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Housing Bubble: About to Burst or Riding a Thermal?

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Is there a housing bubble, or not? Two recent studies provide opposing views.

No one will disagree that there has been a mind-boggling run-up in home sales prices in the last eight years, an upsurge that has exceeded the rate of inflation by more than 30 to 60 percentage points, depending on location.

The Joint Center for Housing Studies of Harvard University in its 2003 State of the Nation's Housing report concludes that the housing market is sound and there is little need for the fear that escalating home prices will lead to market collapse. In fact, it says that when the economy regains momentum and the lingering effects of the recession subside, housing is well positioned for another solid decade.

On the other hand, a research paper released by the Center for Economic and Policy Research (CEPR) warns that "bubble" prices are unsustainable and may mean that home buyers are putting their economic security at serious risk. "Efforts by the government or non-profit organizations to promote homeownership in this environment could prove counter-productive, as families may see wealth accumulated through years of sacrifice disappear quickly with the bursting of a housing bubble," the paper reports.

Both CEPR and Harvard agree that housing markets have intensified in recent years. Harvard cites job losses forcing borrowers into foreclosure, increasing the number of homeowners who are spending more than half their incomes on housing, expansion of mortgage credit to borrowers with past payment problems, and increasing debt levels. On the other hand, the Harvard findings report that while heightened, several of these risks remain relatively well-contained.

On a more negative note, the Harvard study notes that two risks could lead to more serious problems if the recovery stalls. One is the growing number of loans to borrowers with weak credit histories. "Because these loans are highly concentrated in low-income, primarily minority communities, a wave of foreclosures could put a glut of homes on the market, lowering prices and threatening the stability of entire neighborhoods," the study notes. The second risk factor, according to the study, is the dramatic jump in the number of homeowners spending more than half of their incomes on housing (84 percent of vulnerable homeowners).

The CEPR takes issue with the Harvard argument that there is no housing bubble. "It is easy to show that none of the four points (that Harvard researchers used to support their case for no housing bubble, http://www.jchs.harvard.edu/) should provide any reassurance to homeowners about the future value of their property," say the CEPR researchers.

CEPR finds that the bubble has not been even across the country, its effects being felt most strongly on the Northeast and West coasts. It is in those areas, CEPR says, that some home price increases have exceeded the overall rate of inflation by more than 60 percentage points. In Los Angeles, for example, increases in home prices in zip codes with the lowest home prices has been comparable to the increase in prices in zip codes with the highest home prices. According to the research paper, the fact that many homes in bubble areas - including those that could potentially be purchased by moderate income families - are selling at prices far higher than the levels that will likely be sustainable in the long-run, means that many families could lose large amounts of money by buying a home in the bubble-affected markets. Rather than purchase a home at the top of the bubble they see, CEPR researchers suggest potential homebuyers would be better served by delaying their plans "until real estate prices have returned to more normal levels."

Next month in the *LIHTC Report*: the effect of a bubble on residential rental properties, including LIHTC properties.