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Will the housing bubble burst?

By the
Research
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Home sales in most Texas cities are on a six-year winning streak. The numbers have grown steadily while the state has added, on average, 340,000 new residents per year since 1991.

Current market activity has surpassed the housing “boom” years of the early 1980s and with significantly higher prices. The 172,000 sales completed through Texas Multiple Listing Services (MLS) in 1998 was a record. Based on estimates from the first half, 1999 likely broke that record with 180,000 home sales.

The hot markets are setting price records as well. Homes are selling so well, they are depleting inventories of homes for sale. In other words, more homes are selling than new listings are being created. The shortage of listings is pushing up prices and creating a strong sellers’ market.

Builders are keeping busy. In 1999, state-wide permits for single-family homes exceeded 100,000 units for the first time since 1983. Multifamily permits have followed this trend upward but showed signs of peaking in 1999.

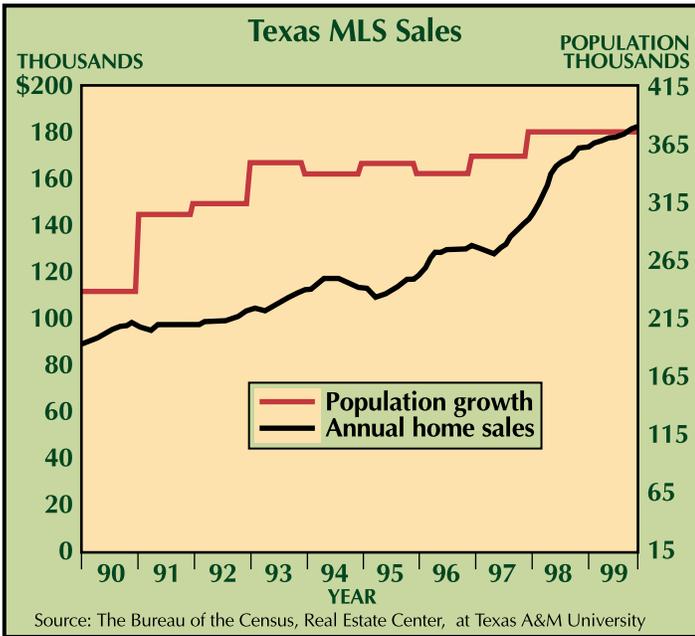
The reasons for the market’s vitality are no mystery. The economy is strong and steady. Mortgage interest rates, although higher than in recent periods, remain in the affordable 7 to 8 percent range. Furthermore, lenders are in an expansive mood, offering special loan programs aimed at first-time homebuyers. The barriers of a high cash down payment and solid credit rating requirement are being whittled down in a

mortgage market geared to providing financing for almost every situation.

How long can the market be expected to perform at this level? If the ride ends, will the market crash like it did in the mid-1980s?

Look at some of the reasons why the party might last at least one more year.

- The outlook for **continued strong population growth** is good. If the projections published by the State Data Center (using the scenario most closely in line with the latest population estimates: 1998) come true, the pace of single-family building would have to increase by 50 percent for 1999 through 2004, compared to the number built in 1990–98.
- Even with recent increases, **mortgage interest rates are low** in light of recent history, making housing affordable—even at the higher prices.
- **Availability of adjustable rate mortgages** at lower interest rates and income tax deductions tend to blunt the effect of interest rate increases on affordability. Homebuyers tend to opt for the adjustable loans when fixed rates spike.



- **Current sales may be even stronger** than the charts show. The figures do not include sales outside the MLS. Yet, as the demand for homes strengthens, the percentage of sales from FSBOs (for sale by owner) and builders may increase to a sizable portion of the market.
- **Homeownership in Texas has not increased as rapidly** during the 1990s as it has in most other states. If mortgage markets remain receptive to young and minority homebuyers, the state should enter a catch-up phase that could stimulate housing markets. There could be almost unlimited opportunities in the sale of affordable homes.

Factors leading to **reduced home sales volume** include:

- The combination of **higher interest rates and slowing employment growth** may erode consumer confidence and drag on the move-up market. The ranks of first-time homebuyers could be cut as well by the need for higher qualifying income. If prices flatten as increased supply comes into the market, the urgency to buy will be diminished further.
- **Heavy debt burdens** may begin to sap the ability of many Texans to afford more expensive homes.
- The **1997 tax law change** effectively made selling a home tax-free. There no longer is a need to re-invest all of the

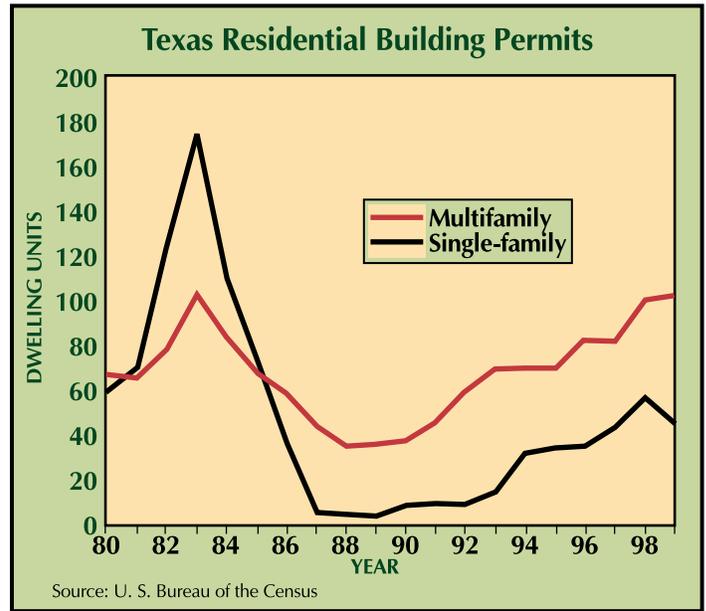
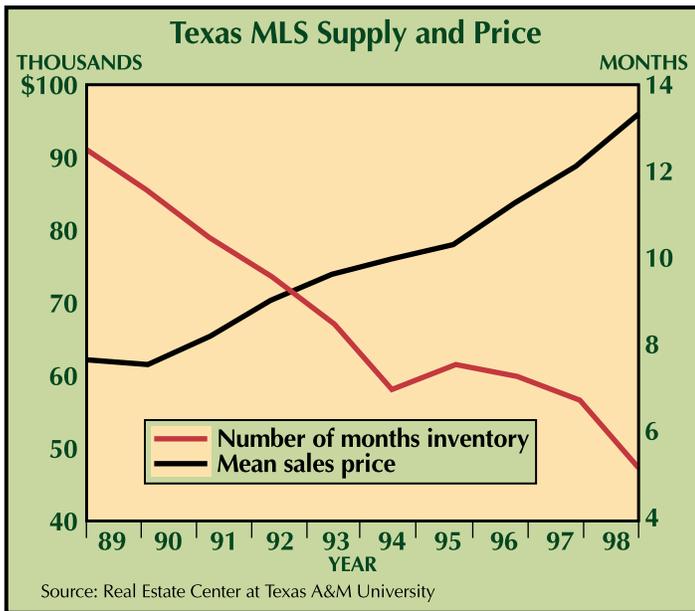
Projected State Population and Home Construction

1990:
 Population — 17,044,605
 Housing stock — 4.6 million single-family
 1.8 million multifamily
 550,000 manufactured homes

2005:
 Population — 22,286,000
 Housing stock — 5.65 million single-family
 2 million multifamily
 850,000 manufactured homes

1990-97 permits issued — 430,800 single-family (54,000 per year)
 146,000 multifamily (18,000 per year)

1998-04 permits needed — 785,000 single-family (98,000 per year)
 205,000 multifamily (26,000 per year)



proceeds from a previous home sale. This might impact the market for higher priced homes as relocates from states with more expensive housing settle in Texas.

As far as a replay of the 1980s debacle, consider the major trends of that extraordinary time:

- High inflation rates led to high rates of appreciation in house prices which, in turn, encouraged speculative buying in housing markets. The Fed's switch to a tighter monetary policy in 1979, removed the basis for high inflation and consequently collapsed the housing boom.
- High marginal tax rates provided a strong case for owning a home as a tax shelter. The rates were reduced markedly during the early 1980s, and the 1986 reform raised the standard deduction and killed most non-housing deductions. While homeowners retained favored tax status, the savings were not spectacular enough to be a primary motivation to buy, especially for lower income households.
- The rise of the Organization of Petroleum Exporting Countries (OPEC) added value to Texas' prime natural resource—oil. The outlook in the late 1970s was for a continuing upward spiral in oil prices, and, with it, a transfer of wealth into the state. Instead, prices collapsed under a world-wide glut. The housing market was caught with tremendous overstock.
- Higher costs of funds and deregulation induced savings and loan associations to take on riskier ventures. Money for construction became abundant with little regard for risk. When loans soured and associations began to fail, the money was cut off, eventually leading to a credit crunch for real estate ventures.

In short, there was a remarkable combination of factors that led to the most drastic boom and bust cycle in the annals of Texas housing markets. It is not likely that such a combination will be repeated. Contrast that situation to **today's market:**

- Annual increase in median home prices is running around 6 percent, compared to 10–16 percent in the early 1980s. Inflation is a minor concern compared to that period. Furthermore, today's price gains are caused by short supplies rather than speculative demand.
- Few buyers appear to be motivated by a desire to access tax deductions.
- Houses are viewed more as a consumer good than an investment.
- The Texas economy is not running counter-cyclical to the national economy. Therefore, while people are moving into the state, Texas is not a Mecca for the nation's unemployed.
- Builders appear to be more cautious and, even if they were not, shortages of labor and materials are hampering their ability to get ahead of demand.
- Texas is less dependent on oil.
- Lenders are taking on more risk. This is the one area where similarities to the earlier era exist. Adding people with less reserve wealth to the rolls of homeowners increases the probability of significant foreclosures if the economy and market stumble. However, this segment is too small to cause major disruptions in the market on the order of the mid-1980s experience. ♣



Metro boxscores

Most and Least Frequent Turnover

Most Frequent Turnover (Home Sales per 1,000 Population)

1	Austin	9.28
2	Houston	7.61
3	Dallas	7.60
4	Tyler	7.13
5	Bryan-College Station	6.57
6	San Angelo	6.42
7	Wichita Falls	6.40
8	Lubbock	6.31
8	Fort Worth	6.31
10	Amarillo	6.28

Least Frequent Turnover (Home Sales per 1,000 Population)

1	McAllen-Edinburg-Mission	1.23
2	Brownsville-Harlingen	1.58
3	Galveston	2.10
4	Brazoria	2.64
5	Beaumont-Port Arthur	3.22
6	Longview	4.50
7	Waco	4.84
8	El Paso	4.88
9	Odessa-Midland	4.94
10	Killeen-Temple	5.01

Biggest and Smallest Price Gains

Fastest Rising Prices Percentage change in median sales price (through July)

1	Sherman-Denison	9
2	Austin	7
2	Bryan-College Station	7
2	Houston	7
5	Dallas	5
5	Longview	5
7	Fort Worth	4.5
8	San Angelo	4
9	Corpus Christi	3
9	Victoria	3

Slowest Price Changes Percentage change in median sales price (through July)

1	Brazoria	-4
2	Abilene	-1
2	McAllen	-1
2	Tyler	-1
5	Odessa-Midland	0
5	Wichita Falls	0
7	Amarillo	1
7	El Paso	1
7	Galveston	1
7	San Antonio	1

MARKET ACTIVITY indicates the strength of demand that supports higher prices. But supply is just as important, and many markets with little price change have an ample supply of homes on the market despite a large sales volume.



Most and Least Active Construction Markets

Smallest and Largest Supply

Most Active Homebuilding Markets Single-family Building Permits per 1,000 Population

1	McAllen	5.50
2	Austin	4.67
3	Brazoria	4.61
4	Dallas	4.39
5	Galveston	4.14
6	Laredo	4.08
7	Fort Worth	3.82
8	Bryan-College Station	3.52
9	Houston	3.44
10	San Antonio	3.42

Cities with Smallest Inventory (mid-1999)

1	Austin	3.0
2	Houston	3.8
3	Dallas	4.2
4	Fort Worth	4.3
5	Bryan-College Station	4.4
6	Amarillo	4.7
6	Victoria	4.7
8	Lubbock	4.8
9	Wichita Falls	5.0
10	San Antonio	5.6

Least Active Homebuilding Markets Single-family Building Permits per 1,000 Population

1	Longview	0.41
1	Sherman-Denison	0.41
3	Texarkana	0.54
4	Odessa-Midland	0.61
5	Beaumont-Port Arthur	0.80
6	Abilene	0.84
7	Wichita Falls	0.89
8	Corpus Christi	1.08
9	Tyler	1.16
10	Waco	1.33

Cities with Largest Inventory (in months)

1	McAllen	12.8
2	Brownsville-Harlingen	11.3
3	Tyler	10.5
4	Galveston	10.0
5	Corpus Christi	9.7
6	Longview	8.6
7	Odessa-Midland	8.3
8	Brazoria	7.1
9	Abilene	6.7
10	Sherman-Denison	6.3

THE HIGHER THE NUMBER OF MONTHS inventory, the larger the current inventory is compared to sales and, therefore, the more sellers competing for available buyers.

The other portion of supply is the number of new homes produced. The best indication of current building activity is the number of permits issued.

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