, the permits were issued in 2011, explaining the large number of permits that year and the significant number of apartments that came on the market in 2012.

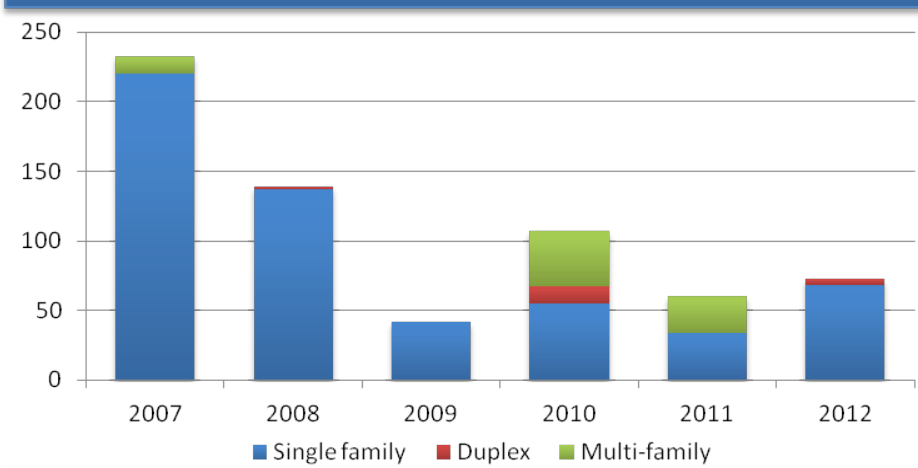
Figures 3 and 4: Building permits issued in 2012 increased in single-family and decreased in multi-family for both the city and county. Single family permits doubled from the previous year in the county.

City of Missoula Building Permits, 2001-2012



Source: City of Missoula Building Department

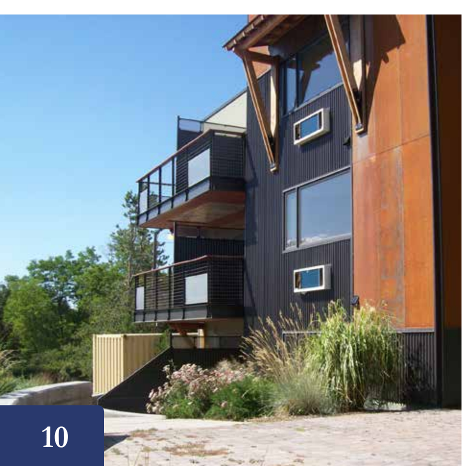
Missoula County Building Permits, 2007-2012



Source: Missoula County Building Department

Missoula County building permits increased sharply in single-family while multi-family is at zero (Figure 4). Please note that the data reported for Missoula County is only nine months of data due to a change in reporting software during the year.

The State of the Nation's Housing 2012, a yearly release from the Joint Center for Housing Studies of Harvard University, reported: ". . . that there is reason to believe that 2012 will mark the beginning of a true housing market recovery. Sustained employment growth will remain key, providing the stimulus for stronger household growth and bringing relief to some distressed homeowners. Over the next 20 years, the echo boomers have the potential to spur new home demand to an even greater extent than their parents did beginning in the 1970's. The good news for housing production is that this new generation already outnumbers that of the baby boomers at the same ages."

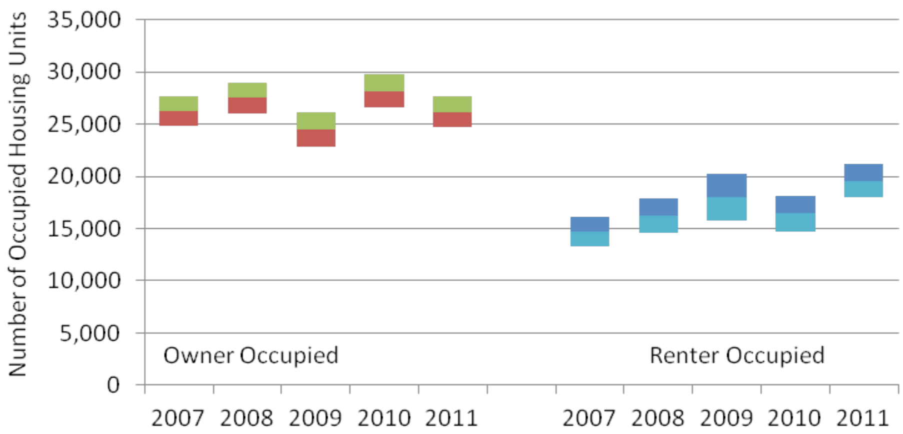


Homeowner Occupancy

Approximately 60 percent of Missoula County residents live in homes they own, as measured by the US Census Bureau American Community Survey, 2011, with the other 40 percent renting (Figure 5). 2011 data is the most current

Figure 5: Approximately 40 percent of Missoulians rented their homes in 2011, up from about 36 percent in 2010

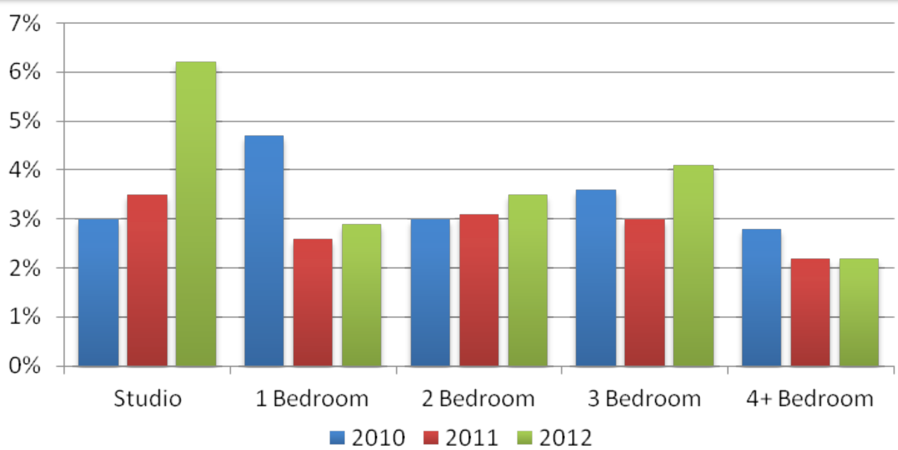
Occupied Housing Units, Missoula County, 2007-2011



Source: American Community Survey

Figure 6: The vacancy rate of studio units almost doubled from 2011 to 2012

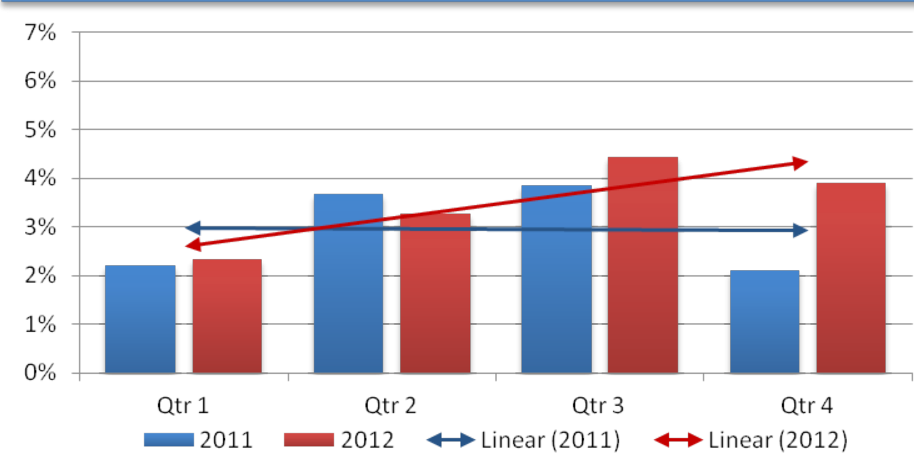
Average Vacancy Rate by Type, 2010-2012



Source: Western Montana Chapter of NARPM

Figure 7: While vacancy rates varied by quarter, the rate increased overall for 2012

Rental Vacancy Rates by Quarter, 2011-2012



Source: Western Montana Chapter of NARPM

information available at the time of printing. The percentage of renters has increased slightly over the last few years. Nationally, 65 percent of Americans live in homes they own, with 35 percent renting.

The fact that Missoula has more renters than the national average is due, in part, to the impact of The University of Montana.

Rental Occupancy

Harvard's *The State of the Nation's Housing 2012* reported the national rental vacancy rate at 9.5 percent in 2011, compared to Missoula's average vacancy rate of 3.5 percent. Although vacancy rates are still below the national average across all categories, some segments took a significant jump in 2012 with the continued development of multi-family units. The vacancy rate of studio units nearly doubled (Figure 6). Given the continued decline in student population, this trend is likely to continue next year.

Low rental vacancy rates are common in college towns due to the pressure exerted by the student population. College towns such as Bozeman and Ft. Collins, CO also have vacancy rates well below the national average.

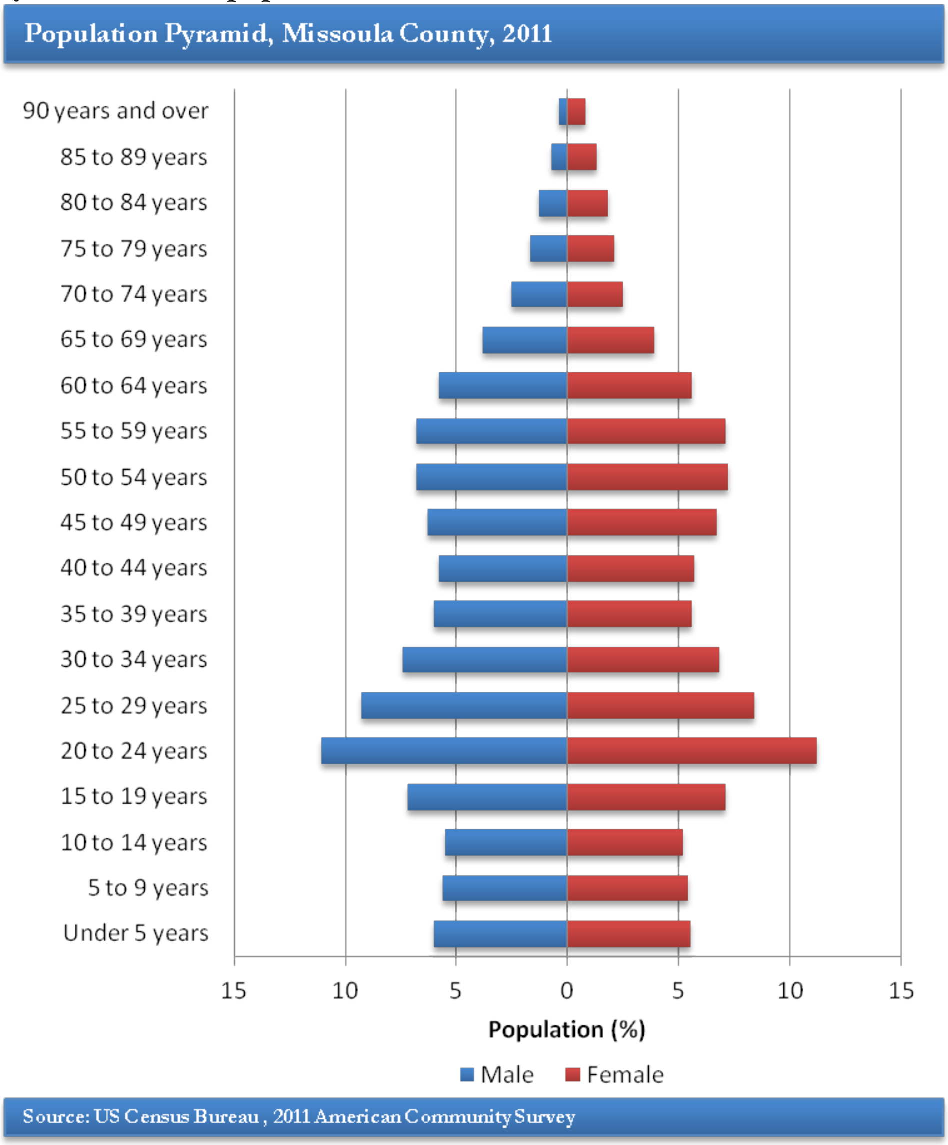
As you can see by the trend lines in Figure 7, the vacancy rate for 2011 was stable. In contrast to 2011, as new units came onto the marketplace in 2012 the rental market experienced an overall increase in vacancy rates. Another item of note is that while the 4th quarter historically has very low vacancy rates, they almost doubled from 2.1 percent in 2011 to 3.9 percent in 2012.

Housing Demand: Population and Income

Age Distribution

The University of Montana continues to figure prominently in the age distribution of the Missoula County population. In 2011, approximately 13 percent of males and females were between the ages of 20 and 24. Another 8 percent, known as Echo Boomers, were between 25 and 29. As this generation – which is even larger than its baby boomer parents – ages, it will play a significant part in the market over the next 15 years. Baby boomers, ages 46-64, make up approximately 25 percent of Missoula's population (Figure 8). The median age of Missoula residents is 34 years old, while Montana's median age is 39.8.

Figure 8: Two dominant age ranges, 20-34 and 45-64, make up a majority of Missoula's population.



Population Dynamics

There is a definite relationship between population and housing demand. The size of a population demands a certain number of housing units, but the number of available housing units also determines a community's ability to accommodate growth. The population in Missoula County grew a total of 14.5 percent between 2000 and 2011. Missoula City grew slightly faster, at 16 percent, than the unincorporated areas of the county. Growth in 2011 was approximately 0.6 percent (Figure 8).

Migration

Four factors influence population growth: birth, death, immigration, and emigration. Birth and death are referred to as natural factors, and immigration and emigration are referred to as migration factors. In Missoula County, natural increase declined as the number of births in 2011 was substantially lower than previous years (Figure 10). Missoula is not unusual in this regard. The national birth rate has dropped to its lowest point in 25 years. This is a reflection of several factors including the economy, as households are hesitant to start or increase a family during uncertain times.

Income Trends

Median household income in Missoula County is about the same as the state level, but significantly below the US median. Missoula County homeowners have significantly higher median income than other Montana Homeowners.

Per capita income is a generally recognized measure of economic well-being. It is a relative measure that can be compared with other regions. It is derived by dividing total personal income by total population. Per capita income in Missoula County is down from its peak in 2007, but has stabilized at about $35,000 per person (Figure 12).

Figure 9: Missoula County has seen steady population growth for the past decade

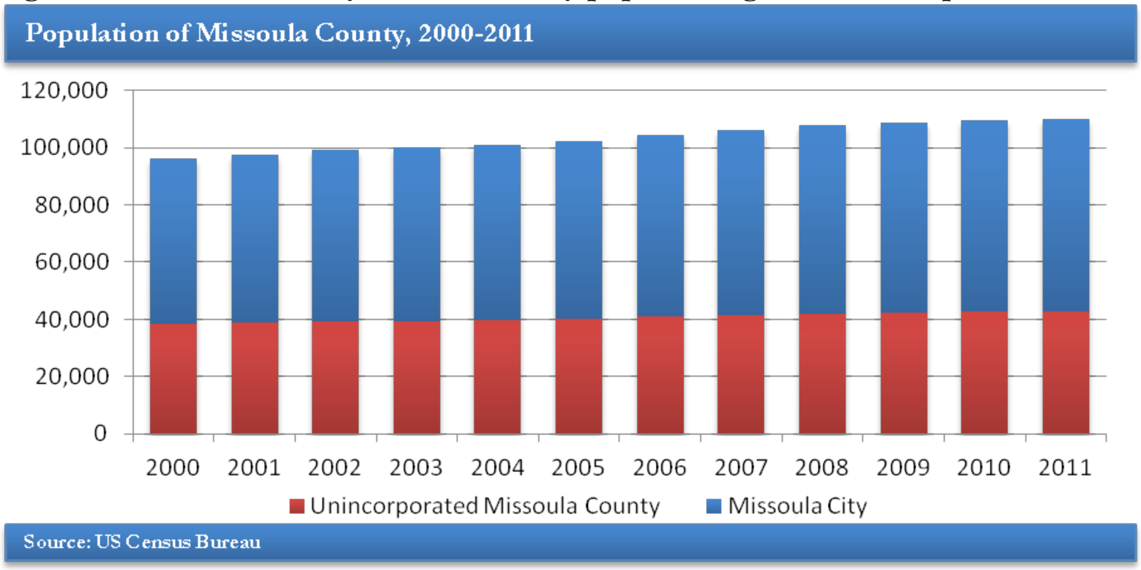


Figure 10: Net migration is the more variable component of Missoula's population

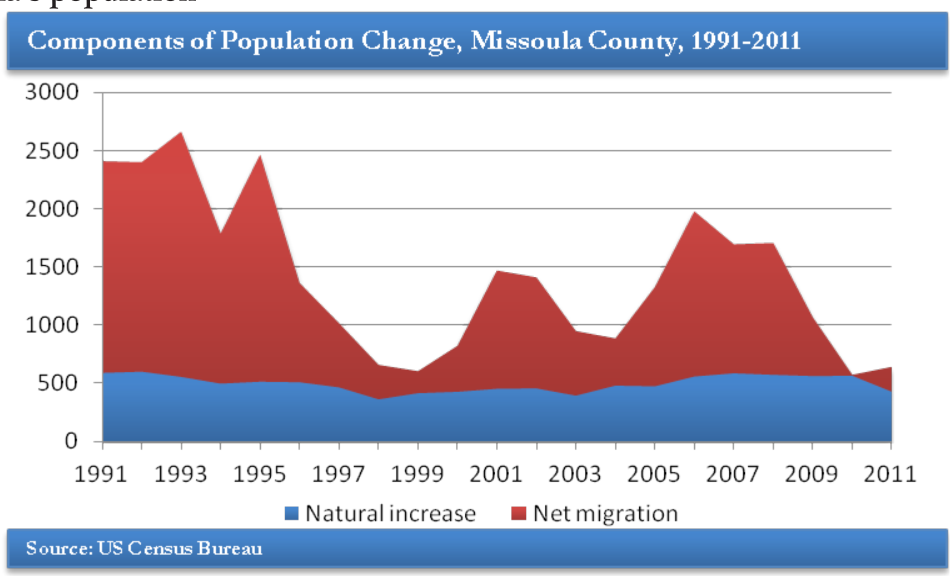
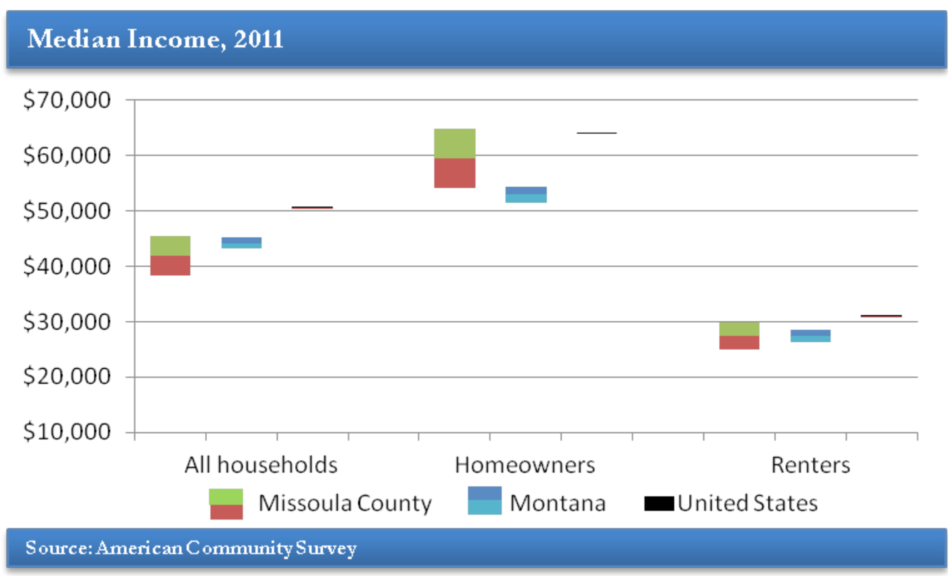


Figure 11: Missoula's median income for both homeowners and renters is above the state level



Nonfarm earnings are another good indicator of economic vitality. After declines in 2008 through 2010 the Missoula economy appears to have turned the corner with positive growth in 2011 (Figure 13).

The GINI Index is a measure of income inequality. Lower numbers show a more even distribution of money, with an index of zero suggesting that everyone has an equal income. An index of one would indicate that all income belongs to one person or entity. The GINI index, which includes college students, suggests that Missoula County incomes were more unequal than Montana State incomes. There is no difference between Missoula County and Montana, however, after 2010 (Figure 14). Missoula income distribution has become more equal after peaking in 2008.

Figure 12: Per capita income saw its first increase since 2007

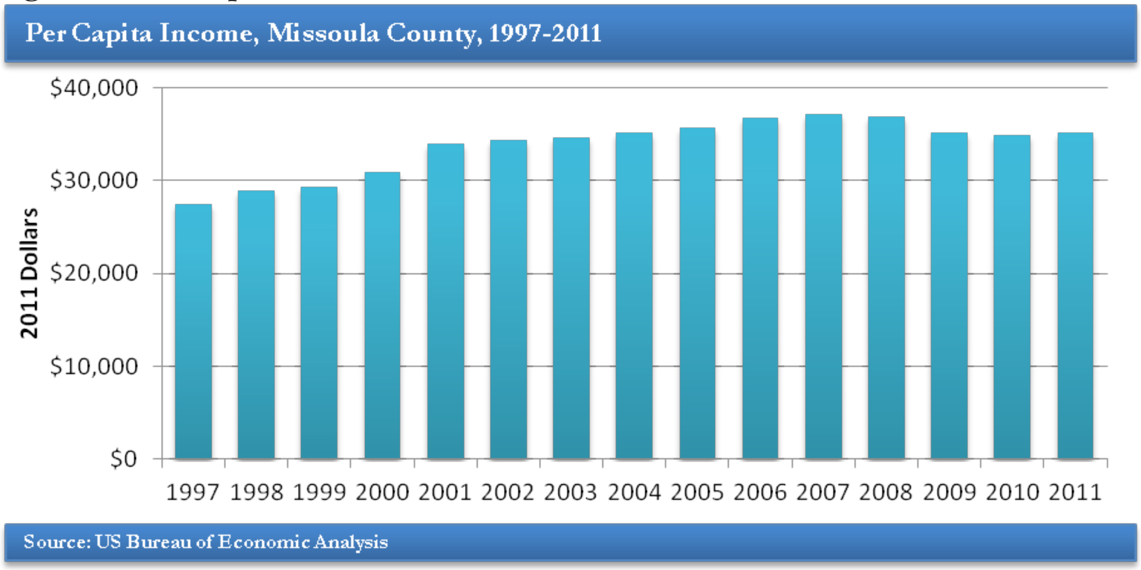


Figure 13: Nonfarm earnings saw its first positive growth since 2007

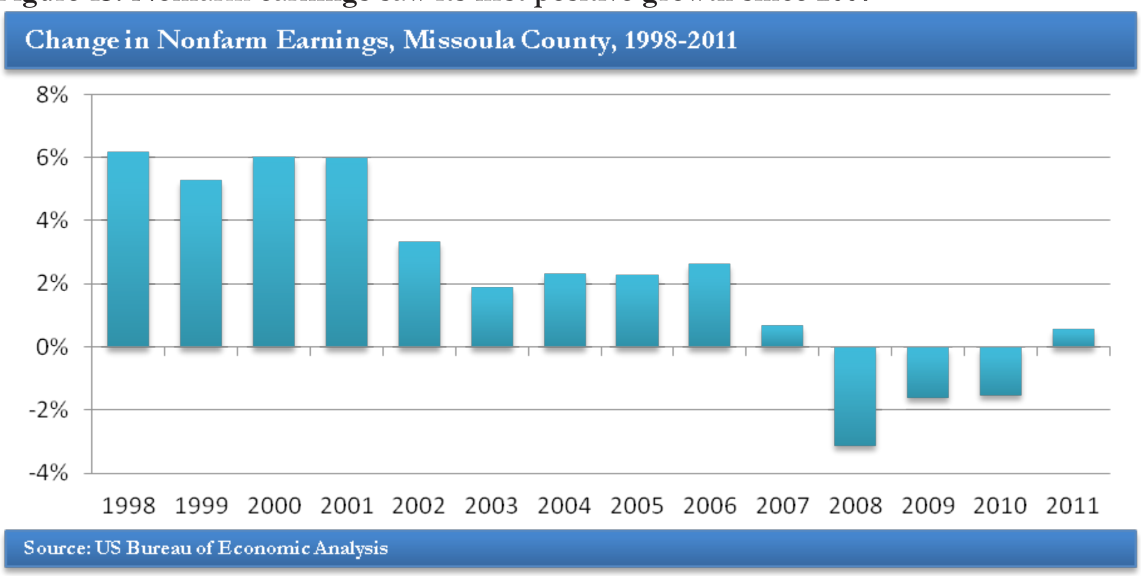
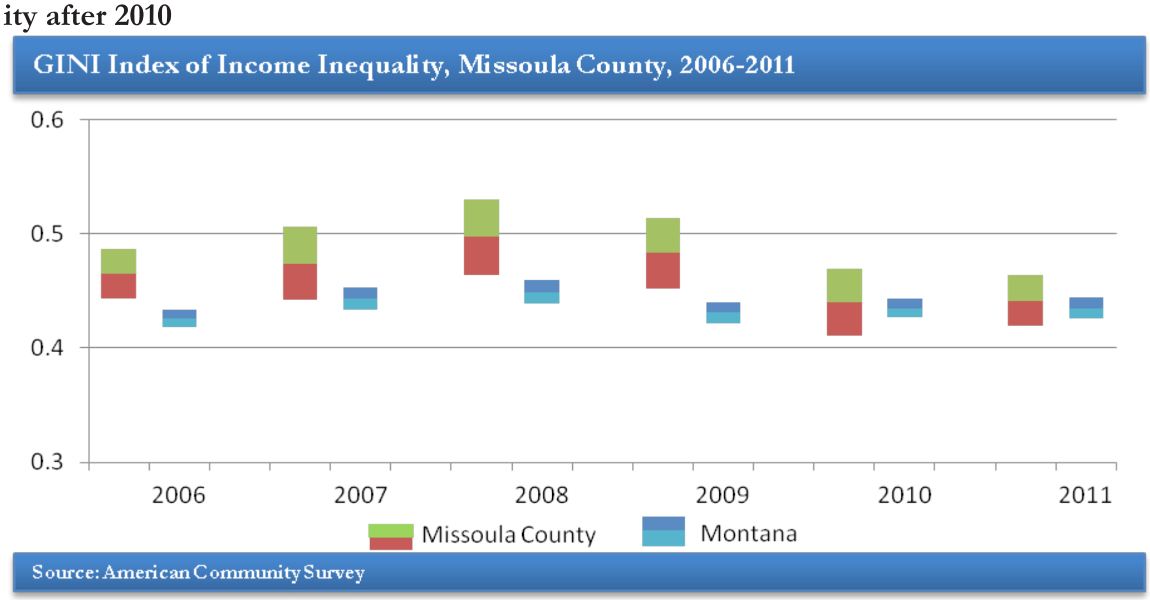


Figure 14: There is little difference between Missoula and Montana income inequality after 2010



Housing Sales and Prices

Home Sales in 2012

The number of homes sold in Missoula increased by 22 percent in 2012. A total of 1,068 homes were sold, up from 878 in 2011 (Table 2 and Figure 15). The median price of homes sold increased by just over 2 percent to $209,700. Home sales were strongest in the $150,000-$275,000 price range. This makes sense given the median price of homes in Missoula. The greatest increase in number of homes sold, however, came in the $275,000-$350,000 price range (Figure 19).

Table 2: Missoula home sales increased both in number and median price.

Median Price of Sales in Missoula Urban Area, 2001-2012			
Year	Annual Number of Sales	Median Price	% Change in Median Price
2001	1,211	$138,000	n/a
2002	1,069	$150,000	8.0%
2003	1,150	$163,000	8.0%
2004	1,300	$179,000	8.9%
2005	1,558	$191,900	6.7%
2006	1,586	$206,600	7.1%
2007	1,392	$219,500	5.9%
2008	996	$215,000	-2.1%
2009	1,033	$208,775	-3.0%
2010	903	$200,500	-4.1%
2011	878	$205,000	2.2%
2012	1,068	$209,700	2.2%

Source: MOR Multiple Listing Service

Both of these measures reflect national trends. The National Association of REALTORS® reports that, nationally, the median home price rose to $176,600, up from $166,100 in 2011 and the number of sales of existing homes was at 4,650,000, up from 4,260,000 in 2011.

Figure 15: 2012 saw a nice uptick after several years of sluggish sales

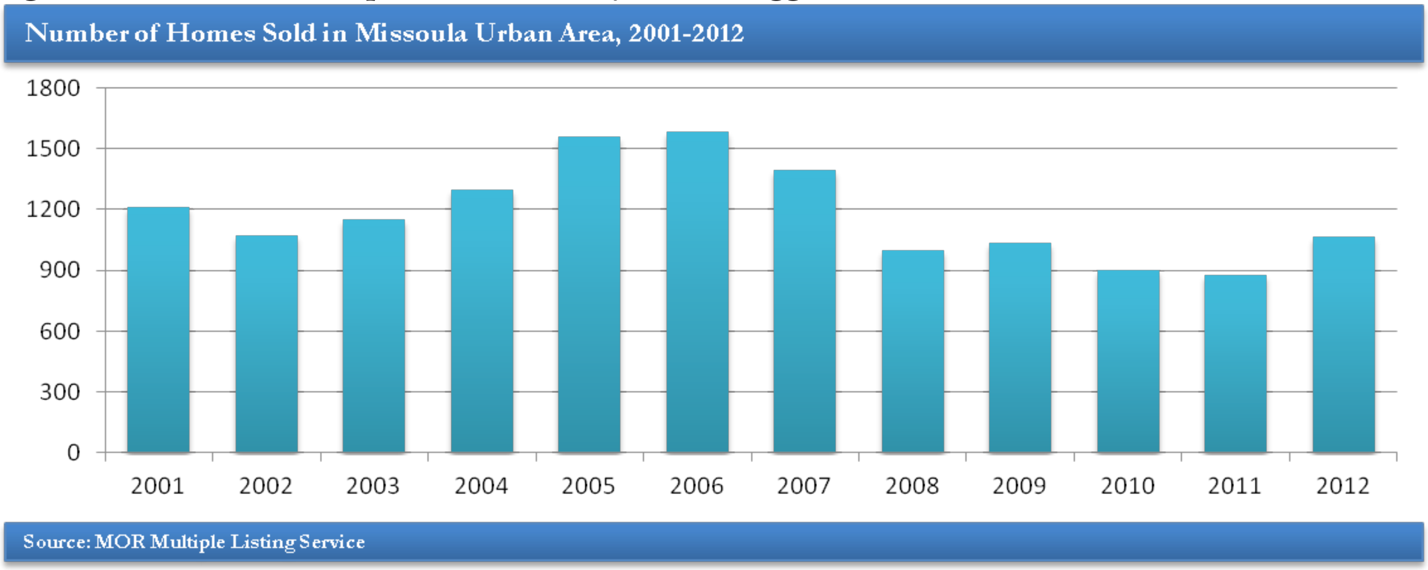
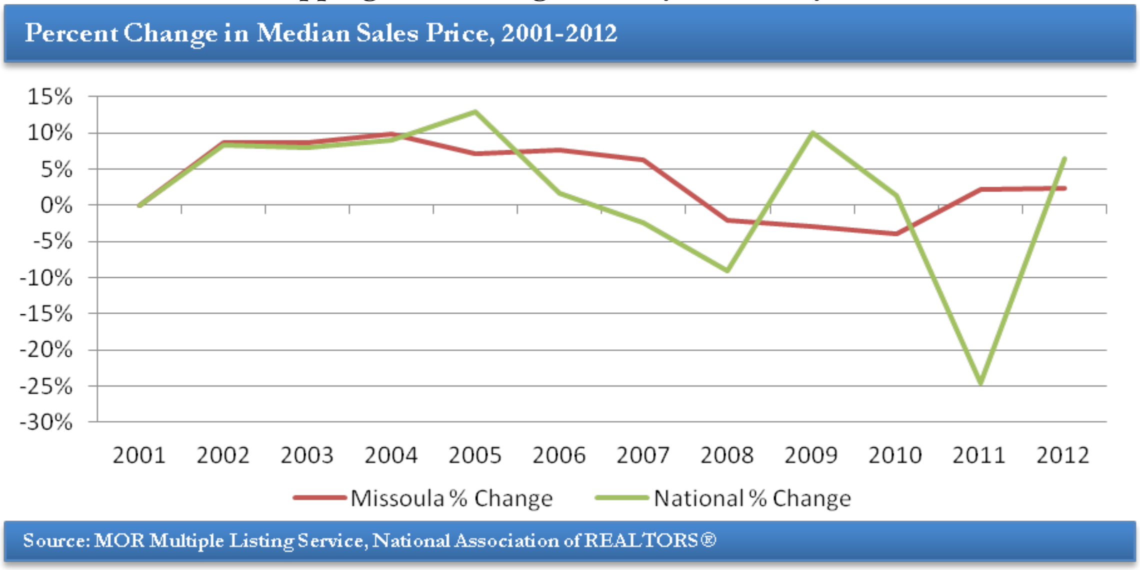


Figure 16: Sales were higher in each quarter in 2012 compared to 2011.

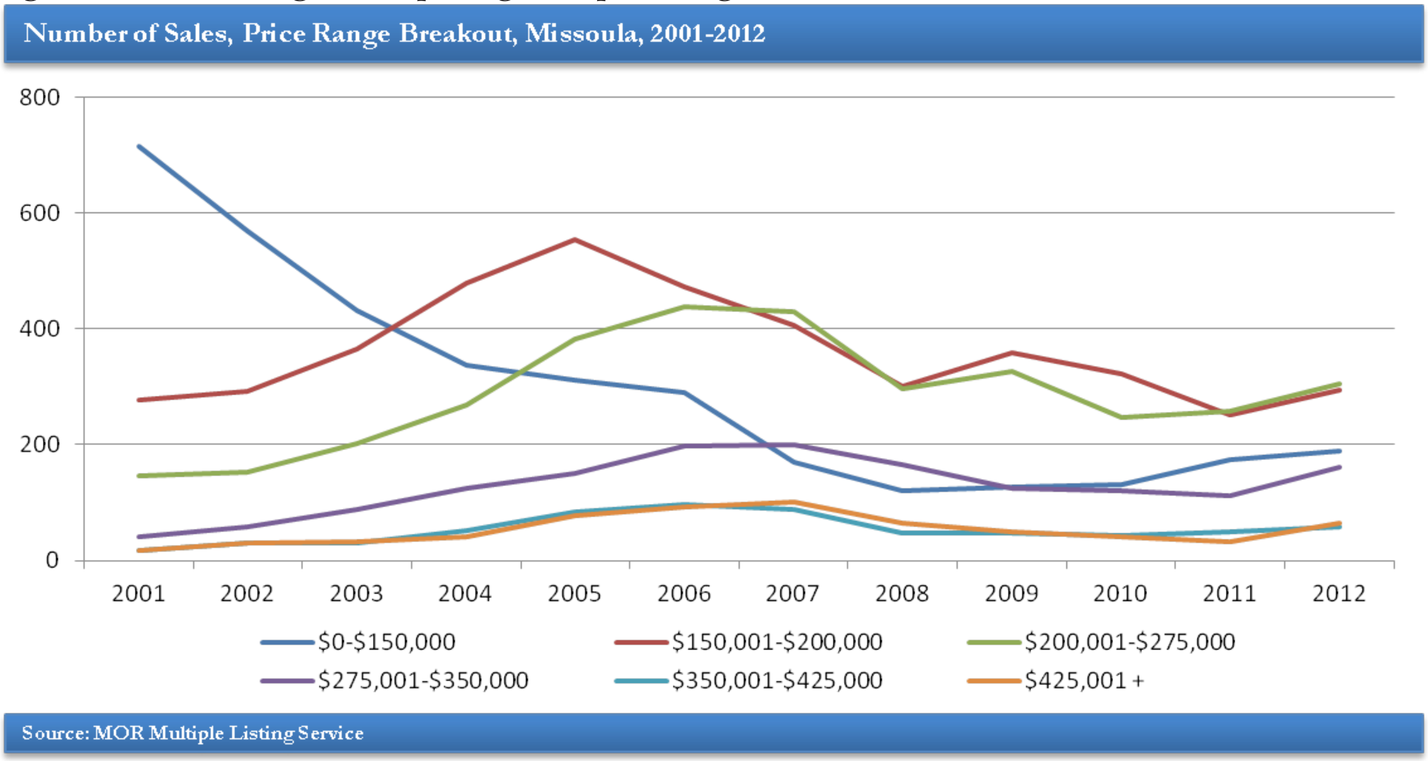
Figure 17: Two years in a row of median price increases represents an encouraging trend. Missoula's 2012 median price is approximately 95 percent of its 2007 price, compared to the national average which is at 74 percent of its 2007 price.

Figure 18: Change in Missoula's median home price has been much less volatile than at the national level, dipping into the negative only the three years of 2008-2010.



Source: MOR Multiple Listing Service, National Association of REALTORS®

Figure 19: 2012 saw a general upswing in all price ranges.



Source: MOR Multiple Listing Service

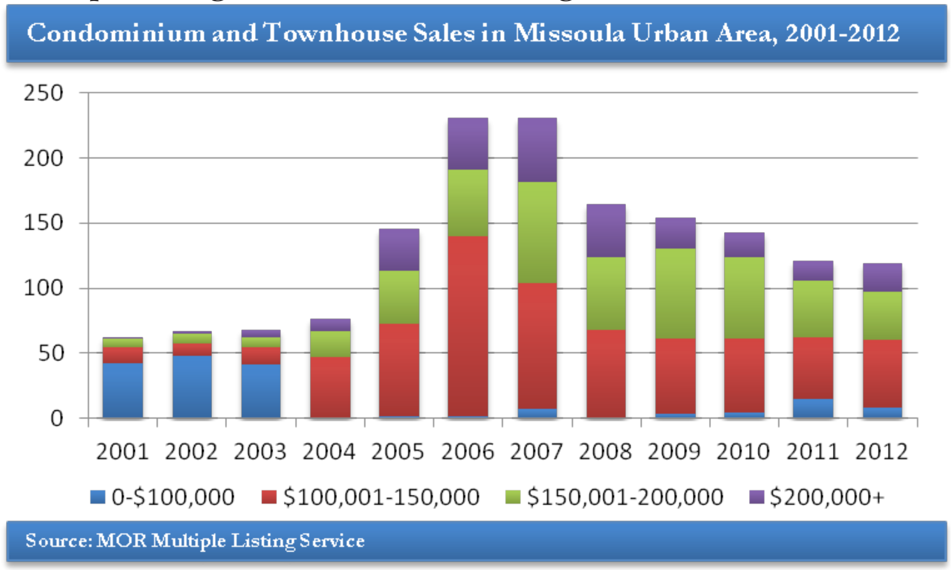
Condominiums and Townhouses

Sales of condominiums and townhouses in 2012 was steady compared with 2011, yet still down considerably from its peak years of 2006 and 2007. Sales decreased in the 0-$100,000 and the $150,000-$200,000 price ranges but increased in the $100,000-$150,000 and $200,000+ price ranges (Figure 20).

Comparative Trends in Home Prices

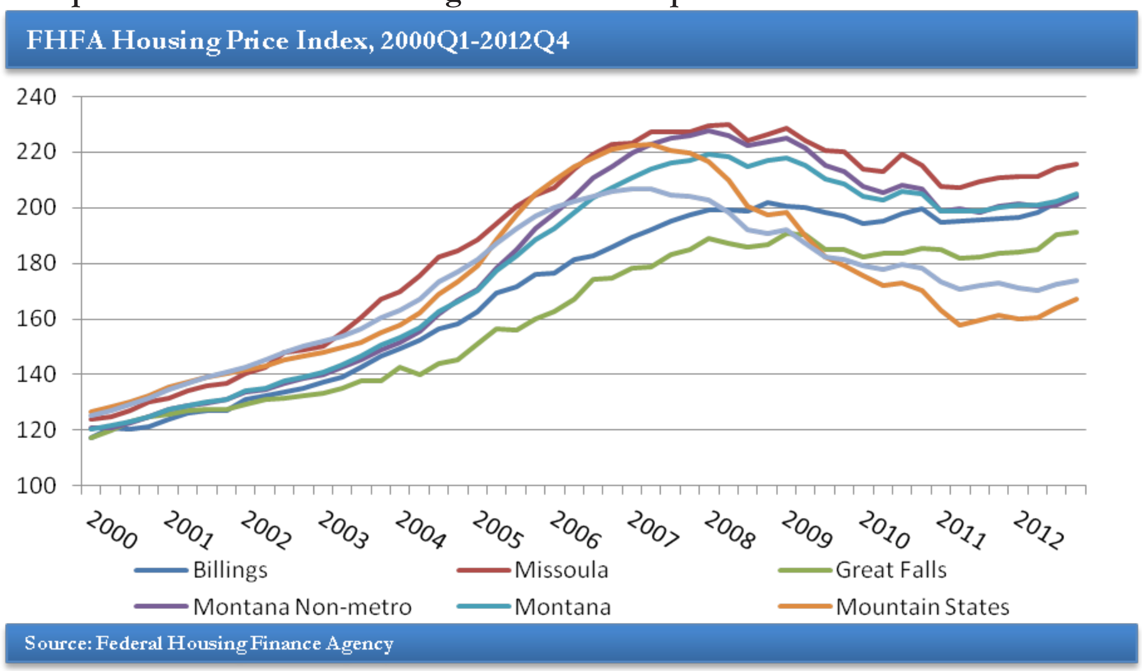
Both the Missoula and national housing markets saw an increase in both number of homes sold and median price. Missoula's median home price increased by 2.2 percent and the national median home price increased by 6 percent. The number of homes sold in Missoula jumped an incredible 22 percent, while the number of homes sold nationally increased by 9 percent, according to the National Association of REALTORS®.

Figure 20: Sales of condominiums and townhouses decreased in the lowest price range and increased in the highest



The Federal Housing Finance Agency Housing Price Index is a broad measure of the movement of single-family house prices. It measures the average price changes in repeat sales or refinancing of single-family properties using data from FannieMae and FreddieMac. In the first quarter of 1995 all price levels were set at 100, which is the base for the index. Housing prices in all Montana cities have increased steadily since 2011 (Figure 21).

Figure 21: Housing prices, as measured by the Housing Price Index, show a continued upward trend since bottoming out in second quarter 2011



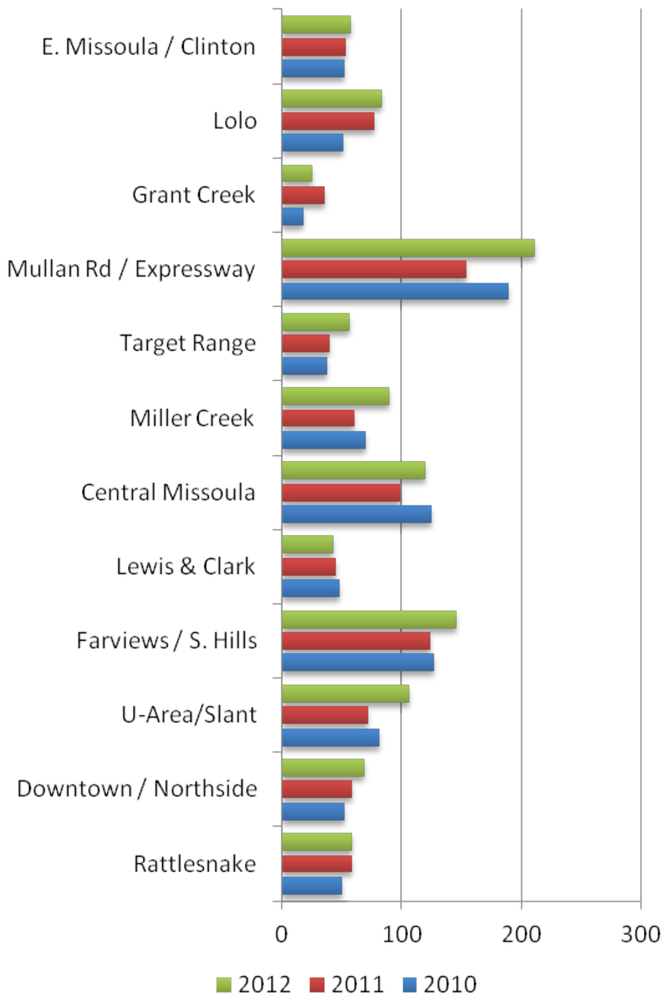
Sales Trends in Neighborhoods

The majority of Missoula's neighborhoods experienced an increase in number of homes sold in 2012 (Figure 22). The exceptions were Lewis and Clark and Grant Creek, which both decreased, and the Rattlesnake, which remained the same as 2011.

Additionally, all but three of Missoula's neighborhoods experienced an increase in median home price in 2012 (Figure 23). The exceptions were Downtown/Northside and Lewis and Clark, which both decreased, and Mullan Road/Expressway, which remained the same as 2011.

Figure 22: Only two neighborhoods experienced decreased sales in 2012

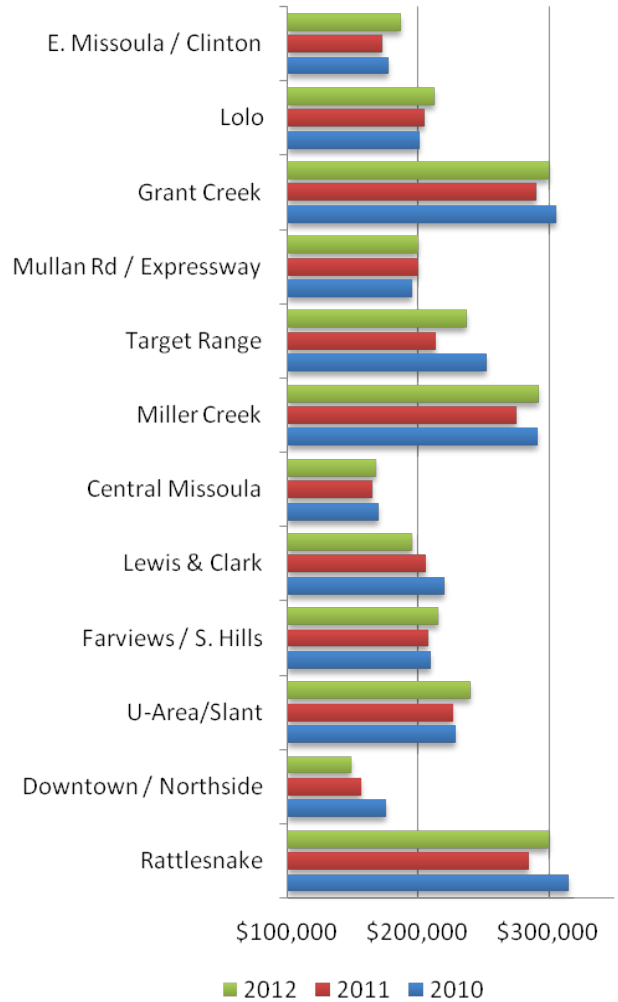
Home Sales by Neighborhood, 2010-2012



Source: MOR Multiple Listing Service

Figure 23: And only two neighborhoods experienced decreased median sales price in 2012

Median Sales Price by Neighborhood, 2010-2012



Source: MOR Multiple Listing Service

Pace of Home Sales

One measure of a healthy real estate market is absorption rate. The absorption rate represents the total housing supply of the market at a given time. Unlike the reporting of "days on market" this rate takes active listing information into account as well. In the past any reported "days on market" numbers reflected the average time on market for only sold properties, but that is only half of the story. The absorption rate digs deeper and looks at the amount of sold inventory compared to the amount of active inventory at the time. To calculate this rate we take the total number of active listings and divide that by the number of sales over a one-month period. The resulting number represents how many months' worth of inventory is currently listed for sale. For example if an area had 20 listings and five sales in the last 30 days, the absorption rate would be 4, meaning that based on the prior market's activity it would take four months for the remaining current inventory to sell. A general rule of thumb is anything under three months is a seller's market, between three to

Figure 24: Missoula's market absorption rate is finally back within the normal range of 3-9 months

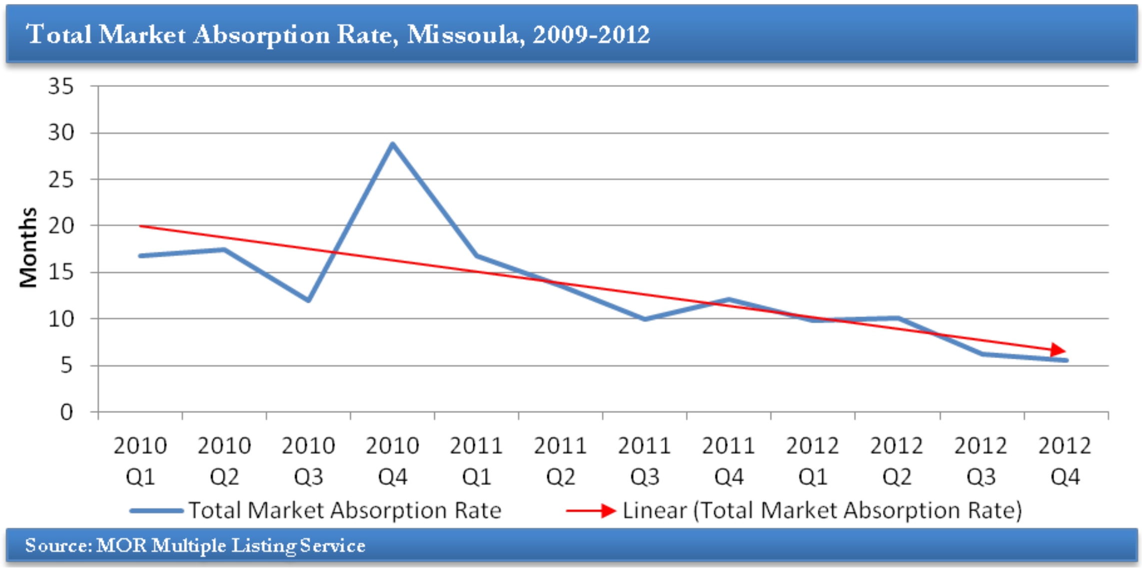
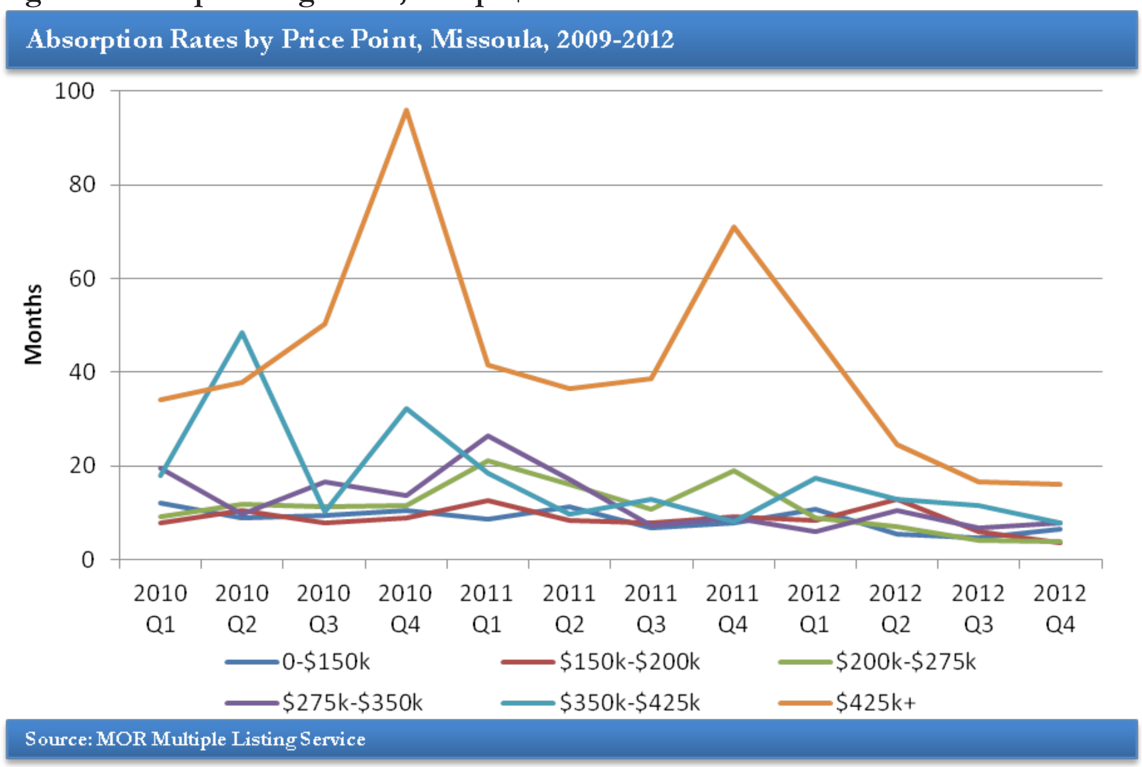


Figure 25: All price segments, except $425k+ have settled back to normal



nine months is normal market, nine to 12 months is over-supply, and the further you get over 12 months the more the market is over-loaded and a buyer's market.

The Missoula Organization of REALTORS® have been keeping absorption rate numbers since 2008 and moved to the current segmented format in mid-2009. The reasoning behind keeping segmented data at certain price points is that it tells stories of which price range is showing better overall market health. As Figures 24 and 25 show, the real estate bubble and the recovery so far have had different effects depending on what price range houses have been selling for.

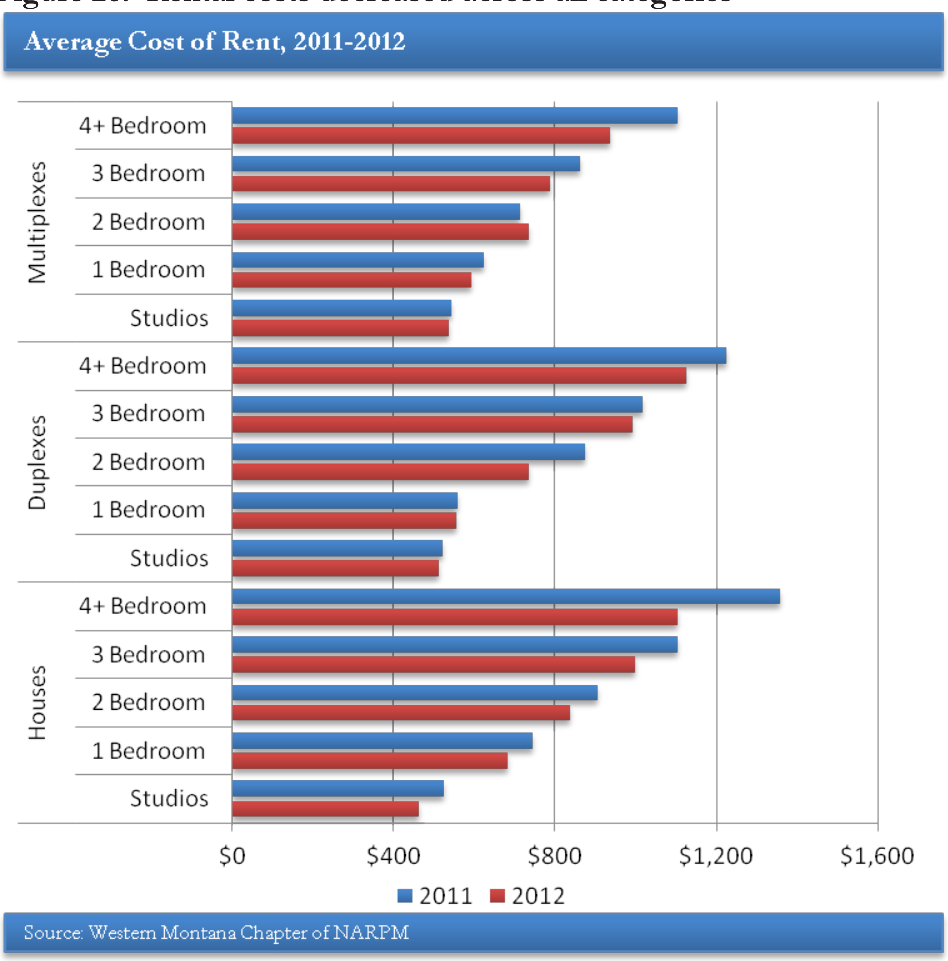
For the total market you can see there was a spike in late 2010 which pushed Missoula's overall absorption rate to almost 30 months (Figure 24). This can be attributed to the end of the first-time home buyer and move-up buyer tax credit. The market lost buyers that either bought or decided against buying once the tax credit was up and had to adjust and recover to that. The market absorption rate has gradually been decreasing, suggesting a return closer to a desired equilibrium. However, if you consider the rule of thumb on over-supply versus normal supply, you see that the Missoula market has only moved into a more "normal" range in the last two quarters.

Taking a look at the segmented data we see that the lower price ranges have adjusted and adapted to the current market more quickly (Figure 25). The positive that we see in this data is that most price segments have moved into a scenario of more normal supply and some areas even creeping down into what one may consider a seller's market. However the lack of supply presents challenges as well while buyers might have to wait longer to find housing they want and find more fierce competition when bidding on listings. Additionally we see the top-end of Missoula's market still struggling with vast over-supply. It has been improving for those who own homes over $425,000 but things are still not close to a market with a normal supply of buyers and sellers.

Rental Prices

Rental prices in Missoula decreased across all categories in 2012 compared with 2011 rates (Figure 26). The largest decreases were seen in the house category and the least change was seen in the duplex category. The decrease in rental prices may be attributed, in part, to the multi-family building that took place in 2012. As noted earlier, a spike in permits issued in 2011 led to a significant number of apartments on the market in 2012, which increased supply over demand.

Figure 26: Rental costs decreased across all categories



Mortgage Loans

In the latter quarters of the year the pending fiscal cliff caused concern for economic slowdown and other repercussions from tax increases and decreases in spending.

Mortgage interest rates closed the year on a nearly record low note (Table 3). 2012 was an improved year for most markets. Sales were revived by improved affordability, provided through low mortgage rates and affordable prices.

Table 3: Lower interest rates dominated the scene in 2012

2012 Mortgage Interest Rates					
Mortgage Type	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Year End
30 Year Fixed	3.750%	3.625%	3.500%	3.375%	3.250%
15 Year Fixed	3.125%	3.000%	2.875%	2.750%	2.625%
FHA/VA	3.500%	3.500%	3.250%	3.250%	3.000%
5/1 ARM	2.625%	2.750%	2.625%	2.750%	2.750%
MBOH	3.875%	3.875%	3.375%	3.375%	3.375%

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 rate for five years. Once the mortgage has matured for five years, the rate adjusts annually until it reaches a pre-determined limit

Figure 27: Federal Reserve policy and programs had a favorable effect on interest rates.

Impacts of Mortgage Insurance

Mortgage insurance is a policy that protects the lender in the event that the homeowner defaults on payments. Mortgage insurance premiums are paid by the homeowner. Mortgage insurance is not required on all loans, but is required on conventional loans when the first mortgage is greater than 80 percent of the property value. FHA and Rural Development (RD) loans also require mortgage insurance.

On a positive note, mortgage insurance is tax deductible for 2012 and 2013 on a qualified personal residence. The deduction is phased out by 10 percent for each $1,000 by which the taxpayer's adjusted gross income exceeds $100,000. Thus, the deduction is unavailable for a taxpayer with an adjusted gross income in excess of $110,000.

Down Payments

Down payment requirements for most loan program types, including FHA and conventional loan products remain virtually the same. FHA continues to require a minimum of 3.50 percent down while some conventional products are being offered between 3 percent and 5 percent. A typical down payment on a conventional loan would be 5 percent or more.

FHA financing is still an option with a minimum down payment of 3.50 percent. It may not be the first choice for borrowers who have a 5 percent down payment because of the upfront and annual mortgage insurance premiums which increased in April 2012. FHA is trying to reduce its risk tolerance by avoiding layering risks, which include lower credit scores, low down payments and high debt-to-income ratios.

U. S. Department of Veterans Affairs (VA) loans are still a viable option for borrowers who are eligible and continue to offer 100 percent financing in most cases.

USDA Rural Development loans continue to be a favorable choice for those borrowers who have little to no down payment and qualify under the income guidelines and other underwriting parameters. There are, however, restrictions on where the property can be located.

Foreclosures Re-Sales and Short Sales

Missoula saw an increase in distressed sales again in 2012, although at a lesser percentage than the past three years (Figure 28). A distressed sale is a property that is either under foreclosure or a short sale. Distressed property usually sells far below market value. A Foreclosure Re-Sale is when the bank sells a property after the foreclosure has taken

Figure 28: Both types of distressed sales increased in 2012

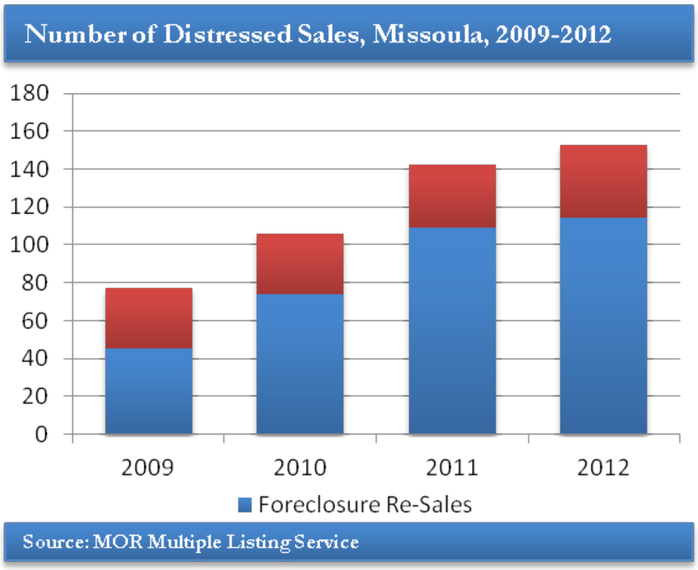
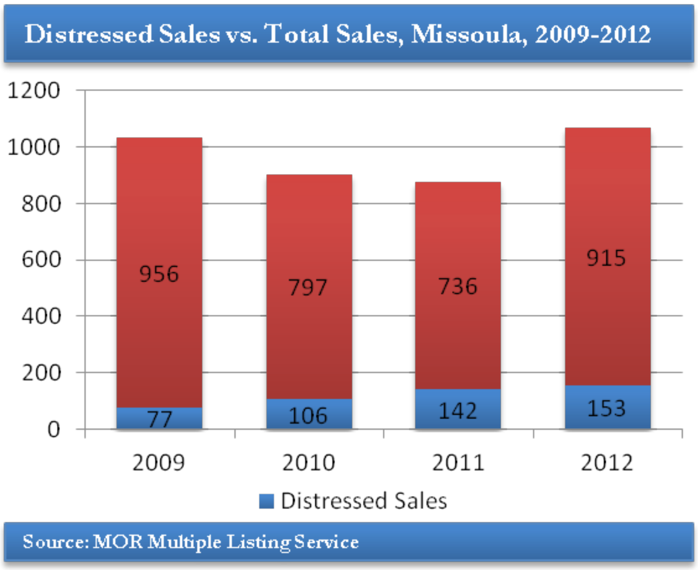


Figure 29: While the number of distressed sales increased in 2012, the percentage of total sales decreased



place. A short sale is a process where homeowners sell their properties for less than their mortgage balance, with the approval of their lender. Short sales allow homeowners to pay their lenders and avoid foreclosure. It reduces additional costs for both the creditor and borrower.

Short sales in Missoula stayed relatively level from 2009 to 2011, and then increased by 18 percent in 2012. The number of foreclosure re-sales has increased each year since 2009, although the percentage of increase is declining each year, with a modest increase from 109 in 2011 to 114 in 2012 (Figure 27).

Distressed sales, as a percentage of total sales, were down slightly in 2012 even though the number of distressed sales increased. While it is encouraging that the total number of homes sold in Missoula increased, the percentage of distressed sales is still twice what it was in 2009 (Figure 28).

2012 saw a six percent increase in the number of net foreclosures in Missoula County, with 151 compared to 142 in 2011 (Table 5 and Figure 29). This follows two years of decreases after hitting a high of 262 in 2009. While there were 62 fewer foreclosure notices of sale in 2012 than in 2011, the number of notices of cancellation of sale decreased by 25 percent. This led to the net increase of six percent.

Table 5: After two years of decreasing net foreclosures, Missoula saw an increase in 2012.

Bank Foreclosure Notices, Missoula County 2001-2012			
Year	Notice of Sale	Cancellation 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
2011	493	351	142
2012	431	280	151

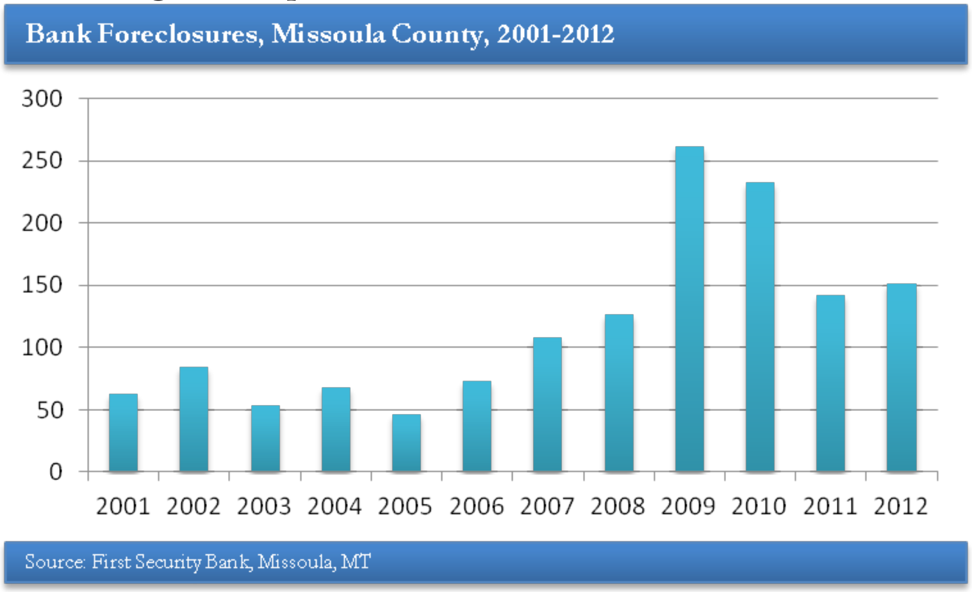
Source: First Security Bank, Missoula, MT

Table 6: Net foreclosures were up in the first three quarters of 2012 over 2011, but decreased in quarter four compared to 2011.

Year	Quarter	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
2011	Q1	124	126	-2
	Q2	119	82	37
	Q3	109	65	44
	Q4	141	78	63
2012	Q1	113	83	30
	Q2	117	62	55
	Q3	100	58	42
	Q4	101	77	24

Source: First Security Bank, Missoula, MT

Figure 30: Net foreclosures, while still quite high, are returning closer to the average for the past decade.



Home Ownership Programs

A grant program, Home$tart, was offered again in 2012. The Federal Home Loan Bank of Seattle partners with participating members to offer low and moderate income homebuyers grant funds that provide $3 for every $1 of homebuyer's funds up to $5,000. Home$tart Program grants may be used for down payments, closing costs, or rehabilitation of owner-occupied housing to qualifying homebuyers.

The Consumer Financial Protection Bureau commemorated its first anniversary in 2012, but there has not been much celebrating. The bureau was created to write and enforce federal consumer protection laws. However, until early 2013 it is unclear how it will affect homeownership. One of the biggest concerns for lenders is a perceived lack of clarity in the language and enforcement parameters.

One area that is impacted by regulatory and legislative changes is collateral evaluation. Collateral evaluation is more commonly referred to as property appraisal. As the residential mortgage industry continues to retrench and rebound, there are unfolding regulations that restrict how lenders are permitted to develop relationships with appraisers. Entities such as the Office of the Comptroller of the Currency, The Federal Deposit Insurance Corp. (FDIC), FannieMae and FreddieMac require lenders to be familiar with the appraisers who provide service. Ultimately, the lender is responsible for how property is valued and for ensuring that appraisers follow the processes to meet underwriting requirements.

As we look back upon 2012 it was a fairly favorable climate for mortgage lending and borrowing, despite obvious challenges.

Housing Affordability

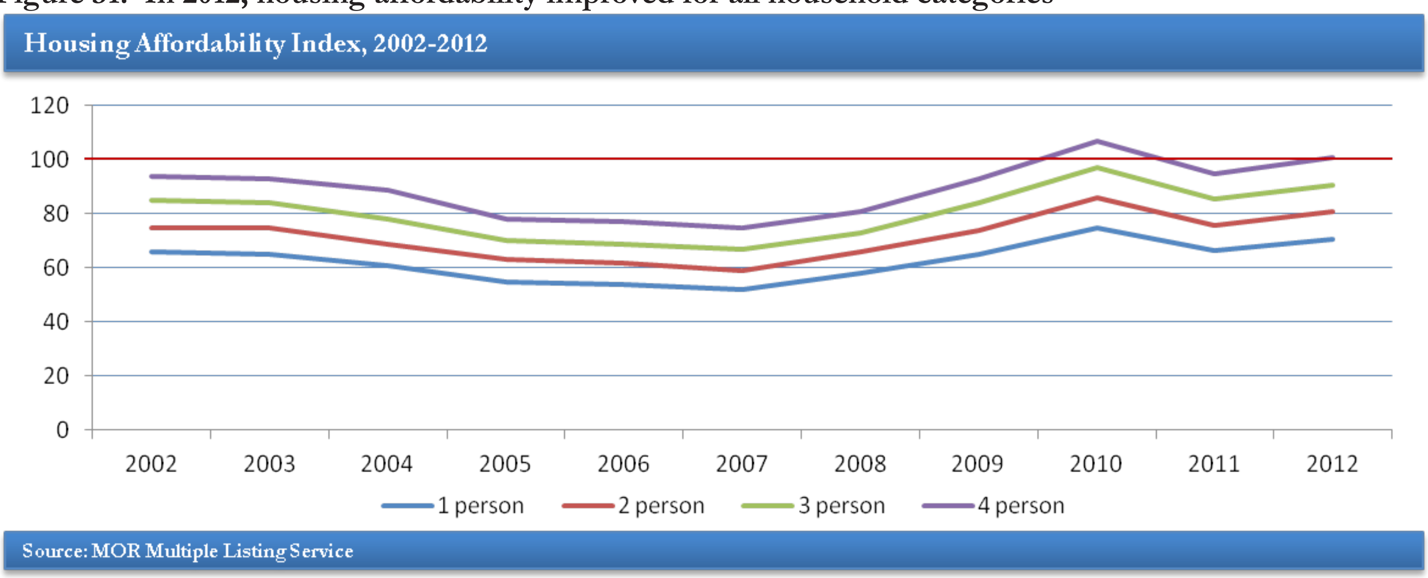
The Housing Affordability Index

The Housing Affordability Index (HAI) compares the median price of a home and the median income of households in a community. A value of 100 means that a household with a median income has exactly enough income to qualify for a mortgage on a median-priced home. For a value above 100, a household with a median income has more than enough income to qualify for a mortgage on a median-priced home. The National HAI calculation assumes a 20 percent down payment and it also assumes that no more than 25 percent of the household's monthly income goes toward the mortgage payment (principle and interest).

In the 2012 report, we heard concern about the fact that mortgage insurance, which is now a significant cost to consumers, was not included in our calculation for the HAI. Our 2012 calculations now include the cost of mortgage insurance (Table 7). Mortgage insurance is protection for the lender (not the borrower) in the event of default. The mortgage insurance company will reimburse the lender for all or part of losses they may have if the home is foreclosed on and must be sold by the lender.

If your down payment is less than 20 percent, or you are refinancing more than 80 percent of your home's value, most lenders will require that you purchase mortgage insurance. Although mortgage insurance is primarily for the benefit of the lender, it does allow homebuyers to purchase their home with a low down payment. The borrower pays the mortgage insurance premium on behalf of the lender. We used an average cost of 1 percent of the principle on the loan.

Figure 31: In 2012, housing affordability improved for all household categories



According to NAR, the national Housing Affordability Index in 2012 hit a record high 193.5, almost two thirds higher than the index reported in the Missoula market. For comparison's sake if we assume a 20% down payment, the HAI for a four person family in Missoula is 133, which tells us that a four person household earning the median income has the income necessary to afford a median-priced home.

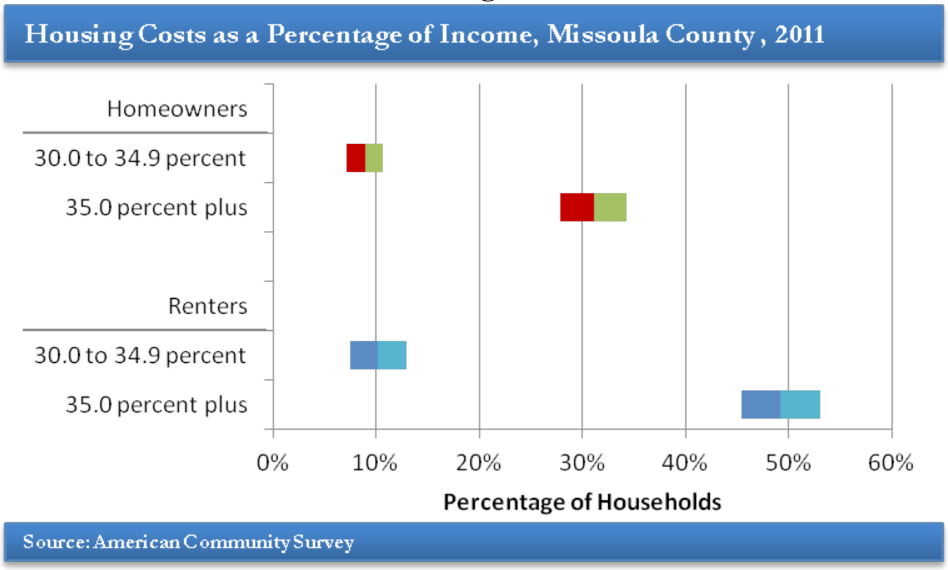
Table 7: HAI calculations now including mortgage insurance

Missoula Housing Affordability Index, 2002-2012	2002	2010	2011	2012
Median Home Price (MOR)	$149,500	$200,500	$205,000	$209,700
Down payment	10.0%	4.0%	4.0%	4.0%
Interest Rate	5.75%	4.50%	3.75%	3.50%
Loan Term	30 years	30 years	30 years	30 years
Mortgage Insurance			$164	$168
Total Monthly Payments*	$948	$1,192	$1,297	$1,299
Median Family Income				
1 person	$30,000	$43,000	$41,400	$44,000
2 person	$34,300	$49,200	$47,300	$50,300
3 person	$38,600	$55,300	$53,200	$56,600
4 person	$42,900	$61,400	$59,100	$62,800
Housing Affordability Index	2002	2010	2011	2012
1 person	66	75	66	71
2 person	75	86	76	81
3 person	85	97	85	91
4 person	94	107	95	101
Median Family Income Needed to Purchase a Median Priced Home	$45,502	$57,226	$62,260	$62,349

Source: MOR Multiple Listing Service
*Includes taxes and homeowners insurance on a 30 year fixed loan

While we did assume a 20 percent down payment for comparison above, very few buyers in Missoula purchased a home with that much. As you can see (Table 7), a 4% down payment was used in 2012 as a more realistic indicator of current trends, which also means that a mortgage insurance payment is required. In that case, only four person families were able to afford the median price of $209,700 for a home, with the other three categories falling far short of the $62,349 median income necessary. Single person households earn only 71 percent of the income necessary to purchase a median-priced home in Missoula.

Figure 32: Approximately half of all renters in Missoula spend more than 35% of their income on housing.



Share of Income Spent on Housing

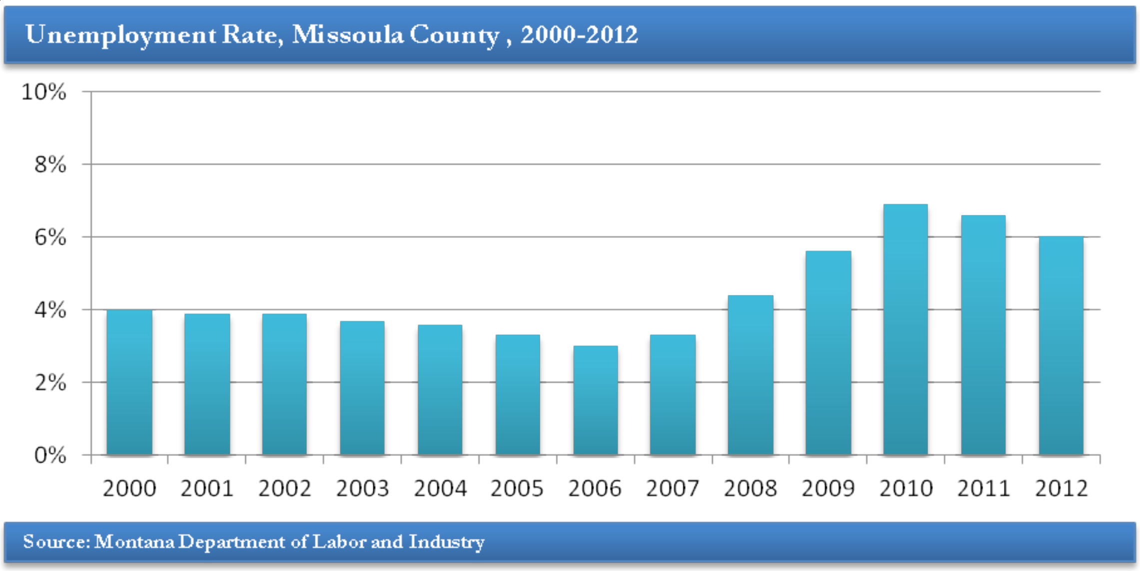
It is generally accepted that no more than 30 percent (and, more safely, 25 percent) of a household's gross monthly income should be spent on housing. The 2011 American Community Survey shows that about 47% of Montana renters spend more than 30 percent of their income on housing.

The problem is worse in Missoula, with about 60 percent of all renters spending more than 30 percent of

their income on housing. Additionally, between 43 and 51 percent of renters spend more than 35 percent of their household income on rent. 29 to 32 percent of homeowners pay more than 35 percent of their household income on housing (Figure 32). That makes Missoula the most unaffordable major market in Montana for renters.

Households who must pay a large portion of income on housing have a difficult time meeting other obligations. Harvard's *The State of the Nation's Housing 2012* states that "…those with severe housing cost burdens spend about three-fifths as much on food, half as much on clothes, and two-fifths as much on healthcare as those living in affordable housing."

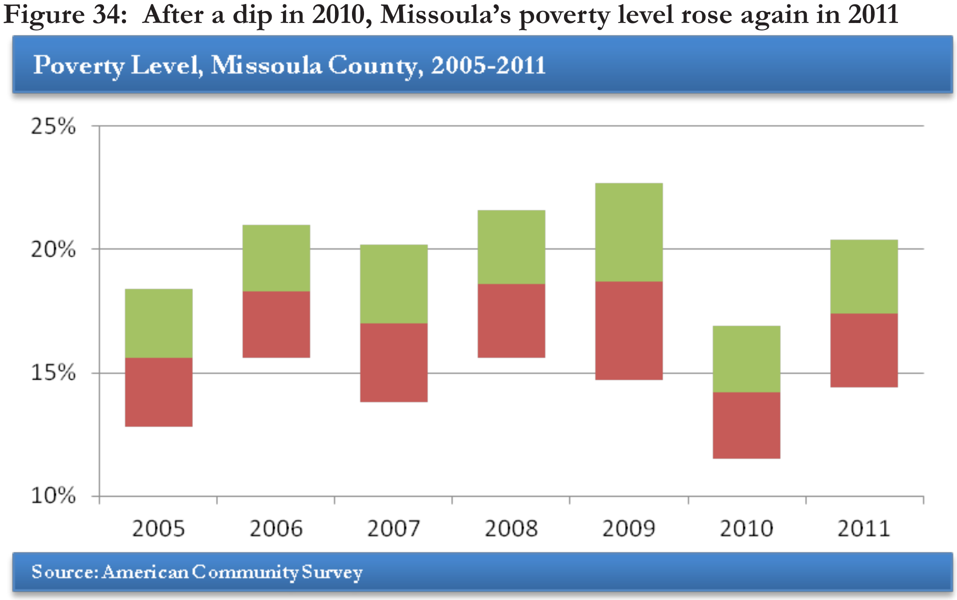
Figure 33: Missoula's unemployment rate dropped for the third year, following a four year increase.



Unemployment

The unemployment rate is defined as the percentage of the total labor force that is unemployed but able to work and actively seeking employment. Missoula County's unemployment rate declined to six percent in 2012 from its peak in 2010 of nearly seven percent (Figure 33). The national unemployment rate in December of 2012 was just shy of eight percent. While Montana experienced lower unemployment rates than the national average throughout the economic downturn, we are still nearly double the rate we were before the crisis began.

Figure 34: After a dip in 2010, Missoula's poverty level rose again in 2011



Poverty

Although the poverty level in Missoula appears higher than the state rate, the difference is not statistically significant. More than 17 percent of Missoula County households live under the Federal Poverty Level, compared to 15 percent of Montana households.

Estimates of poverty in Missoula County varied between nearly 19 percent in 2009 and 14 percent in 2010. One can say with a good degree of certainty that between 6,500 and 10,000 Missoula County households live below the Federal Poverty Level.

Rental Assistance Programs

The Missoula Housing Authority (MHA) has 774 available Section 8 vouchers that subsidize rent to private landlords for eligible 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 continued economic downturn, as tenant incomes are reduced and funding for vouchers has been reduced as well.

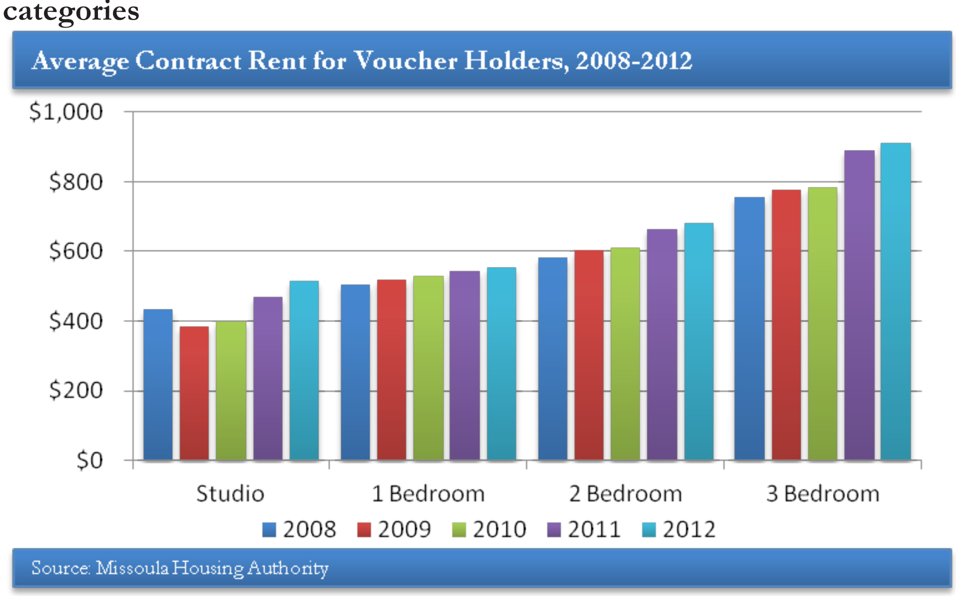
2012 saw the leasing of 35 new affordable units built by Homeword in 2011. Also, 115 new units built by Rocky Mountain Development Group, MHA and the City of Missoula began leasing. This is a mixed income project including 20 units of Public Housing and 95 units of affordable housing managed by MHA.

Table 8: Waiting lists have gone down in all categories in 2012.

Waiting Lists	2007	2008	2009	2010	2011	2012
MHA Unduplicated	1079	1410	1824	1944	2030	1920
MHA Sec 8 Voucher	1063	1315	1669	1653	1845	1756
MHA Homeless Project 1	112	103	136	156	141	85
MHA Homeless Project 2	59	159	118	114	114	111

Source: Missoula Housing Authority

Figure 35: Average contract monthly rent increased again in 2012 for all categories



In December 2012, the unduplicated number of households on MHA waitlists was 1,920, down slightly from 2,030 in 2011 and 1,944 in 2008, but up from 1,079 in 2007. The number of households on the Section 8 waiting list was 1,756, also down from 1,845 in 2011, but up from 1,653 last year and 1,063 in 2007.

Housing Choice Vouchers make private-market housing affordable for low-income families and individuals. In the Housing Choice Voucher program, the Housing Authority pays a fixed amount toward the rent, based on the tenant's income and the Housing Authority's approved payment standards (Figure 35). MHA received a modest increase in the number of vouchers it provides for homeless households in 2012 and has applied for another in 2013. The number of vouchers for homeless is up to 112, from 101 in 2010 and 96 in 2007. The number of homeless individuals on two of the waitlists was 85 and 111, compared to last year's 141 and 114.

Homelessness

In 2011, the City and County of Missoula and the United Way sponsored a 10 year plan to end homelessness. This important community attention to those homeless and at risk for losing housing has not had time to yield any specific results. We wanted to acknowledge the effort in this report by including some relevant housing data regarding homelessness in our community.

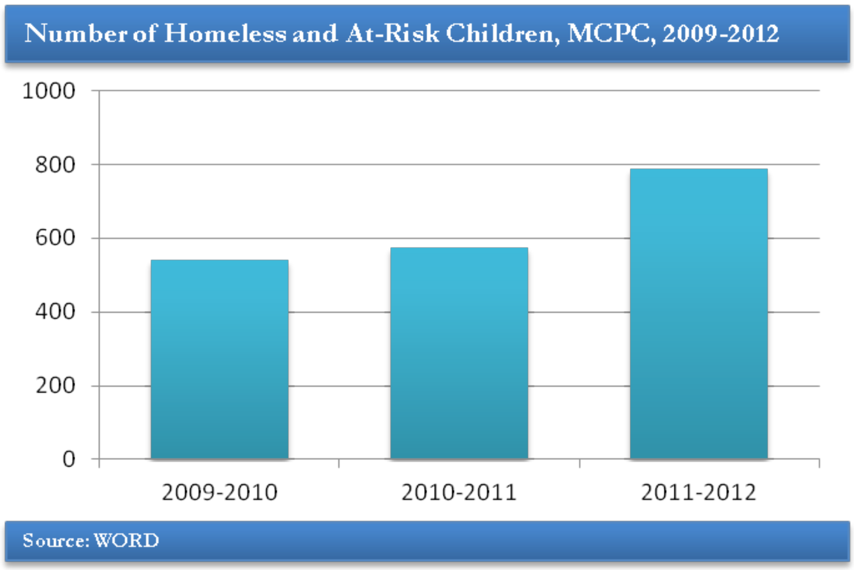
Table 9: Homeless continues to be a serious issue in Missoula

Homelessness In Missoula, 2007-2012		
Year	Individuals	Families
2007	134	18
2008	194	17
2009	133	22
2010	180	33
2011	130	17
2012	184	18
Source: Missoula Housing Authority		

One of the recommendations of the planning committee, however, is that Missoula develop a more systematic data collection and analysis system regarding the needs and causes of homelessness locally and develop informed responses. Coincidentally, the Human Resource Council is devoting some resources to developing a community database to help in assessment and referral.

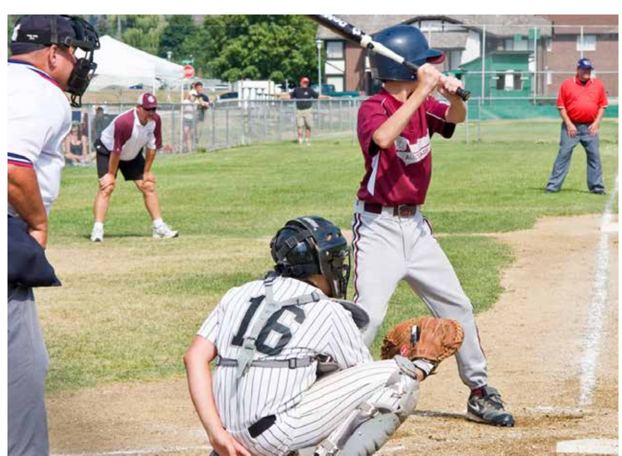
The best data we have currently—the annual Point in Time Survey, a census of the homeless conducted every January—produces inconsistent data, or data that may not inform us much. Because the questions asked and the methods of collection vary from year-to-year, it is hard to draw any conclusions from the data. In the point-in-time-table is the number of homeless individuals and families, which means they're in emergency shelter or on the street, from 2007 to 2012 as an example (Table 9).

Figure 36: 2011-2012 saw a dramatic increase in at-risk children in school



Last year, the school district identified 614 children in Missoula as homeless and another 175 as at-risk (Figure 36). This figure is a cumulative number of unstably housed children identified throughout the school year. The unstable housing varies from brief periods of literal homelessness to a pattern of frequently moving and other situations. According to the National Coalition for the Homeless, families with children is one of the fastest growing segments of the homeless population; as Figure 36 illustrates, Missoula is no exception. The number of homeless and at-risk children in Missoula County Public Schools increased 38 percent in just one academic year.

As mentioned above, MHA has increased the number of vouchers and units for homeless individuals and families incrementally over the last several years. Missoula has two-thirds of the permanent housing for the homeless in the state of Montana. However, during the same period, some other resources serving the homeless have been reduced or eliminated.



Conclusion and Outlook

By almost all measures it looks like the housing market is finally on the rebound. With the number of home sales nationally at its highest level in five years and the median home price increasing, there is definitely reason to be, at least, cautiously optimistic. The fact that the trend in Missoula is mirroring the national trend means that Missoulians also have good reason to be optimistic.

An increase in home prices is great for homeowners but not great for those wanting to buy their first home. Fortunately, the ability of people to buy homes is looking good as well. Lawrence Yun, the chief economist for NAR stated that "The housing affordability index shows that the national median income of families was almost double the income needed to buy a median-priced home in 2012, so most buyers are able to stay well within their means. Even with rising home prices, conditions are expected to stay very favorable with the index averaging 161 in 2013, which would be the third best on record."

The increase in income and decrease in interest rates has allowed homes in Missoula to be more affordable in 2012 despite an increase in median home prices. With a 20 percent down payment, a four person household has an HAI of 133. However, since most families do not have that ability, the actual HAI is 101. If median home prices continue to go up, Missoula will face the recovery still dealing with issues with housing affordability.

Pairing these indicators with today's low interest rates, the real estate market should continue improvements throughout 2013. It is important to remember, however, that not everyone is able to take advantage of the current interest rates to buy a home. While lower interest rates are enticing for homeowners who want to refinance their existing mortgages, current lending standards remain tight and there have been instances where seemingly qualified buyers have come across issues obtaining financing.

While the signs are pointing in the right direction, this economic recovery has been longer and more complicated than most of us hoped for. The Bureau of Business and Economic Research stated in its Economic Outlook 2013 that "There are probably too many uncertainties directly ahead for the national economy to hope for much more than modest growth in 2013. But…in many ways the U.S. economy is in better position for faster growth than it has been in years."

While growth may still be slow, the local market has finally returned to "normal" absorption rates suggesting we are as close to what is expected to be a normal market in terms of absorption (supply and demand) than we have seen in over five years.

But let us not forget that in Missoula we are still experiencing higher-than-average median home prices and lower-than-average median incomes. Additionally, distressed sales in Missoula continue to rise. Couple these issues with an increase in poverty and homelessness, and locally we still have much work to do.

Report Available Online:
www.MissoulaRealEstate.com,
Under “Market Trends”

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