Texas Housing Market Soars to New Highs, Pricing Out Many

By Laila Assanie

ABSTRACT: Texas' low cost of living has been one key long-term factor in the state's growth story—sustaining the economy through oil booms and busts. However, unprecedented home price appreciation and tight supply of starter homes during the housing recovery have eroded this advantage.

elatively low home prices in Texas—contributing to a lower cost of living than elsewhere in the U.S.—have played an important role in the state's robust long-term economic and population growth that has often led the nation.

However, recent gains in Texas home prices have reduced that cost-of-living advantage, calling into question whether Texas can maintain its superior growth. Following another year of record house price appreciation in 2016, affordability continues to slip; Austin and Dallas have fallen below measures for the country as a whole.

Texas home price gains have uncharacteristically outpaced the U.S. since 2011 (*Chart 1*). Texas home prices were up 42 percent in fourth quarter 2016 from fourth quarter 2010 levels, according to Federal Housing Finance Agency data. U.S. home prices rose 30 percent over the same period. Median real (inflation-adjusted) home sales prices in Texas crossed the \$200,000 mark in late 2015.

Thus, a median-income household without a down payment and other obligations, such as a car or student loan payment, could barely afford a median-priced home in 2015 when Texas' median household income was \$55,653.¹

As housing began recovering in 2011, following its collapse nationally, lenders looked more closely at mortgage borrowers' credit ratings and income.

Builders, who also faced escalating land, materials and labor costs and tight lending for land development, responded by constructing fewer "starter" homes, typically priced below \$250,000. Starts of homes priced below \$250,000 dropped from 62 percent of overall new single-family units in 2011 to 33 percent in 2016, according to data from Metrostudy, a market research company.²

Entry-Level Sale Constraints

Texas' rapid recovery from the Great Recession—in part shale oil-boom driven-produced vigorous job and population growth from 2012 through 2014, fueling housing demand.3 Texas' existing-home sales began trending upward in mid-2010, finally surpassing the prerecession peak in late 2015. The housing market kept expanding in 2016, surging to new highs. Total sales rose 5.2 percent in 2016, following a 4.1 percent hike in 2015. These increases occurred despite slowing statewide job growth, particularly in Houston, which accounts for one-fourth of the state's existinghome market. Sales there fell in 2015 but increased modestly last year.

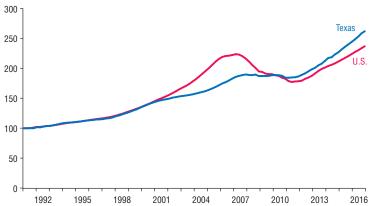
Even with healthy gains in overall housing demand, sales growth has varied across price points. Sales of mid- to higher-priced homes (sales price above \$250,000) have climbed since early 2012 (*Chart 2*). Sales of homes priced \$250,000 to \$399,999 rose 16 percent in 2016, following increases of 17 percent in 2015 and 15 percent in 2014, according to the Multiple Listing Service (MLS) data compiled by the Real Estate Center at Texas A&M University. Activity was similarly brisk among homes priced \$400,000 to \$749,999, with solid gains of units selling for \$750,000 and above.

Meanwhile, sales of entry-level homes—those priced below \$250,000—grew relatively modestly in 2012 and 2013, dipping in 2014 and 2015, and staying flat last year. Sales of these units dropped 10 percent in Austin, the state's most expensive metro, after declining 8.4 percent in 2015 and 8.7 percent in 2014. Dallas–Fort Worth and Houston also slipped, though less than Austin over the past three years. Starter-home sales grew only in San Antonio, inching up 3.3 percent in 2014 and 5 percent in 2015 and 2016.

Chart 1

Texas House Price Gains Exceed U.S. in Housing Recovery





SOURCE: Federal Housing Finance Agency House Price Index, Purchase Only.

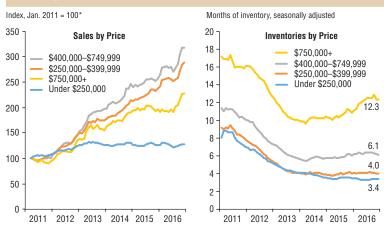
The overall lackluster performance doesn't reflect lack of demand, but rather rapid price appreciation combined with tightening supply. With six months' supply of existing for-sale homes considered balanced, inventory in Texas priced below \$250,000 fell from more than eight months in early 2011 to 3.4 months in 2016 (*Chart 2*).

The stock of entry-level units is more constrained in the state's major metros, particularly in Austin and DFW, where it dropped from six months of supply in Austin and around seven months in DFW in early 2011 to

one month at the end of 2016. Houston and San Antonio inventories also contracted, to about two months in December 2016.

The supply of mid-priced homes (\$250,000 to \$399,999) is a tight four months, while units from \$400,000 to \$749,999 have held steady since early 2015. Meanwhile, the supply of homes above \$750,000 has slowly increased. The Federal Reserve Bank of Dallas Beige Book reported that sales of higher-priced homes have slowed, particularly in Houston. Inventories of homes there priced above \$750,000





^{*}Three-month moving average; seasonally adjusted.

SOURCES: Real Estate Center at Texas A&M University; Multiple Listing Service; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

have grown from around six months in early 2014 to 11 months in the second half of 2016.

Higher-End Homes' Share

The mix of price points in the Texas housing market has changed. While homes priced under \$250,000 still make up the majority of homes sold, they constitute a much smaller share of overall sales than when the housing recovery began in 2011. Sales of entrylevel existing homes dropped from 78 percent of the total in 2011 to 62 percent in 2016, while those at higher price points—notably in the \$250,000 to \$399,999 range—grew from 14 percent to 24 percent (Chart 3). Declining share is particularly pronounced for new homes, where inventories of homes priced below \$250,000 dropped from 56 percent in third quarter 2011 to 24 percent in third quarter 2016.5

This shift is more notable in the major metros. The share of total entry-level MLS sales dropped in Austin from 66 percent in 2011 to 40 percent in 2016. Declines in DFW of 22 percentage points; Houston, 16 percentage points; and San Antonio, 14 percentage points, are significant as well. Meanwhile, in DFW and Houston, the share of homes sold priced \$250,000 to \$399,000 climbed from about 15 percent in 2011 to more than 25 percent in 2016. In Austin, that price range made up 35 percent of sales in 2016—up from 21 percent in 2011.

Housing Affordability Diminishes

Beyond absolute increases is the effect on affordability: price rises relative to gains in income and mortgage rates. For a given mortgage rate, if incomes have grown as fast as home prices, then homes can nonetheless remain affordable.

That hasn't occurred. Instead, Texas' nominal median existing-home sales price has climbed 34 percent—from \$149,500 in December 2010 to \$200,000 in December 2015—more than twice the 14 percent increase in nominal median household income. While mortgage rates dipped between December 2010 and December 2015, the decline was not enough to offset rising home prices.

The appreciation continued, despite a slowing state economy, with median home prices up an additional 8 percent in 2016, further eroding housing affordability. Dallas is the least affordable metro area in the state, with 50 percent of homes sold during fourth quarter 2016 viewed as affordable to median-income families, down from 68 percent in fourth quarter 2010, according to the National Association of Home Builders (NAHB)/Wells Fargo Housing Opportunity Index.

The Dallas index is at an all-time low since the series began in 1991. Similarly, affordability in Austin has dropped sharply, the share of sold homes considered affordable was slightly below the national figure at 59.9 percent in fourth quarter 2016. Fort Worth, Houston and San Antonio also experienced declines but remained more affordable than the U.S. as a whole in the fourth quarter.

Despite marked declines, affordability is better than in many other large metropolitan divisions such as New York–Jersey City–White Plains at 35.4 percent and Los Angeles–Long Beach–Glendale at 12.5 percent, although the Texas comparative advantage has shrunk.

With more than 200 U.S. metro areas tracked by the NAHB/Wells Fargo index, Austin's ranking nationally dropped from No. 115 in first quarter 2010 to 157 in fourth quarter 2016. Dallas' ranking plunged 60 spots, to No. 176, and Fort

Worth dropped 82 places to No. 135. Rankings for Houston at No. 147 and San Antonio at No. 141 are also down sharply.

Inadequate Lot Supply

At the outset of the housing recovery, the supply of vacant developed lots for building was plentiful—over 50 months' supply in DFW, more than double the 20-24 months considered balanced.7 Lot supply began diminishing in 2011, falling rapidly through 2013, as tight credit for land development, delays in land permitting and shortages of skilled construction workers prolonged lot delivery times.8 Lot supply in Austin and Houston (which both rebounded more immediately from the Great Recession than DFW) fell below the 20-month threshold in early 2013 and has remained below or near that level since.

The situation is slowly easing, with lot supply in Houston and San Antonio just above 20 months in third quarter 2016. Lot supply remains below the norm in Austin at 18 months and DFW at 19 months. The NAHB's 2015 construction cost survey found an average lot cost \$4.20 per square foot in 2015—27.3 percent higher than in 2011.

The shortage of lots available for building is most apparent in the under-\$250,000 price point. For instance, regulatory costs make up about a fourth of the final price of a new single-family home, according to the NAHB March 2016 survey. 11 Dallas Fed industry contacts also note increased regulatory burden on developers and builders.

Lot supply for homes priced from \$200,000 to \$249,999 appears to be the tightest statewide, ranging from 10 months in Austin and DFW, to 14 months in Houston and 20 months in San Antonio (*Chart 4*). Meanwhile, lot supply for homes priced \$300,000 to \$499,999 is at or slightly below normal levels (around two years) across the major metros. Lot supply for homes priced \$500,000 to \$999,999 is above the 20–24-month equilibrium range.

Labor Shortage, Wages Escalate

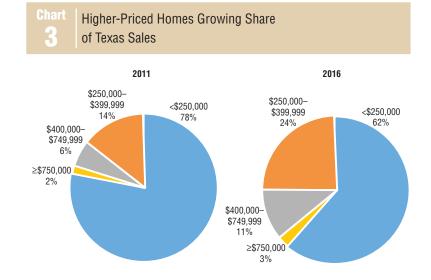
Texas residential construction employment declined more than overall employment during the Great Recession and took longer to recover, despite strong statewide job gains (*Chart 5*). Payrolls in residential construction in mid-2016 remained slightly below their prerecession high of 50,550 workers set in early 2008.

This slow employment rebound was partly a result of the shale oil boom, which absorbed some of the potential residential construction workforce. Labor shortages in residential construction were widespread during most of the recovery. Amid the more recent slowdown in the oil patch, residential construction worker shortages eased in Houston. The market remains tight in Austin and DFW for skilled trades such as framers, masons and bricklayers.

As a result of the tight labor supply, inflation-adjusted average hourly earnings in Texas' construction sector climbed 20.3 percent between 2011 and 2016, nearly quadruple the 4.7 percent increase for the U.S. construction sector and the 5.9 percent growth in Texas total private-sector earnings.

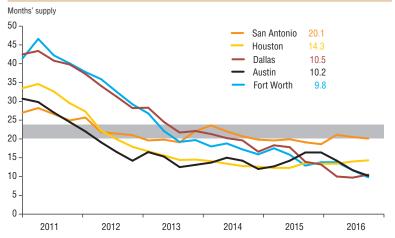
Challenges Lie Ahead

A low supply of lot inventory for lower-priced homes, especially below \$250,000, will make it difficult to deliver affordable homes in the near term. Among the major metros, Dallas has the lowest share of vacant developed lot inventory needed to build at this price point.



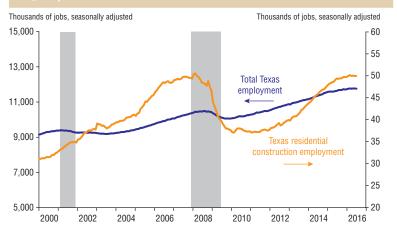
SOURCES: Real Estate Center at Texas A&M University; Multiple Listing Service (MLS)





NOTES: Last data point is third quarter 2016; gray bar is lot supply equilibrium range. SOURCE: Metrostudy.

Chart Residential Construction Employment Remains Below Pre-Bust Peak



NOTES: Last data point is June 2016. Shaded areas indicate U.S. recessions. SOURCE: Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Some builders, such as LGI Homes and D.R. Horton Express, have expanded their offerings at the entry level by reducing the home's footprint and building in more distant suburbs. Dallas Fed's Beige Book contacts also report that builders are concerned about housing affordability and several are now focused on bringing more affordable product to the market through "defeaturing" and reducing square footage and lot sizes.

Given recent improvements in the energy sector, a pickup in Texas job growth expected this year and potential changes in U.S. immigration policy, construction labor shortages will likely persist this year, making it difficult for builders to contain costs. A nationwide survey of homebuilders puts cost and availability of labor as the group's top concern.¹²

Lastly, rising home prices have been masked by low and falling interest rates, giving buyers more purchasing power to buy larger homes, and hence, damping the impact on affordability. The 30-year fixed mortgage rate has increased about 75 basis points from a low of 3.42 percent in September 2016 to 4.15 percent in mid-February 2017. ¹³ If rates continue

trending upward, as expected, they will further reduce housing affordability and bite into sales, particularly at mid- to higher-price points.

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Notes

- ¹ The median-income household with no money for a down payment and no debt obligations, which spends about 36 percent of its gross annual income on a mortgage payment (including estimated property taxes and mortgage insurance), could buy a \$211,000 home, assuming a 4.2 percent, 30-year fixed rate mortgage. Calculated using affordability calculator provided by Nerdwallet, www. nerdwallet.com/mortgages/how-much-house-can-i-afford/calculate-affordability.
- ² Texas data are the sum of annualized starts of homes priced under \$250,000 (as of third quarter 2011 and third quarter 2016) for the five major Texas metros: Austin, Dallas, Fort Worth, Houston and San Antonio.
- ³ "Game of Homes: The Supply-Demand Struggle," by Laila Assanie, Sarah Greer and Luis B. Torres, *Tierra Grande*, Real Estate Center at Texas A&M, October 2016.
 ⁴ Home sales and inventories by price point data are
- from the Real Estate Center at Texas A&M University and Multiple Listing Service.
- ⁵ Texas data are the sum of annualized inventory of new homes priced under \$250,000 (as of third quarter 2011 and third quarter 2016) for the five major Texas metros: Austin, Dallas, Fort Worth, Houston and San Antonio. Data are from Metrostudy.
- ⁶ Median household income data are from the Census Bureau
- ⁷ Vacant developed lot data are from Metrostudy.
- 8 See note 3.
- ⁹ Overall, the total number of vacant developed lots across the major metros in third quarter 2016 was 13 percent below that of third quarter 2011.
- ¹⁰ "Cost of Constructing a Home," by Heather Taylor, Special Study for Housing Economics, November 2015.
- "Government Regulation in the Price of a New Home," by Paul Emrath, Economics and Housing Policy, National Association of Home Builders, Special Studies, May 2, 2016.
- ¹² The cost and availability of labor was noted as a significant issue for 78 percent of builders in 2016, and 82 percent expect this will be their top issue in 2017, according to the National Homebuilders Association survey. See "Top Concern for Builders Remains Unchanged," National Association of Home Builders, Jan. 26, 2017.
- ¹³ Thirty-year fixed mortgage rate data are from Federal Home Loan Mortgage Corp.