THE IndependenceVoice

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Home prices have increased more than 10% year over year nationwide. In many markets, including ours, buyers are engaging in bidding wars and submitting offers greater than list value.

Headlines and talking heads are beginning to describe this positive development as a housing bubble. Just mentioning the words “housing bubble” in a headline generates buzz and viewers. In reality, this is no bubble, but rather genuine demand for shelter paired with a low inventory of desirable homes.

Many may not understand the difference. All this buzz begs the question of **what is the difference between housing demand and speculation**? Let’s review some basic parameters for projecting housing growth. For starters, job growth is paramount. For every two jobs, you can count on needing one additional housing start. Apartment developers like to say for every 2.5 to 3 jobs, one new apartment. If you don’t have job growth, there is no need for additional housing.

Let’s look at the four basic laws of supply and demand: demand and the price of a commodity (real estate) have an inverse relationship.

1. If demand increases and supply remains unchanged, a shortage occurs, leading to a higher equilibrium price.
2. If demand decreases and supply remains unchanged, a surplus occurs, leading to a lower equilibrium price.
3. If demand remains unchanged and supply increases, a surplus occurs, leading to a lower equilibrium price.
4. If demand remains unchanged and supply decreases, a shortage occurs, leading to a higher equilibrium price.

Speculation is known as the practice of engaging in risky financial transactions in an attempt to profit from short or medium term fluctuations in the market value of a tradable good such as real estate. In real estate the common term is ‘flipping’. I liken speculation to gambling, both are risky and usually involve participants that don’t fully understand the business and the risks.

A good example of a speculative market was Las Vegas in the boom years. In 2005, Vegas had 58,000 jobs created and 39,000 home starts, a ratio of 1.5 homes to 1 job. Now that extra 10,000 starts might not seem much, but when you compare it against actual demand the market gets out of whack quickly. Most of the homes starts were speculative, with little thought of who or when somebody was going to move in. Builders were building just to sell as quickly as possible.

Once you start building for a speculative market, it is hard to stop quickly. It takes a while to understand where the demand is. In the aforementioned example they were building speculatively for a speculative demand. As non-construction employment did not keep up with supply, the market was soon overbuilt, which in turn caused values to decrease.

It is also important to know the lag times in completing new product. In Austin it is 2.5 to 3 years from inception to actual completion of development and housing.

Using Austin as an example, we have 60,000+ people immigrating to Austin on an annual basis.

Not all units available are desirable (cost vs. value, geography, schools, etc.). Because of this, and because there has been a limited number of units delivered to the 'home' market, the market is playing catch up from the last five years. Presently that places demand stronger than supply, creating a seller's market.

- 142,669 total rental units Austin SMSA
- 95% occupancy = 7,133 units available
- 10,260 units under construction to be completed 2013

  Total of 17,393 rental units available in the next 12 months

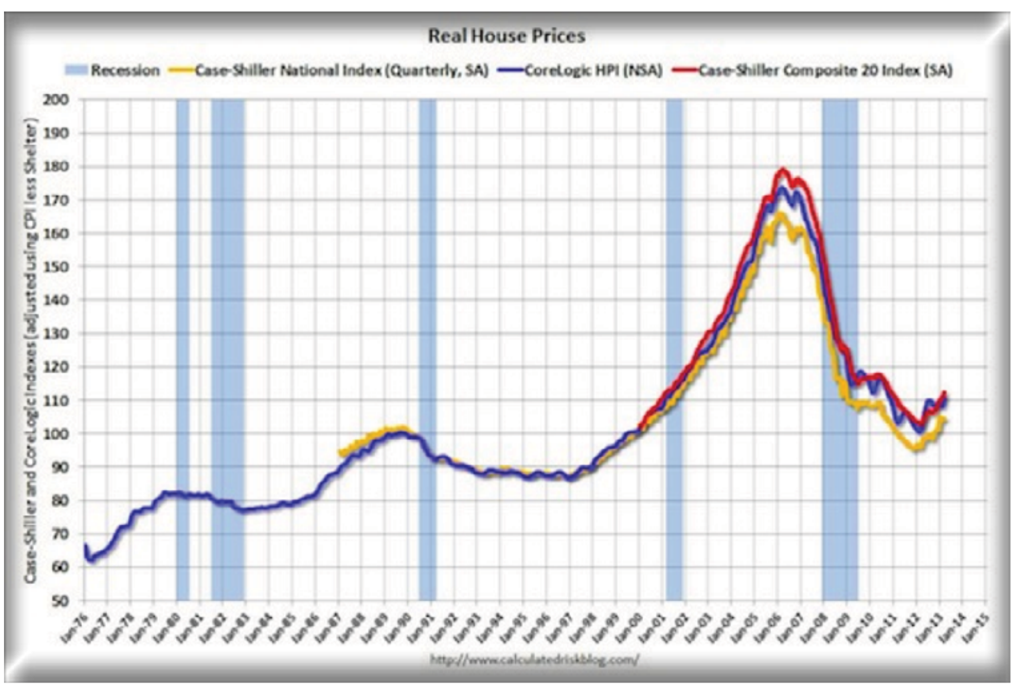
- 7,800 to 9,000 home starts this year
- 5,200 listings presently

  Total shelter 31,593 units available

When you have demand that is greater than supply it forces prices to price. In Silicon Valley, demand is being driven by a flood of new (Facebook, Google) tech money. This has resulted in employees that have a tremendous amount of new money, but all are chasing after a shrinking supply of homes. Transactions are still below boom levels over the last 25 years and half the level seen at the peak in the mid-2000s. Prices would have to skyrocket, as we'll see below, to get back to peak levels, so presently although some areas are experiencing record values from the depressed values of the last five years they do have a way to go.'

During the housing bust, the anchor slowing the economy was lack of construction, which in turn was a drag on the economy due to large mortgages and lower home values. Where are values now?

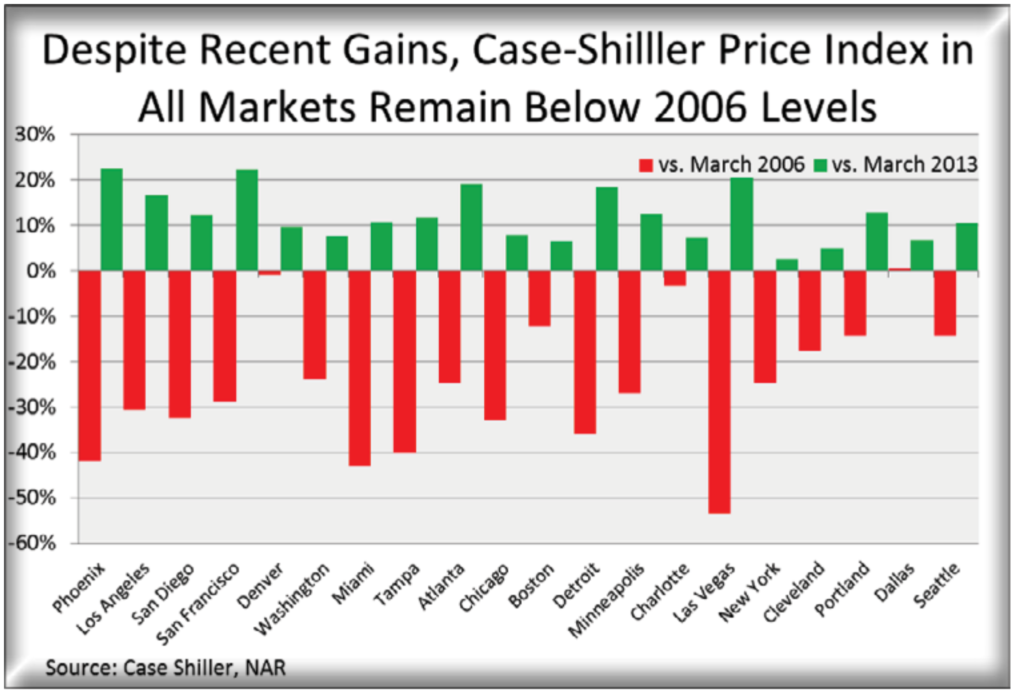
First, prices as measured by Case-Shiller, are still down 27 percent from their peak seven years ago. Case-Shiller calculates nominal prices, not real values. And the (inflation) is up 15 percent since 2006. So real house prices are about 37 percent below 2006 levels and are just now returning to where they were 13 years ago. Bill McBride of Calculated Risk has a great chart showing real house prices going back a few decades:



CLICK HERE for a CR chart from last year that showed housing prices at about 1979 levels, by Robert Shiller's measure, anyway.

And here's a tip for the math-challenged out there: It takes a larger percentage increase to offset a percentage decline. Take a $100,000 house at the peak. If it fell the real national average 42% percent in the bust, it would have been worth $58,000 at the bottom early last year. But to get back to $100,000, it would take a 72.4% percent increase from the trough. Even now, after the sharp bump off the bottom, prices would have to jump 60 percent to get back to their bubble-era peak.

It's not just the national market, either. The bubble stories have focused on markets like Los Angeles, San Francisco, and even Austin. But these markets, for instance, are just now getting back to early 2000 to 2003 prices and have a ways to get to boom pricing in 2005. To get back to 2005/06 levels, San Francisco's home prices would have to jump 60+%, by my calculations (using Case-Shiller data). LA would have to jump 65+%, Phoenix 100%, and Miami 105%. Las Vegas home prices would have to skyrocket 149% to reach 'boom/bubble' levels.



Here in the Texas region, even with our limited exposure to 'bubble pricing', Texas values still have not caught up to the long-term appreciation experienced by California and Arizona. People and realtors have a hard time understanding that. Remember, these markets experienced 45+% annual appreciation for a number of years. So even with a 60% drop in value since the peak, they are worth more than when they started. In that same time period Texas and the surrounding region did not experience the highs or lows of the housing bubble.

The continued diversity in price performance at the local level will be a function of job creation. Demand will follow jobs, which in turn will increase values. That is the main reason for the strength of the market in Austin, Houston and San Antonio over the D/FW area presently. The same can be said for the San José and San Francisco areas. There simply is not enough housing.

So again, what is the difference between speculation and true demand? Presently the multiple offers are caused by true demand in Austin, Houston, San Francisco, etc. There is not enough housing with respect to the jobs being created. This does present a small opportunity for house "flippers", however present financing conditions demand larger down payments, slowing the speculative demand the nation experienced during the boom. Here in Texas, 'flipping' was tempered by the lack of tremendous appreciation (40+% annual in California and other 'boom states). Texas and local homeowners experienced less than 3% annual appreciation at the height of the housing boom. They may be seeing a bit better presently. But you have to look at the whole metro market. There are still challenged submarkets. So just because Tarrytown is experiencing 15+% annual appreciation, does not mean you can expect similar appreciation in Round Rock, Georgetown, or Lago Vista. Real estate is local, and your appreciation is going to be somewhere below or above that. An experienced real estate professional will be able to help you find the 'true value' of your neighborhood and home.

Should you decide that you want to get into real estate speculation, just because you did well on your last home investment, does not equate to doing well with real estate speculation. Get with a professional, not only in the real estate channel you want to participate in, but in the submarkets you decide on. All real estate is local, as are real estate experts. I would suggest getting opinions from two or three of the local experts before making a decision.

Is now the time? That is a personal decision you need to make with your family and financial planners. But from this analysts view point, two years ago would have been the best time, now is a good time and the next three to five years should remain strong for real estate investment in our region. Remember I am not a broker, financial planner, or lawyer. I'm just an analyst with over 35+ years in this market, and right now I'm seeing one of the better markets of my career.

Now really is the time to buy!

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