

# TEXAS

## BUSINESS — ◆ — REVIEW

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### ON THE ROOF:

#### A Review of Texas Real Estate Markets

by  
Ali Anari,  
James Gaines,  
Charles Gilliland  
Texas A&M University  
Real Estate Center

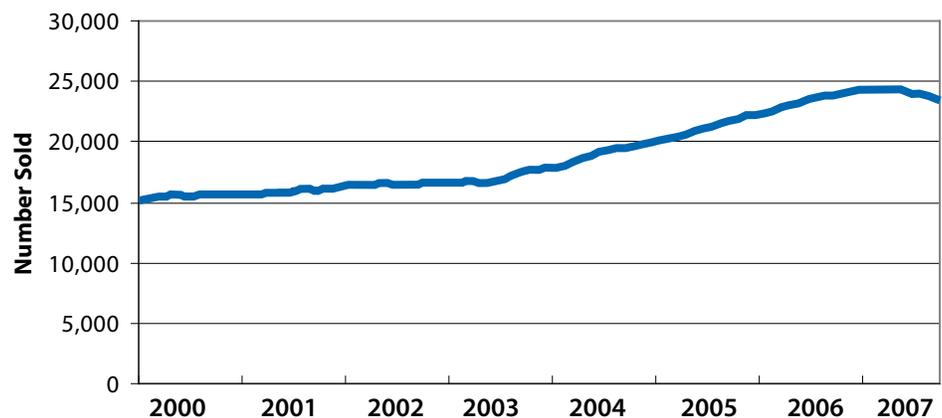
*As housing prices slip in many parts of the country, Texas market conditions, in general, seem relatively stable. This review of real estate markets around Texas reveals that Texas, especially in relation to other states in the country that have been much harder hit, has so far weathered the real estate storm in good shape.*

Real estate, comprised of residential, commercial, industrial and rural land markets, is principally driven by the dynamics of local marketplaces but is also tied to international, national and state economic conditions as well as capital and mortgage markets. The U.S. real estate market benefited most from the 2000 stock market collapse, interest rate cuts, and the ensuing spurt in economic growth. Demand for real estate escalated with lower mortgage rates and higher income growth rates and expanded economic activity. The 30-year, conventional mortgage fixed-rate fell from a national average of 8.52 percent in May 2001 to a historic

low of 5.23 percent in June 2003. Investors, disappointed with the performance of the stock market, transferred funds from the stock market into the real estate equity and mortgage markets. Surging demand by households and investors for properties due to lower mortgage rates, higher economic growth rates, and higher perceived returns from real estate resulted in extensive new construction (especially houses), substantially higher sales volumes and unsustainably higher prices for existing and new properties.

The Texas real estate markets not only benefited from the post-2001 economic expansion and lower mortgage rates but also from higher than national average population growth rates, employment growth rates, and abundant supplies of land, water and natural resources. With a gross domestic product of more than \$1,065.9 billion, the state's economy is the world's 11<sup>th</sup> largest economy, larger than the GDP of the Russian Federation. Since January 2004, the

**Figure 1**  
Twelve-month Moving Average of Home Sales in Texas



Source: Real Estate Center at Texas A&M University

The current slowdown in the number of housing units sold is partly due to the cooling of local economies, somewhat higher mortgage rates, the rise in foreclosures, and the general tightening of mortgage underwriting, especially in the subprime mortgage market.

**Table 1**  
**New Single-family Building Permits Issued**  
*Texas, Austin-San Marcos, Dallas and Houston*

	Texas	Austin-San Marcos	Dallas	Houston
Jan 2006	13,252	1,941	2,351	3,592
Feb	12,902	1,341	2,569	3,763
Mar	16,637	2,160	2,941	4,959
Apr	13,625	1,535	2,587	4,124
May	15,960	1,548	3,046	5,794
Jun	16,369	1,634	2,921	5,218
Jul	12,998	1,211	2,430	4,159
Aug	14,325	1,719	2,500	4,590
Sep	11,141	1,346	2,091	3,593
Oct	11,085	1,181	2,048	3,466
Nov	9,482	1,033	1,644	2,932
Dec	8,713	963	1,278	2,906
Jan 2007	9,380	828	1,563	3,180
Feb	10,259	1,149	1,511	3,440
Mar	12,402	1,388	1,778	4,376
Apr	11,089	1,281	1,869	3,491
May	11,525	1,330	1,789	3,757
Jun	10,305	1,157	1,786	3,333
Jul	9,989	1,082	1,508	3,044
Aug	9,585	927	1,603	3,227
Sep	7,513	803	1,241	2,624

Source: U.S. Census Bureau and Real Estate Center at Texas A&M University.

state's nonfarm employment has risen 11.1 percent compared to 7.9 percent for the U.S. The state's GDP in real terms rose 16.4 percent from 2001 to 2006 compared with 14.8 percent for the U.S. over the same period.

#### Texas Residential Markets

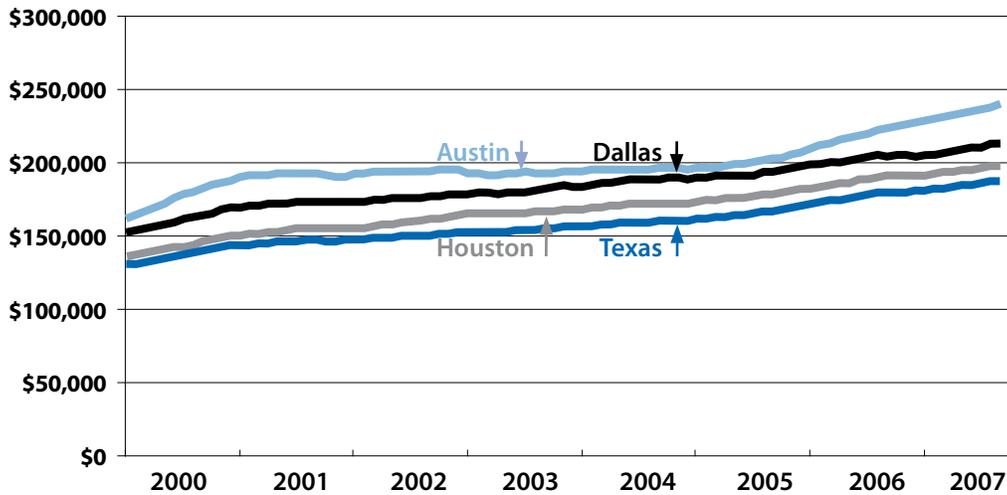
The number of home sales, average home prices, and the number of building permits are key indicators of the state's housing market. There were three distinct phases of home sales activity in Texas since January 2001: a period of slow growth until April 2003 during which the average number of homes sold in Texas (12-month moving average) slowly rose from 15,820 units in to 16,778 units by April 2003; a period of rapid growth from May 2003 to January 2007 during which the monthly average number of homes sold exploded from 16,560 units to 24,247 units; and finally, a cooling period that started in February 2007 as average monthly sales fell (see Figure 1,

p.1). The state's larger metropolitan areas of Austin, Dallas, and Houston experienced the same phases of home sales activity.

The slowdown in home sales resulted in rising inventories of unsold homes in the state as well as the major metro areas. The inventory of homes for sales in Texas increased from 5.2 months in September 2006 to 6.1 months in September 2007. Over the same period, the inventory of homes for sales increased in Austin from 3.7 months to 4.7 months, in Dallas from 6.0 months to 6.7 months, in Houston from 5.7 percent to 6.5 percent and in San Antonio from 4.2 months to 6.3 months.

The current slowdown in the number of housing units sold is partly due to the cooling of local economies, somewhat higher mortgage rates, the rise in foreclosures, and the general tightening of mortgage underwriting, especially in the subprime mortgage market. The state's economy is currently creating jobs at annual rates of around 2 percent compared with

**Figure 2**  
Average Prices of Homes Sold in Texas and its Major Metro Areas



Source: Real Estate Center at Texas A&M University

more than 3 percent a year ago. The 30-year conventional mortgage rate has increased from 5.23 percent in June 2003 to 6.38 percent in October 2007.

Anticipating lower home sales in the foreseeable future and faced with growing inventories of unsold homes, Texas home builders have curtailed their plans for new home building. The annual number of single family building permits in Texas decreased 27 percent from September 2006 to September 2007 compared to the annual growth rate of 14 percent reported in June 2006 (see Table 1, p. 2). The annual number of single family building permits in Austin, Dallas, and Houston fell 30 percent, 37 percent, and 19 percent respectively from September 2006 to September 2007.

So far the downward trends in home sales volume and new construction have had little impact on the average prices of homes sold or the average value of building permits issued. The 12-month average price of homes sold in Texas increased from \$142,000 in September 2000 to \$191,000 in September 2007, an appreciation rate of 34.5 percent. The average home price statewide as well as in the major metro areas continues moving upward as shown above in Figure 2.

The average value per dwelling of single family building permits for Texas increased from \$152,100 in September 2006 to \$168,200 in September 2007, an 11 percent increase. Over the same period, the average value per dwelling of single family building permit for Austin, Dallas,

and Houston rose 15 percent, 14 percent, and 13 percent respectively. Part of this increase is due to the drop off of subprime and other higher-risk mortgages available to households in lower price ranges and the builders' concentration on contract construction for higher-priced properties.

The decrease in sales volume and the increase in the average value of single family building permits suggest that the slowdown in the Texas residential market, to date, has been most pronounced in lower-priced homes.

#### Commercial and Industrial Real Estate Markets

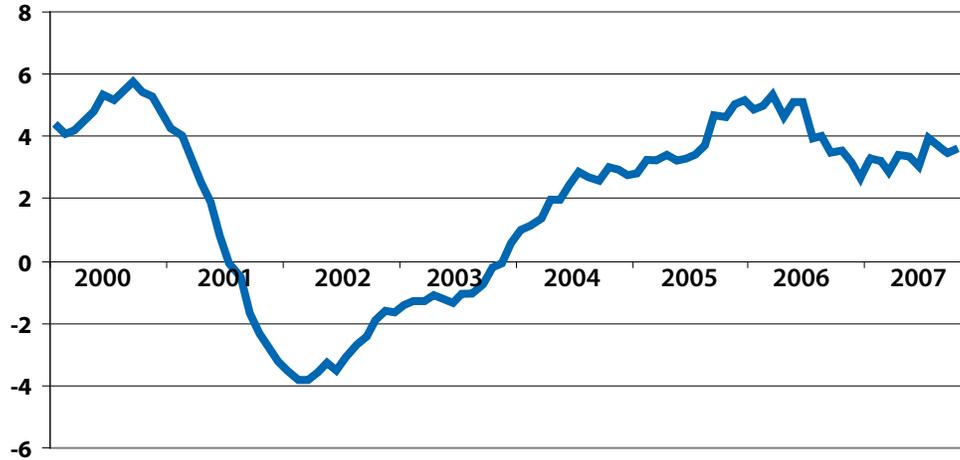
The commercial and industrial real estate markets primarily consist of office, retail, warehouse and manufacturing uses. These markets may also incorporate hotels, hospitals, educational buildings and special-purpose properties such as convention centers, sports facilities and other similar developments.

Perhaps counter-intuitively, the employment slowdown in Texas industries has so far slowed down the growth of vacancy rates and rents in the state's commercial and industrial real estate markets. Developers, sensing slackening statewide economic growth, have reduced the number of new office units they are starting. Office employment is mainly concentrated in three industry groups, namely, professional and business services, financial activities, and information. The annual growth rate of total employment in these three industries rose from 0.6 percent in December 2003 to a peak of 5.4

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**Figure 3**  
**Texas Office Employment Growth Rates (Year-over-year)**



Source: Texas Workforce Commission and Real Estate Center at Texas A&M University

percent in March 2006 and has since slowed to less than four percent, still a healthy growth rate for office space demand (see Figure 3 above).

The overall office vacancy rate in the Houston metro area fell from 12.8 percent in the third quarter of 2006 to 10.8 percent in the third quarter of 2007. Since June 2006 class A office rent in Houston has risen by an annualized rate of 17.2 percent while class B rents have risen by an annualized rate of 8.7 percent. The overall office vacancy rate in the Greater Austin metro area fell from 13.4 percent at the end of 2005 to 10.6 percent in mid-2007. In the first half of 2007, class A rent in Austin rose at an annualized rate of 4.5 percent. The overall office vacancy rate for Dallas/Fort Worth metroplex in the third quarter of 2007 was 17.7 percent, down from 18.1 percent a year earlier. The metro area's class A and B office rents have increased by 2.8 percent and 2.3 percent since the end of 2006. The overall office vacancy rate for Greater San Antonio has remained steady at 10.8 percent since 2005 while the metro area's class A and B office rents have increased by 2.2 percent in first half of 2007.

#### Texas Industrial Real Estate Markets

Again, perhaps surprisingly, overall industrial vacancy rates in the major Texas metro areas are falling despite job losses in the state's manufacturing industry and slow employment growth rates in transportation, warehousing, utilities, and the construction industry. As developers of new industrial properties see evidence of an economic slowdown, they are reluctant to invest in new construction. The

overall industrial vacancy rate in Dallas-Forth Worth fell from 10.1 percent at mid-2006 to 9.4 percent in the third quarter of 2007. The annualized growth rates of the metro area's warehouse/distribution rent, flex/high-tech rent, and manufacturing rent were 3.9, 6.9, and 5.9 percent, respectively. The overall industrial vacancy rate in the Houston metro area fell from 5.9 percent in 2006 to 5.5 percent in mid 2007. The metro area's industrial rent rose at annualized rate of 5 percent in 2006 and 6 percent in the third quarter of 2007. The overall vacancy rate in the San Antonio's flex/high-tech industrial market fell from 13.5 percent in mid-2006 to 11.1 percent in mid-2007, while the corresponding rent fell at an annual rate of 0.2 percent in the first half of 2007.

#### Texas Rural Land Market

Texas land prices have spiraled to ever-higher levels in the past five years, leading many to ponder the future of a market trading at unprecedented levels. In burgeoning markets, buyers scramble to grab anything offered for sale.<sup>1</sup> However, rising levels of uncertainty often prompt caution and buyers begin to focus on quality.

While the 2007 land market in the first half of the year does not reflect such a flight to quality, growing evidence suggests that the long-anticipated cooling of the frenzied market may have begun. Specifically, the number of reported sales in the first half of 2007 confirms a widely perceived slowdown in the volume of transactions in Texas rural land markets. While more first-half sales undoubtedly remain to be

reported, the 2007 first-half volume of 3,769 sales dropped 31 percent below the 2006 first-half volume of 5,452 sales. The 2007 level of activity roughly corresponds to the volume registered in 2002.

At 15 percent, the growth in sale prices slowed from the stratospheric 23 percent posted in 2006. The 2007 first-half price was \$2,075 per acre, topping \$2,000 per acre for the first time. The 2006 first-half price was \$1,811 per acre. Despite the deceleration in price growth, the 15 percent increase nearly matches the 16 percent growth over the entire year in 2003 and 2004 markets.

While indicating the noticeable slowdown in sales volume early in the year, market participants and observers have noted increasing interest in late summer and do not see potential buyers abandoning the market. Two forces are seen to be contributing to the slackening in activity. First, potential buyers are still searching for land. However, they continue to face shortages of quality properties for sale throughout the state. Second, potential sellers have begun to factor anticipated price growth into asking prices. The resulting jump in asking prices has startled some buyers and caused them to delay buying in the hope of finding a more desirable option at those prices.

These developments reflect an emerging disposition among buyers to resist newly escalated asking prices in many areas of the state. Still, the supply of land for sale remains tight and demand remains healthy. Some markets in south Texas appear to be poised to take a breather from the rapid escalation of prices seen in recent years, and some sellers have reduced asking prices. Although more leverage is evident in some areas, cash is still plentiful and looking for investments in the tight market. These factors point to a further rise in already historically high prices in the near term, but current market dynamics suggest that the strong market run up that began in 2003 may be maturing.

## Conclusion

The evidence presented here suggests that Texas' residential, industrial, and rural real estate markets are relatively robust, especially in relation to other parts of the country, where rising foreclosure rates, higher mortgage rates, and tighter credit conditions have combined to bring down home prices and constrict new construction. Median home prices in Texas' major metros have continued to rise in 2007. Residential and industrial rents are high as

developers reduce the pace of new construction in the face of slowing economic growth. And rural land values keep rising steadily due, in part, to a tightening supply of acreage for sale.

While the subprime mortgage mess is a major concern for policymakers and homeowners in some parts of the country, Texas has so far avoided the worst of it. RealtyTrac data measures the number of households per foreclosure, and Texas' incidence rate recently has been substantially lower than the national average. In October 2007, Texas ranked 15<sup>th</sup> in the number of households per foreclosure filing (735 vs. 555 for the U.S. average and 258 for California) while ranking 5<sup>th</sup> in total number of foreclosure filings (12,288) behind California (50,401), Florida (30,190), Ohio (17,276) and Michigan (13,415). Through October, Texas' year-to-date total foreclosure filings were down 2.5% from the same period in 2006, while the U.S. was up 72%. In fact, 55 percent of foreclosures nationwide, at present, are concentrated in seven states (California, Florida, Nevada, Arizona, Ohio, Michigan and Indiana), where either home price declines and/or job losses have been most severe. Because Texas home prices have continued to increase, refinancing or selling a property is still a viable option for homeowners in financial distress. Texas should come through the foreclosure crisis, which may not abate until 2009, in a stronger position than most other high-growth states.

Because of its massive geography, Texas has avoided the speculative excesses and sharp spikes that have characterized other real estate markets along the East and West coasts and in places like Arizona over the last six years. Its diversified economy and growing population have kept demand for existing homes and new home construction strong without leading to price bubbles. These are the reasons, too, that the state's real estate markets should be able to endure a more serious national economic slowdown or recession. Texas remains the largest exporting state in the nation; high oil and gas prices, while the bane of consumers, certainly benefit the state's producers and refiners; and its growing population ensures a healthy demand for new construction for the foreseeable future.

## References

1. For example, in the Hill Country surrounding Kerr County (Kerrville), prices soared from \$3,248 per acre in 2001 to \$7,706 per acre in the first half of this year. Similarly, the area around Taylor County (Abilene) saw prices climb from \$454 per acre to \$899 per acre during that same period. ◆

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*IC<sup>2</sup> Institute Director:*  
John Sibley Butler  
john.butler@mcombs.utexas.edu

*TBR Editor:*  
Bruce Kellison  
bkellison@icc.utexas.edu

*TBR Managing Editor:*  
Margaret Cotrofeld  
margaret@icc.utexas.edu

*Sales Office:*  
(512) 475-7813  
(512) 475-8901 fax

<http://bbr.icc.utexas.edu/>

The University of Texas at Austin  
BUREAU OF BUSINESS RESEARCH  
IC<sup>2</sup> Institute  
1 University Station A0300  
Austin, Texas 78712

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