

### The Pacific Northwest among the Healthiest Housing Markets in the Nation

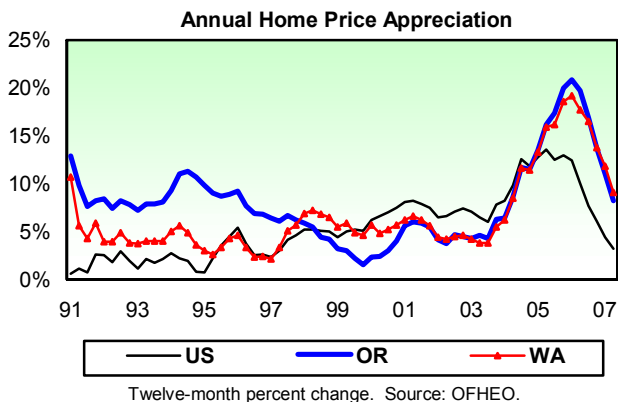
Concerns over U.S. subprime mortgage losses are playing havoc on credit markets around the world. Last month, volatility in the financial market became so great that central bankers in the United States and Europe were compelled to pump a huge amount of liquidity into their respective markets to avoid another financial crisis.

At the same time, lenders have considerably tightened underwriting criteria for subprime mortgages and, in some cases, prime mortgages. Tighter credit means fewer home sales and flat or falling home prices in many local markets. The Office of Federal Housing Enterprise Oversight (OFHEO) recently reported that house prices fell in 15 states during the second quarter of 2007. Nationwide, home prices increased only 0.1% during the same quarter.

The year-over-year home price changes were negative in five states, including Nevada (-1.5%), Michigan (-1.4%), California (-1.4%), Massachusetts (-1.0%), and Rhode Island (-1.0%). The last time that home prices dropped in so many states was in the first quarter of 1997, when 10 states and Washington, DC, experienced year-over-year price declines.

#### Home prices are still rising in the Pacific Northwest.

By comparison, the Pacific Northwest region looks quite healthy. In terms of annual price changes, Washington ranked 3rd nationally with 9.1% appreciation after Utah (+15.3%) and Wyoming (+12.8%). The national average was 3.2%. Oregon ranked 7th with an 8.2% annual increase, but its quarterly appreciation was the fifth largest among 50 states at 1.6%. (See the chart below.)



The hottest local market in the country as of the second quarter was Wenatchee, Washington, with 23.5% annual appreciation. Four more metropolitan areas in Washington made the top-20 list: Longview (+13.6%), Seattle (+9.9%),

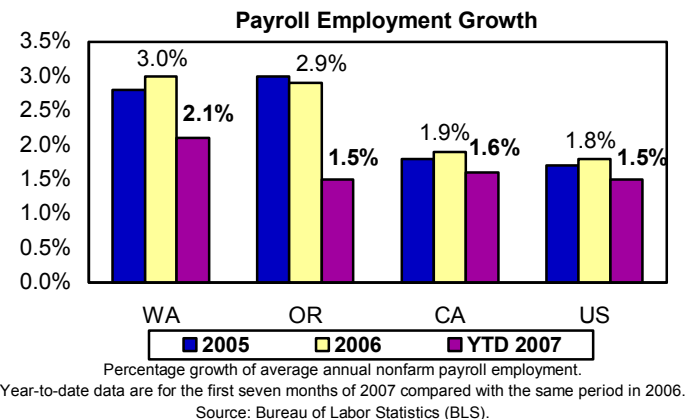
Tacoma, and Spokane (both +9.3%). Salem (+12.0%) was the only Oregon market that made the list.

While the region's residential markets have greater momentum than the rest of the country, the rate of appreciation has slowed from its peak in 2006 when annual price increases were around 20%. The Washington Center for Real Estate Research estimates the median resale price of homes in Washington to be \$316,700 as of the second quarter, 8.1% higher than the same period in 2006. This figure is more or less consistent with the 9.1% estimate by OFHEO.

#### The region continues to gain construction jobs.

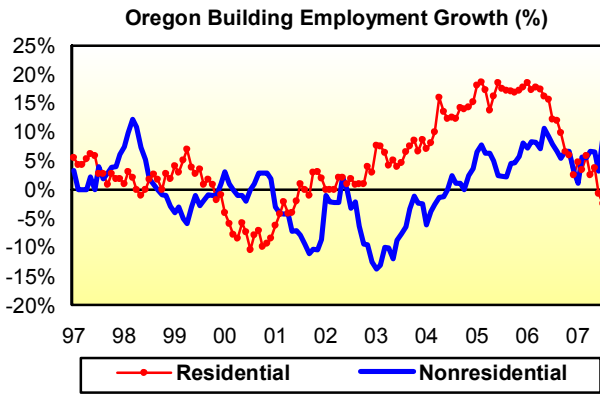
Not only does home price appreciation in the region remain brisk, but Oregon and Washington enjoy some of the lowest subprime mortgage delinquency ratios in the country. What, then, accounts for the strength of the Pacific Northwest housing markets?

One obvious reason is continued growth in payroll employment. As the following chart shows, job growth has slowed in both Oregon and Washington from its rapid pace in 2005 and 2006, but remains either at or above the national average. During the first seven months of this year, average nonfarm payroll employment in Washington was up 2.1% compared with the same period last year.

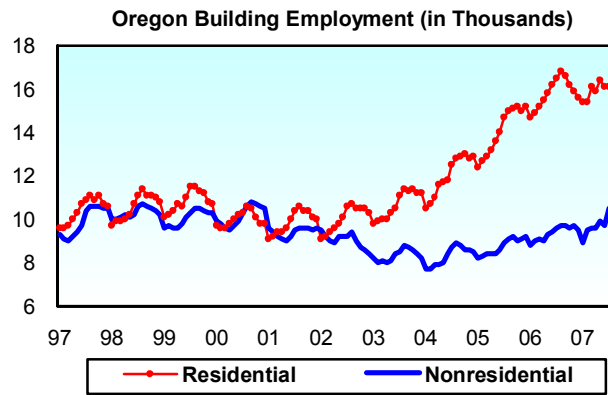


Oregon, where the rate of employment growth was almost halved to 1.5% this year from 2.9% in 2006, experienced a more pronounced deceleration.

Unlike the rest of the country, the construction sector is not shrinking in the Pacific Northwest. Between July 2006 and July 2007, some 64,000 construction jobs disappeared nationwide. Washington gained 9,900 construction jobs and Oregon gained 1,400 over the same period. Most of the job gains occurred in the nonresidential building sector.



Twelve-month changes. Not seasonally adjusted. Source: BLS.



Not seasonally adjusted. Source: BLS.

The chart on the left shows annual percentage growth of employment in residential and nonresidential building construction in Oregon. These sectors were often countercyclical to each other in the past (as indicated by crisscrossing patterns of the two lines), but between 2003 and 2006, the lines moved together—upward. Since 2006, they have once again assumed a countercyclical pattern.

Over the past twelve months, the number of residential construction workers was down 2.4%, while that of nonresidential builders was up 9.4%. The hitch is that many more workers are now involved in residential construction than commercial construction, as the chart on the right shows. Therefore, reduced home building activities have substantially offset the solid gain made by the nonresidential sector. In its recent report, the Washington State Employment Security Department affirms that similar trends also exist in Washington.

**Other housing-related industries are weak.**

All this does not mean that the region is unaffected by the national housing recession. In Oregon, the financial sector

has lost 1,400 jobs over the past year due to mortgage and real estate industry woes. Also, 500 positions have disappeared at building materials and garden supply stores since a year ago because of slower home sales.

The situation is better in Washington, where the economy has greater momentum. Still, job growth in the financial sector has slowed substantially, and so has employment at furniture stores and building material and garden supply retailers.

Fortunately, job growth in service and government sectors remains robust in both states, suggesting that the fallout from the subprime crisis has so far been limited to residential construction, mortgage lending, and a few housing-related industries. How the region will fare for the rest of the year, of course, depends on the ultimate severity of the mortgage loan problem and whether the rest of the economy suffers from its spillover.

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**Economic Forecast – September 2007**

UNITED STATES	2005	2006	2007	2008
Real GDP Growth (%)	<b>3.1</b>	<b>2.9</b>	2.0	3.0
Unemployment (%)	<b>5.1</b>	<b>4.6</b>	4.6	4.8
Payroll Employment	<b>1.7</b>	<b>1.9</b>	1.3	0.8
CPI Change (%)	<b>3.4</b>	<b>3.2</b>	2.8	2.4
Federal Funds Rate (%)	<b>3.2</b>	<b>5.0</b>	5.3	5.3
<b>OREGON</b>				
Employment Growth (%)	<b>3.0</b>	<b>3.0</b>	1.3	1.4
Personal Income Growth	<b>5.5</b>	<b>6.0</b>	6.2	5.4
<b>WASHINGTON</b>				
Employment Growth (%)	<b>2.8</b>	<b>3.0</b>	2.0	1.6
Personal Income Growth	<b>2.9</b>	<b>7.2</b>	5.9	5.6

**Bold: Actual.**

The information in this report is based on data available as of September 6, 2007, and has been obtained from sources believed to be reliable, but its accuracy, completeness, and interpretation are not guaranteed. We do not think it should necessarily be relied upon as the sole source of information and opinion.