Texas Housing Market Finally Building a Solid Recovery

By D'Ann Petersen

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Texas housing is showing evidence of a sustained recovery in 2012. Home sales and construction have bounced back from recessionary levels, and apartment leasing remains robust thanks to solid employment and population gains. Other factors, including historically low interest rates and increased home affordability, are also playing a role, especially in a rebounding single-family market. Unlike the 2009–10 upturn, which resulted from a temporary tax incentive, the latest gains are due to improved fundamentals reflected in lower housing inventories and rising home prices.

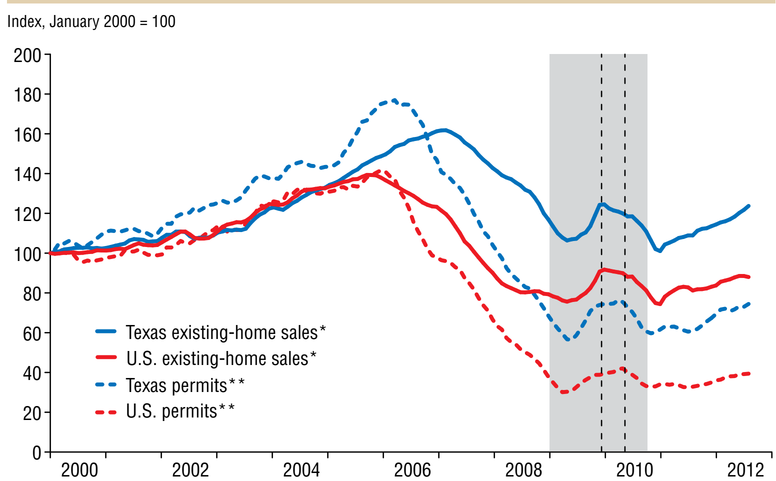
No More Drag on Growth

Recent information suggesting the Texas single-family housing sector is finally on solid footing comes as good news for an industry that had been in the doldrums since before the recent recession. Sales and new-home construction in Texas and the U.S. fell precipitously through 2008. After that, the single-family housing market bounced along at a historically weak bottom—except in 2009 and 2010 when federal tax credits aimed at helping the ailing housing market created a temporary uptick in sales and construction (*Chart 1*).

Even with the tax-credit-motivated temporary boost, the Texas housing sector weighed on the state economy from 2008 until mid-2011. Residential construction jobs declined in each of those years, although on the whole, Texas employment began recovering from recessionary lows in December 2009—earlier than in many parts of the country. The hard-hit single-family sector, which typically makes up about two-thirds of Texas' residential construction jobs, shrank by 28 percent during the period. Multifamily building decreased when the tax credit was available as potential renters became homeowners. Residential construction starts remained near historic lows, restraining growth in overall state employment and output (*Chart 2*).[1]

The construction sector—which is made up of residential as well as nonresi-

Chart 1 Single-Family Housing Sector on Firm Ground



* Six-month moving average, seasonally adjusted

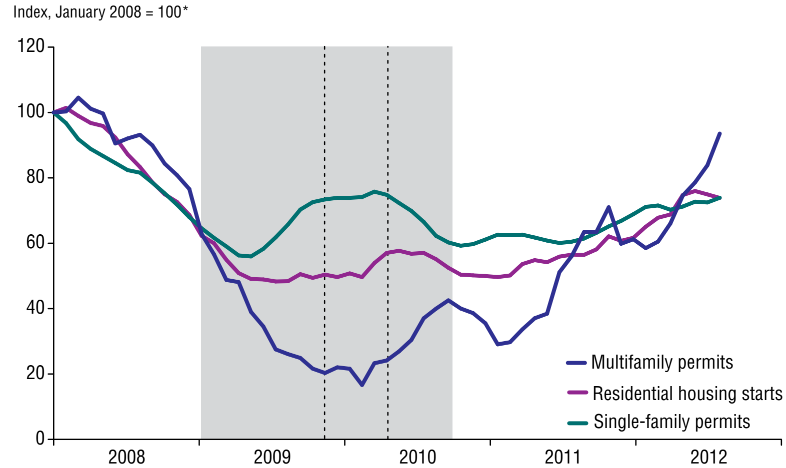
** Five-month moving average, seasonally adjusted

NOTES: Shading indicates when the homebuyer tax credit was active. Vertical dashed lines show original tax credit expiration dates.

SOURCES: National Association of Realtors; Multiple Listing Service; Census Bureau.

Both the single-family and apartment markets should benefit from an expanding economy.

Chart 2 Residential Construction Weak in 2009–10 Despite Single-Family Tax Credit Boost



* Seasonally adjusted, five-month moving average

NOTES: Shading indicates when the homebuyer tax credit was active. Vertical dashed lines show original tax credit expiration dates.

SOURCES: Bank of Tokyo–Mitsubishi; Census Bureau; F.W. Dodge.

dential segments—shed 117,200 jobs, or 17 percent of its total, from mid-2008 to January 2011. Texas construction-related output, measured by gross state product, fell through early 2011 before bottoming out later in the year (*see the box, "Construction Has Broad Impact on State Economy"*).

Construction jobs have contributed to total employment consistently beginning this year, making construction the last of the major private-sector industries in Texas to see a recovery. Strength in single- and multifamily housing paced the recent improvement.

Construction Has Broad Impact on State Economy

Total construction, which includes residential, nonresidential and heavy/civil engineering activity (roads and bridges, for example), has accounted for about 5.9 percent of total Texas employment on average since 2000 and makes up about 4 percent of the state's output, or gross state product. Construction's employment share is larger than the energy sector but small compared with other major industry sectors, such as manufacturing and professional services.

Construction activity, however, spills over into many other parts of the economy, impacting related manufacturing, real estate services and financial activities. Additionally, home price increases or declines affect housing wealth, which in turn can affect consumer spending. Research indicates that changes in housing wealth at the national level had a significant impact during the housing boom and subsequent bust.[1]

Note

[1] See "When Will the U.S. Housing Market Stabilize?" by John V. Duca, David Luttrell and Anthony Murphy, Federal Reserve Bank of Dallas *Economic Letter*, vol. 6, no. 8, 2011.

Many factors restrained housing activity in the state's early jobs recovery—declining personal wealth arising from the financial crisis, low consumer confidence, stricter credit standards and a reduced homeownership rate. This last factor reflected a reduced desire to own a home following the severe housing bust and associated home value drop—down as much as 50 percent in some areas of the country. Decreased prices, in part, kept the single-family market from recovering sooner, as potential homeowners deferred purchases until prices stabilized.

On the multifamily side, construction activity was weak during the recession as the household formation rate slowed. Many potential renters, given employment-related uncertainty, moved back home with their parents or doubled up with roommates.

Apartment Demand Up

In contrast to the single-family market, apartment demand improved in the early part of the state's economic recovery. Growth in leasing activity led to lower apartment vacancy rates in Texas' major metropolitan areas beginning in early 2010 as the Texas economy gained solid footing (*Table 1*).

Strong apartment demand since 2010 has led to rapidly rising rents in Texas' major metropolitan areas. In some locations, such as Dallas' Uptown market, demand is outstripping new supply, which is expected

Table 1 Apartment Vacancy Rates Fall; Homeownership Stabilizes

	Apartment vacancy (percent)			Real apartment rents (price/unit/month)			Homeownership rate (percent)		
	2010:Q2	2011:Q2	2012:Q2	2010:Q2	2011:Q2	2012:Q2	2010:Q2	2011:Q2	2012:Q2
Austin	6.5	5.0	4.3	$895	$896	$940	–	–	–
Dallas	8.2	6.6	5.5	$830	$816	$839	–	–	–
Fort Worth	8.5	7.4	5.6	$737	$723	$737	–	–	–
Houston	9.7	8.8	7.0	$849	$835	$852	–	–	–
San Antonio	6.9	6.3	5.9	$772	$759	$777	–	–	–
Texas	–	–	–	–	–	–	66.3	64.6	64.7
U.S.	6.0	5.4	4.8	$1,243	$1,253	$1,294	66.9	65.9	65.5

SOURCES: M/PF Research; Census Bureau.

to increase as construction picks up through the rest of 2012. Austin ranked sixth nationally in apartment rental rate increases, at 6.1 percent, for the year ended June 30. Dallas rents rose 4.9 percent during the same period, placing just below the top 10 metropolitan areas, according to data provided by M/PF Research.

Apartment rental rates are now high enough in some Texas metro areas to push renters or potential renters into the single-family market, according to business contacts the Dallas Fed interviews for the Beige Book, an anecdotal commentary on regional economic conditions published eight times a year. In fact, the Texas homeownership rate has edged up to 64.7 percent—gaining a percentage point since bottoming in first quarter 2011, which may reflect a change in potential buyers' willingness to purchase a home. Strong growth in rents has also prompted a pickup in apartment construction—30,186 multifamily permits were issued in Texas in 2011 versus 18,389 in 2010. Through July of this year, apartment permits total 27,634, up 46.5 percent.

Both the single-family and apartment markets should benefit from an expanding economy. Both sectors rely on growth in jobs and household formation. Nationally, apartment demand is strong, but the homeownership rate has not increased as it has in Texas. Weaker job growth nationally and continued uncertainty about a jobs rebound as well as the overall financial outlook may still be deterring would-be buyers.

Single-Family Rebound

Following the U.S. housing bust, Texas home demand fell to levels not seen since 2002. A lack of available jobs along with heightened uncertainty—a product of financial turmoil that, in part, resulted from sliding home prices—kept sales weak. The tax credits shifted home demand by pulling forward a large share of sales that would have occurred anyway, providing a temporary uptick that eventually gave way to another sales drop. A 2011 Dallas Fed article estimated that after the expiration of the tax credit, housing demand would not improve until late 2011 or early 2012; in hindsight, that appears to have occurred.[2]

Overall, Texas home sales began improving in the second half of 2011, rising an annualized 9.5 percent. Tight credit conditions hampered first-time homebuyers, typically a large share of Texas buyers.[3] The national share of sales to first-time homebuyers fell to 37 percent in 2011, down from 50 percent in 2010. Dallas Fed housing contacts note that sales in 2011 shifted toward higher-end homes, also reflecting tighter credit. The proportion of Texas home sales priced above $200,000 increased in 2011 and is up from levels prior to the housing bust, according to Multiple Listing Service data compiled by the Texas A&M Real Estate Center.

The sales pace picked up in 2012. Through July 31, existing-home sales rose almost 20 percent on an annualized basis. This activity is consistent with 2003–04 levels, before the national housing boom. In addition, anecdotal reports suggest demand from first-time buyers is slowly accelerating.

Although sales of new homes began rebounding by early 2011, construction of new units did not immediately jump, in part because builders needed time to adjust to renewed demand after cutting production sharply. They are now optimistic, reporting high traffic and improved sales and a pickup in construction. New-home sales growth was up 18 percent in Dallas, 16 percent in Houston and 13 percent in Austin in second quarter 2012, based on data provided by MetroStudy. Recent reports from industry contacts suggest sales continue to outpace expectations and builders remain positive in their outlooks for the year.

Construction Revival

Texas residential construction activity has emerged from the deepest downturn in recent history. Texas single-family permits rose at an annualized pace of 21 percent through July, and multifamily permits increased at an even faster pace. In total, residential construction starts rose 25 percent from June 2011 levels, when activity began picking up consistently. The current level of housing construction is still well below levels seen in 2003 and 2004, before the housing boom. But, with tight new-home inventories and low apartment vacancies, construction levels should continue rising if current demand is sustained.

Texas Home Prices Rise

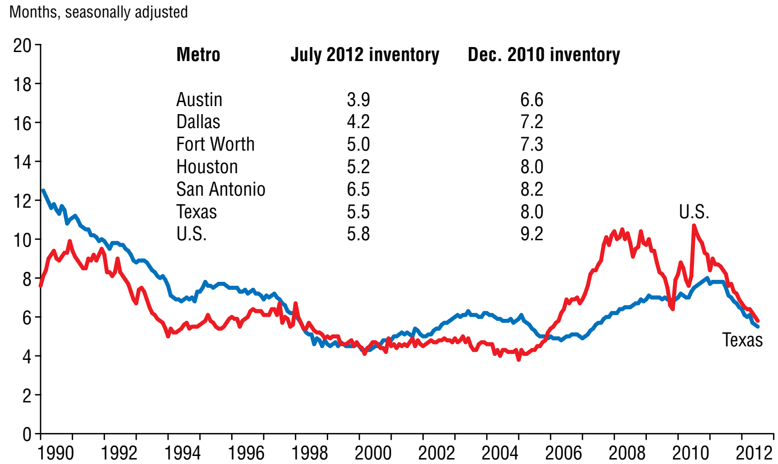
Perhaps the most important factor in the current Texas housing recovery is shrinking inventories. Even though the 2010 tax credits boosted home sales and construction, inventories of new and existing homes remained elevated, putting downward pressure on prices.

Current conditions support higher prices. Texas inventories of existing single-family homes are at 5.5 months of supply at the current sales pace. Inventories below about 6.5 months of supply are historically consistent with rising home prices. Inventories in several Texas metropolitan areas, including Austin and Dallas, are close to four months of supply (*Chart 3*). Inventories are also reduced if homeowners keep their homes off the market because their mortgages are under water, meaning the home is worth less than what is owed. Nationally, this may be a factor in lowering inventory levels, as homeowners in some parts of the country do not want to sell at a loss and are keeping their homes off the market.

Underwater mortgages are less of an issue in Texas than in other parts of the country. The share of Texans with an underwater mortgage edged down in first quarter 2012 from just above 10 percent to

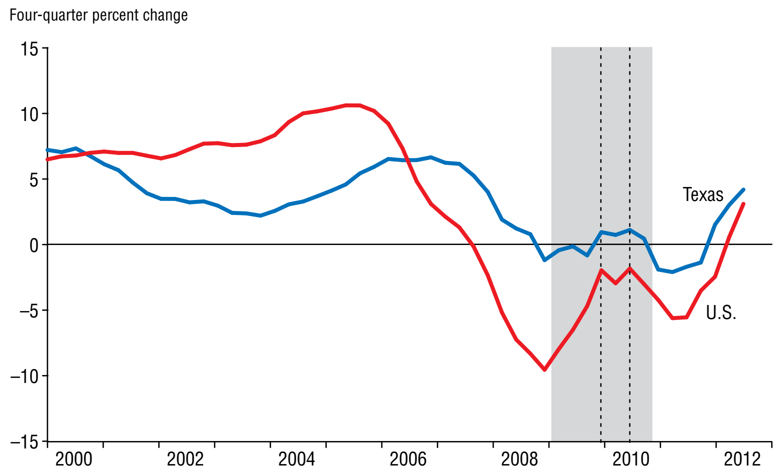
Foreclosures remain a concern because they can add to inventories. The foreclosure rate is still elevated in Texas but well below the national average.

Chart 3 Low Texas Inventories Suggest Continued Home Price Gains



SOURCE: Multiple Listing Service.

Chart 4 Texas Home Prices Turn the Corner



NOTES: Shading indicates when the homebuyer tax credit was active. Vertical dashed lines show original tax credit expiration dates.

SOURCE: Federal Housing Finance Agency.

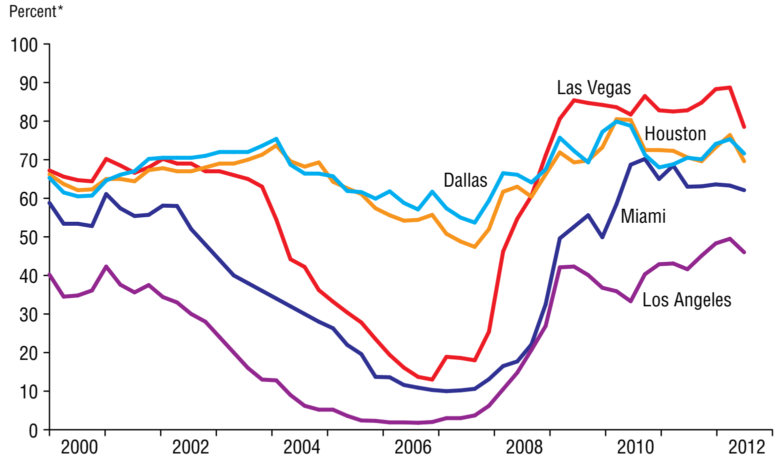
9.8 percent, well below the U.S. average of 23.7 percent and the 61.2 percent reported in Nevada, the state with the largest share of such mortgages.

Foreclosures remain a concern as well because they can add to inventories. The foreclosure rate is still elevated in Texas but well below the national average. The share of seriously delinquent Texas mortgages continues to decline, signaling that the foreclosure rate should improve with time. Currently 4.5 percent of Texas mortgages are seriously delinquent versus 7.4 percent nationally.[4]

Indeed, all the indicators for Texas suggest that prices are on an upswing. The Federal Housing Finance Agency purchase-only home price index shows Texas prices began increasing in fourth quarter 2011 (*Chart 4*). Similarly, the Standard & Poor's/Case-Shiller home price index for Dallas shows rising home prices through June.[5] For homes sold by Realtors through the Multiple Listing Service, the median Texas home price rose from $149,096 in January to $157,639 in July. The increase in this index, however, could partly be a result of the price distribution of homes sold—more

Chart 5

Housing Affordability Improves After Bust



* Share of homes sold that could be considered affordable to a family earning the median income.
SOURCE: National Association of Home Builders–Wells Fargo Housing Opportunity Index.

sales of higher-priced homes will impact the median price. Recent anecdotal reports from industry contacts note that builders are considering raising prices due to rising labor and land costs, and competition for homes on the market is allowing more sellers to get their asking price.

What's Driving Rebound

The Texas economy is one of the fastest growing in the country; by January 2012, it had regained the number of jobs lost during the recession, one of a handful of states to do so. Texas' population is also among the fastest growing. These factors, no doubt, have contributed to the housing recovery. Additionally, interest rates are at historical lows, Texas personal income is increasing faster than the national average and housing affordability has been rising.

Texas home prices are normally lower than the U.S. average, partly due to the ability of builders to react relatively quickly to increases in home demand—a product of land availability and comparatively light regulation. Still, prices statewide edged down during the housing bust—which helped expand the share of median-income Texas families that can afford a home.[6] While affordability has increased across a large part of the country, Texas metropolitan areas still fare better than other large population centers, such as Miami and Los Angeles, which also became much more accessible because of large home-price decreases (*Chart 5*). Las Vegas has become one of the most affordable areas in the country, following large price declines during the housing bust.

A Rosier Housing Outlook

The U.S. economic recovery remains fragile, but Texas buyers and renters appear a little more confident. Housing indicators suggest that demand, both for apartments and for single-family homes, continues its steady rise. Population growth and job growth are fueling demand. Tight inventories and low interest rates are also likely spurring potential single-family homebuyers to act now, and anecdotal reports suggest that some apartment renters that were doubling up are now renting single units.

With the uptick in construction in the first half of the year, even a modest increase in the level of new home and apartment construction in the remainder of 2012 would mean an additional stimulus that was missing from the state's economy in 2011. National headwinds to the housing recovery remain, including elevated foreclosures, tight credit conditions and economic and political uncertainties. However, given a forecast for moderate growth in Texas jobs in 2012, Texas' housing recovery should continue.

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Notes

[1] Single-family permits are a proxy for new-home starts and multifamily permits are a proxy for apartment starts since neither series is available at the state level and permits lead starts only slightly. Residential starts (which include single-family and multifamily) are available at the state level.

[2] See "Texas Housing on Bumpy Road After Stimulus Effects Fade," by D'Ann Petersen and Adam Swadley, Federal Reserve Bank of Dallas *Southwest Economy*, Second Quarter, 2011.

[3] Financing a home purchase became more difficult because of tight credit conditions imposed after the national housing collapse. Lenders required higher credit scores and larger down payments. The Federal Reserve's senior loan officer surveys indicated tight mortgage conditions from late 2006 to mid-2010.

[4] Seriously delinquent mortgages are defined as those with payments 90 days or more past-due plus the inventory of mortgages in foreclosure.

[5] Both the quarterly Federal Housing Finance Agency (FHFA) purchase-only house price index and the monthly S&P/Case-Shiller home price index measure the movement in existing single-family home prices. Both are based on repeat sales transactions, controlling for quality. The FHFA index is more broad in geographic coverage but only includes conforming, conventional mortgages, which are subject to the conforming loan limit.

[6] The National Association of Home Builders' NAHB–Wells Fargo Housing Opportunity Index represents the share of homes sold that could be considered affordable to a family earning the median income. It does not consider the cost of mortgage insurance. Also, the NAHB assumes a family can afford to spend 28 percent of gross income on housing.