

Rural Area House Prices Appreciate More Rapidly than Metropolitan Area House Prices in the 1990s

U.S. Average

Over the past 10 years, house prices in rural areas have grown more rapidly than house prices in metropolitan areas and more rapidly than the prices of other consumer goods and services. The reverse was true in both cases during the 1980s. OFHEO computed rural price indexes for the United States and each of the 9 Census Divisions by using the same methodology and data used for the standard House Price Index (HPI) but eliminating data for properties located in designated Metropolitan Statistical Areas¹. In the accompanying charts, indexes created for rural areas were compared with standard HPI indexes, and each index was adjusted to net out the effects of general price inflation². Inflation-adjusted house prices in rural areas declined an average 8 percent between 1980 and 1990, while the overall inflation-adjusted standard HPI rose 10 percent. However, rural areas have grown more rapidly throughout most of the 1990s. Over the whole 20- year period beginning in the first quarter of 1980, rural house prices declined 9 percent relative to prices in metropolitan areas (see Figure 1).³

The 1980s were characterized by more pronounced cyclical price behavior than the 1990s. During the early 1980s, house prices suffered in all areas because of high interest rates and economic recession. Agricultural areas were especially hard hit, and the sharp house price declines in rural areas reflect that. Prices improved during the second half of the decade, especially in metropolitan areas. Generally, metropolitan areas tend to have less available land on which to build, and more restrictions associated with building. As a result, supply is slower to adjust to increased housing demand than in rural areas where there is abundant available space and fewer regulatory barriers. In a cyclical upswing, buyers often expect house prices to rise in subsequent periods following some positive market impetus. That is, individuals may observe appreciation and anticipate future appreciation, which results in prices rising period after period. The cycles eventually turn down when prices have sufficiently exceeded their natural equilibrium such that they can no longer be sustained. Suppliers can react more quickly to increased demand in rural areas as inexpensive land is more plentiful and fewer regulatory barriers to building exist there. Likewise, market participants are more likely to expect price increases to be temporary. Cycles, therefore, are likely to be less pronounced in rural areas than metropolitan areas. This is what we observe during the boom in the 1980s.

The subsequent bust in metropolitan areas in the early nineties narrowed the gap between rural and metropolitan area house prices. Rural areas experienced modest appreciation during this time, while metro areas experienced significant declines. While rural areas have been performing relatively well, their growth has slowed slightly relative to metro areas in the late nineties. It may not be a warning sign of future divergence, however. A recent article in SMM (Cutts 2000) highlights the convergence of regional house prices in the nineties and attributes this phenomena to technological advancement and the accompanying joining of regional economies⁴. A slightly different twist on this argument can be applied to the case of rural and metropolitan area housing markets. The article alludes to the fact that falling costs of transportation and more efficient communication systems facilitate business relationships that are not as dependent on location as they have been historically. In this case, businesses may find rural areas a more desirable place to locate,



as they enjoy a combination of less expensive land rents and less congestion. Accordingly, individuals follow businesses to rural areas to take advantage of job opportunities. Even the businesses that remain in central cities are more often affording employees the opportunity to telecommute. This provides flexibility for an individual to work from a “central business district” based office while living in a less expensive rural area and enjoying more disposable income from which to pursue other consumption or investment opportunities.

The Case of the New England and Pacific Census Divisions

The largest regional disparities in rural and metropolitan cumulative price movement occurred in the **New England** and **Pacific Divisions** (see Figures 2 and 3). This is not surprising, since metropolitan areas that comprise a large population share in these Divisions are characterized by more stringent regulatory markets and a limited supply of available land⁵. In **New England**, rural area house prices lost significant ground to metropolitan prices in the early eighties. Since then, rural house prices have grown at similar rates. In other words, rural areas appear to have experienced booms and busts in similar magnitudes as in metropolitan areas. Over the full 20 years, rural house prices in **New England** declined 26 percent relative to prices in metropolitan areas.

In the Pacific Division, rural area prices dropped relative to metropolitan prices throughout most of the eighties. By 1990, metro area prices had risen 37 percent while rural area prices had declined 10 percent. In the early to mid nineties; however, metropolitan house prices experienced a large bust while rural areas continued to experience appreciation, narrowing the gap between cumulative rural and metro price change. By 1997, rural area prices had fallen only 7 percent relative to prices in metro areas. The boom of the past two years seems to be once again increasing this gap. The gap between rural and metro area indexes grew to 16 percent by the end of the 20-year period.

Other Census Divisions

Figures 4 through 10 depict cumulative rural and metropolitan growth for the other 7 Census Divisions. All Divisions appear to exhibit widening gaps between metro and rural area price growth in the mid to late 1980s followed by a tightening beginning in the early 1990s. The percentage by which rural house prices decreased relative to prices in metropolitan areas over the past 20 years is as follows:

- 2.3 percent in **East North Central**
- 2.5 percent in **South Atlantic**
- 2.6 percent in **West South Central**
- 5.9 percent in **East South Central**
- 9.1 percent in **Mountain**
- 10.9 percent in **Middle Atlantic**
- 11.3 percent in **West North Central**



Conclusion

House prices have grown more rapidly in rural areas than in metropolitan areas in the 1990s. Technological advancement in the 1990s may be contributing to this phenomena. During recent years, however, we have witnessed rural areas falling off relative to metropolitan areas in the United States as a whole. It is not clear at this stage whether this trend will continue.

¹ As defined by the Office of Management and Budget.

² The adjustment was based on the Consumer Price Index for all urban consumers, specifically “all items less shelter” published by the Bureau of Labor Statistics.

³ References to the behavior of metropolitan house prices are based on the standard HPI, which also contains rural properties. For most Divisions, however, rural properties are a very small share and thus the indexes are essentially representative of metropolitan area markets. The share of rural properties in each Division varies.

⁴ Cutts, Amy Crews, “Stellar House-Price Gains: Breaking New Economic Ground,” *Secondary Mortgage Market*, 16:2, 3-7, 1999).

⁵ A large percentage of the population in these divisions is located in coastal cities such as San Francisco, Los Angeles, and Boston. To the extent that these metro areas are landlocked by water along part of the border, there is less agricultural land available for conversion to urban land within a given perimeter of the central business district. For further discussion of the price phenomena in these regions see J. Abraham and P. Hendershott, “Bubbles in Metropolitan Housing Markets,” *Journal of Housing Research*, 7(2), 191-206 (1996).



Figure 1
Cumulative Inflation-Adjusted House Price Growth
USA

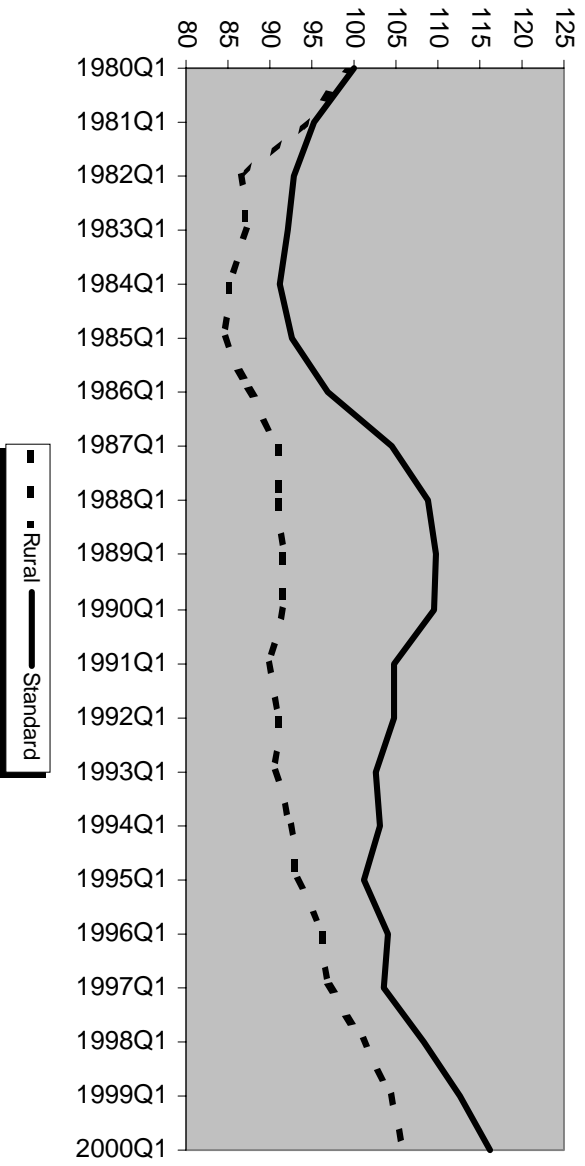


Figure 2
Cumulative Inflation-Adjusted House Price Growth
New England

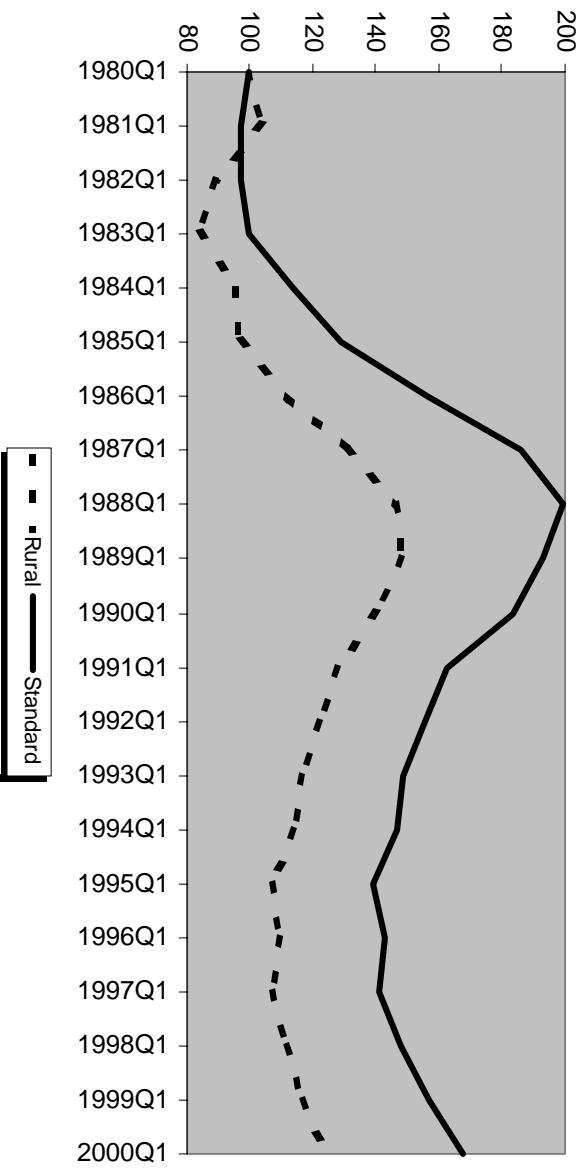
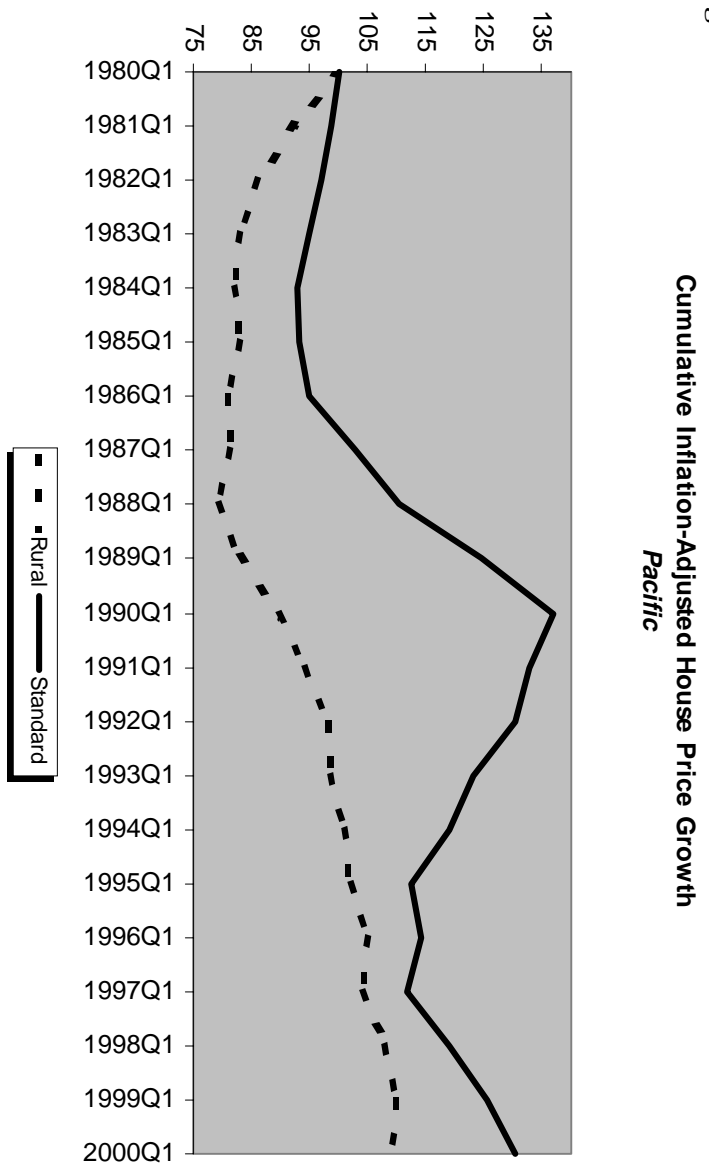


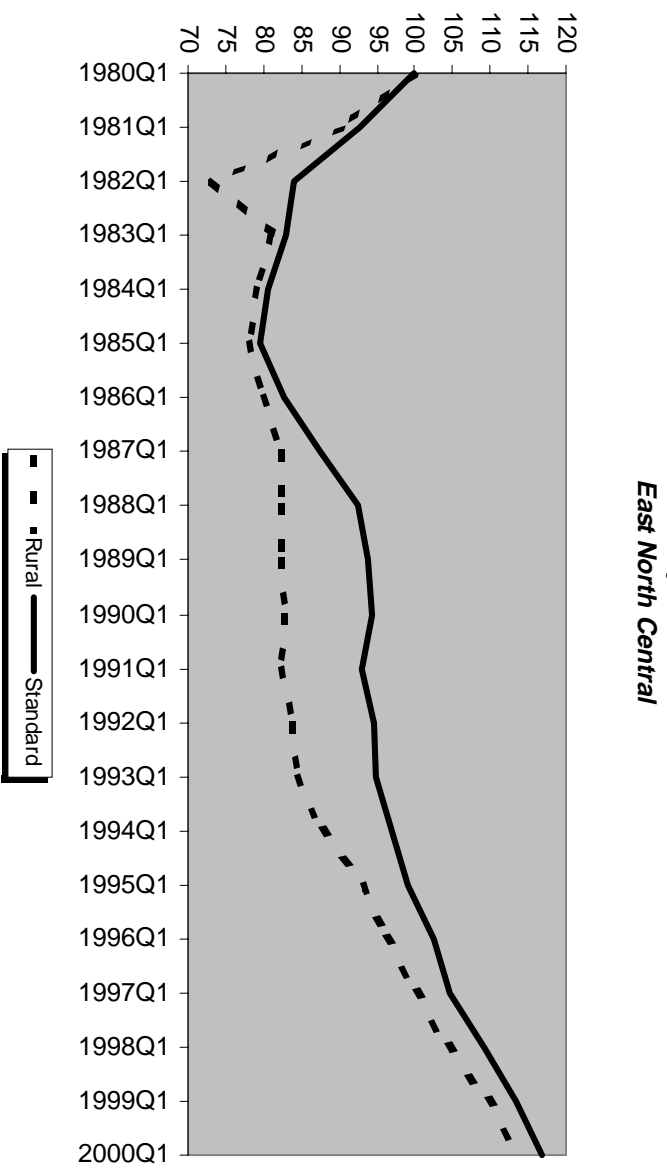


Figure 3



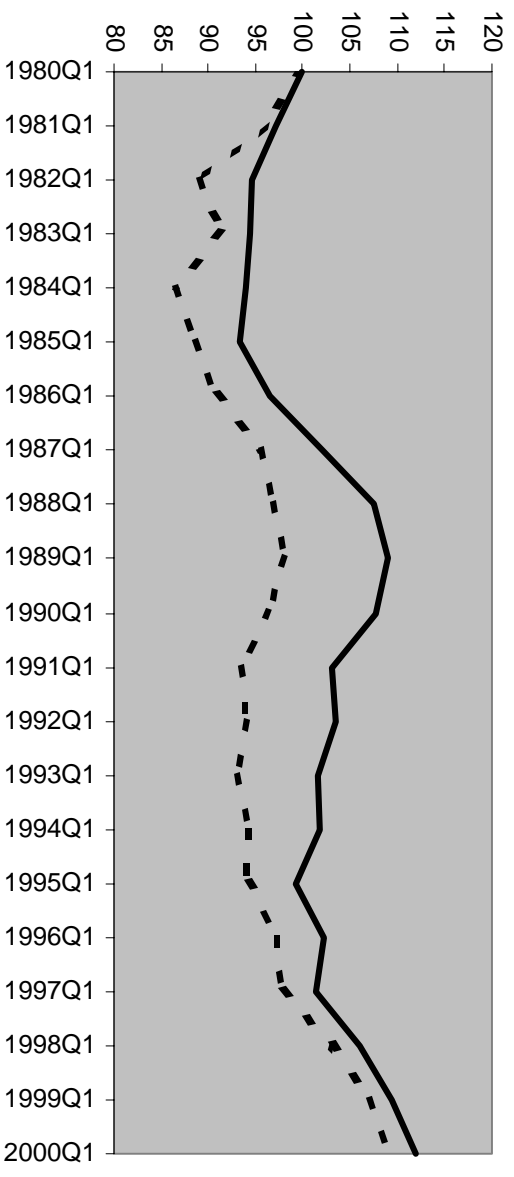
**Cumulative Inflation-Adjusted House Price Growth
*Pacific***

Figure 4



**Cumulative Inflation-Adjusted House Price Growth
*East North Central***

Figure 5



Cumulative Inflation Adjusted House Price Growth
West South Central

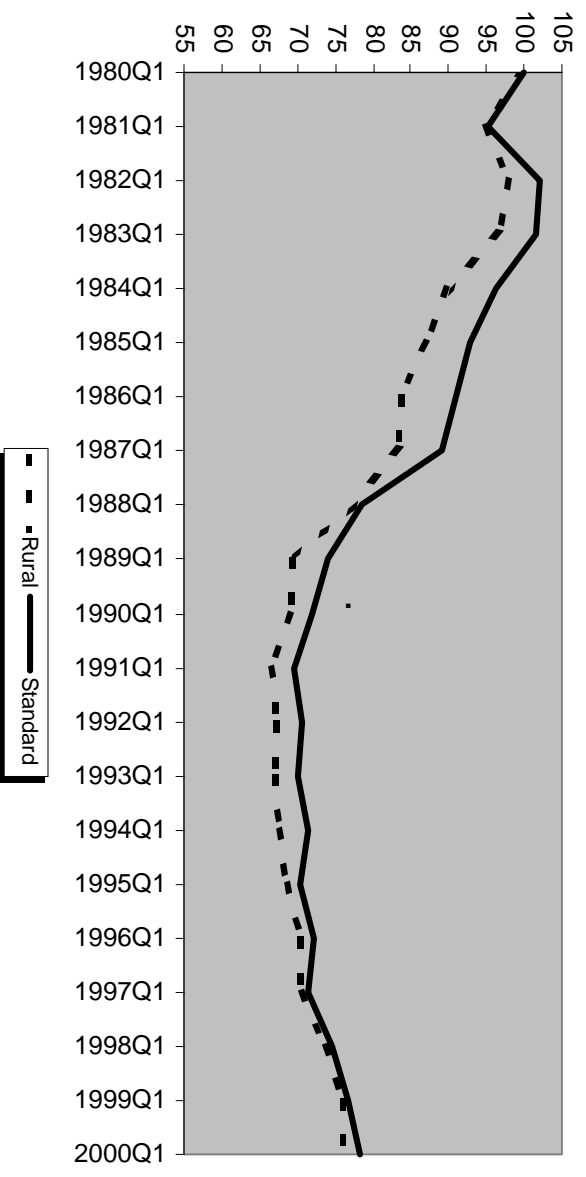


Figure 6

Cumulative Inflation Adjusted House Price Growth
West South Central





Figure 7
 Cumulative Inflation-Adjusted House Price Growth
East South Central

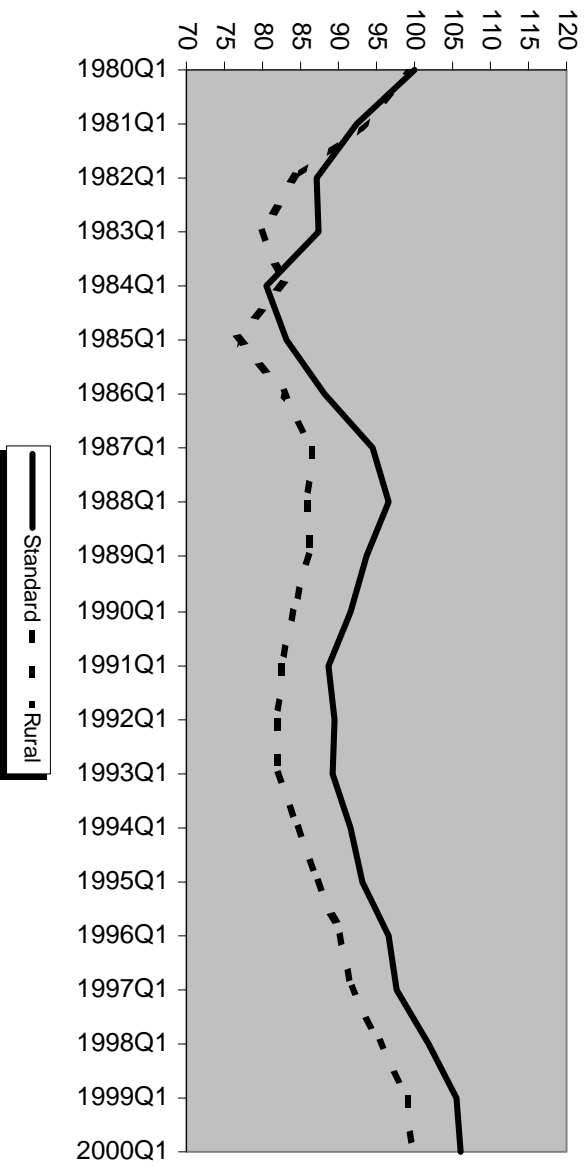


Figure 8
 Cumulative Inflation-Adjusted House Price Growth
Mountain

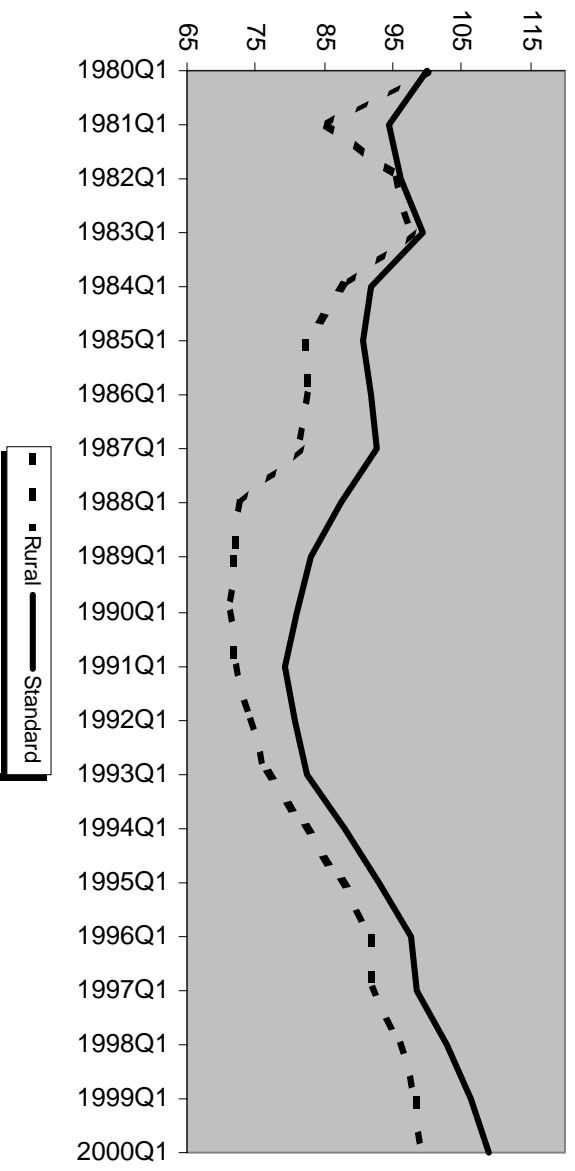


Figure 9

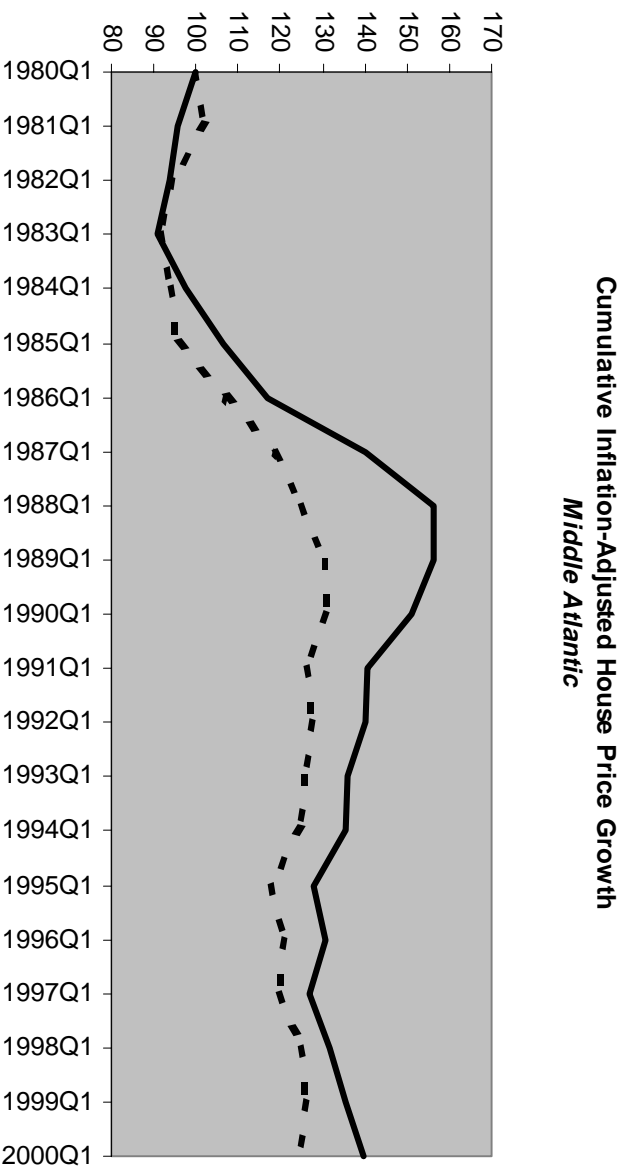


Figure 10

