

Housing Bubble? A Look beyond the Sound Bites

By Brian T. Larrabee

There's no shortage of belief among the media that a "housing bubble" is a de-facto reality. Not a day goes by where we aren't bombarded by the doom and gloom musings of so-called "experts" preparing us for a pop. What's troubling is that our home-owning public and worse, those who might otherwise benefit from joining the club, are influenced by these headlines and have elected to sit on their hands while they wait to see what happens. Worse still is the unfortunate possibility of prevalent perception morphing its way into reality. It seems, at least in some markets that this has already begun. All the while, the underlying statistics reveal an entirely different foundation and the truth will surprise even some of our own.

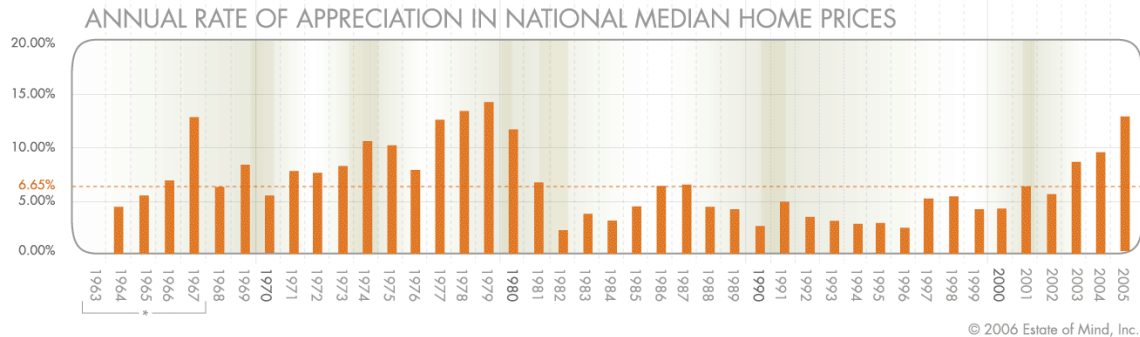
The "me too" tone among those quoted in the media reminds me of a gaggle of geese flying in formation as they follow the leader and honk the same tune. Why blaze your own trail when you can fly in the slipstream? Yet, the hungry bear can saunter onto the same riverbank overlooked by those geese for being void of sustenance, turn over a few stones and feast on something nutritious. While none of us may want to dine on anything hiding under a rock, the analogy should remind us that the information smorgasbord available to anyone willing to look in the right places can help to keep you and your customers from the pangs of hunger.

To cite a few examples, the National Bureau of Labor Statistics tells us that unemployment currently hovers at a low 4.4%. Many of us have listened to Barry Habib patiently explain that the housing market has more to do with jobs than anything else. The simple point being that housing is a basic commodity and we all need a place to live. If we're gainfully employed, we tend to gravitate towards ownership over renting. The US Census Bureau tells us that about 70% of the public own their own homes. That's a record rate and it continues to rise. This growth feeds demand and rising demand fuels rising prices.

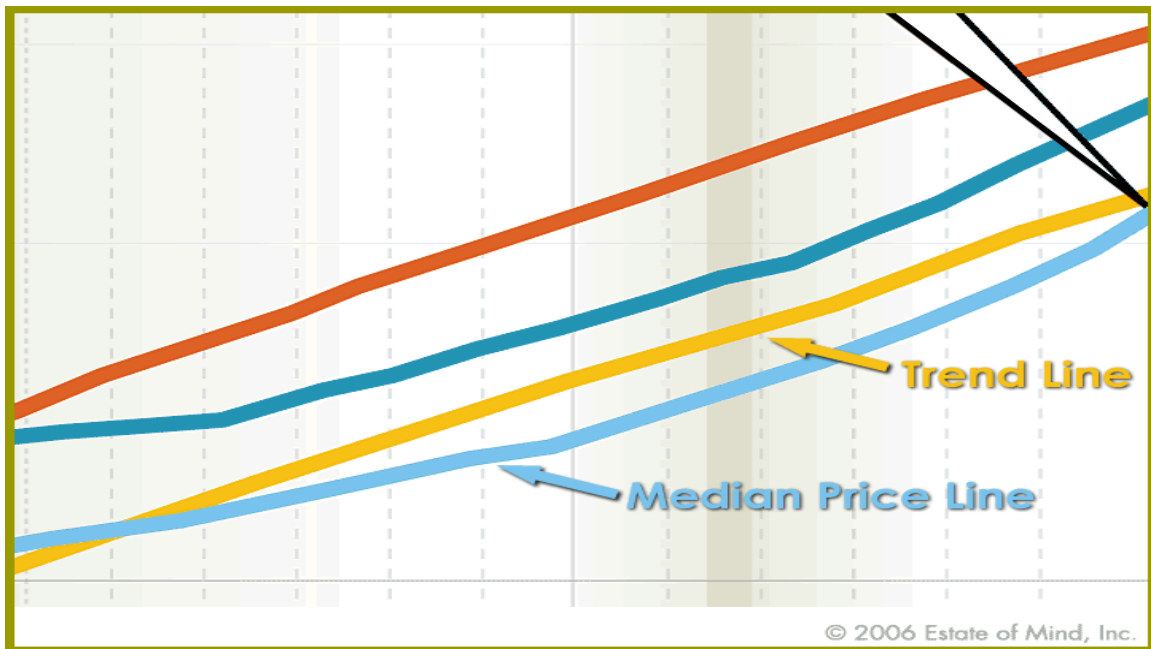
Using the US Census and National Association of Realtors national home price statistics from 1963 forward, the average rate of appreciation in the median home value index is 6.65%. It's no secret that the last few years have given us rapid, yet not unprecedented rates of appreciation. People who've been around this business for more than a few years know that it is cyclical. Periods of above average growth or rapid appreciation are usually followed by periods of slower than average growth. The sun will rise and the sun will set.

If we look at the decades between 1982 and 2002, rates of appreciation were predominantly below average. It shouldn't be surprising that this performance pretty much coincides with one of the longest bull markets in the history of the major US stock market averages. Why put money in your house when it can earn twice as much in the S&P 500? Alas, stock market investors have learned that the better the party, the worse the hangover and if your cash was attending the NASDAQ bash, there wasn't an aspirin big enough to squelch that post-party headache. Add an event as earth rattling as 9/11 to inspire some serious soul searching and re-prioritization of what's really important to our

families and it's not surprising that the comforts of our own homes became the appealing alternative. Ever more so as it became evident that owners were being rewarded handsomely for going nowhere.

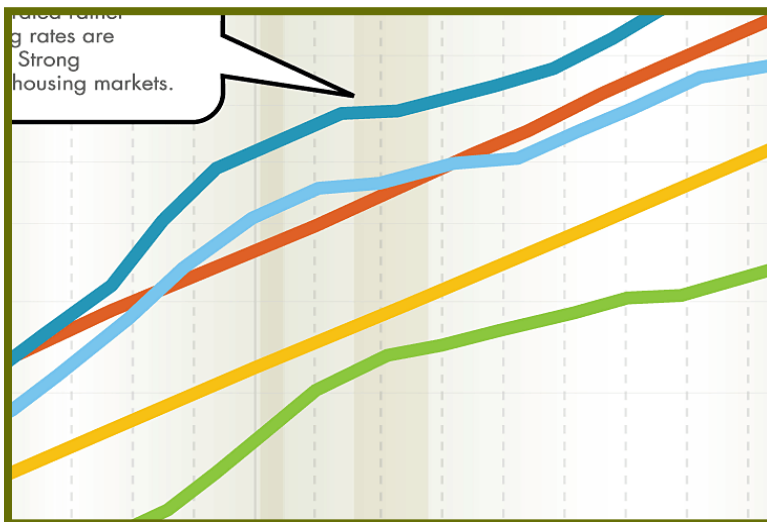


Alas, we should know that above average rates of appreciation cannot be perpetually sustained and evidence of that is only more fodder for those anxious to prove their gloomy theories prescient. Yet, if we roll a few stones, the numbers reveal a median price trend (light blue line in the chart below) that has only returned to the historical norm (gold line) rather than surpassed it. For national average prices (dark blue), we're actually below the trend line (red). Can forty two years of growth be off the mark? Is this really a "bubble" or had values simply gone through a correction to make up for twenty years of below average growth?



Only history will reveal definitively if the theories of doom and gloom are correct or if this was a mere sprint to catch up to a forty two year old trend followed by a pause to catch a breath. Clearly, the factual analysis points to the latter. Our only risk is that of the self-fulfilling prophecy.

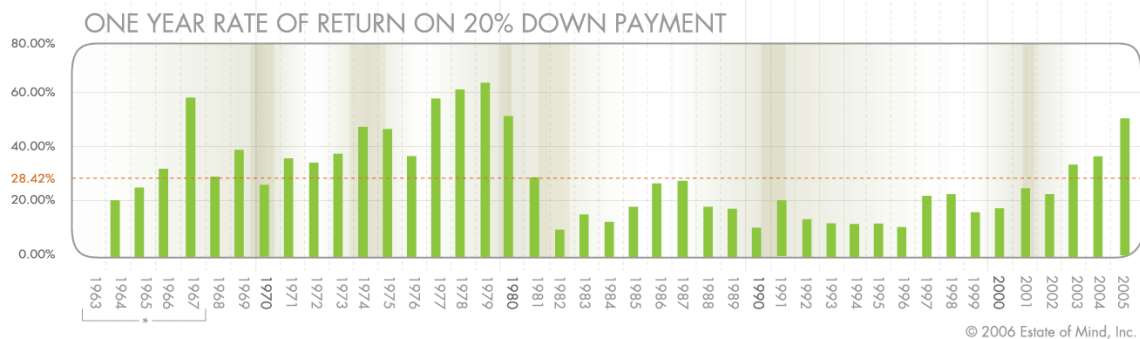
The “experts” tell us that rising rates are the pin that have spilled the gas. Interesting point! If we look back at 1981 (center of the chart below), we had median and average prices far above the trend line. If prices now are only on the trend line now and it’s a “bubble,” then the market of the early 80’s must have been a hot air balloon. To those that would ascribe to the opinions of today’s doomsayers, it might occur as odd that a 30 year fixed rate loan peaked out at 18.63% at that time and never a pop was heard. Prices merely slowed from their speedy ascent and never declined. Looking at today’s market, it’s hard to see how fixed rates going from 5.5 to 6.5% will cause the sky to fall. Particularly with the fundamentals of a strong economic and still historically low rate foundation.



There are plenty of economists citing the disparity between quickly rising home prices and wages that aren't. I have no argument with their facts except to note that they're looking back over a period that often exceeds a hundred years. More pertinent to my point, much has changed over that time. Fannie and Freddie didn't exist; if your local S&L would even give you a loan to buy a house it was usually no longer than 15 years. A much smaller percentage of our citizens owned their homes, indoor plumbing was still a luxury and a “dual income household” meant that more than one family were living under the same roof.

Today, both women and men have professional careers and a down payment isn't always necessary to purchase one's home. Many buyers understand the power of leverage or equity management and realize that unlike stocks, no wayward accountants or corporate scandal can undermine the true underlying value of the land on which they reside.

In fact, using the national housing appreciation rates previously illustrated, a down payment of 20% has been rewarded with an average one year rate of return of 28.42%.



This rate of return is even higher once you factor in the ever present tax benefits of ownership. Drop the down payment to 10% or less and the real yield more than doubles to well over 50%. These rates have held despite wars, recessions, stock market crashes, high interest rates, terrorist attacks, gas shortages, presidential assassinations, resignations and impeachments, natural disasters, etc.

In short, housing is a commodity and like all commodities is subject to price variance due primarily to supply, demand and speculation. While speculation may ebb and flow, the basic need for a place to weave one's nest and lay their head remains. Per Census estimates, our population is growing by 2.9 million per year. That's one additional person every 11 seconds. Where will they all live? Population grows yet the land area does not. That's a text book example for basic supply and demand theory and a formula for rising prices, wouldn't you say?

To offer up a few overlooked but wholly relevant factors underpinning the historically consistent rise in prices, let's touch on a few other factors. The National Association of Home Builders tells us that over the last twenty years, the average size of a home has increased by 23%. We all know that larger homes sell at higher prices. Our population continues to grow, yet our main means of transportation and centers of commerce stay predominantly the same. As commuting becomes ever longer and therefore costlier, demand for housing within reasonably commutable distances of our cities increases. At the same time, our towns impose ever stricter ordinances to protect what little otherwise buildable land remains. The simple result is higher prices and an easy to rationalize tradeoff between lower commuting costs offsetting higher housing expense. This is made even easier to justify when the quality of one's life is improved by spending less time sitting in traffic or on the train.

The flip side of rising prices within city limits is that those displaced, whether by necessity or choice, often elect to relocate further away and end up driving up prices in the surrounding suburbs or rural areas. We can all envision the results of a stone dropped into a pool of water. Here, in essence, we have the economic equivalent of the ripple effect. To now skim a stone or two, layer the impact of the concurrent demand for not only larger but more luxurious properties into the mix. The “knockdown” long part of the vernacular in the Hollywood Hills market has made its way cross country. Most of us have by now witnessed the act of buyers closing on a perfectly good house only to see it bulldozed and replaced by something twice as large.

Anyone that’s been through the process of renovation knows that it’s not cheap. The costs of materials and labor have moved steadily and sometimes even sharply higher. Except in the case of desperate situations, those that have paid that bill are not likely to sell their home to anyone else at a price unjustified by the expense. In fact, we all know that many have financed those improvements and for anyone capable of carrying the debt load, there are rather few that would or even could afford to sell their homes for less than the balance owed. This obviously creates a floor of stubbornness under which, prices are not likely to move.

Probably the most important pillar of strength worth citing is the simple fact that houses, unlike stocks or most other asset class categories; provide a basic necessity- shelter. Our shares of Pets.com have certainly not kept us dry in the rain or warm as we sleep. Nor have they always been here or always will. However, in practical terms, the land and underlying value of our homes has. The simple inherent worth of a near perpetually existing commodity vs. a piece of paper entitling us to something that can vanish with a CEO’s hairline doesn’t deserve comparison in the same context. Yet, we hear it in that manner every day.

In conclusion, prices are at or still below trend, rates are only marginally higher than record low borrowing rates, and there’s a profusion of ever more affordable loan options for those that qualify and understand them. History shows that values don’t crash despite rising rates... unemployment is low, by all the usual measures our economy is good. We need more houses to shelter our growing population, yet there’s less usable space on which to build them. The list goes on still the formula remains the same. I’d say that we’re likely to look back and see that the only shift has been a change from a sellers market, to one favoring the buyer and what a great opportunity that provides for both the bullish and the bear.

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