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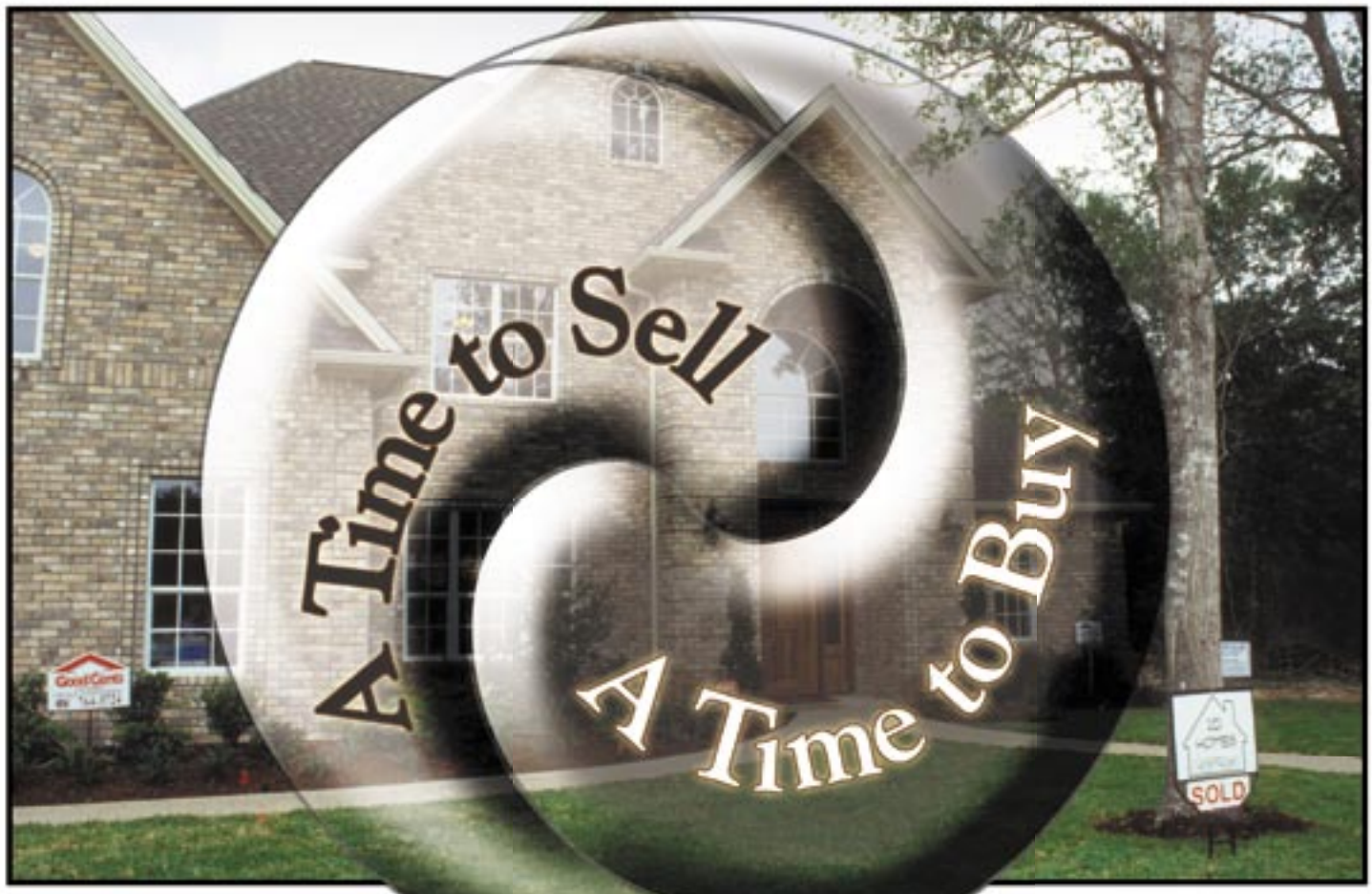


A Time to Sell A Time to Buy

By Jack C. Harris

Real estate professionals know there are times when sellers can get their asking price, while at other times, they have to beg people to look at their properties. These swings are not the normal seasonal changes that depress sales in the winter and boost them in the summer. They are longer term, often taking many years to change from one mode to the other.

Periods when sellers have the upper hand are called "sellers' markets." These are ideal times to sell a home. When buyers have negotiating power, the market is called a "buyers' market." In buyers' markets, it is not uncommon for sellers to offer generous concessions.

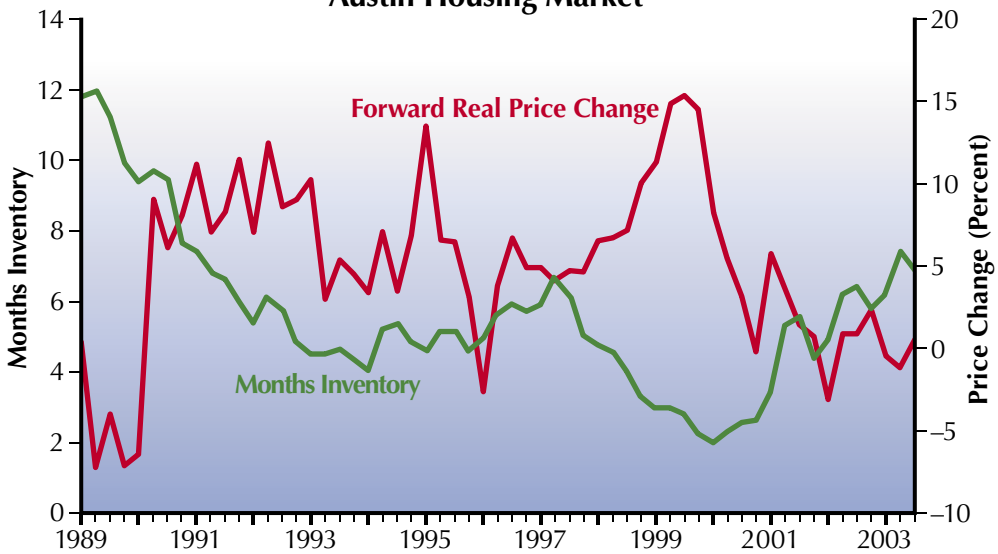
Knowing whether sellers or buyers have negotiating power is important in pricing and marketing a property. This research gives real estate professionals a new tool to alert them when markets are about to change.

What Makes a Market Change

Prices are set by market supply and demand. Home builders and homeowners interested in selling their homes supply the market. First-time buyers, those relocating and move-up buyers provide the demand. In most cases, demand is more sensitive to change than supply. A plant opening or falling interest rates can boost demand almost overnight, while massive job layoffs and rising interest rates can dry up demand quickly.

Supply is more sluggish. It takes time to build new homes, and that is one of the main ways to expand supply. On the

Figure 1. Inventory and Price Change Austin Housing Market



Source: Real Estate Center at Texas A&M University

other hand, it is difficult to withdraw supply already on the market.

As a consequence, housing markets tend to cycle between oversupply and shortage. Ordinarily, these swings take years.

Markets also can spend considerable time close to equilibrium, when neither buyer nor seller has a particular advantage. When a market is in equilibrium, prices are somewhat stable. This means homes appreciate at about the same rate as general inflation.

When demand increases faster than supply, housing becomes scarcer, and buyers tend to bid up prices. Home prices rise faster than inflation because each house becomes more valuable within the market.

In extreme cases, frenzied bidding by buyers may create a price "bubble," an unstable condition based on expectations of further price increases. When a bubble bursts, there may be no demand for homes until prices fall to a realistic level. These are disruptive periods, which is why market observers worry about price bubbles.

THE ABILITY TO READ THE HOUSING MARKET *gives real estate professionals an edge when it comes to marketing properties for clients. Knowing whether a buyers' or sellers' market is likely to continue or is on the way out may affect sales strategies and contract negotiations.*

Usually, a sellers' market calms as it approaches equilibrium. When additional supply becomes available, it evolves into a buyers' market.

When supply is high and buyers are hard to find, prices rise slower than inflation and may even decline. Just as sellers' markets are difficult and trying times for buyers, buyers' markets present challenges to sellers.

Sellers in a buyers' market need to price and market their properties aggressively, perhaps offering warranties and paying buyers' closing costs. On the other hand, buyers in a sellers' market may need to make their offers more attractive by obtaining preapproval for financing.

Reading the Market

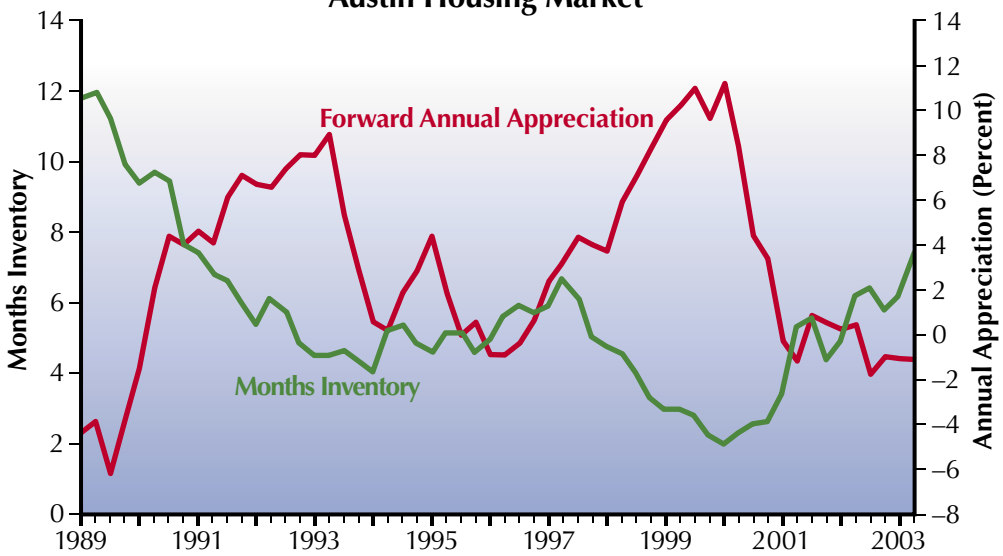
Examining price trends is one way to detect the existence of buyers' or sellers' markets. Trends must persist for several months (not just a one-month spike) before they signal disequilibrium. The problem with tracking prices is that it takes time for price data to become available, and they can be misleading for local markets over short periods.

Because market cycles are caused by shifts in demand relative to supply, a good advance indicator is one that compares these two fundamental quantities. The month's inventory indicator, which the Real Estate Center reports for most Texas markets, does exactly that — measures how many months it will take to sell off the current inventory, based on the average number of sales per month for the previous year.

Inventory in a buyers' market tends to be high because the market is oversupplied. In a sellers' market, inventory is lower, corresponding to the scarcity of homes available. In between, inventory is consistent with equilibrium — that is, there are enough homes to allow buyers adequate choice but not so many as to cause prices to fall. The key to reading market conditions is knowing the equilibrium inventory level.

Equilibrium inventory may be different for each market and may change over time for the same market. Sales volume is the key. In large markets and in times when sales are active, the equilibrium month's inventory can be lower. The higher number of average monthly sales means that each month of inventory will be larger. These larger numbers increase the odds that there will be a wider variety of homes available. A one-month's supply of homes in Houston might equal 5,000 homes, while in Abilene, it may only be 150 homes.

Figure 2. Inventory and Price Index Appreciation
Austin Housing Market



Source: Real Estate Center at Texas A&M University

Real World Applications

How can anyone know what the equilibrium inventory level is for

a housing market? The only way is to examine the recent past and see how prices behaved at different levels of inventory.

The basic idea is to match periods when prices are falling and periods when they are rising rapidly to specific levels of month's inventory. When prices are falling, inventory levels are associated with buyers' markets and those for rising prices with sellers' markets. Because months inventory is used as a leading indictor, the change in price measure is based on change in the subsequent year. Therefore, price change is measured by the percentage change in real (adjusted for inflation) median price over the next four quarters.

The Austin market illustrates the method used to identify market phases. Figure 1 shows one-year forward price change compared to months inventory. Prices were falling in the late 1980s while inventory was nearly 12 months. As inventory fell in the early 1990s, prices began to grow by more than 10 percent a year. A mid-decade spike in inventory slowed price growth to near zero. From 1998 to 2002, inventory levels were extremely low and prices soared. The last several years have shown increasing inventory combined with low-to-negative price growth.

There is an obvious connection between inventory and price change. The chart identifies buyers' and sellers' markets and the inventory level associated with each. Although the price change series works well for the Austin example, there are problems associated with using aggregate prices to describe market conditions. Median prices are influenced by the mix of homes sold, and that can change from period to period.

The Office of Federal Housing Enterprise Oversight (OFHEO) price index, which takes into account changes in the characteristics of homes sold, is a better choice. Figure 2 compares forward annual change in the price index to Austin market inventory. The index change line is smoother and more consistent than the price line used in Figure 1.

Figure 2 and the underlying data series for price index change and inventory yield the following analysis. In 1989 and 1990, the price index fell by 3.5 percent per year and inventory was greater than eight months. This period was definitely a buyers' market.

For the next 1½ years, inventory fell from eight to six months, and the index grew by 5.3 percent per year. This suggests that eight months is the threshold for a buyers' market. Until 1996, inventory stayed under six months, and the index grew by more than 5 percent per year. The index sagged over the next 18 months, as inventory rose above 5.5 months.

When it fell and stayed below five months from mid-1997 to the end of 2000, the index soared by 8.6 percent per year, indicating a strong sellers' market. The index has fallen slightly over the past four years while inventory has remained above the five-month mark. It appears that a sellers' market in Austin occurs when inventory falls below five months. A true buyers' market occurs at levels above eight months.

A similar technique has been applied to all Texas metrowide markets for which the Center has continuous inventory data for the period 1989 through 2004. The table provides the results, showing buyers' markets and sellers' markets and the inventory level associated with each.

Sellers' and buyers' markets significantly affect homeowners' abilities to sell their properties. Knowing when a market has shifted into or out of one of these phases can be helpful in setting sales strategies and negotiating contracts. This article is the first systematic attempt to identify the level of inventory associated with each phase. The author is interested in hearing from readers on the value of such a measure and how it applies to their markets.

Buyers' and Sellers' Markets in Texas Metropolitan Housing Markets

Market Area	Type	From Yr/Qtr*	To Yr/Qtr*	Average Annual Real Appreciation (percent)	Months Inventory
Abilene	Buyers'	1989:1	1990:3	–7.7	>8
	Sellers'	2002:3	2004:2	+1.9	<6
Amarillo	Buyers'	1989:1	1991:3	–2.0	>12
	Sellers'	1993:3	1996:2	+3.2	<6
Austin	Buyers'	1989:1	1990:4	–3.5	>8
	Sellers'	1997:3	2001:1	+8.6	>5
College Station	Buyers'	1989:1	1991:2	–2.4	>12
	Sellers'	1997:3	2000:4	+3.3	<5.5
Corpus Christi	Buyers'	1989:1	1992:2	–1.0	>12
	Sellers'	2001:3	2004:2	+2.9	<6
Dallas	Buyers'	1989:1	1992:3	–1.7	>10
	Sellers'	1997:3	2002:1	+4.2	<5
El Paso	Buyers'	1995:1	1999:1	–2.2	>7
	Sellers'	2002:2	2004:2	+2.6	<7
Houston	Buyers'	1989:1	1996:3	–0.1	>8
	Sellers'	1998:1	2002:1	+4.8	<5
Lubbock	Buyers'	1989:1	1990:3	–4.0	>10
	Sellers'	1999:3	2004:2	+2.4	<4.5
Midland-Odessa	Buyers'	1998:4	2000:2	–2.9	>7.5
	Sellers'	2000:2	2004:2	+2.0	<7.5
San Angelo	Buyers'	1989:1	1991:3	–2.5	>10
	Sellers'	2000:4	2004:2	+1.7	<7
San Antonio	Buyers'	1989:1	1990:4	–3.3	>15
	Sellers'	1998:3	2004:2	+2.0	<6
Sherman-Denison	Buyers'	1989:1	1990:4	–3.8	>20
	Sellers'	1998:2	2001:1	+3.1	<8
Tyler	Buyers'	1989:1	1992:3	–1.7	>10
	Sellers'	1999:2	2002:4	+2.6	<10
Victoria	Buyers'	1989:1	1992:2	–0.5	>9
	Sellers'	2001:3	2004:2	+2.7	<6

*Data series begins in 1989:1 and ends in 2004:2. Specific market phase may have begun before 1989 or continued beyond mid-2004, but that cannot be substantiated by the data available.

Source: Real Estate Center at Texas A&M University

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