

YOUR CUSTOMERS ASKED. WE ANSWERED.

COLLEGE STATION (Real Estate Center) – Two weeks ago, we asked you to tell us [which question you hear most from your clients](#). You told us, and now we've answered it.

We posed the question — have we hit bottom on home prices? — to our team of research economists.

Want to know what they said? Then check out Real Estate Center Senior Editor David S. Jones' latest column, "One Rotten Apple Doesn't Ruin the Whole Market." You'll find it on the [Texas Association of Realtors' consumer website](#).

One rotten apple doesn't ruin whole market

[By David S. Jones](#) | columnist

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If I buy a house today, will it be cheaper tomorrow? In other words, if I buy now, what is the likelihood my property's value will decline, and I won't be able to sell it for what I paid for it? Put yet another way, have we hit bottom on home prices?

Regardless of how it's worded, the question is the same. Real estate agents hear it all the time. So do researchers here at the Real Estate Center. This may be the biggest single question facing the U.S. real estate industry. It certainly is one reason many homebuyers are waiting on the sideline.

There is no single answer. Answers vary from city to city, state to state, property to property and household to household.

Mark Dotzour, Ph.D., the Center's chief economist and director of research, provides some useful commentary on the big question.

“First, we have always said that as long as the inventory of unsold homes hovers around 6.5 months, that's a balanced market, and prices increase. We have subsequently observed that as inventory levels increase toward eight or nine months, prices still hold firm. Only when inventory levels get to 10 or 12 months do prices start to fall.

“Second, the reported median sales prices are not truly reflecting the actual value trends in the local market. As the percentage of ‘distressed sales’ increases, the reported median sales price falls.

“This doesn't mean that home prices are falling; it just means the quality of homes in the sample is falling.

“For example, if three homes sell in one month, and all three are ‘typical’ sellers at \$170,000, then the median price is \$170,000. If foreclosures increase in the next month and three homes sell (but two are foreclosed sales at \$140,000 and \$145,000 and one is typical at \$170,000), then the median price falls to \$145,000. The reported median price has fallen \$25,000, but the ‘typical’ house is still selling for \$170,000.

“Hence the reported median price decline reflects a change in the quality of two bad apples in the basket, not a true reflection on the price of the good apples.

“Third, the quality of distressed properties sold in the market is often very poor – worn or stained carpet, stripped copper wiring, and other defects. Hence, when a lot of distressed properties sell, it means that the overall quality of the basket of apples has deteriorated. It doesn't mean the good apples in the basket have declined, it just means that the basket still has some good apples, but also includes a growing proportion of lesser quality apples.”

Whether real estate is improving or still deteriorating often depends on those same three factors that dictate which property to buy in the first place: location, location, location. In general, if you are buying in Texas, your home's value is less likely to decline.

In 2010, Center economists explained why the Texas housing market fared far better than other states during the recent downturn. They also suggested why the state's economy is expected to continue to do better than the rest of the nation.

“The risk of a home price decline in Texas is low,” says Ali Anari, Ph.D., a Center research economist. “Texas' lower-than-national-average housing cost is one reason for the state's higher-than-national-average growth rate,” says Anari. “When Texans are able to spend more on non-housing goods and services, the state's economy is strengthened and more people are attracted.”

“These results illustrate one of the key reasons the Texas economy outperforms the United States in terms of job growth almost every year,” says Dotzour. “The fact that Texans pay less of their income for housing means they have more to spend on other things that add to the overall quality of life. Texas offers a lower cost of living than many places in the United States.

“This allows Texas employers to be able to attract workers at a reasonable wage rate that allows them to compete successfully in the global economy.”

“The larger the share of housing expenditures in the consumer's budget, the more home prices in their region have fallen since 2007,” Anari says.

Anari points out that home-price changes affect expenditures and wealth. Lower housing costs allow consumers to spend more on other goods and services, leading to higher regional economic growth, increased growth rates, a larger labor force, and more demand for goods and services.

Home prices are used in the formula by Research Economist Jim Gaines, Ph.D., to calculate the Texas Housing Affordability Index (THAI) for Texas.

“Housing affordability may be one of the most significant growth stimulants for Texas during the first half of this century,” says Gaines.

The THAI is the ratio of the median family income to the income required to buy the median-priced house using standard mortgage financing at the current interest rate. Standard financing is a fixed-rate, 30-year loan covering 80% of the cost of the home. A THAI of 1.00 indicates the median family income is exactly equal to the required income to qualify for the standard loan to purchase the median-priced house.

Economists are fond of saying, “The trend is your friend.” If you want to know what current housing trends are, visit the [Real Estate Center Web site](#). There you will find data from Texas MLSs, including median and average prices of existing homes, month’s inventory, and housing affordability. Depending on the area, the numbers vary greatly.

Would-be homebuyers have reason to be cautious. The Dallas Federal Reserve’s December 2010 [EconomicLetter](#) says there is no pain-free path to a healthy housing market. National home prices peaked in 2006 and have fallen 33% since. The authors say, “... home prices still must fall 23% if they are to revert to their long-term mean.”

But they are speaking about the nation in general. Luckily, when you see that “Welcome to Texas” highway sign, you should feel more confident in any home purchase you make down the road.

Courtesy of JB Goodwin