

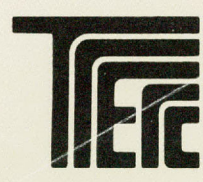
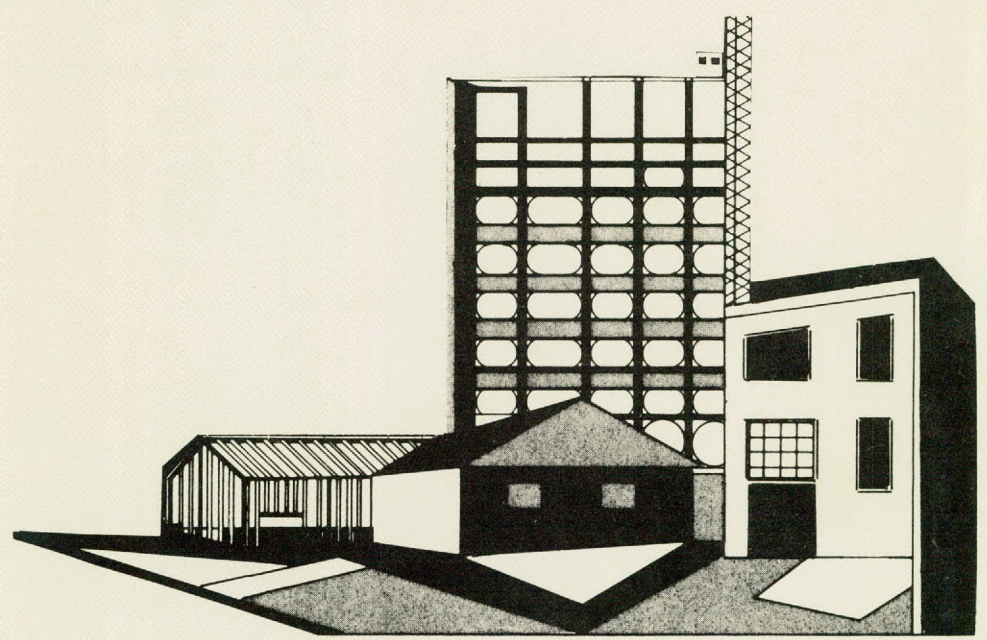
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TRENDS IN TEXAS HOUSING

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A Special Report From
TREND (Texas Real Estate News and Developments)

TRENDS IN TEXAS HOUSING

by Roger P. Sindt*
March 1976

The economy appears to be moving into a solid recovery stage. The effects of the recession that plagued the nation are dampening considerably, especially in some areas of Texas.

Consumer spending is increasing in Texas, and homebuilding, according to the number of building permits issued, is rebounding. Inflation and price increases in the housing sector and building industry have special significance and are of vital interest to the real estate industry. This paper examines some of these trends and evaluates alternative courses the builders and consumers can take to stimulate greater activity in the marketplace.

SUPPLY

The building industry has been hard pressed from all economic aspects during the last recession. Cost increases have invaded every aspect of construction. Material prices have escalated except for some isolated items. The trend has been for wages to increase, and although unemployment has occurred in the building trades, hourly wages have not declined due to rigidities of contracts and other factors. Increasing government regulations at the national, state and local levels, together with market forces, have set the stage for cost increases for developable land. This has resulted in windfall profits for some landowners, but in many instances any price increases over time have been to defray the added costs of regulation and to maintain an economic position in the face of inflation. For example, on a wholly owned (100% equity) investment with an 8% annual inflation rate and a direct holding cost of 2% yearly, a property would have to double in value in about seven years to maintain a breakeven position in terms of real purchasing power, other things being equal. Various equity and debt positions of the investor could significantly alter this situation, however.

Added pressure has been felt in the money markets from federal borrowings, and money has been available only at high interest rates. This has effectively decreased the number of construction loans demanded.

DEMAND

Consumer uncertainty has been apparent in several different ways during the most recent prolonged period of economic instability. Although unemployment has stayed relatively low in Texas (well below the record high of 9% nationwide), it has, nevertheless, had an effect on aggregate personal disposable incomes. Aggregate personal incomes are increasing again. This increase however, is at a lower rate than the rise of the consumer price index, resulting in decreased "real" income. This has caused a wave of caution regarding major capital commitments, such as the purchase of a home.

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Changes in the economics of home ownership have occurred also. Initial costs and ownership expenses, have increased at a faster rate than increases for goods and services in other sectors of the economy. This means the average consumer must reallocate income from other consumption goods to maintain a housing standard consistent with past levels. This higher cost of housing has been manifested in many ways. A shortage of funds in the 1974 money market (the money supply increased but not as rapidly as the demand) caused interest rates to rise to an all-time high. The effects of this situation carried over into 1975 to some extent. With high purchase costs for housing, down payments have increased, thus increasing the amount of front-end money needed to purchase a new home. Life-cycle housing costs are more significant due to the higher interest rates already mentioned and the higher purchase prices. Not only have the monthly payments for principal and interest increased, taxes and insurance have also shown marked increases.

As shown by Table 1, interest rates increased on new home loans from 7.59% in August of 1972 to a high of 9.04% in August of 1974 and then declined slightly to 8.9% by August of 1975.

Table 1. Average Interest Rates for New Home Loans Nationwide from 1972 through 1975*

	August 1975	August 1974	August 1973	August 1972
Interest Rate	8.90%	9.04%	7.94%	7.59%

* Source: Federal Home Loan Bank Board, Washington, D.C.

Utility costs and maintenance expense continue to increase at a rate in excess of the general inflationary price rises in the economy.

TRANSITION

Several factors have caused a change in tastes and preferences and have had far-reaching implications for the home-building industry. The role of some of these factors in the housing sector is easily ascertainable. Other variables are more difficult to distinguish, and their impact is less certain.

Since the mid-1960's a distinct shift has been observable in Texas from the construction of predominantly single-family units to more multifamily housing. This has been due in part to a more mobile society which has demanded the utmost in flexibility.

Many new household formations have occurred in the lower age groups seeking adequate space through smaller living units.

In the past, the availability of mortgage funds has generally tempered the forthcoming supply of rental units, probably more than any other single factor. The easily available funds of the early 1970s led to an increase in supply of apartments in many Texas markets and contributed to extremely favorable rental rates for tenants. New apartment starts have decreased recently, however, substantially lowering the rental vacancy rate statewide. A tendency to a "seller's" market currently exists, and rental rates are advancing but not yet enough to induce new apartment construction. In the past owners have had to absorb increased operating costs due to vacancies and oversupply. This situation can endure in the short run as long as

out-of-pocket costs are covered. In the long run, all costs must be covered before the rental market will be able to attract new capital for additional construction. Given that demand will eventually absorb the existing supply, it is reasonable to expect monthly rental rates will continue to increase. They may even exceed the rate of monthly ownership cost increases for new single-family unit construction, a situation that would shift demand toward the latter housing type.

Home of The Future

Due to the higher costs of shelter, the housing consumption patterns in Texas will continue to change markedly. This will manifest itself in many ways.

- * Despite rising square footage costs, reduction in floor area may allow absolute cost decreases.
- * Garages, which in the past have been finished to nearly the same standard as heated and cooled living areas, will give way to car-ports.
- * New homes will continue to feature fewer built-in appliances as standard equipment; however, the savings will be illusory for consumers will be required to buy under short-term debt arrangements what they could have financed under long-term mortgage conditions. Specific items are stoves, dishwashers, trash compactors and garbage disposals.
- * Other standard items such as fireplaces, patios and walkways will become optional, extra-cost features.
- * More cabinetry will be factory-built and delivered to the house for installation.
- * Landscaping, lawn sodding and underground utilities are likely to become extra-cost options.
- * Some housing changes will occur because of advances in design, and others because of the changing quality of materials. More attention will be given to housing designs that use space more efficiently.
- * Quality will show in heavier insulation and orientation of the home on the lot to utilize the sun, shade and other natural factors more efficiently.
- * More efficient heating, ventilating and air conditioning systems are currently available, and informed home buyers will increasingly compare the efficiency ratings of the installed appliances to reduce the life-cycle costs of home ownership.
- * Solar-and wind-harnessing energy sources should increasingly be considered among the energy-providing alternatives available for heating and cooling purposes. Many of these systems are becoming more economically feasible with each utility cost increase passed

on to the homeowner . For example, recent statistics show that from August 1973 through August 1975, the cost of electricity had increased 30.1% in Dallas, 21.2% in Houston, and 35.4% nationwide.

Economic Considerations

As inflation continues, interest rates will remain high. Since interest rates are composed of a real rate plus an inflation rate, they must over time be equal to, or greater than, the inflation rate. Otherwise, negative real rates result that lead to situations of net capital consumption in real terms (this has been called "disinvestment"). The longer the higher interest rates prevail, the more likely consumer acceptance will be forthcoming. That is, resistance to these higher rates will not be as great a problem as originally experienced.

Many other economic indicators are favorable for Texas housing in the future. The population in Texas continues to grow. An important segment of this growth is net immigration, which will continue to buoy up the demand for existing housing and new housing starts. These conditions will be particularly apparent in the state's SMSA's and will continue the pressures to build in the suburbs of these areas. Prices for developable land will continue to increase in these areas, raising land and lot costs, and hence development costs.

This higher lot development cost will continue to add upward pressures to new housing costs. Nationwide, in September of 1975, the cost of the average new home was \$45,300; the average used home was \$39,300. These figures as shown in Table 2 represent increases of 21% and 19%, respectively, from just two years previously.

Table 2. Selected Data on Price and Financing Terms of New and Used Homes in Houston and Dallas, Texas, 1975*

	Price	Terms	Loan Ratio	Interest Rate	
				Houston	Dallas
<u>September 1975</u>					
average new home	\$44,000	25.9 yrs.	75.9%	9.05%	8.9%
average used home	\$40,600	24.6 yrs.	73.8%	9.22%	9.1%
<u>November 1975</u>					
average new home	\$45,300	26.7 yrs.	76.0%	9.03%	8.9%
average used home	\$39,300	24.7 yrs.	74.3%	9.14%	9.31%

* Source: Federal Home Loan Bank Board, Washington D.C.

Disposable real personal incomes among potential home buyers will continue to increase but has been lagging substantially behind the escalation in new construction costs. The increase in housing cost has been part of the general increase in prices. Since prices have been rising faster than money income, real income has been decreasing. This has important implications for the construction industry in that

consumers, if they desire to maintain a high standard of living with respect to housing, will have to re-allocate their disposable income. They will have less effective spending power for some other items if they are to increase their mix of consumption with respect to housing. If those consumers cannot redirect their spending patterns or if the demand for housing, like the demand for most goods, declines as real income declines, then the quantity of housing demanded at any given price must necessarily decrease -- precisely the phenomenon that has been observed in the recent past. Consumers either unable or unwilling to increase their expenditure levels on shelter have been renting, not buying. In the short run, this is a rational and least-cost strategy. In a longer time frame, it may still be rational due to inherent risks of purchasing, tastes and preferences, and expectations, but may not minimize shelter cost outlays.

Governmental Regulation

The future role of government at all levels of the housing industry cannot be underestimated. Governmental activities have been a significant contributing factor in the rising cost of housing construction. As each new agency imposes its regulations upon construction through requirements for forms, various approvals and time delays, these burdens can only be translated into higher costs for the consumers. Whether it is an act such as Real Estate Settlement Procedures Act (RESPA) which specifically requires the added cost of services to be absorbed by the lending institution, or the Office of Interstate Land Sales Registration (OILSR) requiring approval of lot offerings, these costs will be fully accounted over time and will be passed on to the end-user -- the consumer.

Market Shares

Manufactured housing, particularly mobile and modular, will continue to represent an ever-increasing part of all new housing starts. These homes have the potential of filling the market void created in the site-built housing industry for housing priced under \$25,000 per unit. Manufactured housing continues to be available for \$10 to \$12 per square foot compared to \$20 to \$25 for site-built housing in Texas (excluding land or lot costs in both instances). Governmental regulation, mostly at the local level, is a major obstacle to expanding and aggregating markets. Some state and federal changes are on the horizon which should alter this situation in the future.

CONCLUSION

Optimism tempered with caution should characterize any prediction of trends in the housing industry. The population of the state will continue to have its shelter requirements met. The real challenge will be the ability to deliver quality housing consistent with consumers' taste and preferences at a price that is affordable.

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