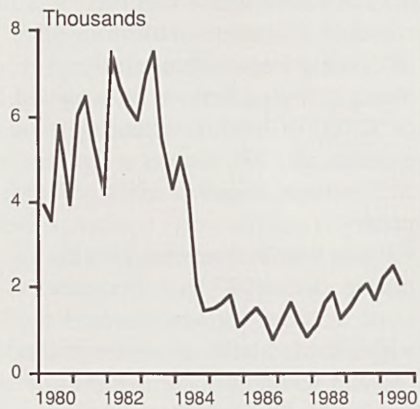
HOUSTON BUSINESS BRIEFS

Analysis Of Houston's Single-Family Housing Market

If Houston seemed to be riding an economic merry-go-round in the 1980s, the city's market for single-family housing fell off the top of the Ferris wheel. Overall, Houston's economy is returning to levels of performance seen in the best of times; employment figures for the first three quarters of 1990 are similar to the number of jobs the city averaged throughout 1981. The return to the previous peak of regional employment may signal general economic recovery, but the number of single-family housing starts remains below 50 percent of the levels reached in the early 1980s.

The ups and downs of Houston's single-family market coincide with highs and lows in the local economy in the 1980s. Figure 1 shows the number of single-family housing starts made each quarter in Harris County since 1980. This graph clearly indicates that the Houston housing market, like the economy as a whole, plateaued in 1982–83, plunged in 1984–85 and began to recover in early 1987. At its peak, Harris County produced 25,000 starts per year. At its lowest level, this figure slipped below 5,000 starts.

Figure 1
Single-Family Housing Permits Issued Quarterly in Harris County



SOURCE: Greater Houston Partnership

The level of housing starts through the third quarter of 1990 remained well below the levels of the early 1980s, with 7,250 single-family starts in 1989 and perhaps 9,000 for all of 1990, if the local economic trends continue. This lag in the recovery of the Houston housing market is largely explained by continued construction and a buildup of huge housing inventories through 1982–83—years in which the city lost both jobs and population. This article presents an analysis of the partial recovery in Houston's single-family housing market and the recovery's effect on local sales and prices.

Strong Markets for New Homes

The hottest real estate markets in Houston can be divided into two classifications. The first is the planned communities that ring the outskirts of the city. These large properties are developed according to a master plan for mixed residential, commercial and industrial uses, with rigid architectural controls on building setbacks, landscaping and other aesthetic details. As many as 20 of these planned communities surround Houston. Among the largest are First Colony, Woodlands, Clear Lake City, Kingwood, Copperfield and South Shore Harbor. These communities together accounted for 4,200 new housing starts in 1989. Smaller communities, such as Champions Forest, Sugarmill and Greentrails, are on tracts of less than 1,000 acres. Still, these three areas accounted for more than 250 new homes built in 1989.

The second category of housing that is doing well is the older *silk stocking* communities located close to the Central Business District. In these neighborhoods, the trend is to tear down existing homes and rebuild. Many of the destroyed houses were built in the 1930s and had poor insulation and wiring. West University is the outstanding example, although the tear-down-and-rebuild trend has spread to the neighboring Bellaire community, as well as Tanglewood, the Rice University area, parts of Montrose, and other areas with good deed restrictions.

Although close-in locations, such as West University, command a significant premium in price over the suburbs, the outlying planned communities also rank among the

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most affluent parts of Houston. Data from the Claritas Corporation, a demographics company that sells marketing data by ZIP code, enable us to take a closer look at some of these communities. Harris County, for example, has an average household income of $36,297 and a median home value of $57,054. For the Clear Lake area, the comparable figures are an income of $61,199 and a home value of $99,639. For Kingwood, the figures are $64,060 and $103,357, and for Champions Forest they are $70,065 and $113,376.

Indeed, the housing revival seen thus far in Houston has been dominated by upper-end properties, with the *move-up* housing priced from $100,000 to $175,000 in the strongest part of the market. A chronic shortage of lots in desirable areas has been a continuing problem throughout the metropolitan area for two years. This shortage partly reflects demographic trends, as baby boomers look for roomier houses in nicer neighborhoods, leaving a surplus of starter housing for the baby-bust generation that follows.

However, the shortage also reflects the changing pattern of job growth in Houston during the 1980s. Houston's recovery has seen virtually no return of the 110,000 jobs lost in oil exploration and machinery industries. Instead, the jobs the city added in the late 1980s have been concentrated in white-collar occupations in medical, business and professional services. Growth in engineering and technical jobs at the Texas Medical Center, the National Aeronautics and Space Administration (NASA) and the largest Houston-based engineering and construction firms has fueled the demand for move-up housing.

Table 1
Decline and Recovery of Housing Prices in Selected Houston Neighborhoods
(Percent Changes)

	1982–87	1987–89	1982–89
Clear Lake City	–16.1	10.3	–7.5
Copperfield	–16.0	17.6	1.2
First Colony	–21.6	12.4	–11.9
FM 1960	–22.3	19.4	–7.2
Kingwood	–13.4	16.4	0.8
Memorial Village	–25.2	29.3	3.3
West University	–25.5	15.4	–14.0
Woodlands	–20.6	19.0	5.5
All above	–20.1	17.5	–6.2
All other	–21.7	9.4	–16.4

NOTE: Averages for *All above* and *All other* categories are simple averages of the percentage changes in each neighborhood.

SOURCE: University of Houston, Center for Public Policy.

Existing Homes

Improvements in the number of housing starts go hand in hand with a better market for existing homes. Recent data indicate that this correlation is true in Houston; sales of existing homes through the Multiple Listing Service hit a record of 31,000 in 1989. For the first three quarters of 1990, Houston ran 10.5 percent ahead of 1989's record pace.

The best markets for existing homes since 1987 have been the same as those for new homes—well-planned, affluent and restricted. Only in recent months has the market for starter homes in the $60,000-to-$80,000 range begun to improve. A very strong apartment market and rising rents throughout the city are making homeownership more attractive. Foreclosures are disappearing, and new-home construction in this price range is just now beginning to flourish.

Housing Prices

The Center for Public Policy at the University of Houston computes price indexes for housing in 39 Houston neighborhoods. For Table 1, we selected eight neighborhoods on the center's list as representative of the affluent communities described above as doing best in Houston. On average, these eight neighborhoods lost 20.1 percent of their value from 1982 to 1987; they have since returned to a loss of only 6.2 percent of the 1982 value. Four of the neighborhoods—Copperfield, Kingwood, Memorial Village and the Woodlands—have, in fact, surpassed their previous peaks. In contrast, the other 31 Houston neighborhoods lost a comparable fraction of their value through 1987 (21.7 percent). But their recovery sharply lags behind the recovery of better neighborhoods, and values are still 16.4 percent below the 1982 peak.

We recently took a close look at how housing prices were being determined in these strong housing markets, using a sample of 182 recent home sales in the Houston area. These sales were made in seven planned communities (Clear Lake City, Copperfield, First Colony, Champions Forest, Kingwood, South Shore Harbor and the Woodlands) or, alternatively, in Memorial Village or West University. Memorial Village is a close-in neighborhood just outside the 610 Loop, while West University lies just inside the Loop. We will spare you the statistical details but share some of the more interesting conclusions from a close look at these data.

- Despite geographic differences, the sample is very homogeneous. All the houses sold lie in good neighborhoods with strong deed restrictions and other property covenants. The houses uniformly have brick exteriors, central air, fireplaces and garages. Custom features are common, and even such obvious features as pools and decks do not seem to differentiate the houses enough to affect selling price.
- A remarkable 87 percent of the variation in selling prices in the sample is explained by three factors: location, floor space and lot size.
- Among the seven planned communities, we found no statistically significant differences in recent selling price. The same house would sell for approximately the same price in all seven areas.
- There were very large and highly significant differences in price between the planned communities and the two close-in neighborhoods. If we could somehow move a house from the suburbs to Memorial Village, we would automatically enhance its value by $90,000. Move it to West University, and the premium is $200,000.
- Putting location aside, a house's selling price rose with the square of its area or floor space. In other words, the bigger the house, the more it cost per square foot. The average cost of a house in this sample was $66 per square foot. However, as the house got bigger, the number of built-in appliances, amount of custom features and quality of construction rose rapidly. The incremental cost of going from 2,500 to 2,600 square feet was $115 per square foot. The incremental cost of going from 2,900 to 3,000 square feet was $135 per square foot.

Conclusion

The Houston housing market continues to make gradual progress and is now reaching the point where the excesses of the early 1980s are beginning to disappear. All segments of the housing market have stabilized, and even the modest performance by the local economy should guarantee continued improvement. What most likely lies ahead is rapid price appreciation. New lots have to be developed. A chronic shortage of construction labor is already evident, and the bargains in construction materials and skills available in the slack market of the past five years have now disappeared. Houston's standing as an incredible bargain for the homebuyer will not be threatened soon, but double-digit appreciation in local home values could materialize within several years. ❖

Houston Beige Book
October 1990

The Houston economy shows some unmistakable signs of slowing down, particularly in construction, retail sales and selected manufacturing industries. Respondents to the Houston Beige Book survey in mid-October reported that uncertainty resulting from the Middle East crisis has dented the strong optimism prevailing in Houston after 3½ years of strong growth. Through mid-October, the slowdown had cut the rate of growth, but growth remained positive. Unlike the rest of the nation, where concern focused on whether the economy had slipped into reverse, Houston had simply lifted its foot from the accelerator.

Retail Sales

Until September, both automobile sales and retail sales at local stores were running 5 percent to 10 percent ahead of last year's levels. In September and October, retail sales returned to levels comparable to those experienced in 1989, but auto sales were 10 percent below 1989 levels. Local retailers were reported to be cutting back wherever possible. The retailers' cutbacks apparently stemmed from talk of a national recession and the possibility of goods spilling into the Houston market at discount prices. Current inventories were reported to be in good shape. Therefore, the cutbacks were apparently precautionary.

Although cutbacks would protect retailers from serious losses, they also would limit potential sales and guarantee Houston retailers a mediocre holiday season at best.

Paper and Wood Products

Bleached paper prices and shipments held steady through October. Pulp prices in October were 7 percent below third-quarter levels and 20 percent below October 1989 levels. Shipments remained strong but had been slowly declining for several months. Despite strong shipments, world inventories of pulp were at a five-year high. Containerboard for packaging was shipping at record levels, with both strong exports and domestic demand. Margins for this product were down one-third, however, because both price competition and higher oil prices squeezed revenues.

Building products experienced "a terrible third quarter," according to respondents. Weakness in wood and lumber stemmed from the low level of national housing starts, and poor home-improvement and furniture markets added to industry problems.

Chemicals and Refining

Given that prices of crude oil feedstocks more than doubled in a few weeks, the news here was surprisingly good. Throughput remained at a very high level for both refiners and petrochemical plants, but one respondent indicated demand for gasoline already had begun to slip. Refiners experienced volatile margins, but product prices rose enough to offset crude prices and keep margins at levels that were half or more of those prevailing in July.

Continued low gas prices provided some cushion for petrochemical producers. The lower dollar and a European industry that is much more dependent on oil than the United States boosted petrochemical exports strongly. Margins were down from July levels but not as sharply as might have been expected from size of the crude price increases.

Construction and Real Estate

Industrial construction in Houston was described as "disappointing." The petrochemical expansion under way in Houston since 1987 shows signs of having peaked. The weaker U.S. economy, higher oil costs, and near-term prospects of oversupply all contributed to this peak. Outside investment in existing Houston office and commercial properties has slowed significantly in recent months. Relatively few of the proposed new large projects in the city were moving forward to the point of obtaining financial commitments, according to one respondent, and this fact could keep construction slow well into next year.

Housing starts have slowed on a year-to-year basis with third-quarter starts in Harris County only a few percentage points ahead of last year. New-home sales in September were 7 percent below the pace of 1989 levels. Used-home sales dropped sharply in September, but the number of Multiple Listing Service sales for 1990 through September was 10 percent ahead of a year before. Starter homes and executive homes over $250,000 were among the strongest segments of the existing-home market.

Oil Exploration and Services

An equipment rental company reported heavy business for the first time since the early 1980s in light stands, compressors and generators headed for the East Texas oil fields. This upswing seemed to result from operators squeezing production out of existing wells, rather than a surge in exploration. Higher oil prices were helping operators, royalty and working-interest owners, well services, workover and other support businesses.

Little faith that current prices are meaningful for longer-term decisions was evident. The rig count continued to rise but only in accordance with seasonal factors and positive trends in place before the Iraqi invasion of Kuwait. Just over 300 rigs were working in Texas in early August when Iraq invaded Kuwait; by late October, the total had risen to 374. Texas accounted for slightly more than half the national increase in the number of working rigs from August to October. ❖

For more information, call Bill Gilmer at (713) 652–1546. For a copy of this publication, write to:

Bill Gilmer
Houston Branch
Federal Reserve Bank of Dallas
P.O. Box 2578
Houston, Texas 77252