A Conversation with Mark G. Dotzour

Bankers Reengage in Housing as Purchasers Confront Budget-Busting Prices

Mark G. Dotzour is chief economist and director of research at the Real Estate Center at Texas A&M University. Dotzour, an observer of residential and commercial real estate trends, discusses why Texas home prices are hitting new highs, the prospects for new construction and housing's overall impact on the Texas economy.

Q. Single-family home prices are rising very quickly in Texas, while new construction appears restrained. What accounts for this?

Homebuilding in Texas, which abated during the Great Recession, is rebounding as homebuyers become more optimistic. Still, new home construction is unable to keep up with demand. Consequently, there are not enough homes for sale. There is also a shortage of single-family lots in desirable locations in pockets across Texas. As a consequence, lot prices are increasing dramatically. This causes the price of new homes to rise as well. Finding a new home under $200,000 is getting difficult.

That said, research at the Real Estate Center has shown that only one variable is consistently useful explaining home price appreciation in Texas—months' supply of inventory available for sale. We found that the Texas residential real estate market is in equilibrium when there is a 6.5-month supply of homes for sale. In the past, when the market was balanced near that equilibrium, home prices increased at a moderate pace.

The months' supply of new homes across all of Texas has been below 6.5 months since November 2011. In January 2014, the months' supply hit a historic low of 3.3 months. Statewide, the inventory has been below four months since September 2013. The supply situation of single-family homes available for sale has never been this low for this long.

Q. Even with the state's population growth, how great is the risk of overbuilding once things turn around? How does the Texas market differ from others?

Texas has a history of being able to outbuild even the strongest demand trends. However, this is not the case today. Low inventories result in higher prices as buyers feverishly compete to purchase a home they want. It is not uncommon for a house to draw multiple offers and ultimately to sell for a price higher than the listing price. Single-family home prices have increased 25 percent in just the past four years. The median price of houses sold in Texas was $191,700 in July 2014, up from $179,400 a year earlier. In July 2010, it was $154,400.

When the national housing market was red hot in 2005–07 and prices increased at double-digit rates in California, Arizona and Florida, prices in Texas rose only 2 to 4 percent. I would get many phone calls asking what was wrong with the Texas housing market. The fact is that there was nothing wrong with the Texas market. Low price appreciation was the result of a high inventory of homes for sale. At that time, thousands of homes were being built and our inventories stayed high.

Q. You've said that it's difficult for developers to get the money to turn raw land into buildable parcels. What do bankers tell you is behind their reluctance to lend?

There are several reasons new-home construction has not increased sufficiently to meet demand. Homebuilders and land developers have historically relied heavily on banks for acquisition, development and construction loans to finance their operations. These funds became very scarce in 2009–11.

In 2014, the situation changed; homebuilders tell me that they can get construction loans again. Money, however, remains scarce for land developers.

Banks across America lost a lot of money from land development loans that went bad in the Great Recession, so they have been reluctant to reengage in this sector. New international banking oversight regulations—the so-called Basel III rules—have yielded a new name for these loans: "high-volatility commercial real estate exposure." Banks that make these loans must have significant capital set aside as a backstop to possible losses. There are exemptions for loans for multifamily development, so it is becoming easier to get loans for new apartments. It isn't so easy for developers to get funding for new subdivisions.

The value of loans outstanding for acquisition, development and construction has declined substantially, Federal Deposit Insurance Corp. data show. At the onset of the recession and real estate collapse, there were $631.8 billion of such loans nationally. The total fell to $206 billion by third quarter 2008 at the height of the recession. Just in the past 12 months, such lending has begun to expand again. In third quarter 2014, loans increased to more than $230 billion.

So the trend is positive, but total credit outstanding to builders and developers is still less than half of what we had before the downturn.

Q. Are there other ways to finance homebuilding-related activities?

As with any other marketplace, there is supply and demand for money; people with money will find a way to get it to people who have a use for it. In recent years, due to the dearth of bank debt financing available for single-

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family lot development, publicly traded homebuilders have become big players in land development in Texas and across the country. They get their funding from the sale of common and preferred stock and the corporate bond market. They have a distinct competitive advantage over smaller builders and developers that don't have access to Wall Street debt and equity funding.

Q. Are labor shortages a problem and, if so, are wages rising in response to worker scarcity? Is it contributing to the rising cost of finished units?

Builders face other problems in addition to funding. A serious labor shortage is plaguing the Texas homebuilding industry. When the housing market crashed in 2008, many construction workers returned to their home countries. Others in recent years have gained employment in the energy industry. Consequently, there just aren't enough workers to support higher levels of new-home construction.

It's hard for homebuilders to keep job-site superintendents as well. I've heard numerous stories of competing builders going to a competitor's job site and luring away the superintendent with higher wages and a signing bonus.

Wages in the new-home supply chain are rising. I know of one firm that raised wages nearly $2 per hour and is now offering "a quarter for each quarter"—a 25-cent-per-hour wage increase, in addition to higher pay, for each three months that an employee stays with the company. The supply chain in the homebuilding industry in Texas is still in a rebuilding phase, and it could take years before there are sufficient workers to meet demand. Home prices in Texas will continue their upward spiral until more supply can come online. This will not happen overnight.

Q. Assuming supply-side issues are resolved and there are more homes on the market, do you have any concerns regarding the demand for housing?

The demand for single-family homes has been increasing since 2011. Buyer psychology changed dramatically, which was evident when the *Wall Street Journal* reported in October 2012 that home prices in once-depressed Phoenix rose 18.8 percent from a year earlier. Continued reports of price appreciation since then have rekindled enthusiasm for homeownership.

The upswing in price appreciation is not uniform across the country. In states that allow nonjudicial foreclosure, the overhang of troubled homes was cleared efficiently and quickly, causing prices to turn up almost immediately. Conversely, states that require judicial foreclosure have been slow to clear. In those states, buyers are still concerned about the shadow inventory of troubled homes that will ultimately have to be sold.

But the fundamental reasons people want to buy or sell a home are not impacted permanently by recessions or credit crises. When people get married, have a child, have a second child, get a promotion, get a divorce, retire, lose a spouse or live next to an annoying dog, they want to move. The Great Recession caused a lot of people to postpone making a move. This pent-up demand has overwhelmed existing supply.

There has been some question about whether the millennial generation [today's young adults] will ever want to buy homes. There is speculation that they will want to live in urban locations and be permanent renters. I personally don't agree. I think these young people have responded to the recession by postponing decisions just like everyone else. Some have postponed moving out of their parents' house. Others have postponed getting married, and some have postponed having children. As these younger people get married and have children, I expect their buying behavior will look a lot like previous generations.

Q. Higher house prices should be good for Texas homeowners. Do you see any downside to the rapid appreciation experienced here?

Rapidly increasing home prices are fun for existing homeowners. It's great to watch the equity in your home increase each year. And we know that when people feel richer, they are more likely to buy things and create jobs. However, there is a downside.

Everyone knows Texas is a great place to do business. Texas businesses compete successfully in the global economy. Part of the reason for their success is that our cost of living has been reasonable and the price of our houses is moderate as well. The lower cost of living allows companies in Texas to hire workers at lower salaries than employers in other parts of our country. By keeping costs low, Texas companies can successfully compete in the global market. But that calculus could change if the price of homes in Texas continues to increase rapidly for several years. If they get too expensive, employers will have to increase pay to make up for the higher costs of living, which will make them less competitive.

I feel that this is one of Texas' most pressing economic development issues. We need to build more homes to keep the supply high enough to prevent prices from getting so expensive that new workers choose not to relocate to Texas. We are nowhere near that level of construction today.