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Some Housing Markets Are Grossly Overheated

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From [The Wall Street Journal Online](#)

February 17, 2005 -- Home prices appear to be excessive in more than a dozen U.S. cities, including San Francisco, Miami and Los Angeles, according to a study by one of the nation's largest mortgage lenders.

At the same time, home prices are at what seem to be bargain levels in cities such as Albuquerque, N.M.; Memphis, Tenn.; and Salt Lake City, says the study by economists at National City Corp., a Cleveland banking company.

There is no sign of a national "bubble" in home prices, says Richard Dekaser, chief economist at National City, but "there is a growing risk of 'bubbles' in certain places."

Mr. Dekaser studied data for the past 25 years on 99 metropolitan areas to determine price levels that would be expected for each city based on such factors as population density, incomes, interest rates and past premiums or discounts compared with other parts of the country. He then looked at the difference between those expected levels and actual house prices in 2004.

Pricey Almond Area

Chico, Calif., a small city in an almond-growing area about 90 miles north of Sacramento, is the most overvalued area, with house prices 43% above the expected price level, the study found. Eight of the top 10 cities deemed overvalued were in California.

Some other cities where prices have been rising fast were nonetheless closer to expected levels. New York was 16% above the expected level, while Boston was 14% above; Chicago, 11%; and Washington, D.C., 10%.

Markets with an overvaluation of 20% or more account for about a fifth of the total U.S. housing stock, according to the study. In most of the country, Mr. Dekaser says, houses have remained affordable, largely because low interest rates have held down monthly mortgage payments. On a national basis, 22% of the median household income was needed to meet payments on the typical single-family home last year, he says. That's down from an average of about 35% in the 1980s, when interest rates were much higher.

STATE OF THE HOUSING MARKET

[See a map](#) that highlights 12 housing markets in the U.S.

Metropolitan areas where prices appear excessive face the risk of falling prices, Mr. Dekaser says, but that doesn't mean prices necessarily will decline. "The true test of today's premiums in these markets will be the economic environment, especially incomes and interest rates, in the years ahead," he says.

Laid-Back Living

Mr. Dekaser acknowledges that his research couldn't include all factors that may explain differences in price appreciation. For instance, house buyers in California have been faster than those elsewhere to embrace "interest only" loans that let borrowers delay paying back the principal, allowing them to buy more expensive homes than would otherwise be possible.

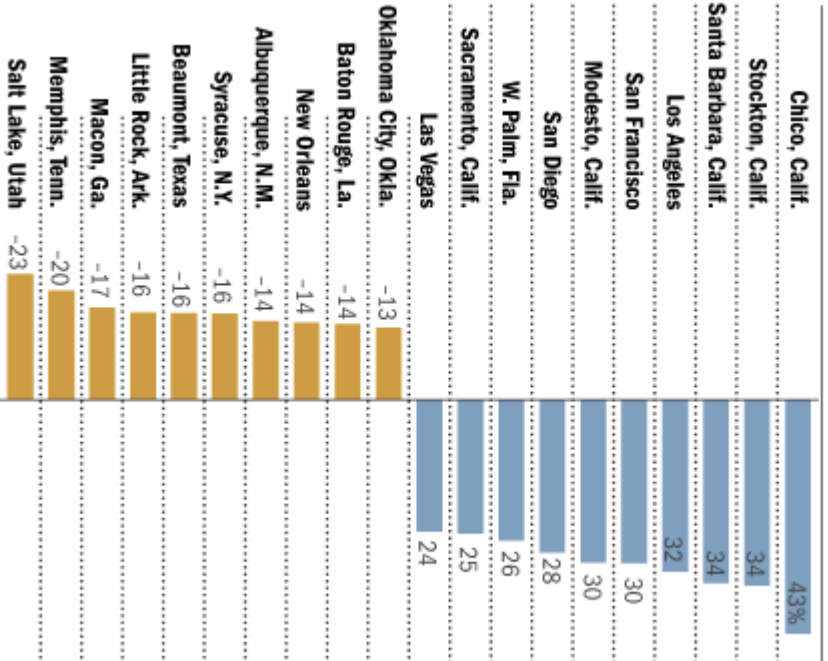
Home prices in Chico have risen fast partly because the city has attracted people from the coastal areas of California looking for a more "laid-back lifestyle," says Rodney Krebs, a broker associate at Coldwell Banker DuFour Realty, a local brokerage firm. Land available for development is scarce, and builders haven't been able to keep up with demand, he says. Locals with relatively modest incomes have trouble competing for houses with newcomers flush with cash from selling homes in high-cost areas.

In Salt Lake City, a loss of technology jobs and a slowdown of business activity after the 2002 Olympics helped hold down house price gains in recent years, says Jaren L. Davis, president of the Utah Association of Realtors. He predicts that affordable housing will draw more employers to Utah.

John Gellhausen, an executive vice president responsible for consumer lending at National City, says the banking company is using the data in analyzing its portfolio of loans but doesn't plan to reduce lending in the areas deemed overvalued. He says most mortgage loans made by National City are sold to Fannie Mae, Freddie Mac and other investors. National City's First Franklin subprime-lending unit has a big presence in California.

Bubbles and Bargains

Percentage above or below expected level based on such factors as population density, incomes and historical price norms for each market. Below, metropolitan area single-family home valuations*



*Figures represent 2004 prices relative to those implied by fundamentals.

Source: National City Corp.

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