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HOUSING CONSTRUCTION

CURRENT STATUS

by David A. Penn

This special issue of *Midstate Economic Indicators* examines the housing construction situation for the Nashville area compared with other metropolitan areas and the United States. In the 13-county Nashville MSA, single-family home construction has slowed considerably, falling 12 percent in the first quarter 2007 compared with the first quarter 2006. Construction activity peaked in the fourth quarter 2005, trending lower to the present quarter (Figure 1).

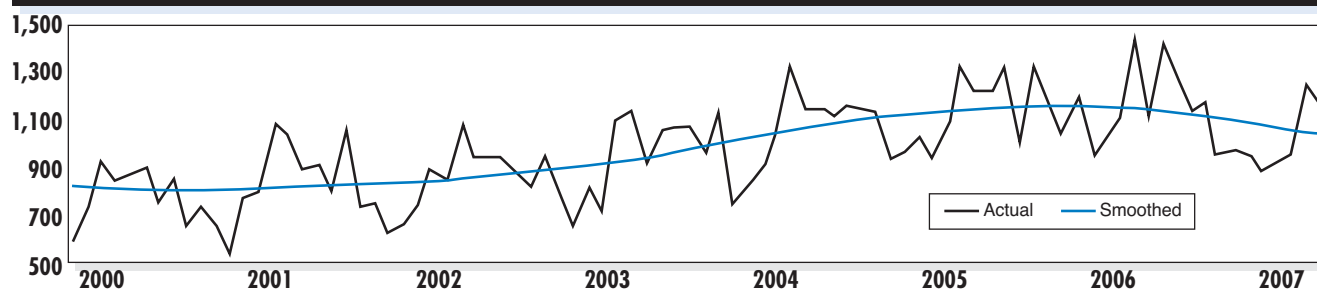
Since the end of the 2001 recession, we have become accustomed to significant over-the-year gains in housing construction in the Nashville area, so much so that the current decline seems unexpected and perhaps a bit scary. In

perspective, however, the current lull in housing construction should be considered a correction due to oversupply, not a catastrophe. Comparing with other nearby metropolitan areas for the first quarter of 2007, the correction in the Nashville area is moderate. As Figure 2 shows, construction is down much more in Atlanta (-32.3 percent), Jacksonville (-51.6 percent), Indianapolis (-37.4 percent), and Memphis (-20.8 percent) and about the same in Charlotte (-12.4 percent). Raleigh experienced a more modest 7.8 percent decline. Housing construction for the U.S. fell 30 percent during this period and is down 21 percent on average across Tennessee. So, if you are a local builder it's fine to wish for the good old days, but you should also thank your lucky stars that you're not doing business in Atlanta, Jacksonville, or Indianapolis.

Housing construction has slowed much more in some metro counties than others. Rutherford County and

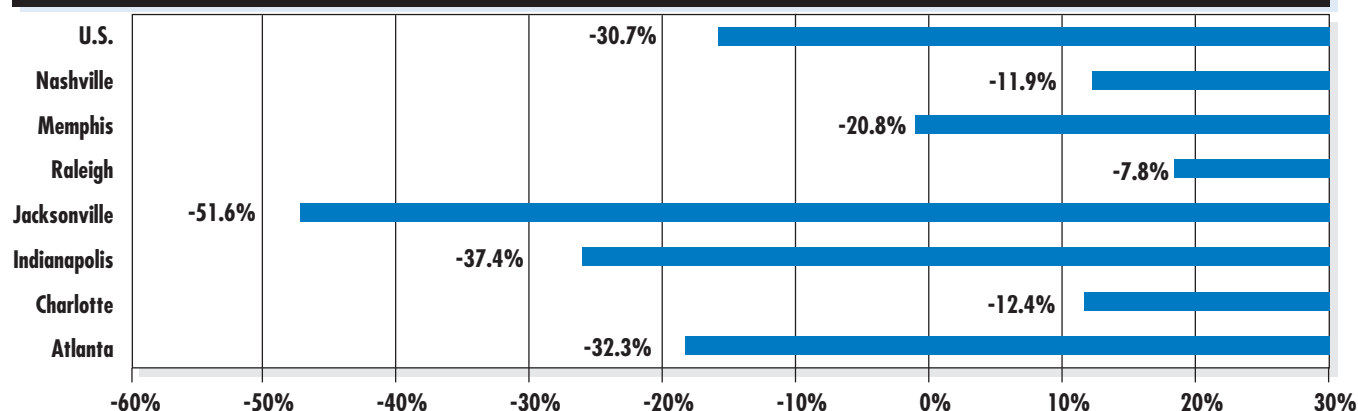
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Figure 1. Single-Family Building Permits, Nashville MSA



Source: Census Bureau

Figure 2. Change in Single-Family Building Permits, 2006–2007, First Quarter



Source: Census Bureau

Table 1. Building Permits for Single-Family Homes

County	City/Place	2005Q1	2005Q2	2005Q3	2005Q4	2006Q1	2006Q2	2006Q3	2006Q4	2007Q1	% Change 06Q1-07Q1
Bedford	Shelbyville	45	56	30	38	72	50	24	52	18	-75.0%
Davidson	Nashville	964	1,032	942	936	910	1,236	916	1,025	973	6.9%
Maury	Columbia	35	35	43	46	45	59	50	46	43	-4.4%
	Spring Hill	325	361	311	462	297	415	303	264	288	-3.0%
	Unincorporated	80	61	89	66	90	90	71	68	75	-16.7%
	Total Maury County	440	457	443	574	432	564	424	378	406	-6.0%
Montgomery	Clarksville	375	482	319	198	265	416	409	347	306	15.5%
	Unincorporated	100	140	125	96	99	174	92	112	100	1.0%
	Total Montgomery County	475	622	444	294	364	590	501	459	406	11.5%
Robertson	Springfield	31	34	34	26	60	47	50	34	36	-40.0%
	White House	34	51	44	34	50	31	64	33	42	-16.0%
	Unincorporated	35	60	61	42	43	61	63	49	46	7.0%
	Total Robertson County	100	145	139	102	153	139	177	116	124	-19.0%
Rutherford	La Vergne	157	181	143	113	192	149	110	98	148	-22.9%
	Murfreesboro	423	408	536	426	534	439	368	269	383	-28.3%
	Smyrna	155	145	119	94	141	145	119	157	93	-34.0%
	Unincorporated	279	305	271	210	227	288	207	154	225	-0.9%
	Total Rutherford County	1,014	1,039	1,069	843	1,094	1,021	804	678	849	-22.4%
Sumner	Gallatin	60	141	68	101	79	82	223	123	63	-20.3%
	Hendersonville	116	169	138	142	139	142	116	82	113	-18.7%
	Portland	44	51	42	35	47	35	29	30	32	-31.9%
	Unincorporated	116	154	162	125	136	136	136	128	131	-3.7%
	Total Sumner County	336	515	410	403	401	395	504	363	339	-15.5%
Williamson	Brentwood	81	87	91	79	116	101	70	29	57	-50.9%
	Fairview	28	29	29	27	31	19	18	16	17	-45.2%
	Franklin	235	241	145	208	202	219	158	58	125	-38.1%
	Thompson's Station	1	-	5	27	8	4	21	10	12	50.0%
	Unincorporated	110	121	114	86	98	126	90	75	74	-24.5%
	Total Williamson County	455	478	384	427	455	469	357	188	285	-37.4%
Wilson	Lebanon	102	68	38	41	27	56	28	56	93	244.4%
	Mount Juliet	116	105	133	127	114	105	104	100	138	21.1%
	Unincorporated	136	161	188	139	173	145	144	121	123	-28.9%
	Total Wilson County	354	334	359	307	314	306	276	277	354	12.7%

Source: Census Bureau

HOUSING CONSTRUCTION

continued from front

Williamson County experienced the largest year-to-year decline in single-family permits, with Rutherford down 22.4 percent and Williamson 37.4 percent. Sumner County and Wilson County experienced more modest declines. Remarkably, construction activity in Davidson County actually rose by 6.9 percent (Table 1).

It may be useful to briefly recount the factors that contributed to the 2002–2005 housing construction boom in the Nashville MSA. The boom can be attributed to a number of factors; perhaps most important are population growth, smaller household size, and falling mortgage rates. Population in occupied housing grew an average of 3.1 percent from 2001 to 2006, but the number of occupied housing units rose at a 3.8 percent annual clip (Table 2). How is

this possible? The size of the average household is shrinking. Average household size was 2.5 persons in 2001, rising to 2.55 in 2002, then falling every subsequent year to 2.42¹ in 2006. Granted, the difference between 2.50 and 2.42 is not much, but consider this: nearly one in five new housing units between 2001 and 2006 for the Nashville MSA can be attributed to shrinking household size.²

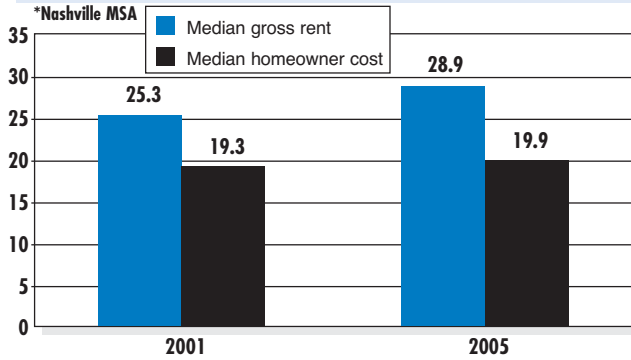
Second, an important factor in the demand for new houses is the cost of renting a house or an apartment compared with home ownership. When rents rise relative to home-owning costs, the demand for owner-occupied homes will increase. Figure 3 shows median rental costs and home-owning costs for the Nashville MSA as a percent of income for 2001 and 2005; rents have increased, but home-owning costs have not, causing home-ownership to be more attractive for qualified homeowners. Incentives for households to shift from renting to owning a home diminished beginning in 2005 as the mortgage rate, although still near

Table 2. Housing Units and Population in Housing Units for the Nashville MSA

	2001	2002	2003	2004	2005	2006	Annual Average Growth Rate 2001–06
Population in housing	1,216,905	1,234,863	1,252,324	1,275,212	1,384,347	1,417,441	3.1%
Total housing units	522,820	533,830	544,806	558,751	611,143	630,000	3.8%
Occupied housing units	487,182	483,557	497,490	511,781	566,146	586,880	3.8%
Average household size	2.50	2.55	2.52	2.49	2.45	2.42	
Vacant housing units	35,638	50,273	47,316	46,970	44,997	43,119	3.9%
Vacancy rate	6.8%	9.4%	8.7%	8.4%	7.4%	6.8%	

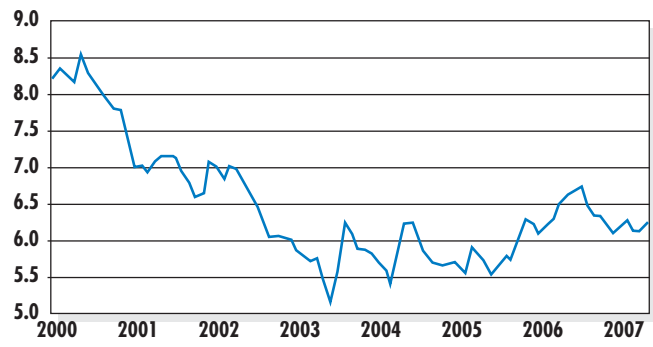
Source: American Community Survey and BERC estimates (2006)

Figure 3. Median Rent and Homeowner Cost as % of Income*



Source: Census Bureau, American Community Survey

Figure 4. Thirty-Year Fixed Mortgage Rate (%)



Source: St. Louis Federal Reserve Bank

a 35-year low, began to climb. We may surmise that much of the decline in demand for new homes in 2006 and 2007 could be attributed to the rising mortgage rate.

The third factor is the mortgage rate. The rate for a 30-year conventional mortgage averaged 6.26 percent in May 2007, up from a recent low of 5.92 percent for 2005 (Figure 4). Though mortgage rates are more likely to climb than to fall in the short term, the current rate still is very low by historical terms, the lowest (excepting 2004–2005) since 1966. As foreign investors trim their holdings of long-term Treasury bonds, market forces are putting upward pressure on the mortgage rate, forcing prices down and yields up. Higher growth and interest rates in Europe and other countries cause foreigners to sell some U.S. assets, putting upward pressure on interest rates.

Housing Prices

Housing prices are softening rapidly in some parts of the U.S. housing market but not so much in the Nashville MSA (Figure 5). That is to say housing prices are not rising quite as fast as they have been for the Nashville area. During the peak of the U.S. housing market in 2004–2005, prices for existing homes were climbing at a 13–14 percent annual rate. Prices began to cool in the first quarter 2006 and a year later were only 4 percent higher. By contrast, the Nashville MSA experienced a more gradual rate of price appreciation beginning in 2004 and peaking in the second quarter of 2006 at 10 percent. Price growth cooled thereafter but not drastically; as of the first quarter 2007, home prices continue to rise in Nashville at a still robust 8.3 percent

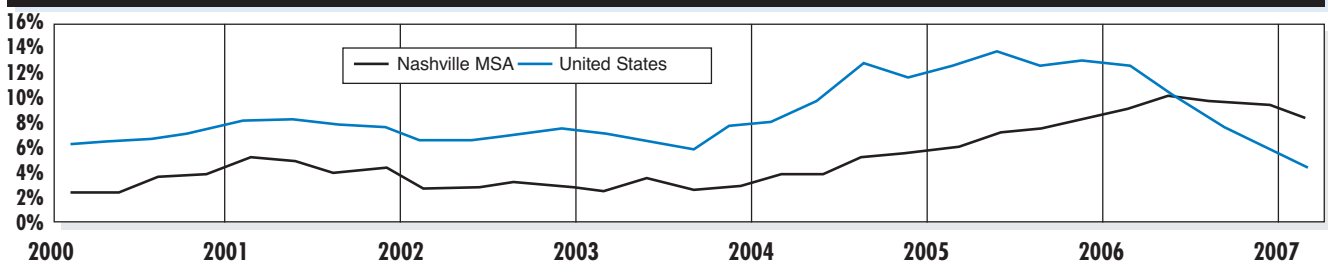
pace. Thus, Nashville did not experience the very robust boom conditions for prices seen in the east and west coasts and certain other areas in the United States but also has not experienced the quick unraveling of home prices.

The ability of a household to make mortgage payments for a home is a critical factor in the demand for housing. As a financial matter, the home-buying decision depends on the level of household income, the price of homes for sale on the market, and the mortgage rate. Although higher very recently, mortgage rates still are very low compared with the past 20–30 years. With mortgage rates relatively stable and low, affordability depends on housing prices relative to income. Nashville housing prices have risen somewhat more quickly than median household income, up 15.7 percent compared with income growth of 13.9 percent from 2001 to 2005. Affordability is not nearly the concern for Nashville that it is for the U.S. housing market, where housing prices have been rising nearly three times more quickly than incomes. Some potential buyers are priced out of the market when housing prices rise faster than household income.

How much of the demand for housing arises from within the metropolitan area and how much is attributable to new arrivals from out of state is difficult to know with precision, but Table 3 offers some clues. The table shows the number of persons who moved to new houses from 2004 to 2005; for the five counties shown, nearly 218,000 persons moved to a different residence in 2005, nearly 20 percent of the total population. Notably, more than one-half

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Figure 5. Year-over-Year Growth of Existing Home Prices, Nashville MSA and the United States



Source: Office of Federal Housing Enterprise Oversight (OFHEO)

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Table 3. Housing Turnover 2004–2005

	Davidson County	Rutherford County	Sumner County	Williamson County	Wilson County
Total population	539,213	210,301	141,577	151,003	98,327
Number living in different house a year ago:	106,557	46,174	27,086	23,419	14,627
■ in same county	69,701	18,930	4,939	3,559	2,479
■ in another Nashville MSA county	14,123	16,169	15,540	10,442	8,164
■ in another Tennessee county	2,894	3,017	998	2,757	1,132
■ in another state	19,839	8,058	5,609	6,661	2,852

Source: Census Bureau, American Community Survey, 2005

HOUSING CONSTRUCTION

continued from inside

of the demand for housing for Sumner, Williamson, and Wilson counties arose from other counties within Tennessee, as did 41 percent of housing demand for Rutherford County. By contrast, demand for housing from in-state movers amounted to only 16 percent for Davidson County.

In conclusion, the housing market has slowed in the Nashville area but not as much as in many other markets in the U.S. Local conditions are likely to gradually improve beginning late in 2007. ■

1. BEREC estimate.

2. To determine this, estimate the number of housing units needed in 2006 assuming household size remains at 2.5, then subtract from the actual number of occupied housing units.

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