Getting ready for the next housing boom

Yes, you read that right. Get ready for the next housing boom. With the negative media, political dysfunction, mortgage delinquencies and foreclosures we still have going on, and the record levels of housing inventory, how could we possibly have another housing boom, right?

Despite all the problems we are seeing today, pent up demand is creating the next housing boom. Demand for housing is closely tied to the rate of household formation which, if you hadn’t noticed, has been lacking the last five to six years. Any growing economy creates more households and more households eventually need more houses and more apartments. Right now, due to the challenged economy and jobs market, household formation is been on hold. This is one reason why the housing market continues to be a pick up.

A household is simply a residential unit of shelter. Everyone has to have shelter. It refers to a person or persons living under one roof. Traditionally, a household has been thought of as a nuclear family. Boy meets girl, boy marries girl, and boy and girl buy a house or rent an apartment. In this way, marriage creates more households and demand for more places to live. Divorce, too, creates more households and demand for more housing. People who get divorced do not want to continue living together under the same roof. Households are also formed when children grow up and move out. Most kids can’t wait to get their own place. The US still has population growth, driving employment growth, which leads to housing growth, and results in increased housing demand.

Much of this growth has been postponed. As we all know, employment remains depressed, particularly marginal manufacturing jobs, that have been shipped overseas (except in Texas). College graduates have been moving back with parents. The process of generating new households seems to have stopped or slowed down dramatically. Whether it is the poor economy or just the new norm, more people are postponing marriage. For the first time since 1940, less than 50% of households are maintained by married couples (per 2010 Census). Others are postponing divorce. And as much as they would like to be independent, many grown children are staying put. Some can’t find jobs even after graduating from college, so they are choosing to live with mom and dad just a little longer. Even those lucky enough to be employed are moving in with their parents in order to cut expenses.

This lack of household formation is good news for housing in the long run. It means there is a lot of pent up demand for housing and, based on the last Census, it is growing. Current household formation may be slower currently, yet potential household demand is strong. As the economy continues to pick up steam and more people start to find jobs, household formation will surge. Once that happens, demand for houses and apartments will also surge.

Let’s examine the primary drivers of this demand.

- Job creation is paramount – Texas leads the nation, having created (and still creating) roughly a quarter of all jobs in the US the last few years and projections suggesting that this should continue.

- Population growth – Texas, primarily the four metros, will double in population over the next twenty years. Austin alone is projected to add 60,000 people a year (160 people a day).
• Baby Boomers/retirees – Texas has a low tax burden (46th in the nation), no state income tax, and warm weather, making Texas the #2 destination for this age group. 46% currently own a home.

• Echo boomers – the biggest opportunity here is that 51% still rent (US Census Bureau). However according to the latest FNMA surveys, close to 70% still think that buying a home is something they want to do. Part of that demand is based on businesses discovering the cost savings of moving to Texas. With no state income tax and a low tax burden, estimated savings is close to 30% compared to most other states.

Looking at all the Texas metros, where is the opportunity?

• Austin is in a unique position with limited supply of residential inventory, developed lots, homes, apartments, and 95% to 98% occupancy for rentals in the five county area. All residential is tight. Office is strong; retail is stronger than other markets. Austin was named by HomeVestors as one of the top 25 areas to buy investment property.

• Inside Houston’s outside loop core we continue to have a unique market with strong appreciation and absorption. Also the Woodlands has seen explosive growth with Exxon moving their global headquarters there.

• San Antonio residential continues to improve with limited availability of new homes and development. Multi family continues to improve. Office, retail will remain flat with industrial having a tremendous boost from the Eagle Ford shale play.

• Dallas/Fort Worth has turned the quarter at 97% of pre-recession residential absorption. Multifamily is doing better, but continues to be challenged with short sales and foreclosures.

It’s happening. Locally we have seen the housing market tighten up tremendously as people from all over the country move here for jobs and the high quality of life Austin offers. Even still, in the Austin area and Texas, there continues to be challenged areas. So recovery may not happen for a few more years nationally (possibly 25+ years in some areas. Here in Austin there are some areas that have over 70 years of inventory still.)

This is not to say that any of this is imminent. More likely than not, the process could take a few more years. The United States continues to slowly improve. However many believe that the housing market will turn around. All that pent up demand for household formation should create a strong rebound in the demand for housing. That is, if we can avoid the coming fiscal cliff, which has the potential to undo all the recovery we have made and plunge the United States into a new recession.

The fiscal cliff and housing

If the federal government does not come to a budget solution, what could it mean for the home building and mortgage industry? As Republicans and Democrats brace for a budget standoff based on ideological differences on tax hikes and their impact on small business, lawmakers may find common ground by including housing market relief into discussions on how to grow Main Street America. Depressed home values remain a key constraint for small business creation and widespread negative home equity in many hard hit regions precludes real estate assets from being used a source of capital for hiring or expansion.

But that’s not to say trends aren’t improving, as the nation’s overall home equity surplus shows an increasing rate of recovery. In third quarter results released by the Federal Reserve in late September, home equity rose to its highest post-crisis level, even eclipsing 2008 levels.
Presently, the nation now faces something equally different and just as dangerous — falling off of the fiscal cliff. The outcome of our trip to the edge of or over the fiscal cliff has wide ramifications for our economy, yet the impact on the housing market could be among the most significant.

Quite simply, the fiscal cliff is the combination of automatic spending cuts and automatic tax increases that take effect either at the end of 2012, or the very beginning of 2013. It was a gimmick, known as the Budget Control Act of 2011, which was put in place by Congress and President Obama to attempt to force a budgetary compromise. It represents a “kick-the-can-down-the-road” approach to policymaking – which seems like the dominant way our national budget has been managed for the last decade.

Unable to reach an acceptable compromise by the deadline, our elected Congressional and administrative officials on both sides chose to vote for something they did not entirely support largely because it contained policies that their opponents also found intolerable.

Among the changes to current law set to take effect at midnight on December 31, 2012 are the end of last year’s payroll tax cuts (2% for most workers), the end of certain tax breaks for businesses, modifications to the Alternative Minimum Tax that would impact far more people, the end of the Bush tax cuts, including capital gains and estate tax cuts, and the initiation of taxes related to the Affordable Care Act.

Concurrently, spending cuts that were agreed upon as part of the debt ceiling deal of 2011 would commence. Estimates are that over one thousand government programs will face steep cuts, including $500 billion from defense over the next decade.

It is vital to remember the recent rebound in the housing market is a function of two primary factors. First, historically low interest rates served to prop up the ailing market. Second, the market has benefited from the sense that it has finally bottomed out, which buoyed consumer confidence. What impact would failure to avoid the fiscal cliff have on the housing market and the economy as a whole? In a word: disaster. Let’s examine how the fiscal cliff will directly derail the two factors that have driven the rebound in housing.

First, failure to address the cliff will end the incredibly low interest rates we have been enjoying. Let’s not forget the reason such massive spending cuts and tax hikes are being contemplated during this time in history is the existence of our nation’s $16 Trillion debt. According to figures from the U.S. Treasury from August 2012, approximately 53% of our current debt is owned by foreign investors. China accounts for 10% of U.S. debt ownership, but — and this is key — China appears to be reducing its holdings of U.S. treasuries.

The reason for China’s reduction in Treasury holdings is a belief on their part that the value of U.S. denominated debt will decrease over time based on the inability of U.S. officials to put a credible debt reduction plan in place that does not compromise economic growth. China and other foreign investors would be tempted to sell more U.S. debt and reduce their future purchases if it appears a responsible plan will not be adopted. When U.S. debt loses its appeal, interest rates have to be increased to lure purchasers. If that happens, our current period of historically low interest rates will end.

The second reason for the resurgence in housing has been a sense that the worst was behind us relative to the economy, the jobs market and property values. A new recession (caused by falling from the fiscal cliff) with as many as 1 to 2 million new unemployed Americans will devastate consumer confidence and risks another wave of home foreclosures. Moreover, the recent gains in home values would likely evaporate as the pool of potential buyers falls dramatically.
In order to avoid a catastrophic outcome, our political leaders must work out a compromise on taxes and entitlements that is amenable to both sides that sets our country on a fiscally responsible path. The alternatives – kicking the can down the road, or simply plunging over the cliff – are unacceptable.

After this hard fought political season, our political leaders difficult response to the crisis at hand is needed. Out of control entitlement, defense, and social spending needs to be a thing of the past. Compromise and working together need to be the mission. Anyone that has been in a successful relationship will tell you that compromise is paramount. If Congress is too late, they risk the wrath of global investors passing on Treasuries with potentially “rocky” consequences. Credible action must take place before the end of the year. It doesn’t have to be the final deal, yet it must be detailed enough and involve pledges from all parties that the deal will be resolved within a very short period of time.

The housing market continues to swim upstream in a sea of uncertainty and won’t be on its way to recovery until some sort of concrete forward-looking directional guidance is offered by an official source, good or bad! This mess can’t be cleaned up overnight, nor do we think it’s fair to expect a broad-based reform package to be implemented with one swipe of the President’s pen. What we do expect is better management of expectations and a clear voice of leadership in Congress or the administration. If the regulators are really having this much difficulty making a decision on the next move, then maybe they shouldn’t implement patchwork regulations just to appease outcries for reform. All that does is create more confusion, which only breeds more uncertainties and adds further barriers to the home loan qualification process.

The housing market is particularly vulnerable at this moment in its recovery. The potential consequences for housing include rising interest rates, dropping home values, a resurgence of foreclosures and a dramatic, perhaps generational long loss of consumer confidence. With stakes like these, all Americans, particularly homeowners and those dependent on the housing economy, must demand action from our leaders.

If no serious attention is given to housing finance reform until after the fiscal cliff, what are the implications on the broader economy? A clear solution is what is needed. It will take time for any solution to start the healing process, but if you continue the political haggling, it is like ripping the band aid off again and again. It slows the healing process.