Texas Real Estate: From the 1980s' Oil Bust to the Shale Oil Boom

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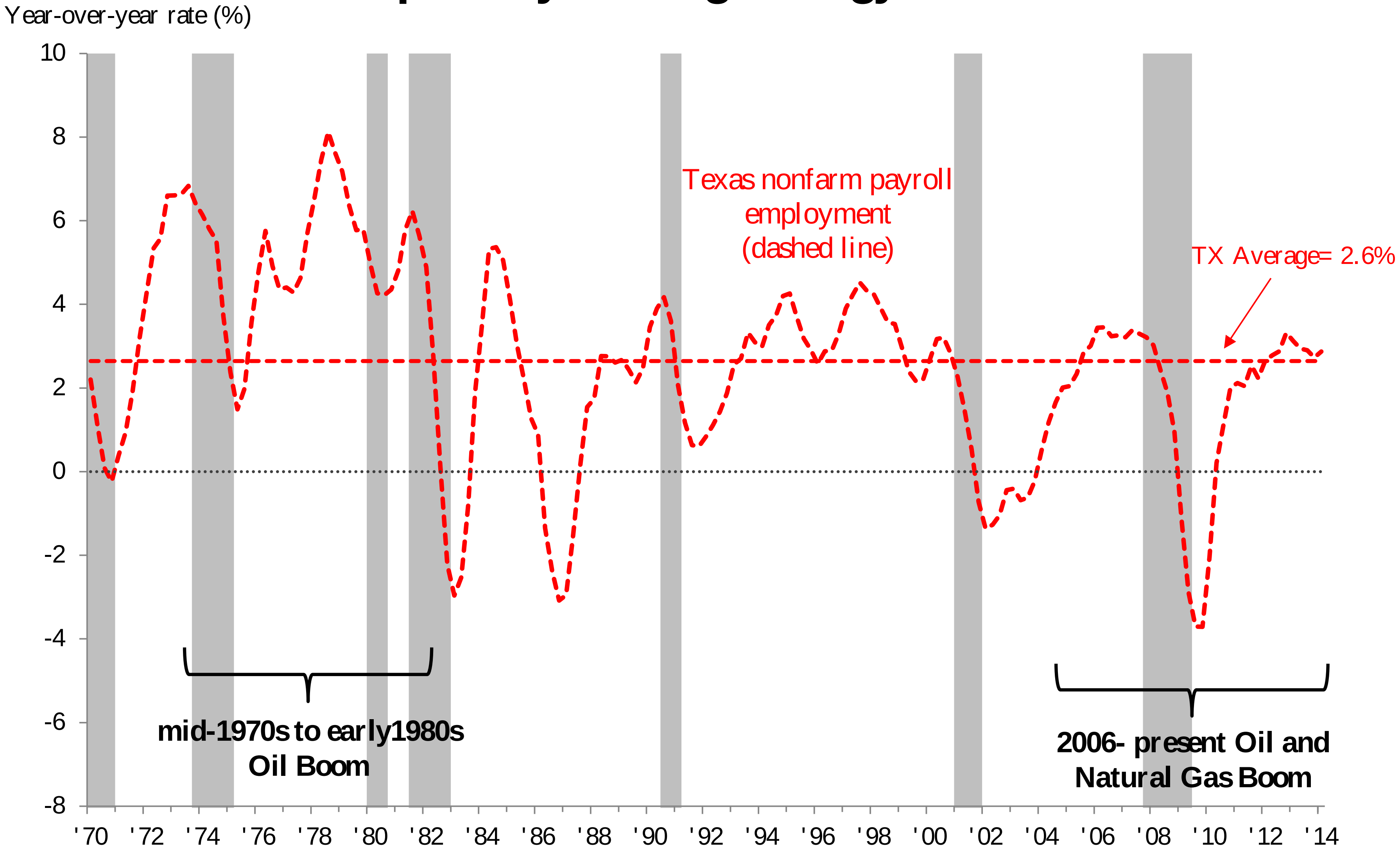
Introduction

- Texas real estate trends over past 4 decades reflect:
  - Broad-based and energy-related economic growth.
  - Faster than national long-run growth owing to low-cost environment.
  - Evolving structure of banking and mortgage finance.
- Texas real estate above its trend in energy-booms, below in busts.
- Shale boom partially behind recent strength in Texas real estate.
- Banking reforms and past experience will likely limit downside risks when the shale oil energy boom eventually ends.

Boom and Bust in the 1970s and 1980s

- Economy in Texas outperformed the US during the turbulent 1970s and early-1980s.
  - Job growth was faster in Texas than not only the nation and the US long-run average, but also faster than the state's long-run average pace.
  - During the period, energy-related growth cushioned the impact of the national economic recessions on the state.

Chart 1: Job Growth in Texas Usually Outpaces the U.S., Especially During Energy Booms



NOTE: Shaded bars indicate U.S. recessions.

SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; authors' calculations.

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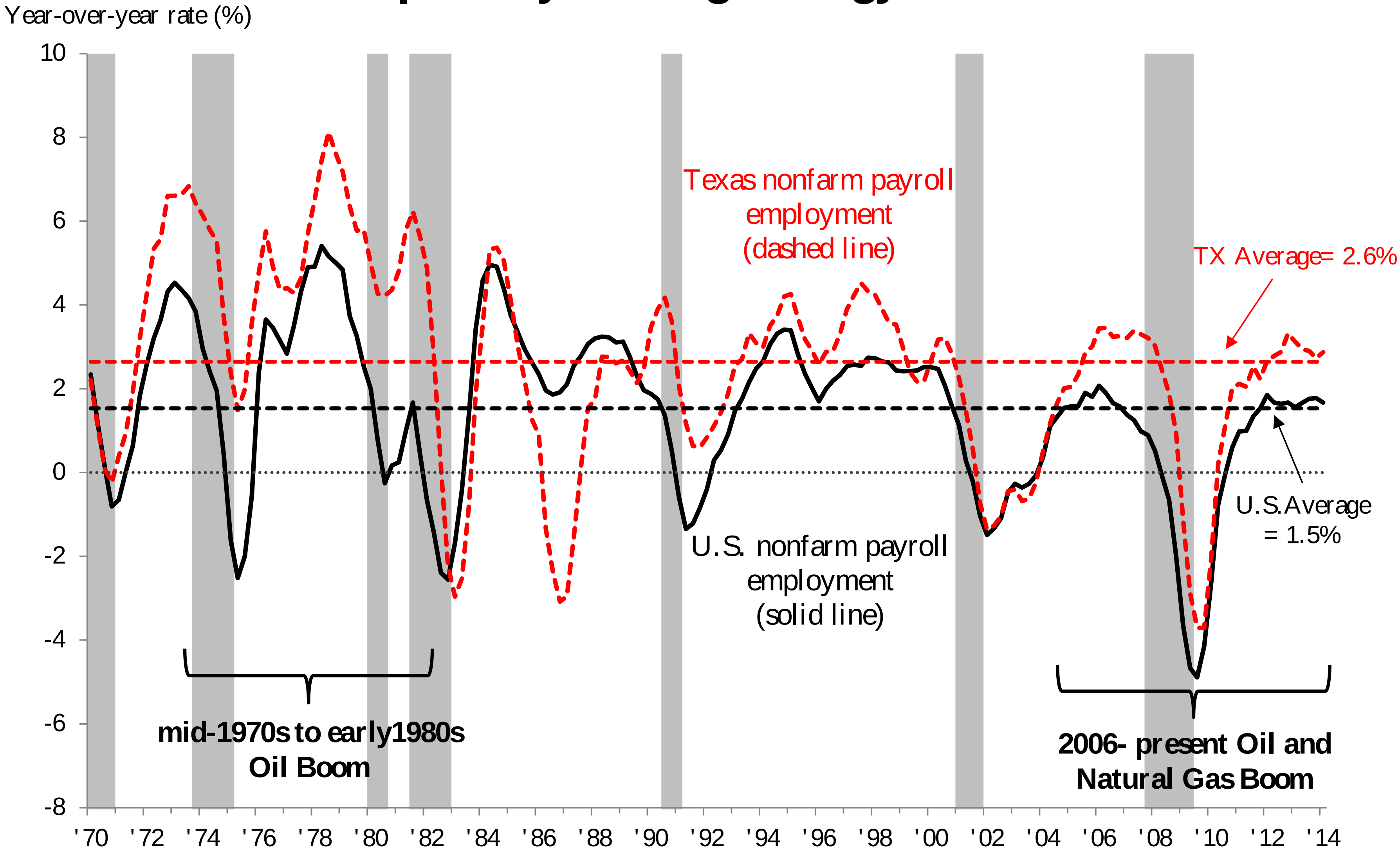

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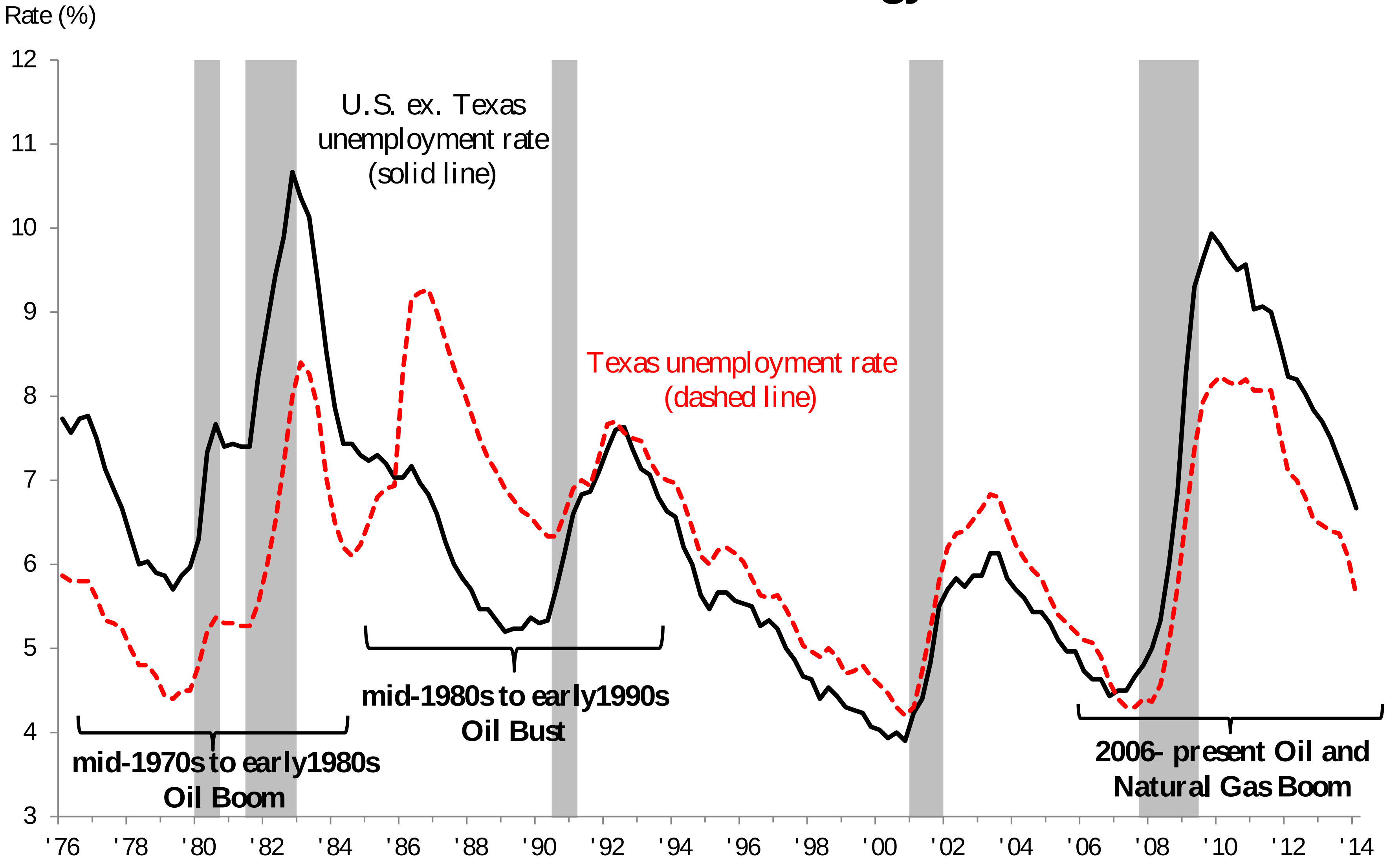
  - During the period, energy-related growth cushioned the impact of the national economic recessions on the state.
- This period ended with the deep recession of 1982 and a bust emerged when oil prices fell in the mid-1980s:
  - To curb high inflation, Volcker-led Fed raised interest rates in the early 1980s, which at first slowed the U.S. economy and hurt job growth even in Texas.
  - Many TX jobs lost in the mid-1980s and unemployment rose above U.S. rate.

Chart 3: Unemployment Rate in Texas Usually Below the National Rate in Energy Booms



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SOURCE: Bureau of Labor Statistics.

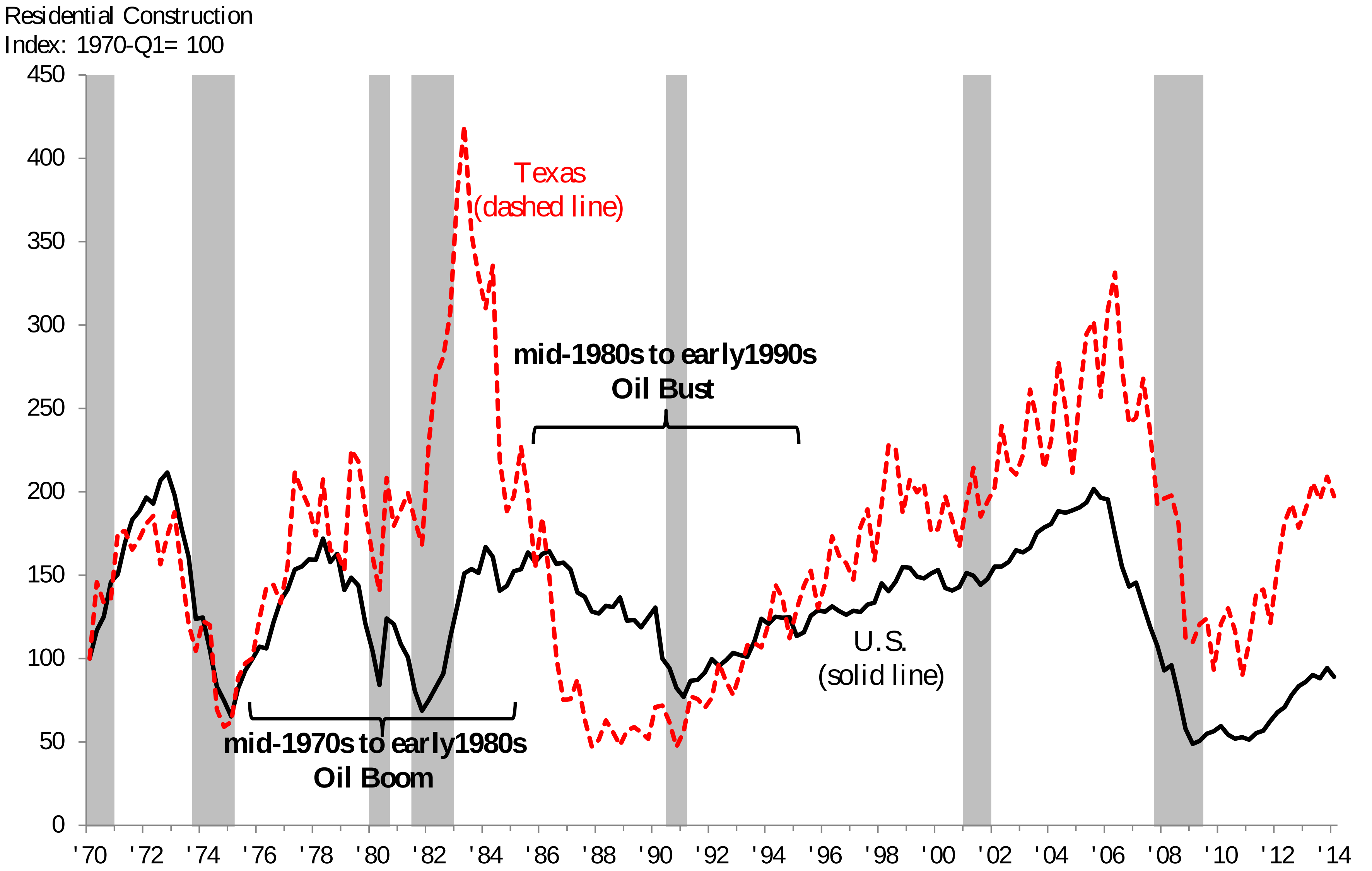
Four Flaws in Texas Banking During 1980's Oil Bust

- **High risk from mismatch between interest rates on assets vs deposits.** Like many S&Ls, TX lenders made many fixed interest-rate, long-term loans—especially mortgages—at low interest rates funded with deregulated deposits whose interest rates later soared with market interest rates in the early 1980s.
- **Overexposed to local economy.** Restrictions on out-of-state banking made TX banks too exposed to TX economy. Boom boosted deposits that stayed inside TX and funded excess (real estate) lending within TX. Construction and land development loans quadrupled from 2 percent (1976) to 8 percent by 1984.
- **Poor regulatory structure.** Banks, which focused on business lending (e.g., energy), and S&Ls, which focused on households, separately regulated. So correlated risks to both parts of the credit system were not regulated enough.
- **Deregulation of undercapitalized, high risk lenders.** Lenders with low or no capital had little or nothing to lose and took risks in new activities opened up by deregulation in which they had little expertise (S&Ls invested in commercial real estate, junk bonds, and energy). Real estate is especially vulnerable because collateral sometimes provides illusory protection to lenders.

How the Flaws in TX Banking Had Worsened the Impact of the Oil Bust on Banking and Real Estate

- **Excess real estate lending in the prior oil boom created an excess supply of housing that was slow to sell, set off foreclosures hurting many lenders, and restrained new construction for years.**

Chart 4: Texas Residential Construction Outpaces the U.S., Particularly During Energy Booms



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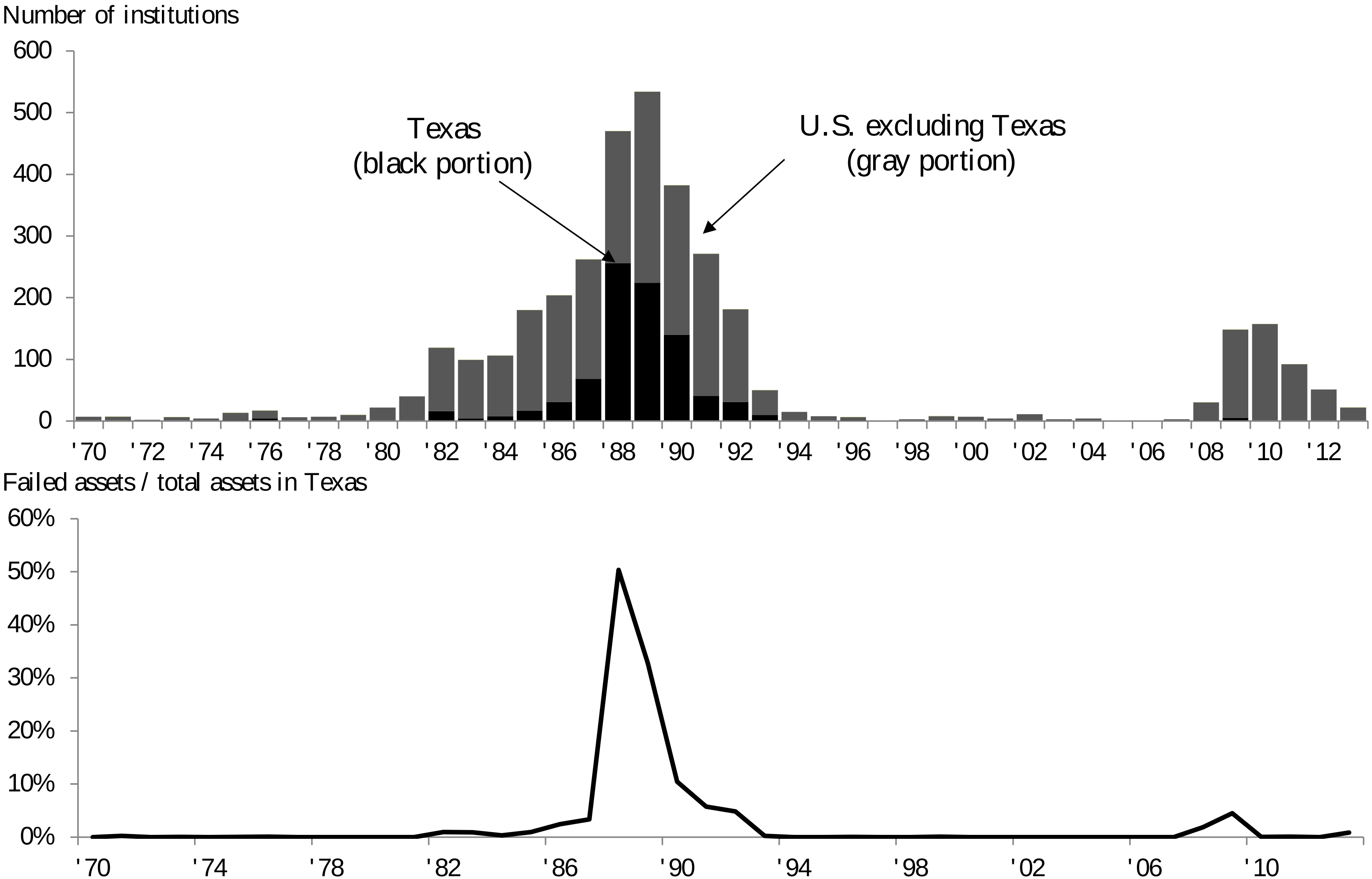
- **Excess real estate lending in the prior oil boom created an excess supply of housing that was slow to sell, set off foreclosures hurting many lenders, and restrained new construction for years.**
- **Lenders overexposed to interest rate risk and the state's energy driven boom had little resilience to survive the bust and failed.**

Chart 5: Banking Institution Failures Concentrated in Texas During the Savings & Loan Crisis, not in the Recent Crisis



SOURCE: Federal Deposit Insurance Corporation.

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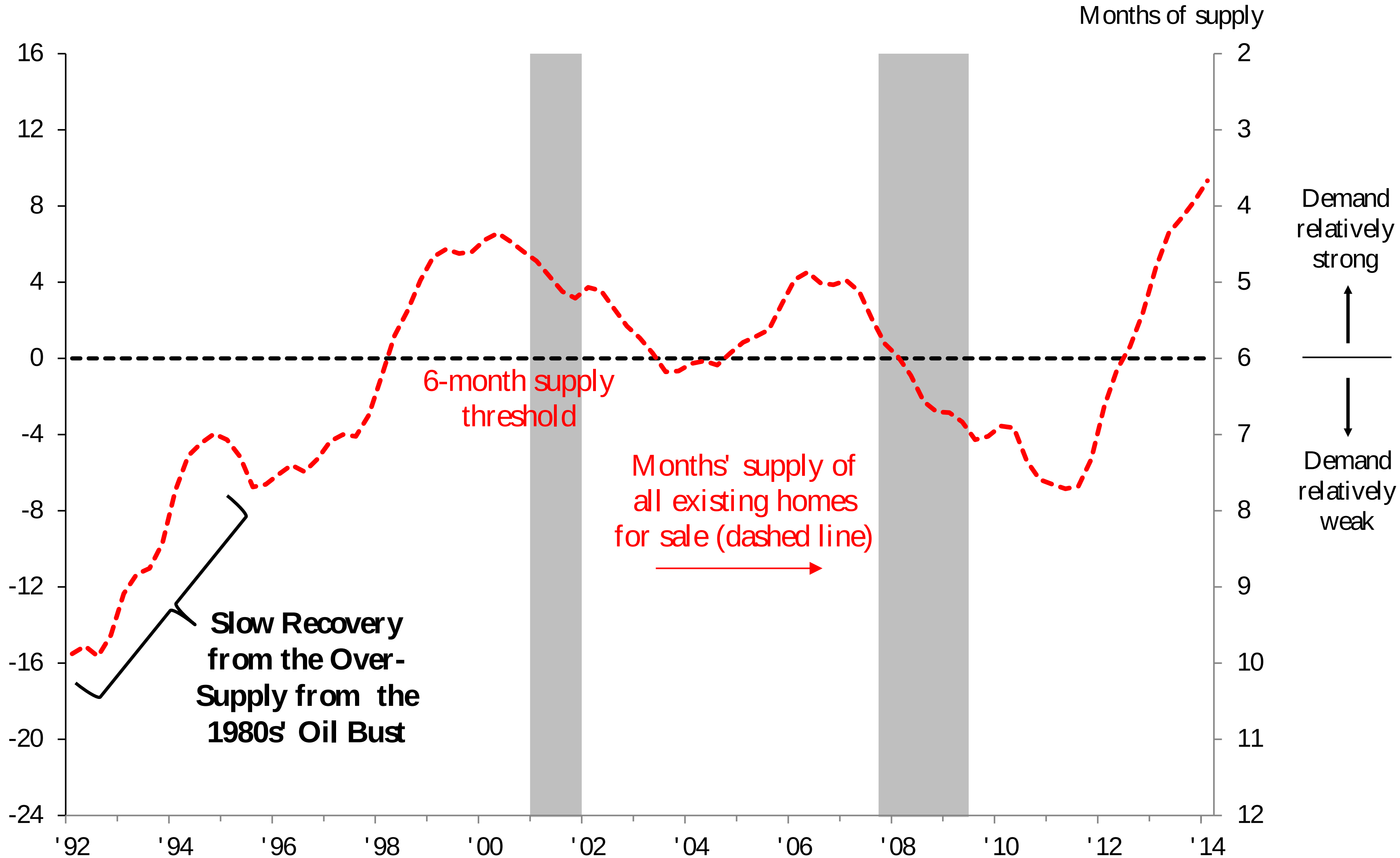
- **Lenders over-exposed to interest rate risk and the state's energy driven boom had little resilience to survive the bust and failed.**
- **A massive credit crunch arose because:**
  - Local banks were impaired by losses and had little or no ability to lend.
  - Much time to shut down failed lenders and resolve bad real estate loans.
  - Local banks had limited ability to work out nonperforming loans.
  - Interstate banking restrictions hindered credit from flowing into the state.
- **Insufficient financing available to businesses and households delayed Texas's economic recovery in the late 1980s and early 1990s until out-of-state banks entered and local banks recovered.**

In the 1990s, Recovery,

- **Recovery in the early to mid-1990s:**
  - Local banks recapitalize and out-of-state banks enter in the early-1990s.
  - Economy aided by growth from low-cost environment.
  - Overhang of unsold homes falls sharply in early 1990s, setting stage for a recovery of home construction.

Chart 6: Low Inventories Consistent with Rising Inflation-Adjusted House Prices in Texas



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In the 1990s, Recovery, Reform, and Expansion

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- **Reforms make TX banking and real estate more resilient:**
  - Capital and interest-rate risk regulation improved in early 1990s.
  - Prime (not subprime) mortgage securitization and interstate banking allow diversification of geographic risk in real estate lending.
  - State allows but limits home equity borrowing, balancing households' need for liquidity with safety and soundness.
- **Real estate aided by broad recovery and tech boom in late 1990s:**
  - State enjoys above average job growth, low-cost, pro-business environment.
  - High-tech industry surge especially strong in Austin and Dallas.
  - Housing demand rises vs. supply, sparking rise in inflation adjusted house prices.
  - High ability to adjust housing supply keeps inventories in a 4-½ to 7-½ month range, limiting swings in inflation-adjusted house prices until 2012. No bust in state house prices—partly reflecting that prices did not boom in mid-2000s.

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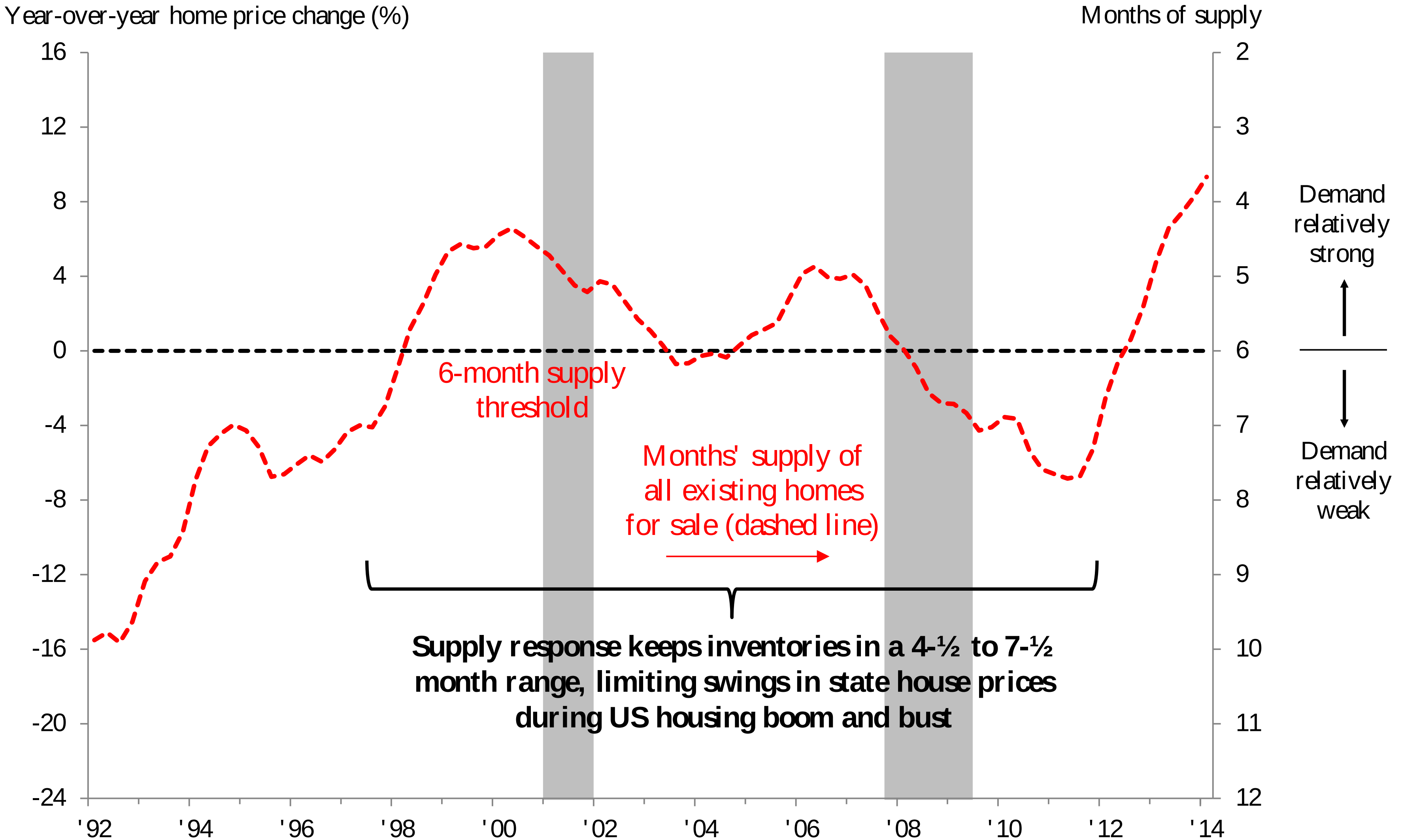

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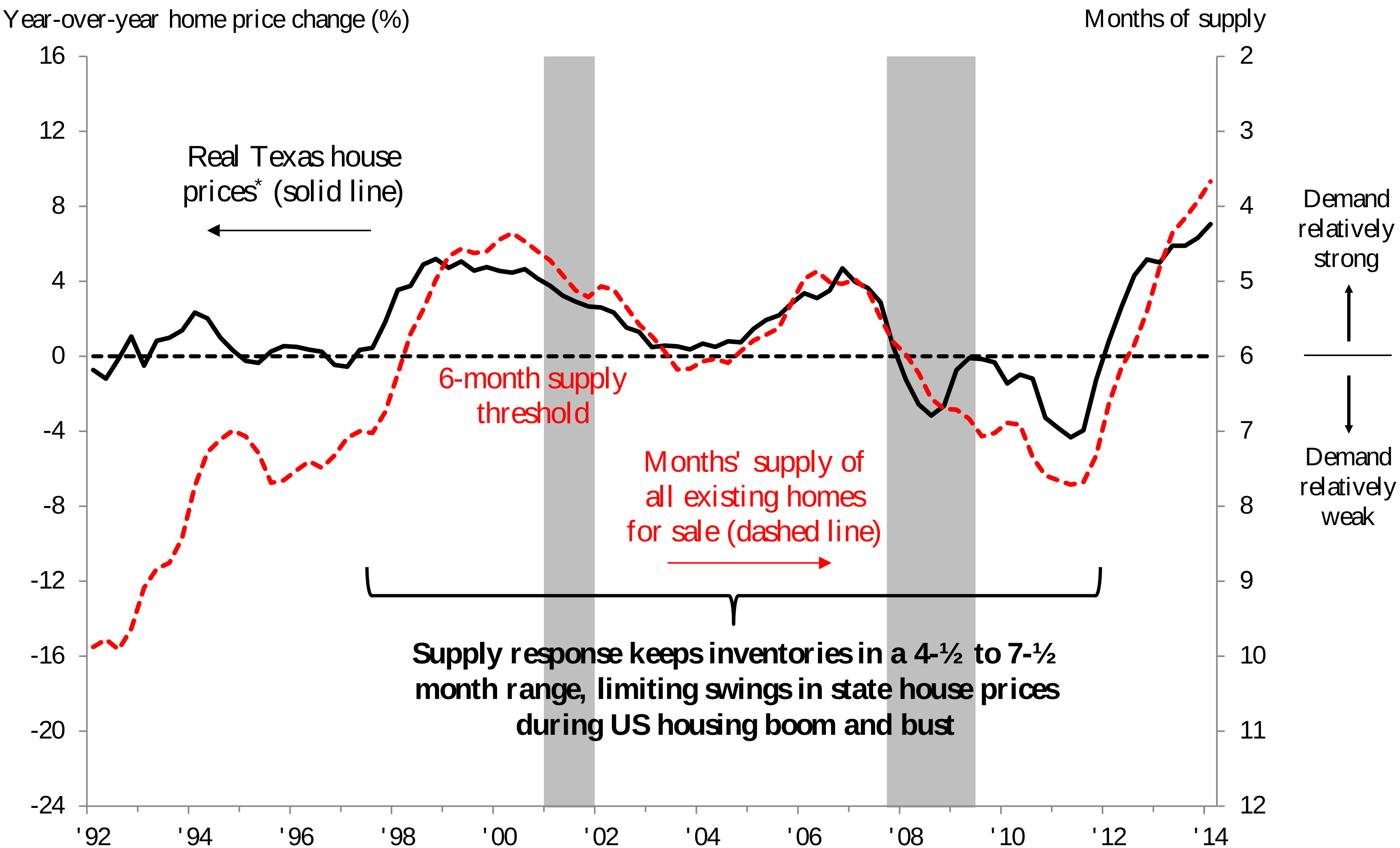

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Great Recession and Energy-Related Rebound

- **Supply and demand limit TX housing decline in Great Recession.**
  - TX entered the national Great Recession with supply near demand.
  - Housing inventories rise some (but by less than elsewhere in US), inducing limited declines in inflation-adjusted house prices over 2008-11.
- **Housing demand outstrips supply in recent shale boom:**
  - Housing demand surges, supply response not enough to prevent inventories from falling and house prices from rising notably faster than inflation.
    - New regulations and tougher supervision hinder banks from making land development loans => shortages of building lots and construction delays.
    - Energy-boom and tighter immigration restrictions limit supply of construction workers at normal construction wages.

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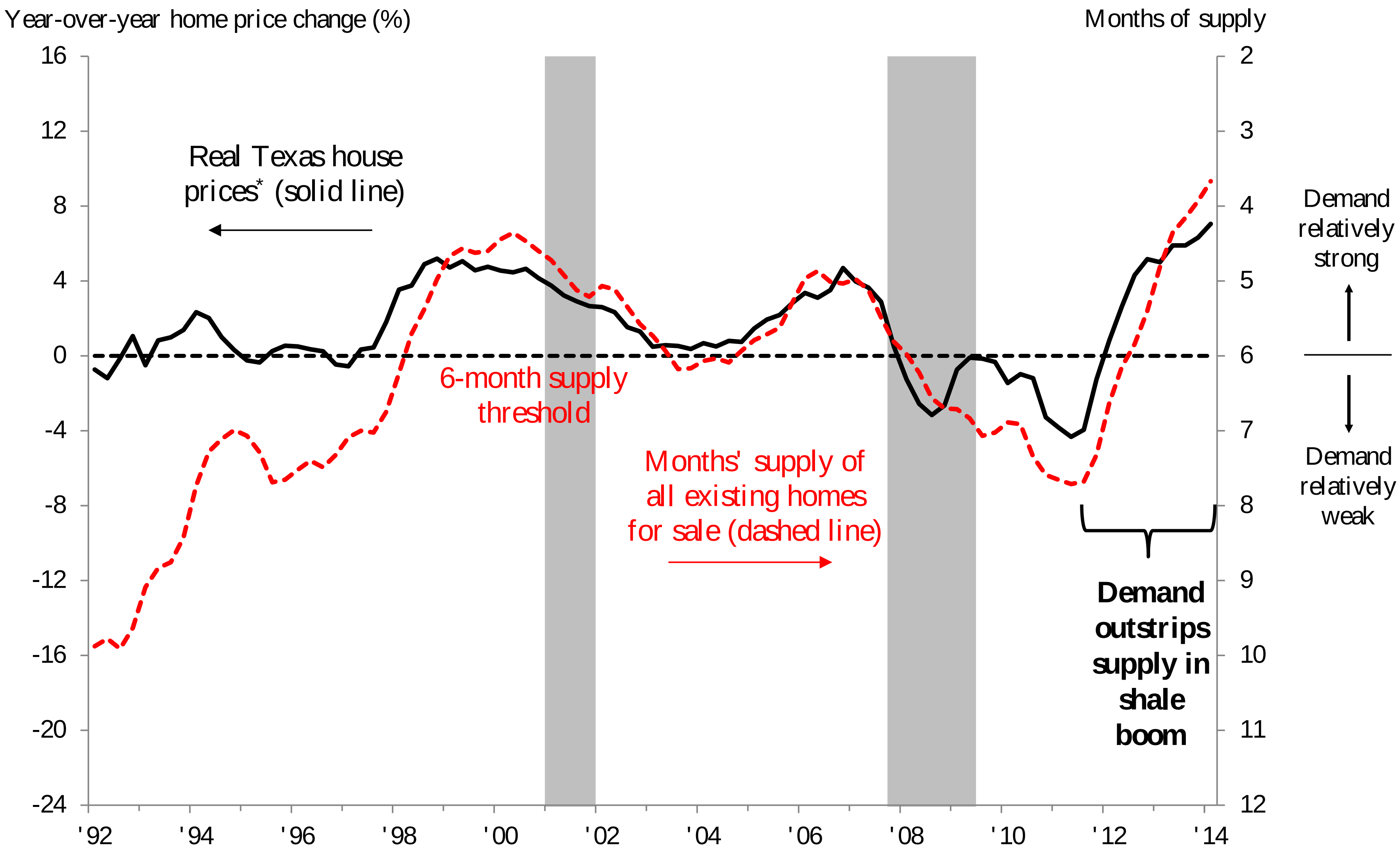

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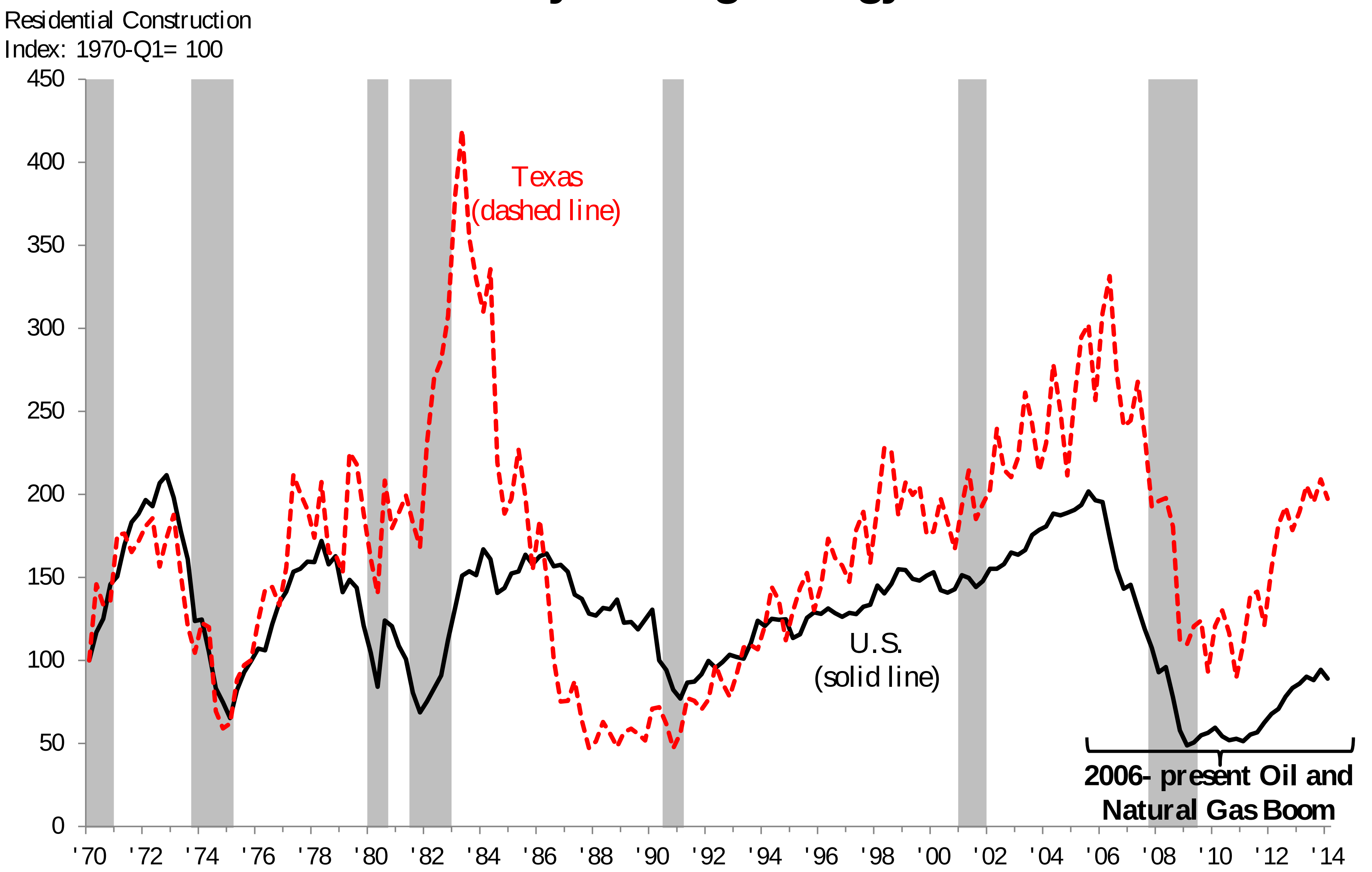

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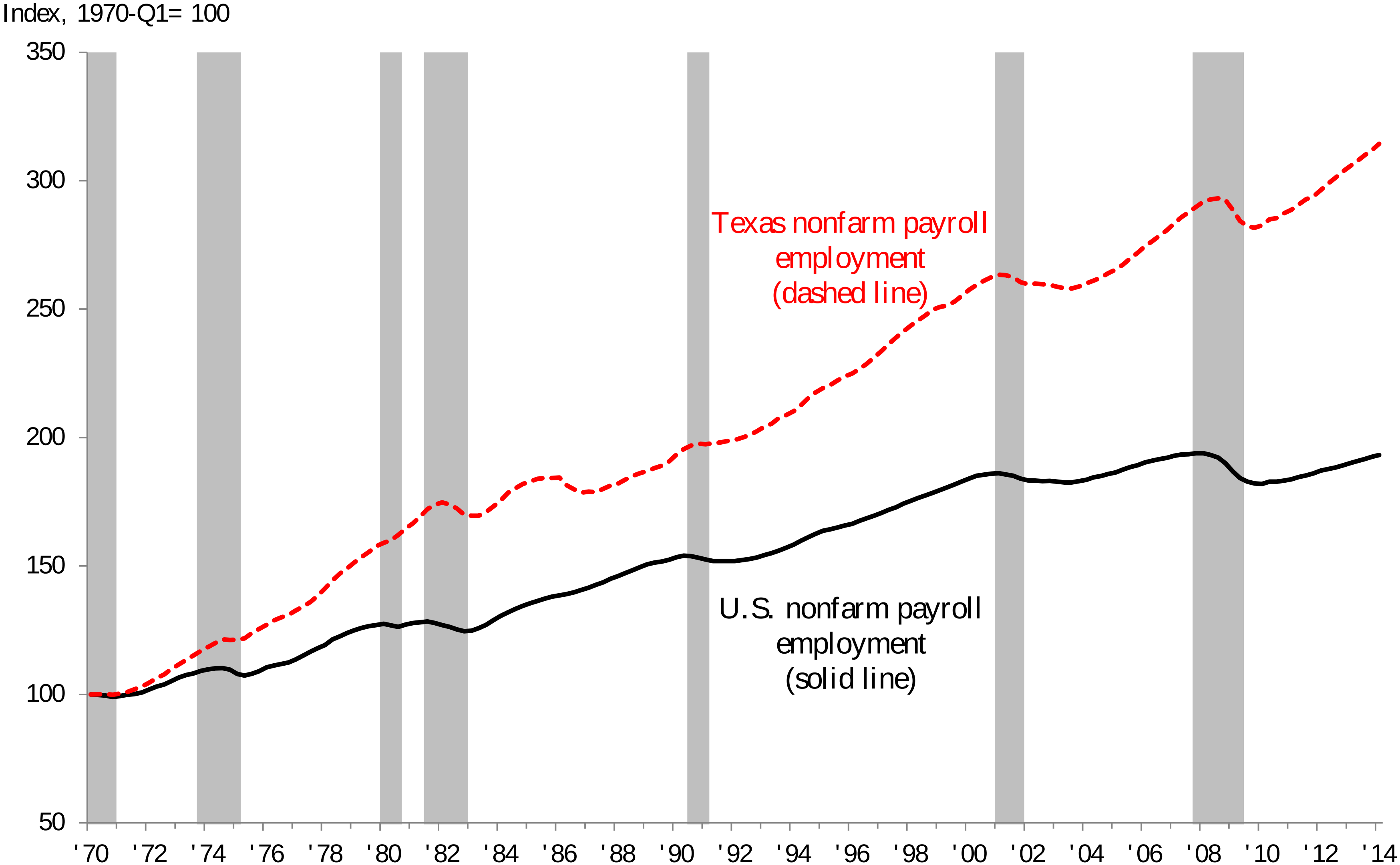
Conclusion

- Texas real estate trends over past four decades reflect:
  - not only swings in the state's pace of economic growth,
  - but also the evolving structure of banking and mortgage finance.
- Texas real estate tends to be below its long-run trend during energy-busts and above during energy booms.
- In recent years, Texas real estate has been robust, aided by general and energy-related strength in the state economy.
- At some point, the shale oil energy boom may eventually fade.
- Nevertheless, banking reforms and the memory of the 1980s' bust seem to have limited the risk of over-building compared to the experience of the 1980s and to have made mortgage finance and real estate more resilient.

Back-up slides

Chart 2: Texas Employment Trends Up Strongly After the 1980s' Oil Bust



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