

Is it a bubble? Experts debate surging US real estate prices



Sun Apr 3, 5:32 PM ET

WASHINGTON (AFP) - Is real estate another bubble ready to burst? Experts are cautiously watching the red-hot US housing market, but remain divided on the likelihood of a crash that could be a devastating economic blow.



AFP/Getty Images/File Photo

On a national level, home prices last year rose 8.3 percent, the fastest pace in a decade, to a median level of 184,100 dollars, government figures show.

But in some big metropolitan areas including Washington and San Francisco, prices are up about 20 percent and million-dollar homes are becoming increasingly common.

Part of the rise is due to an increase in housing speculators. The National Association of Realtors found 23 percent of homes sold in 2004 were bought by investors, and there are widespread reports of buyers "flipping" homes for quick short-term gains in many markets.

David Berson, the chief economist for mortgage finance group Fannie Mae, notes that the level of investor ownership of housing hasn't been this high since the late 1980s, which led to a crash in housing prices.

"Many analysts think that a high investor share in the Northeast and California helped exacerbate the housing downturn that happened during the 1990-1991 recession," he wrote in a recent commentary, adding that "the risk of regional home price declines is higher" as so many purchases are by speculators rather than residents.

Economist John Makin of the American Enterprise Institute argues that there is "objective evidence of a housing bubble in the United States." He notes that home prices have risen 40 percent since 2000, while "the ratio of average yearly rents to house prices has been dropping steadily."

This, says Makin, is "reminiscent of the way earnings plunged relative to soaring equity prices before the tech bubble burst in 2000."

Economists say super-low interest rates have fueled the rise in home prices, making it easy to borrow money for real estate investments. But like many other hot investments, real estate could go cold quickly and send shockwaves through the economy.

"The big mistake, in my view, came when the Fed condoned the equity bubble in the late 1990s," said Morgan Stanley chief economist Stephen Roach.

"It has been playing post-bubble defense ever since, fostering an unusually low real interest rate climate that has led to one bubble after another."

Analysts say rising interest rates are likely to cool the housing fever, but the big question is whether this becomes a soft landing or a calamitous plunge.

"I don't like to make the statement housing bubble for the simple reason there isn't a (uniform) housing market," says Joel Naroff of Naroff Economic Advisors.

"Any city and town has dozens of sub-markets and within those submarkets there are places where there are bubbles. What that means is that you have a slowdown and you might even have a small general price decline, but

that will be made up of some areas declining sharply and some areas rising slowly."

A study by finance firm National City Corp. found housing "bubbles" in one-fifth of US housing markets, where home premiums were in excess of 20 percent.

"The housing market has shouldered much of the economic recovery," said Richard DeKaser, chief economist of National City and author of the study.




"Many are concerned that housing represents an overvalued sector of the economy that will be corrected with future price declines. This study shows that some cities currently may be in the midst of a housing 'bubble' and there is greater risk in these areas for corrections."

Richard Berner, economist at Morgan Stanley, says the heady days of real estate are over, but does not see a collapse.

"The pace of home price appreciation is unsustainable, at 13 percent from a year ago in the third quarter," he said.

"As I see it, nationwide housing valuations are only back to neutral from being undervalued, consistent with my thesis that home prices will rust, not bust, for the next few years."

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"Of Course, There's No Bubble"

Tue Mar 15, 8:12 AM ET

The story of Barbara Corcoran is the stuff of entrepreneurial lore. Three decades ago, she quit her waitress job, borrowed \$1,000 from her boyfriend, and started a real estate shop that eventually blossomed into one of New York City's largest residential brokerages. It was worth an estimated \$4 billion when Corcoran sold it to national giant NRT in 2001. But she retained the post of chairman and remains the public face – literally, on billboards – for a housing empire that now stretches from the canyons of Manhattan to the shores of Palm Beach, Fla.

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So what does the Big Apple's most famous real estate mogul not named Donald think of the market? BusinessWeek Online SmallBiz Editor Rod Kurtz recently spoke with Corcoran about what the future of the real estate market holds for brokers and buyers alike. Edited excerpts of their conversation follow:

Q: First things first – bubble or no bubble?

A: Of course there's no bubble. I think we're just getting started. But I don't expect anyone to believe me. There are so many more buyers than there are homes to sell. Bidding and overbidding are the norm of the day. So it's going to take a lot to slow this market. Even if it does – which I don't see the signs of – it will still slow down slowly. That's not what a bubble does.

I think the bubble theory is nothing more than an intellectual expression of people's typical worry that good times can't last forever. When your marriage is going well, you worry there's a problem on the horizon. I think it's more psychological than fact.

Q: So what's causing the shrinking supply and begging demand?

A: Seven out of 10 deals are going for asking price or above. I think it's a much scarier world that we live in. When kids are scared, where do they run? They run home. People are staying home more. I think it's really reassuring for people to know they own the walls around them.

People have also become more distrustful. People don't trust the government, they don't trust Corporate America, they don't trust the stock market. They trust their house. It's psychological. People like to feel they can control a little piece of their destiny.

Q: So what are some of the trends you're seeing?

A: People are buying their second or third homes, retirement homes, very early. They're saying, "Why not retire in 10 years and get my hands on something now?" I don't really believe a majority of those people move into them eventually, but they justify the purchase by saying, "I'll buy now, before this goes too far."

In the last nine months or a year, I've seen a big uptick in that. There is also a change in that most people who previously didn't think they could buy a home for pure investment are now acting on it.

Q: What are some of the next "it" locations? Are high prices sending people to unlikely places?

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