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HOUSING SLOWDOWN

BEGINNING TO SPREAD

by David A. Penn

The housing construction slowdown is showing signs of spreading to other parts of the Nashville area economy. As measured by permits issued for new homes, housing construction has been in decline since the fourth quarter of 2005 when single-family permits peaked at 3,490 units. Since then, single-family units plunged to 3,051 in the second quarter, the lowest level since 2003 (Figure 1). Slower housing growth, combined with the job cuts for retooling the GM auto manufacturing plant in Spring Hill and the associated job losses in auto parts manufacturers, make for a less than stellar economic report for the Nashville area.

With fewer houses under construction, home builders are spending less for building materials, as shown by the small 0.9 percent rise in sales tax collections from building materials stores in the second quarter for Tennessee. One also might expect slower sales for items both large and small that homeowners need for a new home such as washing machines, clothes dryers, furniture, and electronics. On this account the evidence is mixed: furniture sales are up 6.7 percent over the year for the state and appliances rose 4.3 percent, but sales by furnishing stores fell 1.8 percent and electronics sales are down 1.7 percent.

Growth of taxable sales for the Nashville MSA slowed considerably, up just 4.2 percent in the second quarter from 2006. More recently, seasonally adjusted sales fell 0.5 percent from the first quarter, 2.0 percent annualized. To be fair, part of the reason for slower sales growth has to

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Table 1. Economic Indicators for Middle Tennessee

Series (seasonally adjusted)	Geographical Area	2006Q2	2006Q3	2006Q4	2007Q1	2007Q2	% Change 07Q1-07Q2	% Change 06Q2-07Q2
LABOR FORCE AND EMPLOYMENT								
Midstate Total Employment	Midstate**	1,110,924	1,118,558	1,125,753	1,135,389	1,140,851	0.5%	2.7%
Midstate Labor Force	Midstate	1,170,716	1,177,105	1,179,535	1,189,321	1,191,144	0.2%	1.7%
Midstate Unemployed	Midstate	59,793	58,547	53,782	53,932	50,293	-6.7%	-15.9%
Midstate Unemployment Rate	Midstate	5.1%	5.0%	4.6%	4.5%	4.2%		
Nashville MSA Nonfarm Employment	Nashville MSA*	750,201	753,578	755,289	759,384	761,376	0.3%	1.5%
Average Hours Worked per Week in Manufacturing	Nashville MSA	39.6	40.1	40.2	40.1	40.1	0.0%	1.2%
Initial Claims for Unemployment Compensation	Midstate	38,650	42,774	41,149	41,945	37,657	-10.2%	-2.6%
HOUSING CONSTRUCTION								
New Residential Permits	Nashville MSA							
Single-Family		3,448	3,181	3,271	3,131	3,051	-2.5%	-11.5%
Total		3,667	3,830	3,616	3,546	3,320	-6.4%	-9.5%
Value of New Residential Units (million $)	Nashville MSA							
Single-Family		584.3	523.6	535.0	536.9	541.2	0.8%	-7.4%
Total		602.4	578.2	562.9	568.9	563.7	-0.9%	-6.4%
TOURISM								
Hotel Tax Revenue (million $)	Davidson Co.	5.88	6.00	6.48	6.21	6.56	5.5%	11.5%
Total Air Passengers, Nashville International Airport	Davidson Co.	2,313,688	2,447,611	2,580,710	2,431,076	2,435,324	0.2%	5.3%
TAXABLE SALES (estimates, million $)								
Nashville MSA	Nashville MSA	7,181	7,184	7,312	7,514	7,480	-0.5%	4.2%
In-State Sales Only		6,115	6,086	6,239	6,406	6,327	-1.2%	3.5%
Midstate	Midstate	9,721	9,740	9,907	10,175	10,163	-0.1%	4.6%
In-State Sales Only		8,285	8,241	8,452	8,682	8,604	-0.9%	3.8%

Notes: Seasonal adjustment with X11. *Nashville MSA includes 13 counties. **Midstate is a 41-county area. *Sources:* U.S. Department of Labor, Bureau of Labor Statistics; U.S. Bureau of the Census; Davidson County Clerk's office; Metropolitan Nashville Airport Authority; U.S. Bankruptcy Court, Middle Tennessee District.

HOUSING SLOWDOWN

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do with the April sales tax holiday on clothing and other items: tax collections for apparel and accessory stores fell 25 percent in April from a year earlier but were 7.9 percent higher in May and up 3.5 percent in June.

Two bright spots are apparent in the local economy. First, construction employment shows a very large over-the-year gain of 7.3 percent, although it is little changed from the previous quarter. Despite the housing slowdown, skilled construction workers are scarce owing to new office buildings and industrial projects in the Nashville area. Second, the tourism and travel industry continues to grow rapidly: the number of airline passengers increased 5.3 percent from one year ago, hotel tax revenue for Davidson County is up 11.5 percent over the year, and employment in accommodation and food services shows a higher increase than most other sectors locally (Table 1).

But much of the economic news nationally and locally is focused on the housing sector, especially the number of foreclosures. For the first six months of 2007, according to RealtyTrac, one foreclosure was filed for every 134 households in the national market. Nevada ranked first at one foreclosure for every 40 households, followed by Colorado (60), California (69), Michigan (80), Florida (81), and Georgia (84). By comparison, Tennessee ranks 12th with one foreclosure for every 123 households.

In the first quarter, subprime mortgages accounted for 14.5 percent of all mortgages in place in Tennessee and 13.4 percent for the U.S. While the proportion of subprime mortgages is not large, its impact can be attributed to the rapid growth of such mortgages since 2003. From 2003 to the first quarter of 2007, nearly two of every five mortgage loans in Tennessee were subprime, compared with just two of 16 loans for the preceding four-year period, 1999–2003. Consequently, much of the housing and real estate boom since 2003 has relied heavily on subprime loans.

Table 2. Quarterly Growth of Nonfarm Employment for Selected Metropolitan Areas (seasonally adjusted)

Metropolitan Area	06Q2–06Q3	06Q3–06Q4	06Q4–07Q1	07Q1–07Q2
Atlanta–Sandy Springs–Marietta, GA	0.4%	0.4%	0.5%	0.4%
Birmingham–Hoover, AL	0.5%	0.1%	0.3%	0.2%
Charlotte–Gastonia–Concord, NC–SC	0.5%	0.6%	1.1%	0.4%
Indianapolis, IN	0.2%	0.4%	0.3%	0.4%
Louisville, KY–IN	0.1%	0.2%	0.9%	0.1%
Memphis, TN–MS–AR	0.6%	0.4%	0.4%	-0.1%
Nashville–Davidson–Murfreesboro, TN	0.4%	0.2%	0.5%	0.3%

Source: Bureau of Labor Statistics, CES series

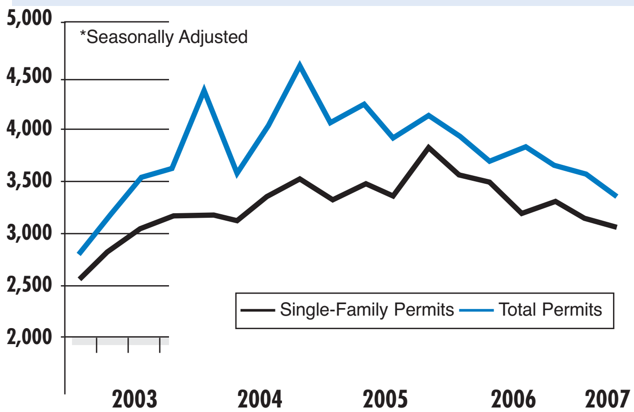
One would imagine that subprime mortgages' rising share of all mortgages occurred at the expense of prime mortgages. This is in fact not the case; prime mortgages actually increased their share from 65.8 percent in 2003 to 68.2 percent in 2007. Instead, the share of combined FHA and Veterans Administration (VA) loans fell from 29.5 percent to 17.4 percent during the four-year period (Figure 2).

Recent reports from the Greater Nashville Association of Realtors (GNAR) suggest that the supply of housing con-

Table 3. Nashville-Davidson-Murfreesboro MSA Nonfarm Employment (seasonally adjusted in thousands)

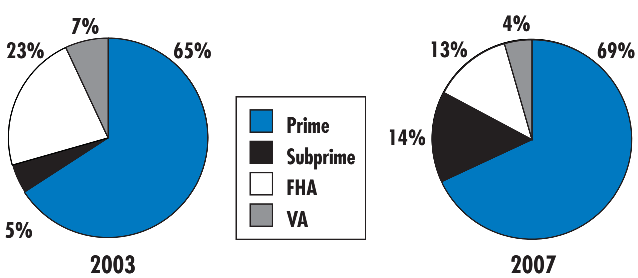
Sector	2006Q1	2006Q2	2006Q3	2006Q4	2007Q1	2007Q2	% Change 07Q1-07Q2	% Change 06Q2-07Q2
Total Nonfarm	747.9	750.2	753.6	755.3	759.4	761.4	0.3%	1.5%
Total Private	650.5	652.3	655.3	657.0	660.4	661.8	0.2%	1.4%
Natural Resources, Mining, and Construction	39.0	38.9	39.3	40.0	41.7	41.8	0.2%	7.3%
Manufacturing	84.5	84.1	84.7	84.2	83.8	82.9	-1.1%	-1.5%
Durable Goods	57.7	57.6	58.2	57.9	57.5	56.9	-1.1%	-1.3%
Computer and Electronic Products	4.5	4.3	4.2	4.1	4.3	4.3	-0.2%	-1.5%
Electrical Equipment, Appliances, and Components	7.3	7.4	7.6	7.7	7.5	7.7	2.7%	3.2%
Transportation Equipment	19.8	19.9	20.2	20.1	19.6	19.4	-1.0%	-2.2%
Nondurable Goods	26.8	26.4	26.5	26.3	26.3	26.0	-1.1%	-1.7%
Wholesale Trade	36.7	36.7	37.0	37.0	37.3	37.3	-0.1%	1.7%
Retail Trade	85.9	86.6	86.5	86.1	86.7	87.1	0.6%	0.6%
Transportation and Utilities	31.3	31.4	31.2	31.3	31.9	31.9	0.1%	1.8%
Information	19.6	19.7	19.7	19.8	19.8	19.9	0.3%	0.7%
Financial Activities	45.7	46.0	46.2	46.1	46.0	46.2	0.2%	0.3%
Professional and Business Services	97.6	97.9	99.3	99.9	99.3	99.5	0.1%	1.6%
Educational and Health Services	103.4	103.8	104.3	104.8	105.5	105.5	0.0%	1.6%
Educational Services	22.6	22.8	22.8	23.1	23.2	23.3	0.5%	2.3%
Health Care and Social Assistance	80.9	81.0	81.4	81.7	82.3	82.2	-0.1%	1.4%
Leisure and Hospitality	76.8	76.8	76.5	76.8	77.6	78.2	0.8%	1.9%
Arts, Entertainment, and Recreation	9.8	9.9	10.1	9.8	10.0	10.0	-0.3%	1.5%
Accommodation and Food Services	66.9	66.9	66.3	67.0	67.5	68.2	1.0%	2.0%
Other Services	30.2	30.4	30.8	30.9	31.1	31.6	1.4%	3.8%
Government	97.6	97.7	98.5	98.2	99.2	99.4	0.2%	1.8%

Figure 1. Building Permits Issued for Housing, Nashville MSA*



tinues to grow faster than demand, as evidenced by growing inventory: in the second quarter, inventories of unsold homes averaged 14,149 units, up 31 percent from last year, and the average number of days on the market increased from 60 last year to 67 this year. One would expect that the growing surplus of homes supplied to the market would put downward pressure on home prices. Indeed, prices are falling in some parts of the country but not in

Figure 2. Distribution of Tennessee Mortgage Loans Serviced by Type



Source: Mortgage Bankers Association

Table 4. Residential Real Estate in the Nashville MSA, 2nd Quarter

	2006	2007	Percent Change 2006-2007
Inventory	10,838	14,149	30.6%
Median Price	$177,933	$186,435	4.8%
Days on Market	60	67	11.7%

Source: Greater Nashville Association of Realtors

Nashville, however, as median home prices continue to rise, up 4.8 percent over the year. Unless home sellers ratchet down their expectations, surplus conditions will continue, and builders will encounter soft markets, given current demand.

Two important labor market indicators offer a mixed message for the Nashville MSA. First, the unemployment rate continues to fall, suggesting a tighter labor market. Indeed, at 4.2 percent, the second quarter unemployment rate is the lowest since May 2001. The unemployment rate, partially based on a random survey of households, measures the number of persons willing and able to work and actively seeking work. Falling initial claims for unemployment insurance this quarter suggest the unemployment rate may drop to even lower levels in the third quarter.

The second indicator, nonfarm employment, is growing but at a much slower pace than a year ago. Nonfarm employment—based on a survey of major employers and measuring the number of jobs by industry—is generally considered our most reliable measure of labor market conditions. In the second quarter, over-the-year nonfarm employment growth slowed to 1.5 percent, down from 2 percent last year. More recently, figures for July show 1.2 percent growth over the year.

The most interesting characteristic of the job-growth slowdown is how widespread the slower job creation is: of the

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Table 5. Economic Indicators for Chattanooga MSA and Clarksville MSA

Series (seasonally adjusted)	2005Q4	2006Q1	2006Q2	2006Q3	2006Q4	2007Q1	2007Q2	% Change 07Q1-07Q2	% Change 06Q2-07Q2
CHATTANOOGA MSA									
Nonfarm Employment (thousand)	241.9	242.2	245.2	247.2	246.9	248.6	247.6	-0.4%	1.0%
Unemployment Rate	4.6	4.5	4.6	4.4	4.1	4.1	3.8	-7.5%	-17.6%
Taxable Sales (million $)	1,562.1	1,609.2	1,622.7	1,646.0	1,638.9	1,670.5	1,685.0	0.9%	3.8%
Permit-Authorized Housing Construction									
Total	745	764	692	738	633	556	580	4.3%	-16.2%
Single-Family	737	711	654	576	617	512	521	1.9%	-20.3%
CLARKSVILLE MSA									
Nonfarm Employment (thousand)	83.1	83.1	83.0	83.1	83.8	84.7	84.6	-0.1%	1.9%
Unemployment Rate	6.0	5.6	5.9	5.4	5.0	5.4	4.9	-8.6%	-16.5%
Taxable Sales (million $)	534.8	514.1	544.6	567.9	590.2	600.6	599.1	-0.3%	10.0%
Permit-Authorized Housing Construction									
Total	438	483	621	1,156	780	717	531	-26.0%	-14.5%
Single-Family	365	398	474	533	577	436	409	-6.2%	-13.9%

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21 employing industries shown in Table 1, 15 are experiencing slower growth compared with one year earlier. Manufacturing is the only sector with fewer jobs, down 1.5 percent from last year. Remarkably, construction employment (which dominates the natural resources, construction, and mining sector) is 7.3 percent higher over the year even while housing construction is experiencing a downturn. The large gain in construction employment can be attributed to a large amount of commercial, industrial, and nonbuilding construction including streets and roads in the Nashville area. Seasonally adjusted growth of construction employment, while very strong over the year, shows little change from the first quarter. Construction employment does not show the ill effects of the housing construction slowdown; indeed, some commercial builders have reported shortages in particular skills.

The leisure and hospitality industry continues to post above-average job-growth figures. This, coupled with increasing room occupancy among area hotels and motels and increasing airline traffic, suggests that businesses and convention groups remain willing to spend for travel, at least for now. If the probability of a recession is rising for the U.S. economy, as some economists believe, businesses will cut their travel budgets with ill effects for the Nashville leisure and hospitality industry.

Turning to other metropolitan areas of interest in the midstate, the Chattanooga area is experiencing modest employment growth of just 1.0 percent, a falling unemployment rate, moderate growth of taxable sales, and single-family housing construction down 20.3 percent from a year ago. The Clarksville MSA also is experiencing a significant decline in housing construction but moderate employment growth and strong taxable sales compared with last year. ■

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