



Single-Family Housing Squeeze Eases in Texas; Multifamily Soars

By Laila Assanie

ABSTRACT: Single-family home sales in Texas—constrained by steadily rising prices, tight bank lending standards and insufficient new-house inventory—should gain traction in 2015. A booming apartment market moderates slightly amid still-elevated construction activity, occupancy rates and rents.

The Texas single-family housing market has lost some of the rapid momentum attained over the past two years. Home sales and new-home construction increased at double-digit rates in 2012 and 2013 as strong job growth and rising incomes drew new residents to the state. Although economic and population expansion remain robust, growth in home sales turned relatively flat in 2014 after the market experienced record-high prices, depleted existing-home inventories and declining affordability.

The lean inventories along with a strong Texas economy have spurred demand for new homes. However, persistent labor shortages, low lot supply, tight lending for land development and higher input costs have hindered construction. As a result, new-home supply trails demand, leading to rapid price appreciation.

In turn, affordability has declined, leaving entry-level buyers—typically accounting for an outsized share of Texas home purchasers—priced out of the market. However, easing lending constraints indicate construction of new houses could increase in 2015.

For now, demand has shifted to the multifamily market. The apartment market has faced similar building constraints—labor shortages and higher construction costs. But a strong appetite for apartments, supported in part by a favorable financing environment, has driven up construction and sent rents and occupancy to multiyear highs.

Rapid Home Price Gains

Texas has a vast supply of land and relatively few building regulations, typically allowing construction to respond quickly to demand and limiting price swings relative to what other large states

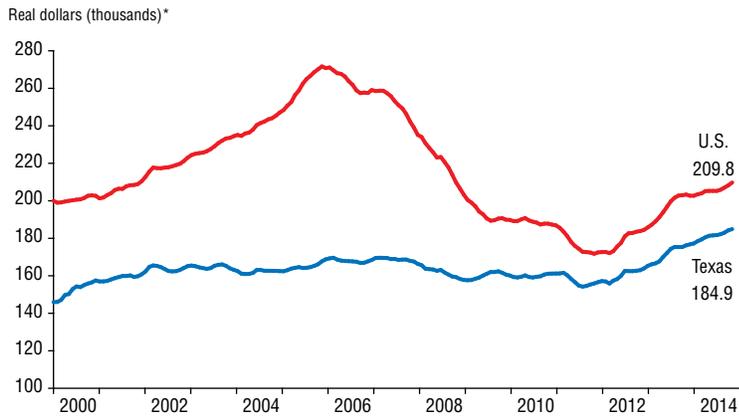
experience. For example, during the U.S. housing boom, Texas recorded modest home price appreciation even as prices nationwide reached record levels. While home prices in Texas advanced 3.6 percent in 2004 and 6 percent in 2005, nationally they rose 10 percent in both years.¹ Similarly, Texas prices were relatively restrained when the national housing market peaked and values collapsed.²

Things have played out differently during the housing recovery, with Texas price increases outpacing those nationally. In 2012, Texas saw a 6.9 percent price gain, compared with a 5.4 percent increase for the U.S. In 2013, the state at 7.4 percent was close to the nation's 7.7 percent gain.³

The rapid Texas increase pushed home prices to record levels. In the third quarter, prices stood 18.7 percent above where they were in fourth quarter 2007—the high before the housing bust. U.S. prices remain 6.2 percent below their prerecession peak, reached in first quarter 2007. Measures such as the S&P/Case Shiller index and data from the Multiple Listing Service (MLS) show a similar pattern of less volatility in Texas home prices during the U.S. housing boom–bust period, but an uncharacteristic surge during the recovery (*Chart 1*).

All indicators point to a slowing pace of appreciation in 2014—on average. Texas home prices increased 6.6 percent (annualized) through the third quarter, according to Federal Housing Finance Agency data (*Table 1*). Similarly, the real median home price was up an annualized 4.8 percent through October, compared with a 6.7 percent increase the year before. Anecdotally, housing consultants and sales agents report buyers are increasingly resistant to price increases.

Chart 1 Texas Existing-Home Median Price Surges in Recovery



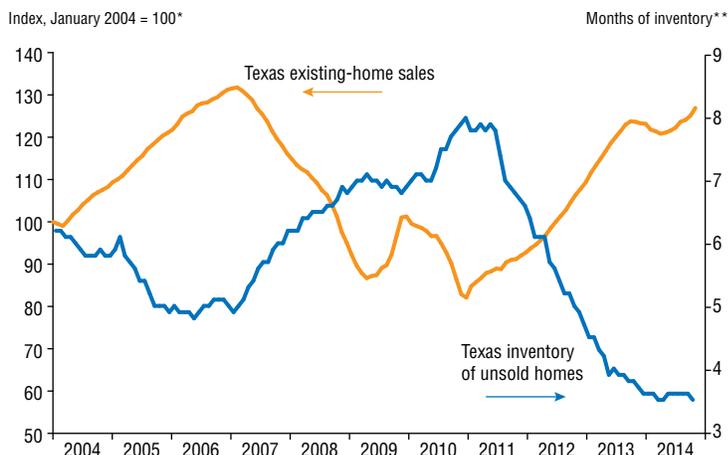
*Four-month moving average, seasonally adjusted.
 SOURCES: Multiple Listing Service; seasonal and other adjustments by Federal Reserve Bank of Dallas.

Table 1 Texas Home Price Gains Slowing

	2014 year to date annualized		2013	
	Texas	U.S.	Texas	U.S.
*FHFA House Price Index (Q3)	6.6	4.4	7.4	7.7
**S&P/Case Shiller Index (Sept.)	5.9	2.8	10.2	13.4
MLS real median sales price (Oct.)	4.8	4.7	6.7	8.1

*Data are quarterly.
 **Dallas is used to approximate Texas.
 SOURCES: Federal Housing Finance Agency (FHFA); S&P/Case Shiller; Multiple Listing Service (MLS).

Chart 2 Home Sales Rise, Inventories Fall to Record Low Levels



*Six-month moving average, seasonally adjusted.
 **Seasonally adjusted.
 SOURCES: Multiple Listing Service; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Improved Demand

Shrinking inventories, especially since 2012, significantly figure in the price run-up. Following the national bust, Texas home demand fell to levels not seen since 2002 as hiring slowed and sliding home prices kept cautious buyers on the sidelines. A temporary tax credit program provided a reprieve in 2009 that gave way to another sales drop the following year (*Chart 2*). Texas existing-home sales began improving in 2011, rising 1.7 percent amid tight credit conditions and new mortgage lending regulations that damped activity among first-time and lower-income buyers.

A booming Texas economy, in part due to a flourishing energy sector, subsequently attracted businesses and workers to the state and reinforced demand.⁴ Existing-home sales rose 15.2 percent in 2012 and 16.2 percent in 2013, the best year for Texas in terms of overall sales since the onset of the U.S. housing bust in 2006.

Inventories of existing homes were quickly depleted, falling in mid-2012 below the six-month threshold thought to signal adequate housing stock. Below that level, a “seller’s market” prevails as buyers bid up prices for what’s available. Inventories declined throughout 2012 and 2013, falling to a record low of 3.6 months of supply in December 2013 and holding steady at that level for most of 2014. Inventories in all of Texas’ major metros are at or near record lows.⁵ In October, inventories stood at 2.3 months in Dallas, 2.6 months in Fort Worth, 2.7 months in Houston and Austin, and 4.3 months in San Antonio. U.S. inventory in October was just above 5 months of supply.

Bad weather and rising mortgage interest rates crimped sales in the second half of 2013 and into early 2014.⁶ Sales picked up in spring 2014. Through the first 10 months of the year, existing-home sales in Texas were 2.4 percent ahead of year-ago levels—a much lower rate of increase than in 2012 and 2013.

Tight Credit, Supply Limitations

Homebuilding activity (as measured by single-family permits issued) is not only well below its prerecession peak but

also lower than the levels seen in 2002 and 2003, before the national housing boom. Among factors constraining building is a low supply of vacant developed lots, tight credit for land development, escalating land and materials costs and labor shortages.

After the Texas housing market peaked in late 2006, homebuilders sharply reduced new construction as demand weakened and inventories ballooned. Vacant developed lots (improved and ready for building) were at a 6-year supply in Dallas and nearly 3.5 years in Austin and Houston in mid-2009 (Chart 3). A 20- to 24-month supply is considered equilibrium, when neither builders nor developers have a pricing advantage. Financing for further land development—including in newer, high-demand areas—was tight from 2009 to 2011, hampering building.

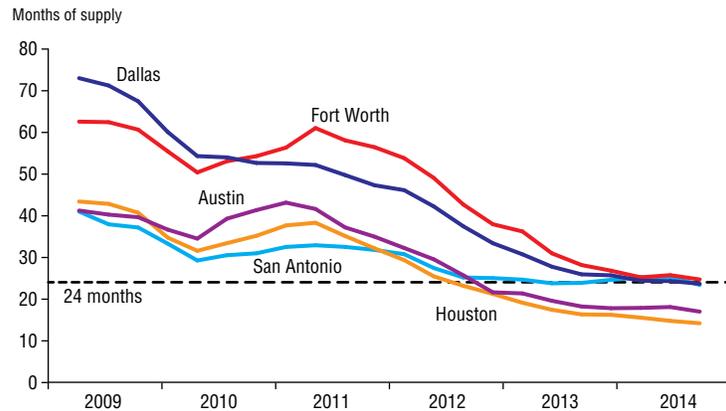
Tight Lot Supply

During the initial phase of the housing recovery, with lots in adequate supply, single-family permits issued throughout Texas grew from 63,876 in 2011 to 77,472 in 2012, or 21.3 percent. The permit growth rate slowed to 15.9 percent in 2013, reflecting bureaucratic delays due to cuts in local government personnel and shortages of skilled construction workers, some of whom had moved on to oil fields where the shale energy boom was fully underway. Meanwhile, the supply of buildable lots shrank in most major metros.

Lot supply was below the equilibrium level in Austin and Houston in third quarter 2014 and near the two-year threshold in Dallas, Fort Worth and San Antonio, as seen in Chart 3.⁷ Tight lot supply and builders' cost pressures have restricted the range of single-family housing types offered for sale, limiting new-home construction growth.

The Federal Reserve's senior loan officer survey results show that from 2008 to 2010, a higher share of respondents (loan officers) nationwide were tightening credit standards for commercial real estate loans, which include construction and land development loans for residential and nonresidential structures.

Chart 3 Vacant Developed Lot Supply Moves Below Equilibrium



NOTE: A 20- to 24-month supply of vacant developed lots is considered equilibrium.
SOURCE: Metrostudy.

The trend gradually reversed beginning in 2011, with an uptick among those reporting loosening credit requirements for these loans. More recently, in third quarter 2014, the survey suggests financing for construction and land development loans became significantly easier to obtain.⁸ Some industry participants confirm that bank willingness has further improved (see "On the Record," p. 8).

Moreover, labor shortages have lengthened the time it takes to build a home and reduced the number of units constructed. In Houston, some builders have placed cameras and armed guards at jobsites to prevent poaching of employees. Thus, single-family building remains soft even though permits were up 9.4 percent year to date through October compared with the same period in 2013.

Declining Affordability

A downside to the unprecedented run-up in Texas house prices is declining housing affordability over the past three years. Affordability is at multiyear lows in most major metropolitan areas, according to the Housing Opportunity Index, a measure of the percentage of homes sold that are affordable to the median-income family.⁹ This share has declined over time across all Texas metros.

More than 70 percent of homes sold in Austin, Dallas, Fort Worth and Houston in third quarter 2010 were considered affordable (Table 2). Despite relatively low interest rates and rising incomes, the share plunged to a near seven-year low in Dallas, Fort Worth, Houston and San Antonio in third quarter 2014.

Still, the Texas markets—with a median sales price of \$184,942 in October

Table 2 Housing Affordability Drops Sharply in 2014
(Percentage of homes sold, affordable to median-income family)

Area	2010:Q3	2012:Q3	2014:Q3
U.S.	72.1	74.1	61.8
Austin	73.9	73.3	61.2
Dallas	71.3	71.7	55.0
Fort Worth	79.8	80.8	64.6
Houston	72.5	70.5	55.5
San Antonio	68.7	73.3	57.2
Los Angeles	40.3	44.1	16.3
New York	22.6	28.5	21.6

SOURCE: National Association of Home Builders-Wells Fargo Housing Opportunity Index.

2014, according to MLS data—compare favorably to the national average of \$211,819. The proportion of Texans who can afford homes in the state’s big cities also remains significantly larger than the share in Los Angeles and Orange counties, 16.3 percent, and New York, 21.6 percent.

Entry-Level Buyer Squeeze

Entry-level buyers have been feeling particularly squeezed: Mortgages are difficult to obtain, while home prices are rising. New guidelines from government-

sponsored mortgage enterprises Fannie Mae and Freddie Mac, effective Dec. 1, ease lending standards and clarify guidelines for lenders. The revamped rules eliminate Fannie Mae’s requirement that a borrower put 20 percent down and are likely to motivate lenders to relax underwriting rules. This will allow low- and moderate-income borrowers greater access to credit, speeding up the review process and stimulating the housing industry.

Meanwhile, developers and builders have shifted away from entry-level hous-

ing toward a higher-priced, move-up product for two reasons. First, qualifying entry-level buyers for mortgages has been difficult and, second, it’s easier to recoup increasingly pricey material and labor costs with a more expensive offering.

Moreover, the scarcity of lots and homes has enabled builders to charge higher prices, while the number and proportion of under-\$200,000 homes has shrunk.

In San Antonio, traditionally among the most affordable new-home markets in the country, the share of home starts for units priced under \$200,000 plummeted from 65 percent in 2009 to 36 percent in 2014 (Table 3).¹⁰ Over the same period, starts of \$250,000–\$399,000 units increased from 15 percent to 27 percent—a pattern repeated in other major metropolitan areas in Texas.

Along with the decline in share, the absolute number of home starts—particularly homes priced under \$150,000—is down notably from 2009, when the housing market was in a fledgling stage of recovery.

A few builders are branching out into high-density products such as townhomes, patio homes or detached condos to meet growing demand from first-time or moderate-income buyers looking for less-expensive options.

Some entry-level buyers have turned to the existing-home market, where an estimated 56 percent of homes sold throughout Texas this year were below \$200,000, according to MLS data compiled by the Texas A&M Real Estate Center (Chart 4). The proportion of such homes sold relative to the overall market held relatively steady at around 70 percent from 2007 to 2010 before rapid appreciation took hold the past three years, especially in Austin, Dallas and Houston.

Multifamily Recovery

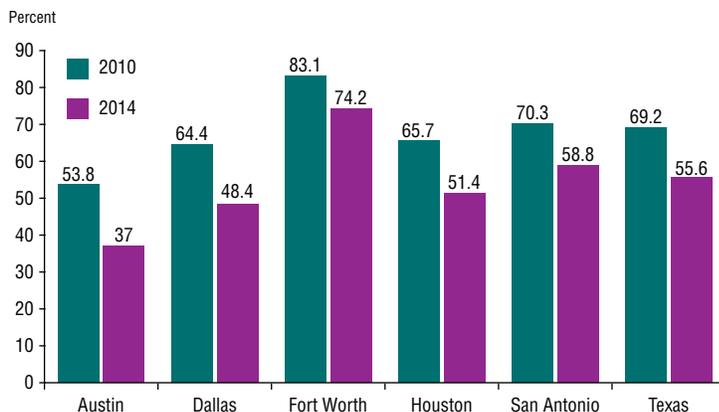
Multifamily construction has been off the charts since bottoming out in late 2009, especially when compared with single-family activity (Chart 5). Texas apartment permits—a measure of multifamily building activity—rose rapidly from 2010 to 2012, reaching prerecession levels by the end of 2013. The biggest

Table 3 Recent Home Starts Reflect More Expensive Product*

	Percent of homes priced under \$200,000		
	2009:Q3	2012:Q3	2014:Q3
Austin	51	41	26
Dallas	43	31	18
Fort Worth	63	55	33
Houston	53	43	30
San Antonio	65	53	36
	Percent of homes priced from \$250,000–\$399,000		
	2009:Q3	2012:Q3	2014:Q3
Austin	21	29	35
Dallas	24	33	37
Fort Worth	13	17	29
Houston	20	27	32
San Antonio	15	21	27

*Starts data are annualized.
SOURCE: Metrostudy.

Chart 4 Share of Entry-Level Homes Sold Drops Markedly (Existing homes priced below \$200,000 as a percentage of all existing-home sales)



*2014 estimate.
NOTES: Data represent Multiple Listing Service housing activity only. Residential data include single-family homes, townhouses and condominiums.
SOURCE: Real Estate Center at Texas A&M University.

jump, 73 percent, occurred between 2011 and 2012.

Multifamily building activity achieved a new high in early 2014 before moderating. Total permits covering 54,773 individual apartment units were issued through October, up 20 percent from the year-ago period. At the end of third quarter 2014, about 28,000 units were under construction in Dallas–Fort Worth, 32,600 in Houston, 12,000 in Austin and 9,000 in San Antonio.¹¹

As the state’s economic recovery took hold in 2010, falling house prices along with an improving job market and tight credit redirected demand from single-family to multifamily product. Heightened leasing activity led to a steady decline in apartment vacancy rates in Texas’ major metropolitan areas beginning in 2010, pushing nominal rents to well above prerecession highs in all major Texas metros by early 2012 (Chart 6).

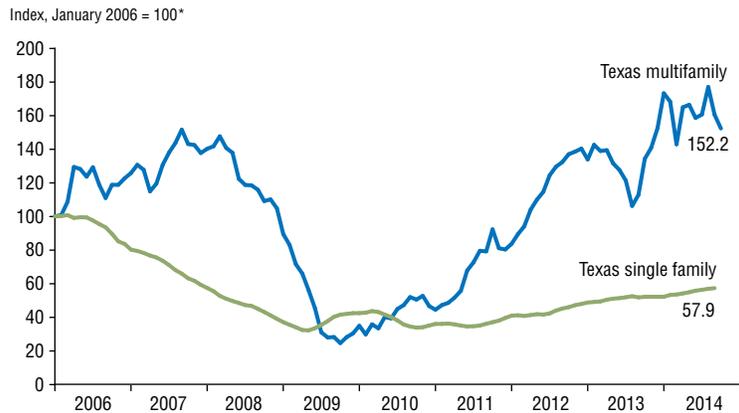
Vacancy rates continued edging lower in third quarter 2014 in major metropolitan areas even as new apartments came to market.¹² The expanding Texas economy and tight credit conditions that deter would-be homebuyers from making a purchase are further boosting apartment demand.

Data from apartment market analyst MPF Research confirm the strong leasing fundamentals in Texas. In third quarter 2014, occupancy of rental units in Dallas and Houston was tight at 95 percent—a 13-year high for both markets. Occupancy in Austin was even higher, at 95.7 percent, while San Antonio, at 93.6 percent, wasn’t far behind. Austin, Fort Worth and Houston ranked among the top 20 U.S. markets in terms of year-over-year rent increases in the third quarter.

Outlook: Moderate Growth

Despite sound economic fundamentals—including a booming Texas economy, high in-migration and rising incomes—growth in home sales and single-family construction activity has been modest in 2014. Entry-level buyers have been left out of the market amid rapidly rising prices and credit constraints. Thus, improved access to credit

Chart 5 Multifamily Construction Leads Residential Recovery

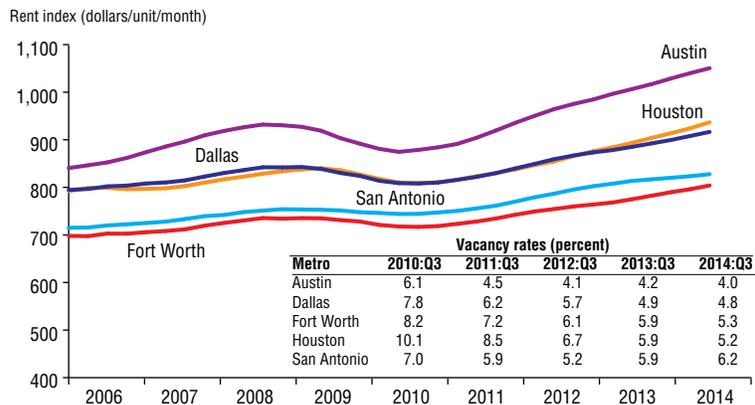


*Five-month moving average of building permits.

NOTE: Last data point is October.

SOURCE: Census Bureau.

Chart 6 Apartment Market Fundamentals Strong in Texas Metros



NOTE: Data are for third quarter 2014.

SOURCE: CBRE Econometric Advisors.

and an expanding supply of new homes for first-time and lower-income buyers are essential for the state’s housing market to strengthen in the coming year.

Some builders are expanding their offerings aimed at the entry-level buyer. Moreover, of the anticipated easing of mortgage-lending rules should spur modest housing demand growth in 2015. Headwinds include rising mortgage rates that could damp sales activity.

On the multifamily side, brisk construction activity is beginning to moderate and will likely slow further. Occupancy levels and rent growth will

cool as units under construction are completed. However, continued healthy economic and population expansion and diminished housing affordability combined with a steadily declining Texas homeownership rate should continue to generate a strong appetite for apartments. That will keep both occupancy and rents at or above the long-run average through 2015.

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Notes

¹ Data are from the Federal Housing Finance Agency (FHFA) purchase-only home price index, four-quarter percent change; for example, the change in home prices between fourth quarter 2003 and fourth quarter 2004.

² Between March 2007 and May 2009, the S&P/Case-Shiller Home Price Index for the U.S. fell 31.1 percent, while prices in Dallas (a proxy for Texas) declined 7.5 percent.

³ FHFA purchase-only home price index four-quarter percent change.

⁴ Texas ranked third in 2012 and sixth in 2013 among the states in job growth. Texas also ranked No. 1 for domestic in-migration for the eighth consecutive year in 2013, according to Census Bureau population estimates.

⁵ Texas' major metropolitan areas are Austin, Dallas, Fort Worth, Houston and San Antonio.

⁶ Mortgage rates rose nearly 1 percentage point—from 3.35 percent in early May to 4.29 in early July 2013. Mortgage rates have fallen slightly since then. Data are from the Freddie Mac Primary Mortgage Market Survey.

⁷ Data are from Metrostudy, which estimates that 20 to 24 months of lot supply is equilibrium for Texas' major metro housing markets.

⁸ In third quarter 2014, the net percentage of respondents indicating tightening standards for construction and land development loans was minus 9.6, suggesting that 9.6 percent more loan officers are easing standards compared with those tightening credit.

⁹ The Housing Opportunity Index is produced by the National Association of Home Builders and Wells Fargo. The index measures the percentage of homes sold that are affordable to the median-income family based on standard mortgage underwriting criteria.

¹⁰ All data are third-quarter figures for 2009 and 2014. Starts data are from Metrostudy and are annualized.

¹¹ Data on multifamily units under construction are from MPF Research.

¹² Data are from CBRE Econometric Advisors' Multifamily Housing Quarterly Outlook History and Forecast, third quarter 2014.

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