Home Affordability in Montana: An Issue Once Again?

by Kyle Morrill and Patrick M. Barkey

There wasn't much good about the housing bust and the Great Recession of 2007-09 for the Montana economy. Employment, income, and state tax revenues all took a significant hit, with construction and real estate markets feeling special pain as the downturn stressed economies and businesses around the state.

There was one silver lining, however. That came from the steep declines in home prices across most of Montana. After nearly a full decade that saw housing prices rise faster than income, the issue of housing affordability was looming large in many Montana markets. The recession put an end to that trend, and affordability went up across the state.

Not that it mattered much. The downturn affected economic well-being in so many ways that the fact that housing was more affordable was of little importance to most Montanans.

But the old trend is beginning to re-emerge. Since 2010, real estate markets are returning to health, and housing prices
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Trends in Housing Affordability

Just as the choice of a dwelling is something that individuals and families ultimately decide, the question of what constitutes affordable housing is determined by individual circumstances. But those choices will be constrained by the prices and rents presented by the marketplace, as well as the financial capacity of consumers to handle those costs. This is why discussions of housing affordability usually boil down to comparisons of the growth in monthly payments for housing and household income.

Like many markets nationwide, Montana housing prices rose very rapidly for much of the previous decade, as shown in Figure 1. Measured by the Federal Home Finance Agency’s Housing Price Index, single family homes experienced cumulative price appreciation of just under 70 percent statewide between 2001 and 2007. This housing boom period was a marked departure from the 1990s, when price growth was just six percent per year.

The growth in income in Montana during the boom period in housing was more restrained, as the graph shows. Median household income grew significantly between 2001 and 2007, but at only about half the rate as housing prices. Thus a household earning the median income level faced housing costs that consumed an increasing fraction of total household budgets.

A change occurred with the housing bust, however. Between the years 2007 and 2011, the value of Montana homes fell dramatically, bringing cumulative price growth since 2001 into much closer alignment with income growth. Beyond 2011, as shown in Figure 1, the divergence between housing price growth and income growth has reappeared, raising the issue of affordability once again.

The increased burden of housing prices is not limited to just homeowners. Since 2010, the number of Montana renters paying more than 30 percent of their income towards housing has increased by nearly 13 percent, according to data collected by the American Community Survey. In nearly all of Montana’s major housing markets rents exceed 30 percent of income for more than 40 percent of renters.

The Housing Affordability Index

These trends in housing affordability can be measured more precisely by constructing a Housing Affordability Index (HAI). The HAI developed by the U.S. Housing and Urban Development Agency asks the question, what fraction of the monthly payment on the median price home can a household earning the median income comfortably make? If the percentage is 100 or above, then the market is considered affordable. However, if the index is less than 100, it implies that households face pressure making their housing payments.

Some basic assumptions go into the computation of the HAI regarding the size of down payment, closing costs, and length of the mortgage note. While important, these assumptions do not affect trends in the index over time. On the other hand, changes in interest rates, housing prices and median income do cause the HAI to change exactly as you would expect.

How affordable are owner-occupied housing markets across Montana? The results from the HAI computed for the eight largest counties in the state for the even-numbered years, 2008-2014, address that question (Figure 2). There are several findings of note:

- In 2014, the most recent year available, Ravalli County is the only market considered to be unaffordable (HAI less than 100). Flathead, Missoula and Gallatin Counties have HAI’s that remain slightly above the 100 percent threshold.

- Every market in the state has seen affordability fall in 2014, after registering considerable improvement in affordability between 2008 and 2012. In Flathead, Gallatin, Missoula and Ravalli Counties, the housing price bust changed the status of these counties from unaffordable to affordable.
In four of the counties measured – Cascade, Lewis and Clark, Silver Bow and Yellowstone – markets are considered affordable in all years shown.

**The Factors Driving Housing Price Growth**

The discussion of changes in housing affordability – over time, or between markets – is in reality a discussion about differences in housing prices. It has been the swings in direction of housing price growth, and differences in housing prices across Montana’s major markets that drive outcomes in affordability. Prices and rents, in turn, are market outcomes that have been shaped by changes in the fundamental forces underpinning the supply and demand sides of the marketplace.

The past fifteen years of boom, bust and recovery in Montana housing markets illustrate these forces at work. Let’s examine the demand side of the marketplace first.

Growth in the number of households as well as in income are the primary drivers of housing demand. Changes in population are best measured, in the short-run, by net-migration. As with housing markets, the recession had a significant impact on migration patterns, with high levels of in-migration associated with the boom years. The recession slowed down in-migration, and some communities, including Flathead, Gallatin, and Missoula Counties, actually lost population. Greater job uncertainty, fewer employment opportunities, stagnating wages, and falling home prices all made it more difficult for families to sell their homes and move.

The economic recovery, along with increasing employment and income, loosened the forces restraining migration. Between the years of 2012 and 2013, the most recent year available, yearly net-migration has approached pre-recessionary levels in Montana. This trend is evident in many of the major housing markets in the state, with Flathead, Gallatin, and Ravalli Counties all showing significant population increases. Increases in net-migration are most concentrated in western Montana and, with the exception of Missoula County, correspond to markets with growing housing prices. Even in markets less affected by the bust in terms of population, such as Yellowstone County, the recovery is associated with increases in annual net-migration that provide pressure on vacancies and inventories.

Along with population growth, Montanans’ incomes have increased by 2 or 3 percent annually coming out of the recession. While more sluggish than in the early 2000’s, and certainly at a slower rate than that of housing prices, non-farm earnings in most of Montana’s major housing markets have steadily grown since 2009. This, in concert with increasing population, spurs housing demand and exerts upward pressure on prices.

While population and incomes have increased, Figure 2 shows that homeownership rates have steadily declined since 2011, dropping 5 percentage points to 67 percent in 2014. As less Montanans become homeowners, pressure on the rental market increases, generating higher rents and increasing housing prices. Renters, on average, pay a higher share of their income towards housing. Decreasing homeownership rates coupled with increased rents makes it more difficult for prospective first-time homebuyers to save for a down payment.

Moving to the supply side, housing starts have certainly
Table 1
Net Migration, Montana and Selected Areas (Migrants per Year)

<table>
<thead>
<tr>
<th>Area</th>
<th>2002-08</th>
<th>2009-11</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Montana</td>
<td>4,300</td>
<td>1,652</td>
<td>3,946</td>
</tr>
<tr>
<td>Cascade</td>
<td>-361</td>
<td>-74</td>
<td>-672</td>
</tr>
<tr>
<td>Flathead</td>
<td>1,319</td>
<td>-223</td>
<td>1,084</td>
</tr>
<tr>
<td>Gallatin</td>
<td>1,218</td>
<td>-225</td>
<td>623</td>
</tr>
<tr>
<td>Lewis and Clark</td>
<td>416</td>
<td>485</td>
<td>323</td>
</tr>
<tr>
<td>Missoula</td>
<td>332</td>
<td>-146</td>
<td>-287</td>
</tr>
<tr>
<td>Ravalli</td>
<td>467</td>
<td>142</td>
<td>332</td>
</tr>
<tr>
<td>Silver Bow</td>
<td>-89</td>
<td>95</td>
<td>37</td>
</tr>
<tr>
<td>Yellowstone</td>
<td>868</td>
<td>734</td>
<td>1,037</td>
</tr>
</tbody>
</table>

Source: U.S. Department of the Treasury, Internal Revenue Service

bounced back from their recessionary low. New housing starts totaled over 6,500 units in 2014, up nearly 200 percent from 3,370 in 2010. While significant, new construction remains at only 67 percent of 2005 levels, the peak of the boom years. Nonetheless, growth has been strong, notably so in Flathead, Gallatin, Ravalli, and Yellowstone Counties. Of particular note has been the shift to multi-family construction as a driver for new home growth. Multi-family units made up 28 percent of new construction in 2014, up from just 14 percent in the peak boom years and 21 percent in 2010. Of Montana’s major housing markets, multi-family housing starts contributed 45 percent or more of new home construction in Cascade, Lewis and Clark, Missoula, and Silver Bow Counties in 2014.

What’s Ahead for Affordability

By and large, we expect current trends to continue into 2016. Housing affordability will continue to be an issue as home prices grow faster than incomes. The recent uptick in single-family housing starts will increase supply; however, migration trends look to keep pace or even exceed housing growth in many of Montana’s major housing markets.

One factor lurking in the background of all these trends is the apparent delay in home purchase decisions by young adults. For a variety of reasons – including delays in marriage and family formation, increased educational debt, or even urban lifestyle preference – the dream to own a home is less pronounced, and declining homeownership rates in Montana and elsewhere have shifted the mix for housing in important ways. Many of these shifts pre-date the great recession, and while income growth and the continued economic recovery point to growth in housing demand in coming years, evidence suggests these demographic shifts are here to stay.

Amid rising home prices, demand growth, and tightening inventories, one area where Montanans may see some relief is in rental markets. The growth in multi-family housing starts in 2014 should help to relieve demand and ease growth in rental prices. We’ve seen homeownership rates in Montana reach historic lows as the mix of homeowners reaches equilibrium with economic conditions and lifestyle choices among young adults. In turn, as rents make up a smaller proportion of Montanans’ incomes, more families and individuals will be able to save for a down payment on a home. We expect the erosion of homeownership rates to bottom out in the coming years.