Texas Housing Recovery Gains Momentum

By D'Ann Petersen and Christina Daly

The state's strength made it a magnet for those looking for work and contributed to Texas' No. 1 ranking for domestic in-migration for a seventh consecutive year.

The Texas housing market is swiftly recovering as rapidly rising sales approach pre-housing-boom levels and apartment rental demand remains strong. New home and apartment construction abounds, the product of a relatively strong regional economy generating jobs, drawing new residents and increasing consumer confidence.

The result: Texas home prices and rents have risen more rapidly than usual.

Further improvement is anticipated in the housing sector as the regional economy continues its expansion. Historically, lean home inventories and low apartment vacancy rates have spurred more building. Given the Texas construction sector's ability to respond quickly to strong demand, however, building activity will catch up to demand and the current rate of home price and rent increases will ease.

A healthier housing sector is not just a byproduct of economic growth; it also makes its own contributions to growth. In the past year or so, residential construction emerged as a major source of jobs—a sharp turnaround from the drag the sector applied during the state's recovery from the recession. Because of the housing expansion and uptick in home values, the proportion of Texas mortgages in trouble is well below the national average and declining.

Housing's gains spill over into other sectors of the economy, such as manufacturing and service-related industries. Wealth effects from higher housing values influence consumer spending and bolster a sense of financial well-being.

Texas' Economic Strength

Underpinning the housing sector's gains is a broad-based expansion of the overall Texas economy. The energy sector is providing a particularly large boost, as reflected in growing oil and gas production in the Eagle Ford Shale formation in south central Texas.[1] By late 2011, Texas had recovered all the jobs lost during the recession, and the job growth rate in 2012 was the nation's third fastest, trailing energy producers North Dakota and Alaska.[2]

The state's strength made it a magnet for those looking for work and contributed to Texas' No. 1 ranking for domestic in-migration for a seventh consecutive year (*Table 1; also see "Noteworthy," page 11*). Dallas, Austin and Houston were among the top five destinations for those new arrivals in 2012—each adding nearly 38,000 people on average in one year, exclusive of births or international migration.

The new residents led a strong demand for apartments—with occupancy rates exceeding 90 percent in major metropolitan areas—and laid the foundation for additional rental construction. Multifamily building permits at the end of 2012 rebounded to prerecession levels (*Chart 1*).

The single-family market's recovery lagged behind the apartment rebound, a function of lingering effects from the national housing crisis, reduced credit availability, still-elevated unemployment rates and uncertainty about the U.S. economic recovery. Many prospec-

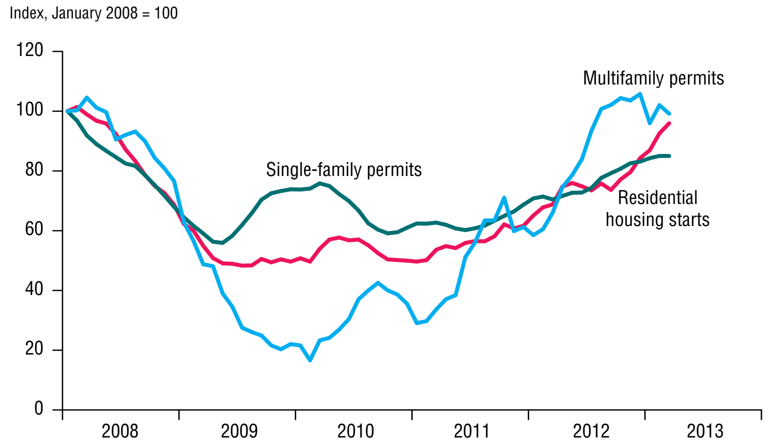
Table 1 Texas In-Migration Still No.1 (July 2011 to July 2012)

Ranking	State	Net domestic migrants
1	Texas	140,888
2	Florida	101,411
3	Arizona	34,456
4	North Carolina	33,641
5	Colorado	27,684
46	Ohio	–37,622
47	California	–44,541
48	New Jersey	–49,300
49	Illinois	–73,453
50	New York	–115,754

SOURCE: Population Estimates, U.S. Census Bureau.

Through April, Texas home sales rose at an annualized 23 percent, a rate of increase approaching levels seen just before the housing collapse.

Chart 1 Texas Construction Leads Rebounding Housing Sector



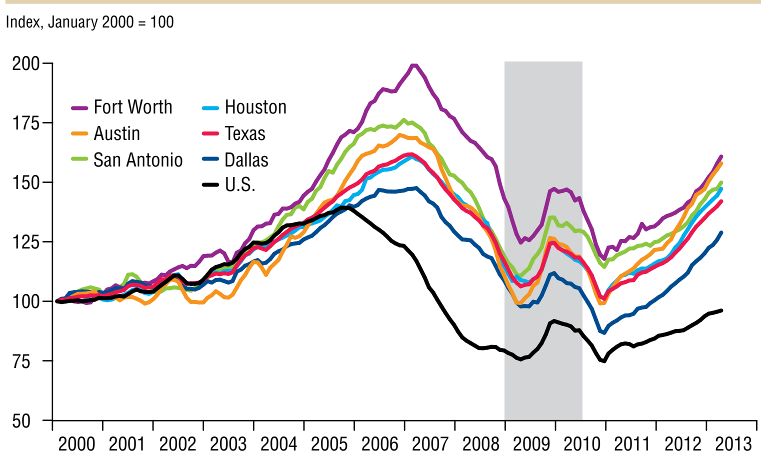
NOTES: Five-month moving average; residential starts include both single-family and multifamily starts.
SOURCE: U.S. Census Bureau; Bank of Tokyo-Mitsubishi.

tive homebuyers rented instead of buying while waiting for the housing market to bottom out and their own financial situation to improve. The housing market's subsequent rapid recovery is a product of this pent-up demand and some shifting from apartments to single-family homes.

Existing-home sales statewide and in major metropolitan areas have risen by more than 33 percent since the start of the housing recovery in early 2011 (*Chart 2*). As Texas' economic growth has strengthened, consumers have become more confident and financial conditions have improved. Through April, Texas home sales rose at an annualized 23 percent, a rate of increase approaching levels seen just before the housing collapse. Anecdotal reports from Dallas Fed industry contacts suggest a very competitive marketplace for buyers, with multiple offers on homes driving up prices.

Historically low interest rates, fewer lending restrictions and rising apartment rents have helped increase the attractiveness of buying over renting in some areas, which, in turn, strongly drove new home construction in early 2013 amid tight supplies.

Chart 2 Existing-Home Sales Continue Rising



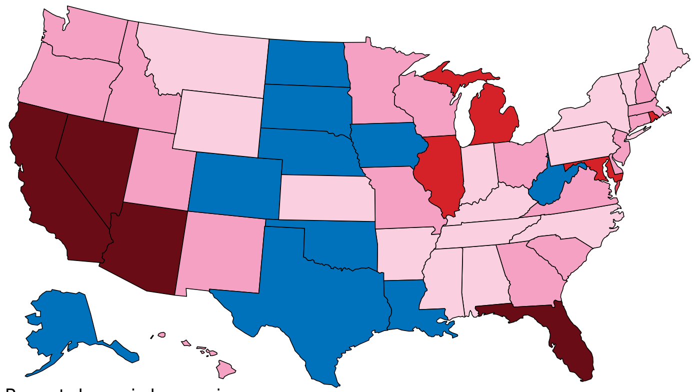
NOTES: Six-month moving average. Shading represents period of first-time homebuyer tax credit.
SOURCES: Multiple Listing Service; National Association of Realtors.

Rapidly Increasing Home Prices

Through first quarter 2013, Texas home prices exceeded by 7 percent the prerecession peak recorded in fourth quarter 2007.[3] Texas, one of just 10 states above its prerecession top, trails only North Dakota in the amount that current prices have surpassed the previous high (*Chart 3*). Nationally, prices remain 13.8 percent below their peak in first quarter 2007, with some of the states hardest hit by the housing bubble still well below those levels—Nevada prices remain 50 percent below their high after falling by as much as 60 percent.

Texas prices have especially improved since single-family demand began turning the corner in late 2011:

Chart 3 Existing-Home Prices Remain Below Peak in Most States



NOTE: Blue states are above peak as of first quarter 2013; states shaded from light pink to dark red are still below each individual state's prior high.
SOURCE: Federal Housing Finance Agency.

Prices rose 6.2 percent in the 12 months ended March 31, 2013, compared with 6.7 percent for the U.S. Even Nevada prices increased, gaining more than 20 percent over the same period.

Still, many U.S. markets retain a "shadow" inventory of homes with underwater mortgages—homes worth less than the amount owed. Just over 21 percent of U.S. homeowners hold such mortgages. Future price increases nationally will be subdued if these homes come to market, boosting supply—an unlikely scenario in Texas, which has relatively fewer distressed mortgages.

The holders of troubled mortgages typically hold out until housing prices recover. These homeowners are less likely to stretch themselves further by relocating to areas offering better employment opportunities and higher pay. Such an impact has been most acutely felt in Nevada, with a nation-leading 52.4 percent of mortgages under water, after reaching a high of 70 percent in 2010.

So, while the U.S has a 5.1-month supply of existing single-family homes and Texas has a 4.2-month inventory, the Texas housing market may be poised for continued short-term home-price strength, reflecting the relatively lower number of homes under water. Low foreclosure levels in Texas—1.5 percent of mortgages in foreclosure compared with 3.6 percent nationally in first quarter 2013 (and a U.S. high of 11.4 percent in Florida)—also tend to elevate prices. Conversely, once foreclosed units come to market, they depress overall home prices.

The housing recovery is inconsistent across several states—such as Virginia, Connecticut and Rhode Island—where there is no sign of a persistent price upturn.

Recent price increases in Texas have uncharacteristically resembled those in the nation as a whole. Texas home prices are normally less volatile than the U.S. average (*Chart 4*). The state has ample land and relatively few building restrictions and can add to inventory relatively quickly, unlike population centers along the east and west coasts. But new units haven't been added fast enough to meet demand from the state's economic expansion, as builders who cut operations during the downturn ramp up production. With growing supply, the rate of price increases should become more moderate, in line with historical averages. In first quarter 2013, the Texas pace eased slightly.

Driving Prices Higher

Historically, inventories below 6.5 months of supply at the current sales rate have coincided with rising home

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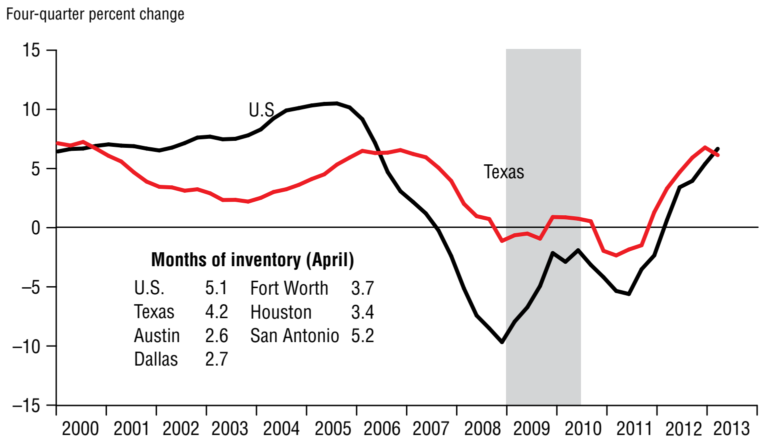
The share of seriously delinquent mortgages—loans 90 or more days delinquent or in the process of foreclosure—continues to decline in Texas, portending falling foreclosure rates in the future.

Chart 4 Home Prices Climbing in Texas and U.S.



NOTE: Shading represents period of first-time homebuyer tax credit.
SOURCE: Federal Housing Finance Agency purchase-only home price index.

prices because potential buyers bid up prices when supplies are tight. Inventories across the state slid below the 6.5-month threshold in January 2012 and were down to 2.6 months in Austin, 2.7 months in Dallas and 3.4 months in Houston in April 2013, while the months of inventory in the U.S. rose to 5.1 from 4.9 in March. Such inventory levels in Texas were not even achieved during the height of the housing boom in 2007 and were last noted in 2000.

The low inventories can also be measured in terms of total listings of homes on the market. After reaching a high in August 2010, in response to a first-time homebuyer tax credit, listings declined by more than one-third to levels not seen since 2002. Once on the market, houses sell briskly. From a low of 14,053 in July 2010, sales have increased to almost 23,000 a month, only 3,400 short of the monthly rate during the housing boom.

The share of seriously delinquent mortgages—loans 90 or more days delinquent or in the process of foreclosure—continues to decline in Texas, portending falling foreclosure rates in the future (*Chart 5*). At 3.8 percent, Texas' share of seriously delinquent mortgages compares with 6.6 percent nationally and with more than 15 percent in Florida. Many states remain significantly above their 2000–06 delinquency average, which was 2.1 percent nationally, suggesting increasing inventories of existing single-family homes in many other parts of the country for years to come.

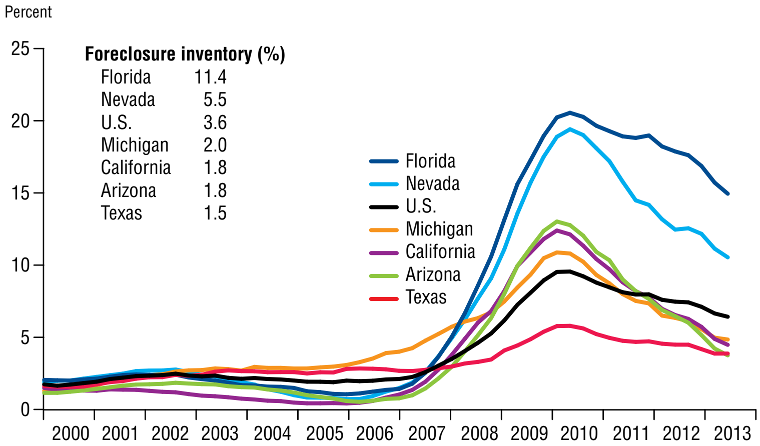
Housing Market and Jobs

The Texas housing market—notably new single-family and apartment construction—provides jobs for a significant share of the Texas labor force in building trades as well as in manufacturing and real estate-related services and sales.

The state's quick housing turnaround after prolonged weakness is reflected in construction employment, which totaled 611,900 jobs as of March 2013, 7.5 percent above its 2000 to 2006 long-term average of 569,100, but still below a peak of 679,200 in May 2008. As residential construction picked up, related sectors gained employment, particularly specialty trade contractors and construction-related manufacturing—including in wood, brick, stone and fabricated metals industries. Building materials suppliers and rental and leasing services are expanding (*Chart 6*).

New home construction provides an important source of overall housing supply. Texas residential permits were roughly half their long-term average from December 2008 to December 2011, partly accounting for low new-home inventory

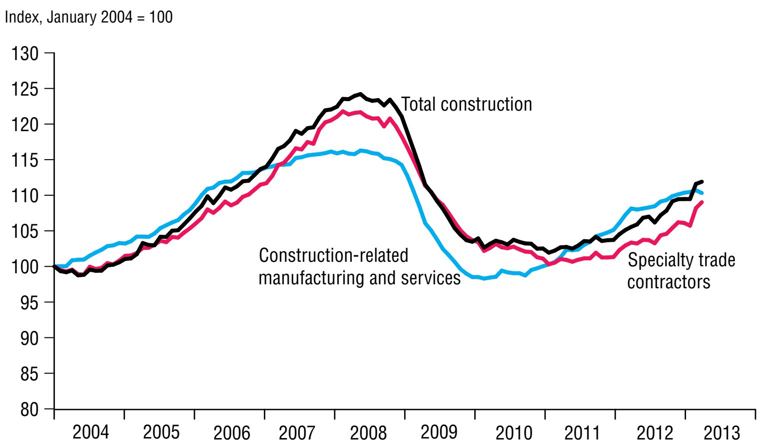
Chart 5 Seriously Delinquent Mortgages Declining



NOTES: States shown, excluding Texas, were some of the most affected by the housing bust. Seriously delinquent mortgages are those with payment 90 or more days past due or in the process of foreclosure.

SOURCES: Mortgage Bankers Association; Haver Analytics.

Chart 6 Texas Construction-Related Employment Picks Up



SOURCES: Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

levels. Responding to higher prices, Texas contractors are planning to build about one-third more homes than a year ago.

Nationally, housing starts are up nearly 35 percent in the past year, bouncing back from the depth of the bust, when construction fell 68 percent from its long-term average. Yet even as U.S. and Texas housing construction declined during the downturn, Texas has accounted for an ever-larger percentage of the new units begun nationwide. Before the housing boom, Texas represented 9 percent of permits, roughly in line with its share of the U.S. population; Texas homebuilding now amounts to 14 percent of the total. Current U.S. home construction is half its long-term average, while Texas is 15 percent below the long-run figure.

Staying Strong in 2013

The Texas housing outlook is positive overall. Stronger-than-average employment growth and consistent in-migration should continue boosting demand for homes and apartments. Additionally, increased construction jobs and enhanced consumer wealth effects from improved financial conditions should add to economic growth, which in turn aids housing.

Headwinds remain, however. The nation's budget debate over fiscal issues and possible tax reform could slow growth in the national economy and affect housing demand. While the forecast for Texas suggests moderate expansion, Dallas Fed business contacts remain cautious.

Still, in the near-term, residential construction will continue contributing to growth in Texas. Pent-up demand coupled with a tight supply of inventory will propel single-family construction, while apartment construction in many Texas metropolitan areas is already at high levels.

Given the increased building activity, prices should eventually slow their ascent in both the apartment and single-family home sectors.

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Notes

[1] See "The Oil Boom in Eagle Ford Shale" on the Dallas Fed website for more information on the role of Eagle Ford in the Texas economy, http://dallasfed.org/research/econdata/eagleford.cfm.

[2] See "Texas Likely to Continue to Lead Nation's Recovery," by Keith R. Phillips, Federal Reserve Bank of Dallas *Southwest Economy*, First Quarter, 2013.

[3] We use the Federal Housing Finance Agency (FHFA) purchase-only home price index to measure home price movements. The data are available for each state and the U.S. and cover repeat-sales purchases. Many other price indexes show results similar to the FHFA index, but are not as widely available at the same geographic level.