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IS RURAL AMERICA FACING A HOME PRICE BUST?

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After soaring earlier this decade, U.S. housing prices are now falling. As of September 2008, home values in the 20 large U.S. metropolitan areas tracked by the widely followed S&P/Case-Shiller composite house price index were down more than 20 percent from their mid-2006 peak—and are expected to fall further based on futures values of that index. Other national home price indexes reveal similarly steep recent declines.

Have home prices in rural America also been falling—or will they fall in the future? This article reviews trends in newly released home price data for non-metro areas of the United States. In contrast to metro home values, rural values have fared relatively well so far. Rural America was largely bypassed by the national home price boom of the first half of this decade and thus seems likely to avoid much of the correction in U.S. home prices currently under way.

Rural America's home values, however, are not risk-free. While not as extreme as in metro areas, rural home price gains in the early part of the decade clearly outpaced rural income gains—a likely unsustainable trend. In addition, since metro-area home prices began falling in 2006, the rural economy has enjoyed a commodity price boom. In late 2008, however, energy and agricultural

markets started to cool. A subsequent slowdown in rural economic growth could threaten home values.

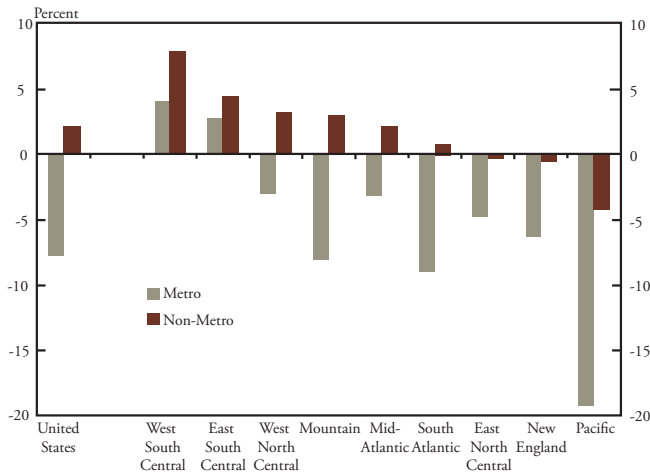
RECENT TRENDS IN RURAL HOME PRICES

Most of the data available on home prices in the United States are for large metro areas, states, or the nation as a whole. In early 2008, however, the Office for Federal Housing Enterprise Oversight (OFHEO) began releasing periodic non-metro home price indexes for all 50 states.¹ These data provide a glimpse into how housing markets in rural areas have been faring during the national home price bust.

According to the OFHEO index, since early 2007, home prices in rural areas have risen slightly more than 2 percent (Chart 1). Though small, this increase compares favorably with the severe decline of nearly 8 percent in metro-area home prices during the same period.²

Rural home prices over the past two years have also been remarkably resilient across the various regions of the country. Only rural parts of the Pacific Census region have experienced sizable declines since the beginning of 2007. Rural houses in most other regions have either held their value or edged upward, while prices in rural areas of the energy-intensive West South Central region of the country have continued to rise solidly.

CHART 1
CUMULATIVE HOME PRICE CHANGE BY CENSUS
REGION, 1ST QUARTER, 2007—3RD QUARTER, 2008



Source: OFHEO

In addition, home prices in rural areas have outperformed home prices in metro areas in all regions of the country. In contrast to rural home values, metro-area home values are down from recent peaks in nearly all Census regions, especially in the Pacific, South Atlantic, and Mountain regions.

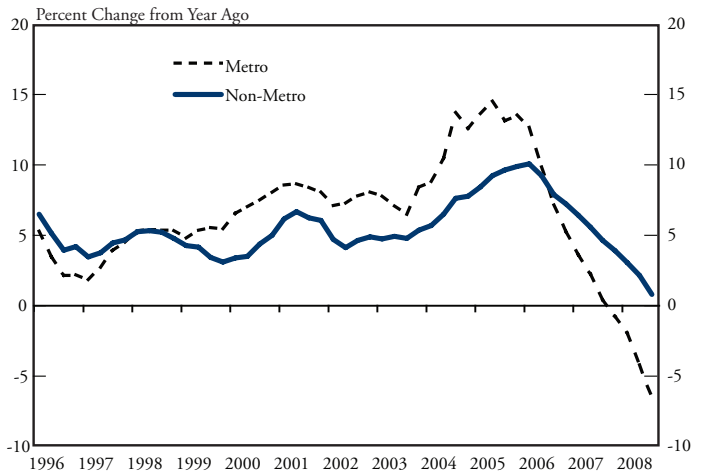
EXPLAINING THE BETTER RURAL PERFORMANCE

To see in general terms why rural home prices have not mirrored price drops in metro areas, one need only look at a longer history of home price trends. During the first half of this decade, the average annual price gains of homes in metro areas was nearly 10 percent, with gains approaching 15 percent in 2004 and 2005 (Chart 2). In many metro areas during the period, home price gains were considerably higher. By contrast, home price gains in rural parts of the country stayed largely in line with recent historical averages through 2003, before rising somewhat more rapidly from mid-2004 to mid-2006.

Since rural areas experienced much less of the home price boom of the first half of this decade, it stands to reason that now they are experiencing less of a bust. But why did home prices increase less in rural areas than in metro areas during the boom years? Two potential reasons stand out—greater availability of rural land and, perhaps, somewhat better credit underwriting standards by rural lenders.

In general, from 2000 to 2005, home prices in many coastal states and metros—including Florida, California,

CHART 2
U.S. HOME PRICE GAINS, 1996-2008



Source: OFHEO

and much of the eastern seaboard—rose faster than home prices in interior areas of the country. Some analysts attribute this trend to higher costs and greater restrictions on land use in coastal areas, which constrained housing supply even as demand for housing surged. By contrast, areas with plentiful open land tended to see smaller increases in home prices, purportedly because of greater ability to build another house on the edge of a city or beyond. Thus, space in rural areas helped the supply of housing keep up with rising demand.

Analysts also now generally agree that the rapid increase in demand for housing earlier this decade was driven in large part by a sizable expansion in credit availability in the United States.³ Among other things, underwriting standards for mortgages deteriorated, resulting in the issuance of a large number of “no-doc” mortgages—in which borrower incomes were often not sufficiently verified. These years also witnessed an increase in the use of low- or zero-down-payment mortgages—often with low initial “teaser” interest rates that would later reset to a much higher rate. Often supporting these trends was a belief that home prices would continue to rise, allowing borrowers to refinance at a future date, if necessary.

The easy availability of mortgages earlier this decade is likely evident in a comparison of gains in home prices with gains in per capita incomes. Historically, home prices and incomes have typically tracked one another. But from 2000 to 2005, home prices nationally rose nearly three times as fast as per capita incomes. In metro areas, the

ratio of gains in home prices to per capita income was even higher, at 3.2 to 1.

By contrast, during the same period, home prices in rural areas rose less than twice as fast as incomes, at a ratio of 1.8 to 1. Similar trends held true across all Census regions, with the ratio of gains in home prices to per capita income greater in metro areas than in non-metro areas (Map 1). This difference suggests that home prices may have been more out of line with “fundamentals” in metro areas. It further suggests that mortgage underwriting standards could potentially have been tighter in rural areas, although actual data on mortgage underwriting in rural areas are very limited.

Even so, home price gains in both metro and non-metro areas clearly exceeded income growth by wide margins in the first half of this decade. This trend departed sharply from the previous five-year period. From 1995 to 2000, home prices and incomes rose at about the same rate in both metro and rural areas of the country. Indeed, during that period, nowhere in the country—neither in metro nor rural areas—did home price gains exceed per capita income growth by more than 20 percent.

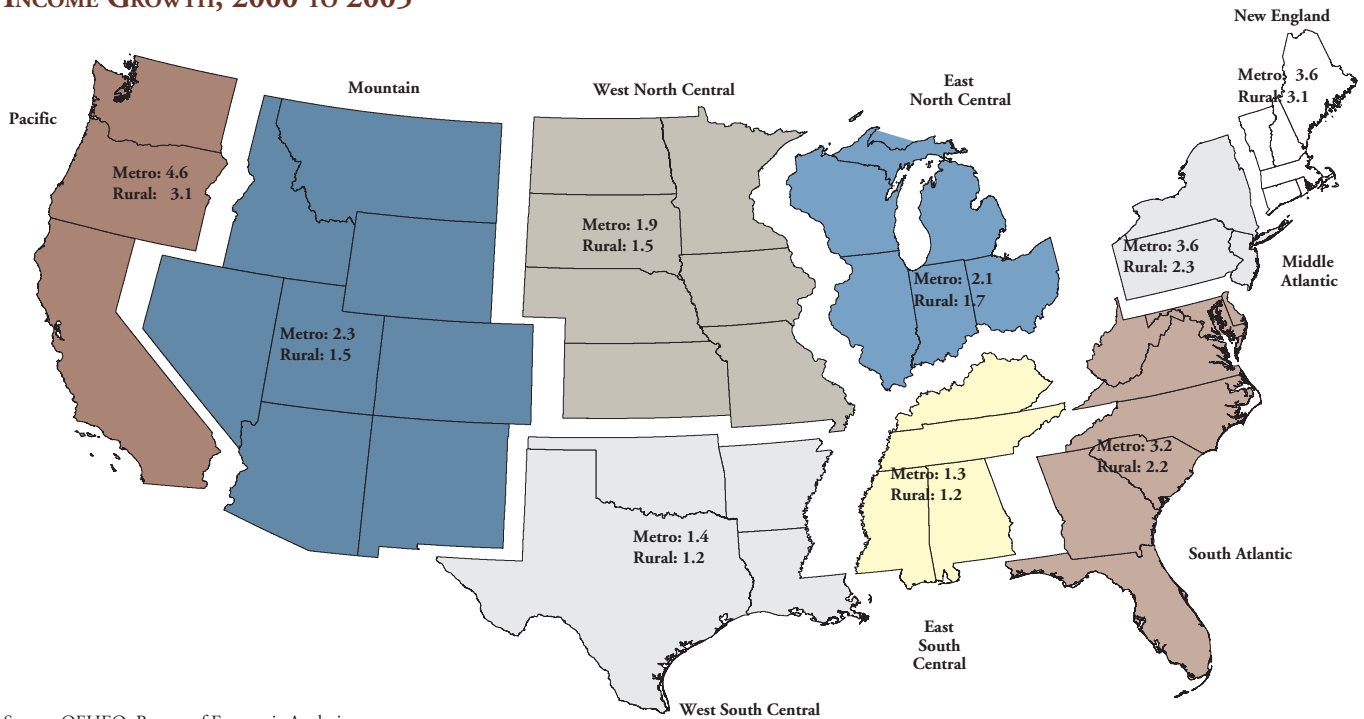
LOOKING AHEAD

So are rural areas likely to follow metro areas into a home price freefall? With more reasonable ratios of home price gains to income gains in rural areas than in metro areas earlier this decade, coupled with more moderate rises in home prices, a severe drop in rural home values seems unlikely.

Further supporting this expectation are recent trends in the issuance of single-family housing permits in rural areas. Since the difficulties in the nation’s housing sector emerged in 2006, plans for construction of new homes have dropped sharply in both the nation’s cities and rural areas (Chart 3). However, rural areas made more sizable initial reductions in homebuilding than metros, and in 2008 rural areas cut residential construction even more dramatically. This sharper reduction in rural building activity should help keep inventories of unsold homes more in check, thus providing some support for rural prices.

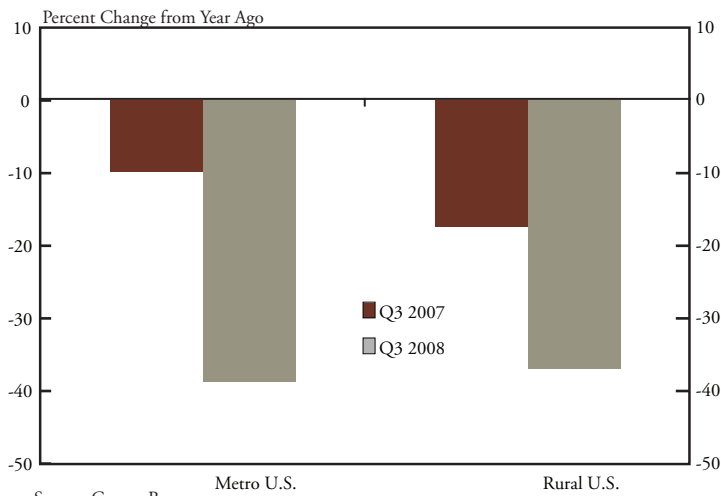
Still, risks to rural home prices remain, due to both past excesses and future economic uncertainty. As in metro areas, home prices in many rural areas outstripped income gains by considerable amounts from 2000 to 2005. Indeed, home values increased at least 50 percent more than per capita

MAP 1
RATIO OF HOME PRICE INCREASE TO PER CAPITA
INCOME GROWTH, 2000 TO 2005



Source: OFHEO, Bureau of Economic Analysis

CHART 3
SINGLE-FAMILY HOUSING PERMITS ISSUED



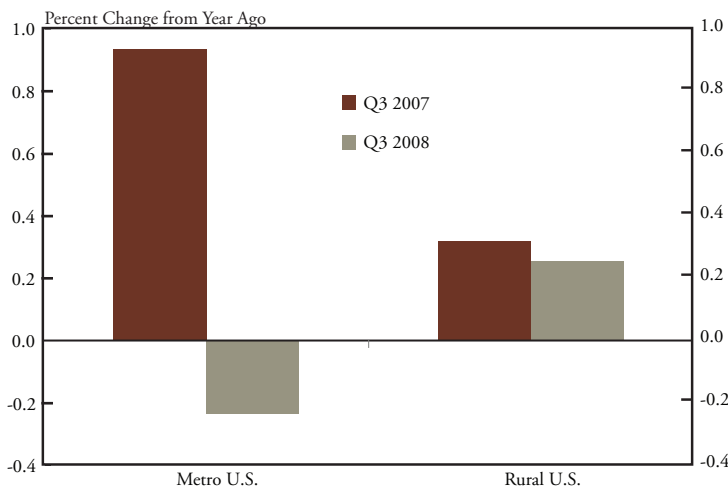
Source: Census Bureau

incomes in rural areas of all Census regions except the West South Central and East South Central. Some unwinding of this trend seems likely heading forward.

Furthermore, during much of the time that metro home prices have been falling, the economies of many rural areas of the country have been boosted by strong activity in the energy and agriculture industries, driven by a boom in commodity prices. Indeed, while job growth in the nation's metro areas slowed dramatically from the third quarter of 2007 to the third quarter of 2008, in rural areas, employment gains largely continued (Chart 4).

Commodity prices have come down since mid-2008, however, increasing economic uncertainty for rural areas that depend on energy and agriculture. Should these rural

CHART 4
EMPLOYMENT GROWTH



Source: Bureau of Labor Statistics

economies begin to experience job and income losses, their housing markets could also come under more pressure.

CONCLUSIONS

So far, unlike metro areas, housing markets in rural areas of the country have suffered only a glancing blow from declining home values. This resilience can be explained largely by better fundamentals in home prices in rural areas in recent years. In particular, gains in housing values were less out of line with income growth than in metro areas. In addition, since the outbreak of the nation's housing difficulties, new home construction has slowed more sharply in rural areas than in metro areas, a trend that should help prevent a glut of unsold rural houses.

As such, any future home price declines in rural America are likely to be much less severe than in cities. Still, rural home values are unlikely to rise appreciably in the years ahead. Though not as extreme as in metro areas, rural home prices outpaced per capita incomes by a sizable margin earlier this decade, a trend that may need to unwind somewhat. Finally, with commodity prices falling sharply in late 2008, many rural economies are bracing for slower economic growth heading forward—and, in turn, softer demand for housing.

ENDNOTES

- ¹ In July 2008, the OFHEO officially became part of the Federal Housing Finance Authority (FHFA).
- ² For an analysis of differing methodologies of national home price indexes, see Rappaport (2007), "A Guide to Aggregate House Price Measures," Federal Reserve Bank of Kansas City Economic Review, Second Quarter. OFHEO does not construct national or regional rural home price indexes. Such indexes were constructed for this article by weighting the individual state metro and rural indexes by the number of metro and rural owner-occupied homes in each state in 2000, the same method as used by OFHEO to construct its overall national home price index.
- ³ See, for example, Davis et al (2007), "What's Really Going on in Housing Markets?" Federal Reserve Bank of Cleveland Economic Trends, July, and Edmiston (2007), "Rising Foreclosures in the United States: A Perfect Storm," Federal Reserve Bank of Kansas City Economic Review, Fourth Quarter.