A few months ago, a single-family home in Overland Park, Kan., went up for sale. Within 24 hours, the house had 27 showings and a bidding war ensued among four potential buyers. A short time later, the buyer who came in with an all-cash offer bought the house for about $270,000.

“It wasn’t a higher-end house,” said Dennis Curtin, president of RE/MAX Mid-States and Dixie Regions/Ireland. “The house is what you would consider for the area just above the starter-home range.”

This type of sale is common in today’s housing market, Curtin said—a result of the supply shortage of new and existing homes for sale.

New housing starts

The economy has shown signs of improvement. Unemployment is down, consumer confidence is up and financial institutions have reported an increase in consumer debt—meaning people are easing their frugal spending habits ingrained by recession. Home sales also have shown some improvement since the recession, but there have been several highs and lows.

In April, new single-family home sales surged by 16.6 percent across several regions, except for the Midwest, where sales fell, according to recent housing data.

Jordan Rappaport, a senior economist at the Federal Reserve Bank of Kansas City, says the increase in sales shows there is a strong demand for new homes.

“One factor constraining sales is the limited supply of new homes available for purchase,” he said.

For instance, although homes sales increased in April, the ratio of listed homes relative to sales—months supply—remains well below figures before the recession and has remained modest since the recovery. Most of the April increase in new sales was for pre-construction homes—people paying for the construction of a home for which a permit had been issued.

Curtin says that although there is a surge in demand and prices, the cost of building a new home has gone up since the recession due to available property values, material cost, labor and regulations. The only way to make money in new construction is to build higher-end homes, he added.

“If I was a builder trying to make a living off of this, I wouldn’t do it,” Curtin said.
Katrina Washington, broker and owner of Stratos Realty in Oklahoma City, used to work regularly with five developers before the Great Recession. After the recession, only two remain in the business.

Some developers got out of the business voluntarily and others were forced to close their businesses. To survive, some decided to concentrate on other segments of the housing industry, such as repairs and remodeling.

“If a buyer wanted to build a home, there isn't a lot to choose from,” Washington said. Curtin says you won't see anyone building 40 to 50 spec homes anymore; it's too much of a financial risk. And many developers can't afford to keep crews at full capacity.

Rappaport thinks increasing sales prices for single-family homes, however, will encourage developers to build new homes, improving the supply in the market. But it will be nowhere near pre-recession levels.

In February, annualized home starts equaled just 6.4 percent of U.S. households, about half its average during the 1980s and 1990s. “Ramping up to higher rates of construction will take time,” Rappaport said.

Washington, who also serves on the Kansas City Fed's Community Development Advisory Council, says securing funding is another issue for developers. Since the recession, financial institutions have been cautious about lending for new housing developments, either due to increasing regulations or uncertainty about the market or both.

“When looking at the housing issue, it's about affordability,” Curtin said. “Both for the buyer and who's financing the purchase.”

April's new home sales may have improved over previous numbers, but the level of construction remains at a historic low, Rappaport said. Over a 12-month period through April new sales grew at a 10 percent annual rate, which is probably close to the maximum that is sustainable in today's market, he added.

DENNIS CURTIN, PRESIDENT OF RE/MAX MID-STATES AND DIXIE REGIONS/IRELAND, says home prices are being driven by the lack of available houses for sale.


**HOUSING CONSTRUCTION TRENDS**

Single-family construction since 1990 can be divided into four periods: pre-boom, boom, crash and recovery.

**Pre-boom**

From 1990 to 2002, single-family construction was characterized by several runs of moderate-to-strong growth punctuated by several moderate retracements.

**Boom**

From late 2001 through late 2005, the growth of single-family starts accelerated to an average annual rate of about 10 percent.

**Crash**

From late 2005 through early 2009, single-family construction plunged. Starts contracted at an average annual rate of almost 30 percent, with a cumulative decline of more than 70 percent.

**Post-crash**

From early 2009 through mid-2013, single-family construction began with a boost from the tax credit for first-time homebuyers followed by an offsetting contraction when the credit expired. Vigorous growth of single-family construction resumed in mid-2011, but paused at the beginning of 2013. Since then, new construction has grown at an actualized rate of about 1.7 percent annually.

Multifamily construction since 1990 can be divided into three periods: pre-crash, crash and recovery.

**Pre-crash**

During the long pre-crash period, multifamily construction first fell sharply and then rebounded. Then, from late 1998 through early 2006, multifamily starts remained approximately constant.

**Crash**

Although there was no boom in multifamily construction, there was a crash. It began in mid-2006 and significantly accelerated in mid-2008. Over a three-and-a-half year period, multifamily starts fell by three-fourths.

**Recovery**

In sharp contrast to weak post-crash growth in single-family starts, multifamily starts rebounded almost immediately. As of mid-2013, multifamily starts regained two-thirds of the preceding fall. Total multifamily spending as of January 2016 was at a seasonally adjusted annual rate of $59.8 billion, which is higher than the peak readings seen during the housing boom years, and is a 30 percent increase year-over-year.

—Jordan Rappaport
income individuals, Washington said.

In Oklahoma City, a starter home could range from $185,000 to $225,000, and for a first-time buyer there is no affordable new construction.

“They don’t have many options,” she said.

This lack of supply flies in the face of the preconceived notion that there remains of glut of desirable homes for sale due to foreclosures and bank receiverships of developments from the recession and recovery.

Following the recession, Curtin said for a while investors or financial groups were prevalent in buying foreclosures and short sales—real estate in which the net proceeds from selling the property will fall short of the debts secured by liens against the property. These groups paid cash and either fixed up the homes for re-sale or turned them into rental properties.

“Investors are not as prevalent,” Curtin said. “The inventory of desirable homes on the market due to foreclosures or short sales is drying up, so buyers are competing within the same price-range market for (existing) homes.”

Although the shortage of existing homes has caused prices to increase, the average homeowner is only seeing an equity increase of 2 to 8 percent a year, Washington said.

And even though multiple buyers make offers on a house, appraisers are coming in soft with appraisals, which makes it difficult for buyers to purchase homes using a traditional mortgage loan—a reaction to the inflated home prices and mortgage lending practices that led to the recession, Curtin said.

Washington says this has led to an increase in cash sales, estimating they make up about 25 percent of all sales in his regions.

“Investors still make up a percentage of those sales, but it’s a much smaller percentage,” he said.

The increase in cash sales is helping to push sales prices upward.

“They don’t have to worry about appraisals or banks lending them the money,” Curtin said.

So where are people getting the cash?

Curtin and Washington say some are cashing in their retirement funds, while others are taking their money out of stocks or bonds and other investments and re-investing in property.

Despite improvements in the economy, for many people, whether as a first-time buyer or someone buying a second home, homeownership remains out of reach.

“A lot of people still haven’t got to where they can purchase again,” Washington said.

This is one of the reasons the rental market remains hot right now.

An increased demand for rental property

“The demand in the rental market in some ways directly correlates to the recession—many people who lost their homes in foreclosure turned to renting, and people who once qualified under pre-recession conditions no longer qualify for mortgage loans.

Taxes within the housing market also have changed. There’s a growing trend among baby boomers and Millennials to move into multifamily housing, especially in urban areas, Rappaport said. Many businesses also have moved from the suburbs to central business districts, finding it easier to attract and retain employees there.

“In the past, single-family homes were primarily constructed in new suburban subdivisions at the periphery of metro areas,” Rappaport said. “Going forward, a much larger share of homes are likely to be constructed closer to the center of metro areas, but this infill will be constrained by limited undeveloped land and regulations on land use.”

This change in taste may improve the housing supply as baby boomers downsize from single-family to multifamily homes. The trend, however, probably won’t occur until baby boomers reach their late seventies, which is five years away for the leading edge of that generation, Rappaport said.

So for now, Rappaport thinks the housing supply will remain tight continuing to push purchase prices upward and place constraints on multifamily housing.

Since 2015, rent on multifamily homes has increased at more than a 4 percent annualized rate. And the price pace for co-ops and condos is similar.

“We do see a lot more of higher-end rentals,” Washington said. “However, there is still a lack of affordable properties to rent.”

Even with the market trending toward multifamily housing, Curtin says buyers can still get more for their dollar purchasing a home in the suburbs.

“The square-footage is still there,” he said.