

A Reprint from *Tierra Grande*

WHAT'S HAPPENING WITH HOME APPRECIATION?



By James P. Gaines

There's good news and bad news.

First, the good news. Texas has avoided the house price bubble. Now, the bad news. Texas has avoided the house price bubble.

Whether the lack of a bubble is good news depends on which side of the for-sale sign you are on. For buyers, it is good news. But investors and would-be sellers view the state's slow price appreciation rate in a different light.

Texas has avoided an overly speculative housing market, so far. But sellers have not benefited from the rapid price gains seen in California, Nevada, Florida, Arizona and much of New England, either. During the past three years, the national median home

price increased more than 32 percent, according to both the Office of Federal Housing Enterprise Oversight (OFHEO) and National Association of Realtors (NAR), while Texas' home prices increased just 12 percent. Since 1990, Texas home prices increased an average of only 4.4 percent per year compared with a national average of 8.4 percent.

The table compares 2005 percentage increase in home prices in selected Texas metropolitan areas to the state and U.S. appreciation rates reported by OFHEO and NAR.

What's Going On?

Why has Texas not experienced higher home appreciation?

It is the second largest state in terms of population, employment and number of housing units and the largest of the contiguous states in total land area. The state's economy has been relatively strong, new jobs are emerging and the population continues to expand rapidly.

Moreover, during 2005, out-of-state investors began to eye Texas, looking to acquire not only commercial real estate but also land and single-family residences. Because these types of investments in high-growth states are either unavailable or extremely high-priced, Texas is now viewed by many as the land of real estate opportunity.

Texas MSAs are among the lowest priced housing markets in the country (Figure 1). Appreciation rates in the major Texas MSAs ranked in the bottom third of all MSAs in third quarter 2005 (Figure 2). Only El Paso (19.5 percent) appreciated at or better than the U.S. average rate (14.7 percent).

Texas' housing market has not experienced the levels of home appreciation reported in other states primarily because of a number of market balancing influences.

Home Construction Rate

Home construction kept pace with demand not only at the high end of the market but also at the middle and low end where the bulk of the demand is. Both 2004 and 2005 were high years for new home starts in the state.

During the past three years, Texas homebuilders have been constructing single-family homes at a significantly greater rate than normal. Between 1990 and 2004, the average number of single-family permits issued per year was 2,357 per 10,000 residents added to the state's population. Single-family permits totaled 2,901 in 2001; 3,165 in 2002; 3,617 in 2003 and 3,915 in 2004. The estimated number of 2005 permits

	NAR (Percent)	OFEHO (Percent)
El Paso	19.5	8.3
Amarillo	13.3	6.1
Corpus Christi	10.2	8.5
Beaumont-Port Arthur	8.8	2.4
San Antonio	8.8	7.3
Houston-Baytown-Sugar Land	5.5	4.5
Austin-Round Rock	5.4	6.5
Dallas-Fort Worth-Arlington	4.9	4.2
Texas	6.3	5.3
United States	14.7	12.0

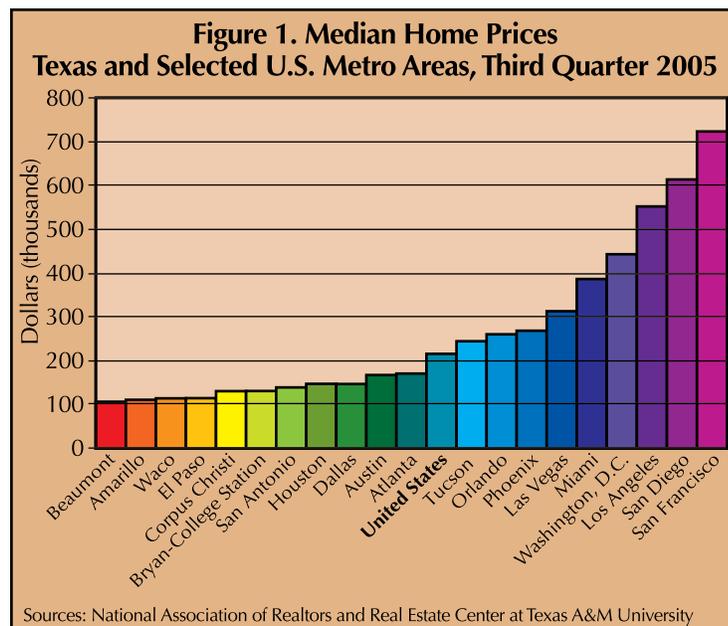
Sources: OFHEO and NAR

is approximately 3,710 per 10,000 new residents (Figure 3).

Sensible Lending Practices

Texas mortgage lenders continue to apply reasonable underwriting standards to home loans, reducing the lending risks occurring in some areas. Lenders generally have not overextended themselves into the more exotic loan packages offered in other states.

While higher loan-to-value ratio mortgages at lower interest rates have been readily available, Texas lenders have issued relatively few of the option-ARM mortgages with negative amortization or interest-only provisions. Competition in the mortgage loan market has been intense, and Texas lenders have had to offer attractive terms but by and large have not been forced into extreme positions.



Construction financing has remained available and at substantially lower cost than in the prior decade. Small- and medium-sized home building firms found financing readily at the local level.

Moderate Speculation

The single most important reason Texas home prices have risen moderately during the past several years is that the state has generally avoided the type of unbridled speculation that can unduly drive up housing prices. Such speculative fervor — buyers clamoring to buy homes at any price — is what has pushed prices up so rapidly in California, Arizona and Florida.

Demand in Texas has remained consistently strong with no corresponding housing shortage, so buyers have choices. Texas' housing market has remained primarily in balance (measured by the months of inventory of existing and new homes available), keeping prices from rising to higher levels.

Although investors and speculators have affected the market to some degree, especially in specific submarket areas, in general, buyer expectations have

not exceeded reality in terms of price changes and activity levels. Returns on investment, both rent and capital appreciation, have been modest and have not caused prices to inflate abnormally.

Construction Costs Under Control

Construction labor and material costs have increased

proportionately to prices in part because Texas is a nonunion, right-to-work state. Costs have remained consistent with market conditions.

Unlike the regulatory environments of many other states, Texas regulatory processes foster the home building industry without adding significant costs to the price of new houses. State and local governments generally have progrowth attitudes and encourage real estate development. Entrepreneurship is prevalent in the home building industry throughout the state, and land for new development and construction is available and highly affordable.

Stagnant Personal Income

Personal income levels in Texas have not changed dramatically over the past several years. While home sales and home prices have increased, a good part of the relatively slow rate of increase can be attributed to this lack of personal income growth.

Since 2001, per capita personal income in Texas has increased only 4.1 percent. Median family income increased by only 5.4 percent.

Employment growth has likewise been modest, with the job market good but

not overheated. This has provided some impetus for housing increases but has

when they feel reasonably secure in their jobs.

What's Ahead?

Texas has avoided excessive home price increases by keeping supply and demand in relative balance and by evading rampant speculation, so far. As the markets in California, Florida, New England and Arizona cool, however, greater speculative activity could enter Texas, causing prices to increase at a faster rate. ⬇

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Figure 2. Median Home Price Appreciation Rate Third Quarter 2005

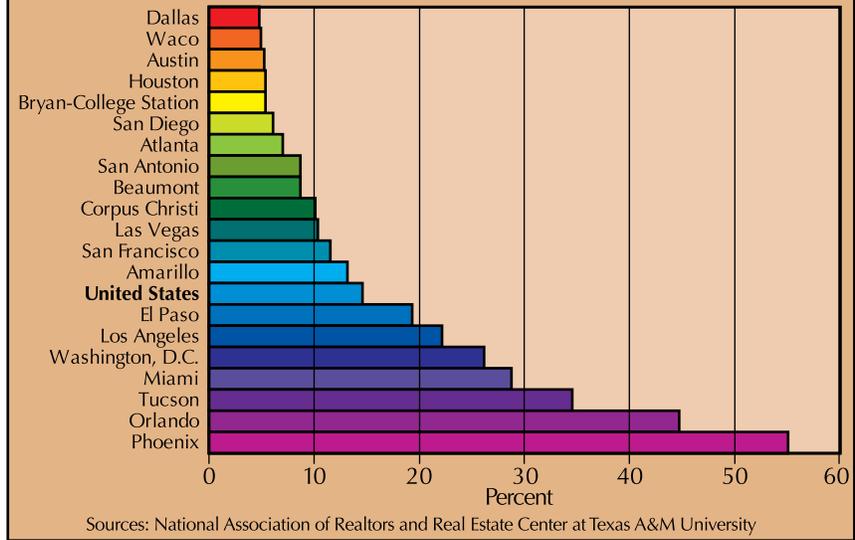
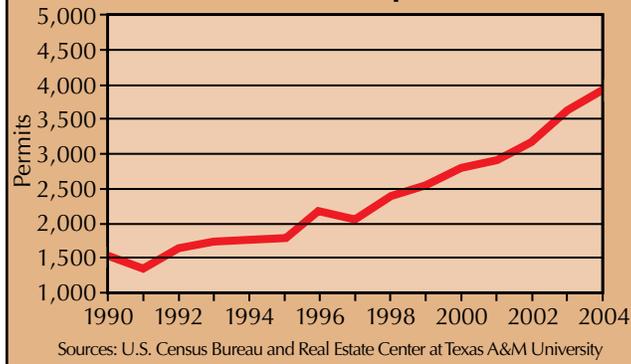


Figure 3. Texas Single-Family Permits Per 10,000 New Population



not contributed to overwhelming price changes.

Job security and stability may be more important to the housing market than new jobs created. While some concern exists regarding these issues, so far they have not dampened residential demand.

The move-up market contributes heavily to increases in the market, and households move up



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Tierra Grande (ISSN 1070-0234) is published quarterly by the Real Estate Center at Texas A&M University, College Station, Texas 77843-2115. Subscriptions are free to Texas real estate licensees. Other subscribers, \$20 per year. Views expressed are those of the authors and do not imply endorsement by the Real Estate Center, Mays Business School or Texas A&M University. The Texas A&M University System serves people of all ages, regardless of socioeconomic level, race, color, sex, religion, disability or national origin. Photography/Illustrations: JP Beato III, p. 1; Real Estate Center files, p. 3.