THE IndependenceVoice

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Almost ten years after the housing bubble peaked and three years after home prices bottomed, the boom and bust still cast a long shadow nationally as well as regionally. What does 2015 have in store for the housing and real estate market regionally?

The 'rebound effect' we felt in 2013 that drove the recovery after the bust is now fading. Prices are no longer significantly undervalued and investor demand is falling. Ideally, strong economic and demographic fundamentals like job growth and household formation should take up the slack. But the cycle of gains in jobs and housing is relatively weak nationally, and that will slow the recovery in 2015.

Despite many predictions earlier this year about spring growth in the housing market forecast being flat, and despite an improving economy that changes its mind quarter-to-quarter, most analysts expect an uptick in the economy and housing market through next year on into 2016.

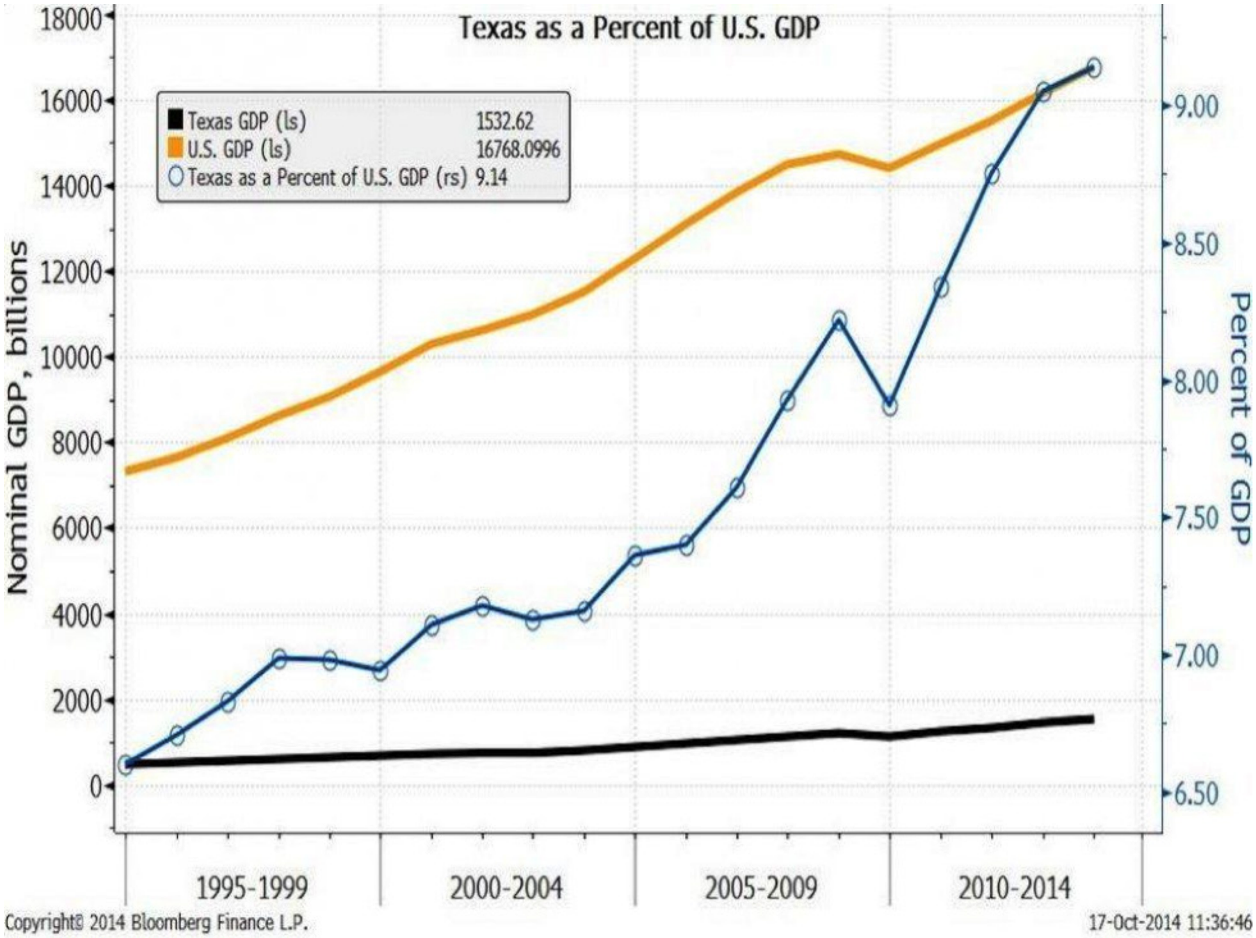
During the early years of the housing recovery – from the bust to present – the rebound effect drove the recovery. Investors scooped up undervalued homes and took advantage of foreclosures and short sales, boosting overall sales volumes. Markets hit hardest in the housing bust posted the largest price rebounds. Now, though, the rebound effect is fading nationally as well as locally. Price levels and price changes are both approaching normal, foreclosure inventories are dwindling, and investors are pulling back. This is inevitable as the market improves and therefore shifts to slower, more sustainable price increases and a healthier mix of home sales.

So what is the next stage of the housing recovery through 2016? The good news is the real estate and housing market will increasingly depend on fundamentals such as job growth, rising incomes, and more household formation which are all strong in Texas, but challenged nationally. But here's the hitch: these fundamental drivers of supply and demand haven't returned to full strength yet. They aren't strong enough to fully take the reins from the rebound effect. Importantly, the share of young adults with jobs is still less than halfway back to normal, many young adults are still living with their parents, and income (wage) growth is sluggish. This points to a tricky handoff, and means housing activity in 2015 might disappoint by some measures though the rental market will remain strong as evidenced by continued rent appreciation, even as more product comes to market.

Real estate values will remain strong regionally, but sale will slow from the rapid expansion of 2013.

The reason for the cautious optimism is a hefty pent-up demand for houses coupled with expectations of job growth regionally — which itself has been more feeble nationally than anticipated. Regionally it has remained robust, but restrained. When you look at the jobs-to-population ratio, the current period is weaker than it was from the late 1990s through 2007. This explains why Main Street America and even Texas, as well as it has done, does not fully feel the recovery.

Many of us living and working in Texas forget that the rest of the country is not creating jobs or recovering as quickly. Although the U.S. GDP and overall economy have occasionally fluctuated quarter-to-quarter these past few years, there are no fresh signs of recession or stalling of the economy for 2015-16, which should grow about 3 percent. Texas continues to be a larger portion of the economy as shown in the chart below. A major key to housing growth, of course, is job growth. The U.S. overall has recovered nearly all of the eight million jobs lost to the Great Recession. Most analysts agree that employment is expected to grow 1.6 percent this year and 1.9 percent next. Similarly, the GDP is on course to grow 2.2 percent this year and about 3.0 percent in 2015.



Next year promises to be far less aggressive than it has been when it comes to sales and prices. This does not mean a softening market. Demand is still there as evidenced by continued occupancy rates of residential, office, and commercial channels.

Easier mortgage underwriting could help home markets. FNMA and other government lending institutions are offering loans with lower down payments, which is good. However, the massively punitive environment of over $165 billion dollars in penalties against financial institutions over the last eight years slows anyone in the lending business with good reason. The parameters of Dodd-Frank and Basel III also make lending to small business more difficult.

In Texas, energy has always been a major portion of our economy, and the fracking and shale oil boom have continued this trend. Fracking has been a welcome economic engine, generating thousands of jobs and higher incomes. Oil values tumbling at the end of 2014 and into 2015 will have an economic impact in our state, cooling real estate and business development in oil industry heavy areas. Values should hold, but sales will slow. We are transitioning into a slower price appreciation environment through 2016. The real estate scene going forward may seem dull, but is characteristic of a market that hit a tipping point after the rocket ride of 2013. Investors swooped in, scooping up foreclosure stock. Inventory was crimped. Cash was king. The good news is that a bottom of values was found, but the bad news is that the market in much of the nation was not consumer driven. Texas has had a different experience with values never being tremendously strong comparatively, but steady. That should continue.

That said, here is what we see for the coming year. First let's look at new home starts in 2014:

- San Antonio: 8,406 new home starts;11,000 annualized
- Houston: 22,000 new home starts; 30,000 annualized
- Dallas / Fort Worth: 24,000 new home starts; 28,000 annualized
- Austin: 8,500 new home starts, 11,500 annualized

2015 will see more home starts, but probably less than a 10% increase. New home sales have slowed in all metros a bit, except D/FW which did not have the surge the other markets had in 2013 and seems to be more optimistic than the rest of state metros.

Resales in 2014 in our major metros:

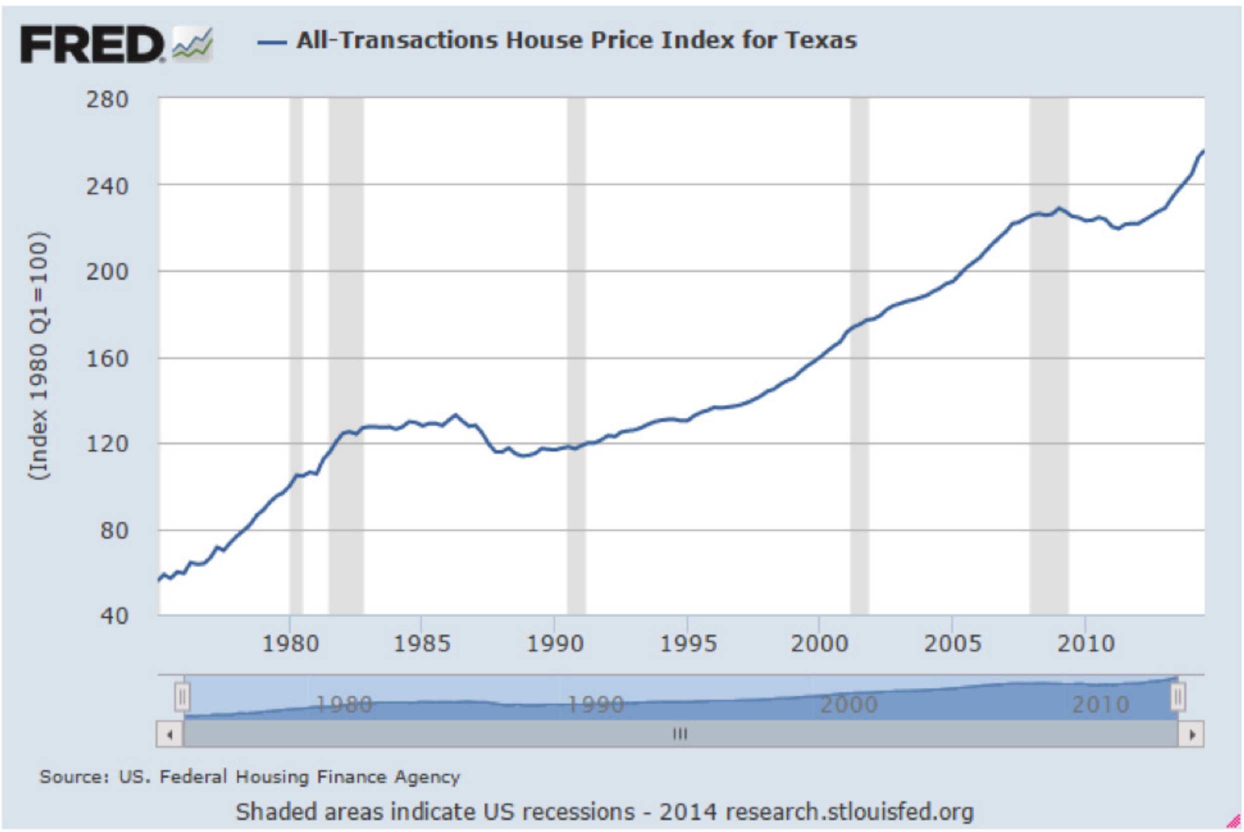
- Austin: 26,467 home resales; 32,000 annualized
- San Antonio: 21,599 home resales; 27,000 annualized
- Houston: 70,570 home resales; 86,000 annualized
- Dallas: 51,176 resales; 62,000 annualized
- Fort Worth: 9,938 resales; 13,000 annualized

Resales and new home sales are off from my 2014 projections due to lack of lots and entry level product (below $200K). Luxury (above $2 million) is also off 30% in Austin, San Antonio, and D/FW.

Texas home prices

We project sales will increase 2-3% in 2015 with current conditions, with values maintaining a slower increase. Continued pressure on underwriters will continue to slow home sales. In Texas, the price of oil will dampen current run rates by about 10%.

Historically, the average rate of house price appreciation in Texas over the past 38 years is 4%. For those who are on vigilant alert for a "price bubble" in the Texas housing market, here is another fact for consideration. Texas home prices went up by 12 to 15 percent for four years in a row from 1976 to 1979. Then they went up an additional 17.8 percent in 1981. This supercharged price appreciation didn't create a bubble in Texas. Home prices fell in 1986, 1987 and 1988 but not because a price bubble burst. Prices fell because the price of oil dropped below $15 per barrel and crushed the state economy. When the 2013 FHFA numbers come out soon, it looks like Texas home prices will have increased about 5.5 percent for the year. This is not the making of a bubble, but it is slightly above average. We'll take it! Below is chart showing the All-Transactions House Price Index for Texas. An interactive version is available here.



- Home prices increased 5.4% YOY in Texas in 2014 in our metros combined
- Home prices in Texas increased in 31 of the past 38 years
- The highest rate of appreciation was 17.8 percent in 1981
- House prices increased by more than 10 percent in five of those years
- Texas home prices declined in six of the past 38 years
- Four years of decline occurred in the 1980s when the oil market collapsed
- Two years of decline were during the Great Recession in 2009 and 2010
- The largest decline was in 1987, when prices fell 9.6 percent

Mortgage rates

Mortgage rates will move higher, to 5% by the end of 2015.

Freddie Mac, the government controlled corporation that buys and sells mortgage securities, conducts a weekly survey of mortgage rates being offered by lenders in the U.S. They also make various forecasts relating to the housing industry. The Federal Reserve long-term outlook calls for gradually rising rates over the next 12 months.

The chart above was created by narrowing their forecast to show the 12-month period from Q4 2014 to Q4 2015. As you can see, they expect the average rate assigned to a 30-year loan to rise gradually, perhaps reaching or exceeding 5.0% by the end of next year.

When interest rates increased by about 1.5% in mid-2013, we forecast that the housing market would stop growing and would even turn down this year. That it did, making a trough at about the end of last winter. Since then, it turned up, but only at a very low rate. Generally, apartments are being constructed at a slightly faster rate than single-family homes, which have slowed compared to 2013. Meanwhile, prices generally have continued to appreciate, although there are signs that these too actually slowed down earlier this year before starting to appreciate again.

Realize, this is only a real estate prediction for 2015 — not an assurance. But it is based on some of the best data available, analyzed by economists who specialize in mortgage and housing trends. So we probably won't be far off. Think of it as a well-educated guess. When rates historically rise we see a slow down due to interest shock. However within 2 to 3 months, consumers wake up to the fact rates are not going back down in a healthy economy, and begin in earnest looking to buy homes and real estate.

Affordability worsens

Price gains slowed in 2014 and we'll see more of the same in 2015. In October 2014, prices increased 4% year-over-year in our Texas metros, down from 10.6% in October 2013. With the possibility of rates rising and fewer bargains, there is little room for prices to rise without becoming overvalued. What's more, with consumers expecting 2015 to be a better year to sell than 2014, more homes should come onto the market, cooling prices further. Nevertheless, despite slowing price gains, home-buying affordability will worsen in 2015 for two reasons. First, even these smaller price increases will almost surely outpace income growth. In 2013, incomes rose just 1.8% nationally year-over-year in nominal terms following a historical trend of the last 10 years, and a negligible 0.3% after adjusting for inflation. Second, the strengthening economy and the Fed's response should push up mortgage rates. Remember for every 1% rise in rates, the consumer loses 12% buying power.

Rents will continue to rise in Texas. Next year will see strong rental demand and lots of new supply. The demand will come from young people leaving homes belonging to parents or roommates and renting their own places - household formation. Until now, they've been slow and reluctant to leave the nest. But the 2014 job gains for 25-34 year olds in Texas will lead to the rise in household formation we've been waiting years for. At the same time, the apartment construction boom we have seen over the last few years will mean more supply in 2015 since multi-unit buildings take about a year to build. Even with the new inventory in each of our Texas metros, rent gains have not slowed. At some point, this new supply will outstrip the formation of renter households. In our metros it has not happened yet. This surge of renters moving to our metros will cause the homeownership rate to improve over the next few years as the higher rents push those consumers to look at buying a home.

If these predictions for 2015 sound similar to our predictions for 2014, you're right. As the rebound effect fades and fundamentals take over, the recovery gets slower and the market starts to look more similar from one year to the next. But there's good news here. Even though the recovery remains unfinished, the housing market is becoming more stable and more certain for buyers, sellers, and renters.

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