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Home Construction Has Plummeted

Single family home construction in Conway has fallen by 65 percent in the first three months of 2011 compared to the same period in 2010. There were 28 permits issued for this period in 2011 compared to 80 in 2010. The homes being built in 2011 are larger and more expensive; averaging 850 square feet larger and $95,000 dollars more in construction costs.

In Faulkner County, however, the sale of existing homes sold through realtors has improved. For January and February of 2011, there were 141 homes sold in Faulkner County compared to 112 for 2010. (Data on existing home sales by realtors are only available at the county level.)

Conversations with bankers and home builders point to the qualifications for obtaining financing, not economic conditions, as the cause of the dearth in construction. Conway's economy is strong with an unemployment rate at 6.1%, well below the national average of 8.9%, and the state average of 7.8%. Foreclosures have been minimal in Faulkner County, and there is no shortage of money by lending institutions for making loans.

Loan requirements have tightened, and fewer people, particularly first time home buyers, can qualify. Also, it has become more difficult for home builders to obtain construction loans for speculation (spec) homes.

The obstacles to obtaining financing are credit ratings, incurred debts and down payments. Credit ratings, called FICO scores, must be above 619 for most conventional loans. A credit rating is a numerical rating of one's creditworthiness created by one of several companies that track credit data on individuals. Scores range from 300 to 850; a score between 750 and 850 is excellent, a score between 660 and 749 is good credit whereas a score between 620 and 659 is considered only fair.

The other factor is income-to-debt ratio, generally interpreted as the percentage of monthly debt service (payments) of income. This includes all debts - credit cards, car payments, student loans and the anticipated mortgage payments. Creditors like this to be 42% or less than the gross monthly income where a few years ago it could be as high as 60%.

Many young people who are potential buyers of entry level homes have too much debt to qualify. Often, both husband and wife have student loans to repay. This, coupled with car payments and possibly credit card debt makes it very difficult to qualify. You can also see this played out in the number of multi-family apartments being built. This is the only housing alternative for many young couples.

Purchasing a home through a conventional mortgage requires a 20% down payment and a good credit record to qualify. The 20% down payment can be overcome if the other qualifications can be met. Buyers who have less than 20% are required to purchase Private Mortgage Insurance (PMI) to cover that portion less than 20%. Companies offering PMI insurance have dwindled, but PMI insurance is still available to those who qualify. PMI rates have gone up in the last year which adds to the monthly payments and affects the income-debt-ratio.

Financing through the Federal Housing Authority (FHA) and Veterans Association (VA) are still available with down payments as low as 0% for VA and 3.5% for FHA. However, credit requirements have become much stricter for these loans also.

There are other programs available with low down payments; the most popular is the Rural Development loans where 100% financing is available. These are restricted to rural areas and homes in Conway are not eligible; however, many homes throughout the county are. These loans have restrictions on the size and price of the homes, but they are excellent source of financing for first time home buyers.

A conversation with a home builder who has built many lower priced entry level homes in Conway relates the difficulty within the industry. Previously, he operated on lines of credit of several million dollars whereby he could buy building lots and develop a number of homes in succession. Now, each house is financed separately, and builders are required to have 20% equity in each house and demonstrate that they have the cash flow to build the home. Lot and construction costs generally exceed 80% of the value of a house resulting in the builder having to put cash into each home built. This severely limits the number of houses a builder can have under construction at one time and has brought the development of spec homes to a near standstill. Most of the homes being built now are presold to owners who have the means to finance. The fact that only 28 permits were issued for single family homes this year and that they average 850 square feet larger and $95,000 more in cost, confirms this.

The collapse of the housing market is a result of abuse of the system by providing loans to home owners who could not afford them. The lack of due diligence in the mortgage originators to enforce standards such as income-to-debt ratio, employment and income, and credit history is the leading cause of the market collapse. Banks that adhered to traditional standards and did not sell the mortgages and had their own capital backing the mortgage, did not experience financial disaster.

Maybe the pendulum has swung too far in the opposite direction with qualifications too high for entry level home buyers to attain. This may be a hard case to argue with the number of foreclosures across the nation. But the hard facts are that he American Dream of homeownership is slipping away for many families.

More information on building permits and the construction industry can be found at PulseofConway.com