TEXAS A&M UNIVERSITY
Real Estate Center

Building Blockage
Affordability Obstacles Piling Up

Joshua Roberson
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More than a decade has passed since the mortgage crisis and Great Recession (GR) that left the residential construction market in disarray. As the 2010s rolled along, Texas' economy began to boom again, but this time with the new-home sector struggling to get back on its feet. This contributed to the squeeze in home availability that would escalate throughout the decade and diminish home affordability in Texas.

The Takeaway

Texas new-home construction is returning to historic levels, but affordability remains a problem for many because of the escalating costs of lot development, labor, permits, and local fees, among other things.

New-home output is returning to historic levels, but little relief has come to overall affordability. One of the biggest reasons is increased development costs. Examination of new-home cost changes over time helps explain what shapes some of today's housing affordability issues.

Residential Construction Labor's Comeback

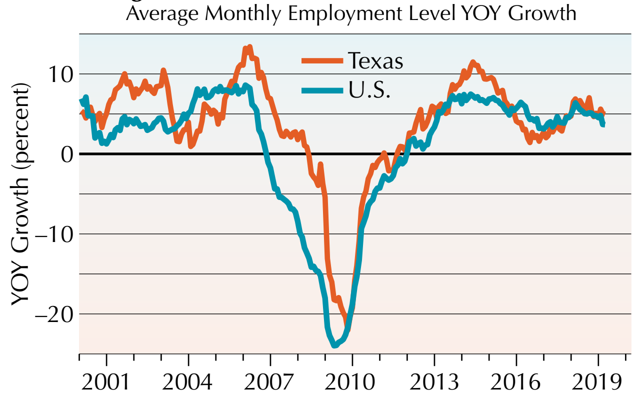
Texas construction jobs are more ample and wages are much higher today than they were even at their peak in the mid-2000s. Before reaching that point, the industry had to overcome massive job losses brought on by the GR. In Texas, construction job levels exceeded 10 percent year-over-year growth in 2006 (Figure 1). They did not begin to recover from the GR until late 2009, several months after national job losses reached their lowest point. Texas construction job losses were not as severe as those for the U.S., but year-over-year loss did exceed 20 percent at its lowest point.

Nationally, residential construction jobs still have not recovered from the mid-2000s peak. According to the Bureau of Labor Statistics' Quarterly Census of

Employment and Wages (QCEW), residential general contractor employment throughout the U.S. peaked in 2006 with over one million employed. The highest employment level since then has been around three-quarters of that. Meanwhile, Texas eclipsed prerecession levels sometime around late 2017 and is still growing along with wage rates.

The QCEW categorizes residential general contractor employment as either single-family or multifamily. Of the two, more labor is found in single-family, but recovery trends are about the same. Residential remodelers, a category that dips into both single-family and multifamily markets, is historically more robust than new construction against economic downturns. Although smaller proportionally, remodeling employment has grown considerably as a larger proportion of a growing pie, jumping from less than 20 percent in the mid-2000s to almost 30 percent as of 2018.

Figure 1. Private Residential Construction
Average Monthly Employment Level YOY Growth



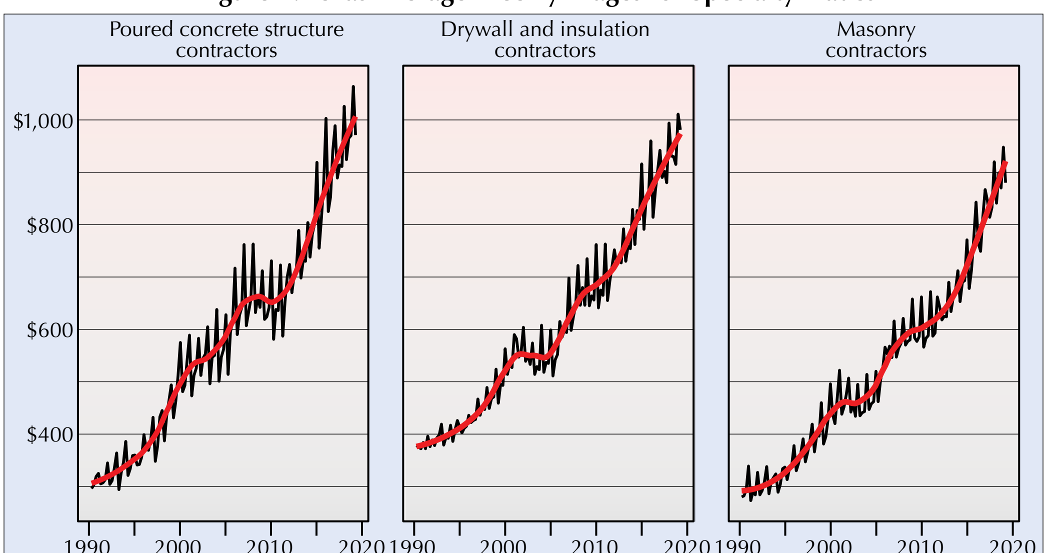
Sources: Bureau of Labor Statistics Quarterly Census of Employment and Wages and Real Estate Center at Texas A&M University

Part of what sustains residential remodeling employment during downturns is the ability to supplement work when new construction is down. However, that alone does not explain its current expansion in a growing industry. Instead, growth is possibly because of homeowners staying put instead of upgrading to a new home. This trend has locked up much of the existing housing stock in prime metro locations, restricting the supply of homes for sale.

Strong employment growth in Texas has come with stronger wage growth. Construction wages for residential general contractors in Texas have historically been stronger than those nationally, but the premium has grown wider since 2010. During the past couple of years, the premium in wages has been anywhere from $300 to $400 a week. During a time of stagnant wage growth, this segment of the construction market has stood out.

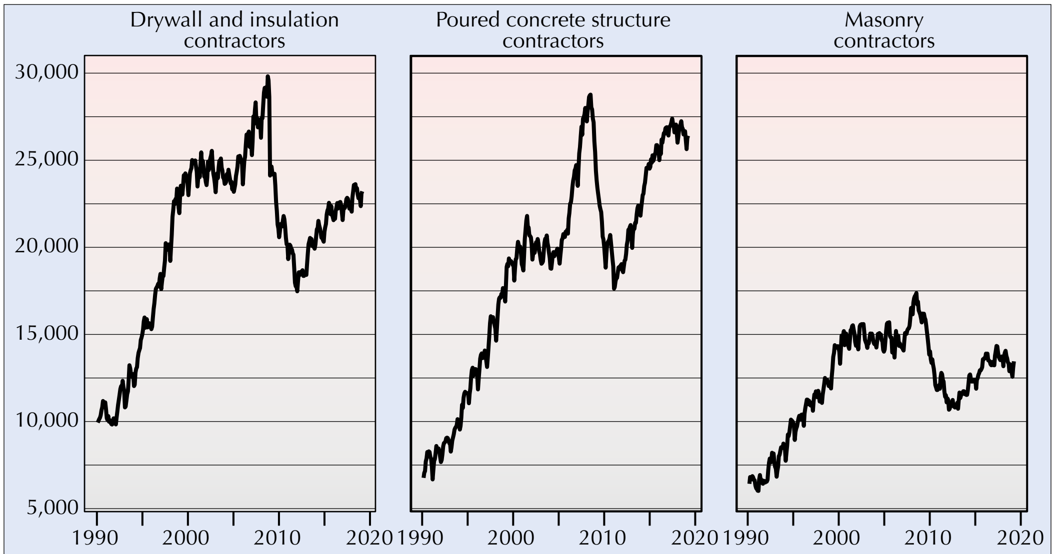
The QCEW categorizes subcontractors as specialty trade contractors. Like general contractor employment, Texas subcontractor job levels have already surpassed prerecession levels while those for the U.S. as a whole have not. According to QCEW data, employment shortages have resulted in exceptional wage growth for many specialty trades, particularly in the latter half of the 2010 decade. Examples include occupations such as poured concrete workers, framers,

Figure 2. Texas Average Weekly Wages for Specialty Trades



Sources: Quarterly Census of Employment and Wages and Real Estate Center at Texas A&M University

Figure 3. Texas Average Monthly Employment Levels for Specialty Trades



Sources: Quarterly Census of Employment and Wages and Real Estate Center at Texas A&M University

drywall and insulation workers, and masons (Figure 2). Each of these specialties is still below peak employment levels, whereas most other specialties have long surpassed them. Drywall and masonry employment, meanwhile, is still below early 2000 levels, before employment for those jobs ramped up (Figure 3).

In its 2018 survey, the Associated General Contractors of America reported that almost 80 percent of Texas commercial and residential construction firms cited difficulty hiring needed subcontractors. Among the most sought-out trades for the residential market were electricians, carpenters, and plumbers.

Growth in housing units produced has not been commensurate with the rapid growth in overall construction employment and wages. Part of the reason could be increased competition for subcontractors across industries. QCEW data for subcontractors do not partition this job category between residential and nonresidential, possibly revealing the versatility among sectors and, therefore, increased competition for these occupations. This means increased job levels in some subcontractor jobs may come from the commercial rather than the residential sector.

Lots, Fees, and Other Costs

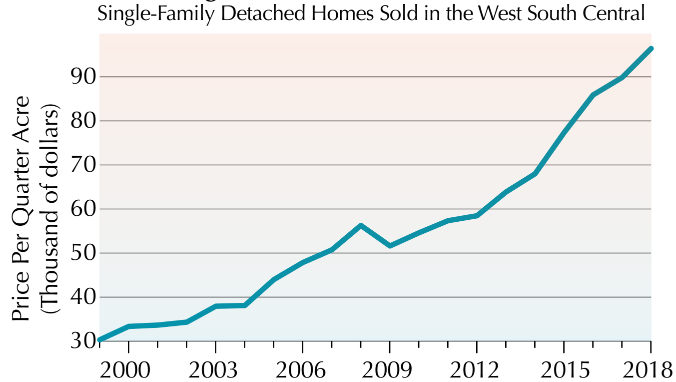
Residential lot costs and various development costs have also grown. Lot costs have risen at a considerably higher rate than overall inflation. According to the U.S. Census Bureau's Survey of Construction (SOC), lot prices in the West South Central (WSC) Census Bureau Division, in which Texas resides, are significantly higher today than they were just ten years ago. The SOC tracks new homes at various stages in the construction pipeline.

Before the GR, the estimated cost of a developed quarter-acre lot, (the long-term average size) was less than $50,000. It is now closer to $100,000 (Figure 4). Lot scarcity in the state's largest metros is a major contributor to escalating prices.

Other development costs have increased at a similar rate. In the past four years alone, input costs for single-family construction, excluding capital investment and labor costs, have grown nationally by approximately 10 percent according to the Bureau of Labor Statistics' producer price indexes. Whether these indexes include hard and soft costs is uncertain, but both costs are believed

Figure 4. Price Per Quarter Acre

Single-Family Detached Homes Sold in the West South Central



Sources: U.S. Census Bureau Survey of Construction and Real Estate Center at Texas A&M University to have increased at similar rates. Hard costs relate to physical components ("bricks and sticks") while soft costs relate to professional service and municipal fees, to name just a few.

Hard costs, given their tangible nature, often come to the consumer's mind when building a home. In reality, some of the more significant costs are soft costs. One example is impact fees, which many consumers are unfamiliar with but which can be expensive. Many municipalities have increased their reliance on these fees to meet or catch up with increased infrastructure demand. For the consumer, such fees can mean higher overall lot prices. "Hidden" soft costs may include time delays for final plat or permit approval, utility connection fees, and local regulatory requirements.

Scarcity of Smaller Homes

Nationally, the number of homes built is still nowhere near peak, pre-GR levels, and Texas is no exception.

SOC data show single-family detached home starts in the WSC division peaked in 2005. Sales followed the next year as new orders stopped and inventory dwindled (Figure 5). The WSC division from this survey includes Texas, Arkansas, Louisiana, and Oklahoma. Because of its size, Texas accounts for at least 80 percent of 1–4 residential permit activity in any given year for the division as a whole.

New-home starts are currently closer to levels from before the prerecession ramp-up. With inventories so low, much more output is needed to catch up with current demand—specifically, more output in wider price and size ranges.

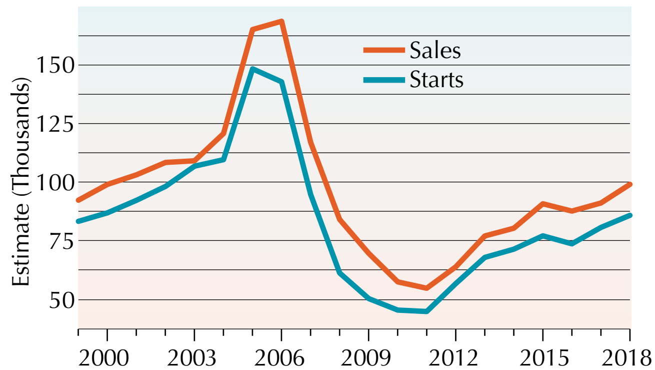
Most homes built in 2008 were between 2,000 and 2,500 square feet (Figure 6). This is still true today. The difference, besides a smaller overall pipeline, is that now a higher proportion of total output is built in this range.

The affordability problem comes from this shift away from smaller homes. Current size distribution is only slightly larger than it was in 2008, but it is also narrower. That means there is a narrower distribution of home sizes closer to the mean at the expense of homes under 2,000 square feet.

This trend has become the new reality largely due to higher lot prices, and it leaves numerous buyer segments underserved. Many Texas neighborhoods with the most drastic home shortages have median home sizes between 1,500 and 2,000 square feet. These are popular choices for younger households wanting to live closer to jobs, but they represent a challenging segment for new construction.

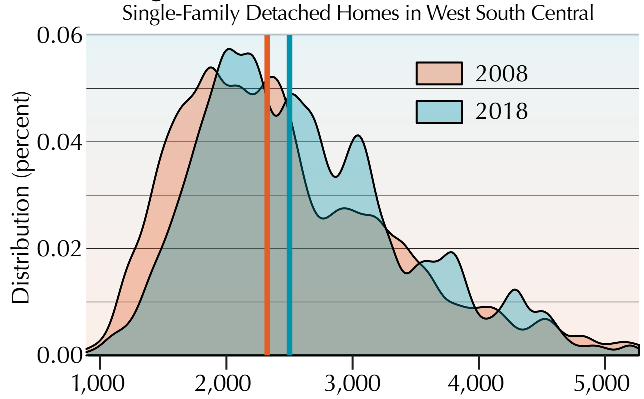
As lot prices increase, new homes have actually gotten smaller (Figure 7). The average size of a new home was at its largest in 2016 at almost 2,900 square feet, but it

Figure 5. New Construction Activity
West South Central Census Bureau Division



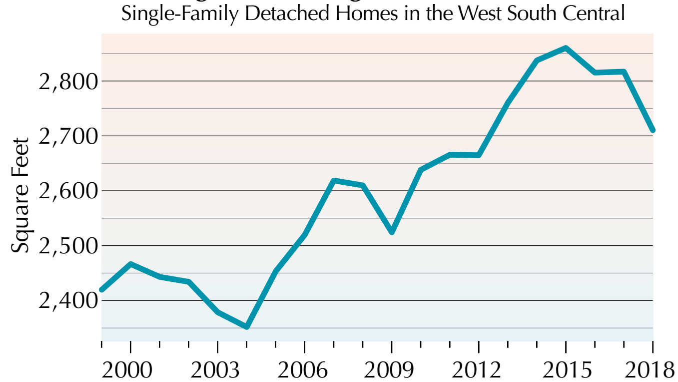
Sources: U.S. Census Bureau Survey of Construction and Real Estate Center at Texas A&M University

Figure 6. New-Home Size Distributions
Single-Family Detached Homes in West South Central



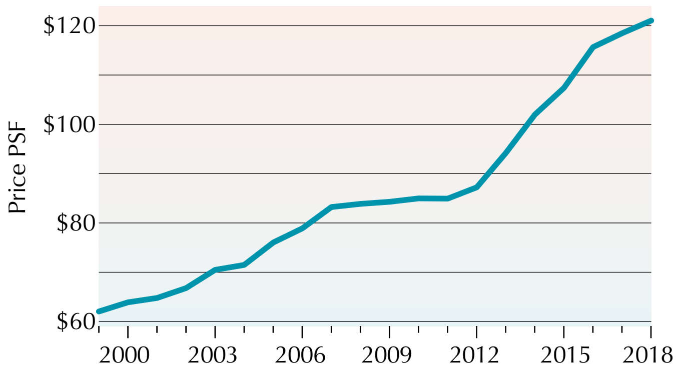
Sources: U.S. Census Bureau Survey of Construction and Real Estate Center at Texas A&M University

Figure 7. Average New-Home Size
Single-Family Detached Homes in the West South Central



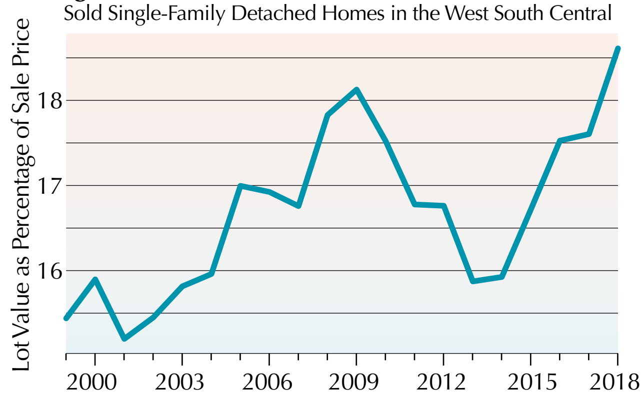
Sources: U.S. Census Bureau Survey of Construction and Real Estate Center at Texas A&M University

Figure 8. Average New-Home Price PSF
Single-Family Detached Homes in the West South Central



Sources: U.S. Census Bureau Survey of Construction and Real Estate Center at Texas A&M University

Figure 9. New Construction Lot Value to Sale Price
Sold Single-Family Detached Homes in the West South Central



Sources: U.S. Census Bureau Survey of Construction and Real Estate Center at Texas A&M University

gradually dropped to nearly 2,700 by 2019. Normally this might mean greater affordability, but instead it has led to a rise in price per square foot (PSF).

Price PSF in the WSC division grew exponentially from less than $90 in 2012 to $121 in 2018 (Figure 8). While this is a big spike for Texas, these prices are still much more competitive compared with coastal Census Bureau Divisions to the Northeast and West. The jump puts the WSC in line with Census Bureau Divisions containing other southern states from Mississippi to Southeast coastal states. Until 2013, the WSC had the least expensive single-family detached home price on a square-foot basis compared with all other Census divisions.

Smaller home sizes have blunted continued growth in overall new-home prices. In 2015, new single-family detached homes sold in the WSC division exceeded $300,000. Three years later, aggregate year-over-year prices dropped for the first time since the GR. Based on statewide building permit values for single-family residential units (a broader category that includes both detached and semi-detached single-family homes), lower prices are expected to continue for the foreseeable future. Smaller homes may take up more of the market in a continued effort to offset rising lot prices (Figure 9).

Struggles for Developers

Juggling development costs is a constant struggle for developers. It is an even bigger struggle when almost everything across the board seems to be on the rise. On top of that, developers must contend with market factors such as mortgage interest rates. The sudden uptick in rates in late 2018, followed by the gradual decline in 2019, was a reminder of the residential construction market's sensitivity to sudden interest rate changes.

While interest rates are expected to remain near historical lows for the foreseeable future, development costs will likely remain high, adding to the decline in housing affordability. Adapting to this new reality will be a major challenge for Texans looking to enter the homebuying market.

Roberson (jroberson@mays.tamu.edu) is a senior data analyst with the Real Estate Center at Texas A&M University.