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**NATIONAL HOUSING WOES THREATEN CONTINUED ECONOMIC GROWTH
UH's Barton Smith Predicts a Local Slowdown as Houston Adjusts
to New Energy and Construction Trends**

HOUSTON, May 8, 2007 – Everyone is talking about the national real estate bust and the soaring level of foreclosures. The new fad for many who have escaped the pain of foreclosure is to invest in foreclosed properties at a significant discount. But is the bottom really near? Some optimists say yes, but University of Houston economist Barton Smith says the national housing market correction is far from over, echoing sentiments from even such self-promoting organizations as the National Association of Realtors.

Furthermore, the worsening housing market is likely to have negative implications for a national economy that is already limping along. "There are a sufficient number of regional markets throughout the nation in which the severity of the housing market correction has already risen to heights that it is likely to produce a further slowdown in the U.S. economy," Smith predicted.

Smith, director of the Institute for Regional Forecasting at UH, addressed more than a thousand people May 8 at his symposium Houston's Twin Booms: Energy & Housing – Will They Continue For Another Year?

During the real estate-focused program he presents each year, Smith pointed out that the nation's housing markets are suffering from three different maladies: excessive prices, overbuilding and foreclosure rates. While some markets, like California, are being affected by all three, Houston is struggling only with an unusually high foreclosure rate. Local housing prices remain affordable, and the degree of overbuilding within the metropolitan area is still rather modest. Smith refers to today's foreclosures as 'subprime foreclosures' since prime mortgage foreclosure rates are still relatively low and remain below 1 percent. The subprime foreclosure rate, on the other hand, is eight times greater.

"Builders should not be too complacent and believe Houston will be immune to the housing market correction just because housing remains affordable here and fixed rate mortgages are still quite low," Smith said. "Subprime loans will be much more restricted in the future, either from regulation within the mortgage lending industry itself or from state and federal regulators. That is going to significantly shrink the number of eligible households in Houston who qualify for home ownership." Coupled with slightly higher interest rates today than two years ago, Smith estimated that a large reduction in subprime lending will eliminate nearly 100,000 Houston households from the owner-occupied market.

Smith's economic forecast for Houston indicates a slowing growth rate, but one that still is substantially above the national average. This too will help to cushion Houston from the severe pain being suffered in some of the nation's major metropolitan areas. But Smith warned that even Houston's upstream energy sectors are not likely to repeat their stellar performance of 2006. He emphasized that all real estate markets in Houston will greatly depend upon the health of the energy economy, since the non-energy sectors will limp along with the national economy. "Keep an eye on exploration activity as indicated by such statistics as the national and international rig count. Watch for a sudden slump in energy prices. Look for a leveling off in energy-related employment. These statistics will provide an early warning to developers to lower their sails," he advised.

"While we can worry endlessly about the risks of new terrorist attacks, the more obvious and certain concerns involve Federal Reserve Bank policy, the financial health of the consumer, and the extent to which the housing market correction gets dramatically worse," Smith said. He sees plenty of clouds over the national and regional economies, but no thunderheads. "The likelihood of a national recession is not zero, but I would place it less than the 30 percent forecast by Alan Greenspan."

Smith is worried new FED chairman Ben Bernanke has implicitly reduced the central bank's inflation targets to unrealistic lows and the FED will be slow to provide relief to a national economy under excessive stress. "Bringing the housing market back down to earth slowly will require real finesse, perhaps a level of monetary fine-tuning beyond the FED's abilities, especially when they are preoccupied with the inflationary implications of high energy prices."

Even with slower growth in energy, Houston will outperform the national economy, but it won't be immune from a significantly worsening national economic environment as evidenced by current data. Smith cited a variety of statistics suggesting Houston's economy is already beginning to feel spillover effects from the national slowdown. The region's non-energy sectors have been slowing down for about six months, and even energy is showing signs of leveling off to a lower growth rate. Houston's construction sector is seeing a degree of moderation which, while lowering job growth temporarily, is a good thing to prevent an excessive buildup of unoccupied real property inventories.

In the long run, Smith sees nothing but good things for energy, at least in terms of jobs and profits. However, for the consumer, those long-run prospects may be less exciting with gas prices hitting \$4 per gallon before this decade is over. In tandem, oil prices will eventually settle around a new equilibrium of about \$80 per barrel. This is the level at which the nation can begin to seriously fill the energy gap and reduce our foreign dependence on oil through the development of alternative fuels. In the short run, however, there still remains the possibility of an energy market correction that could send oil prices down below \$50 per barrel before it stabilizes. Such a correction will be short-lived unless the nation's economic woes turn into a recession that spills over to the world economy.

The next one or two years will be confusing to some builders and developers, Smith noted, especially those who just watch employment growth statistics. One anomaly is that population growth is proceeding at a much slower pace than employment growth. He attributed this to an exodus of Katrina/Rita evacuees. "We estimate that approximately 15,000 households (40,000 people) who were a part of the Katrina/Rita evacuee community one year ago have now left," he said. To a large extent, this explains the significant increase in apartment vacancies during the past 12 months. This, along with the impact of a reduction, if not elimination, of new subprime lending will greatly reduce the size of the local Houston area population qualified for owner-occupied housing.

Smith stressed that local home builders will have to be more cautious with their future building plans than in the past few years. This will be particularly critical in the region's "starter market" of homes in the \$100,000 to \$150,000 range, he said.

Smith has conducted numerous studies in urban, housing, transportation and environmental economics. For nearly two decades, he has gained increasing national and local recognition for his analyses of the Houston economy and real estate markets. Smith wrote "Handbook on the Houston Economy" and continues to publish two symposium reports a year about Houston's economy and real estate markets.

For more information about the Institute for Regional Forecasting, see <http://www.uh.edu/irf/>.

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