HOMES

Housing Prices Continue to Rise

But New Study Suggests Bubble Mentality Has Developed in Some of the Hotter Markets

By JAMES R. HAGERTY
Staff Reporter of THE WALL STREET JOURNAL
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(See Corrections & Amplifications item below.)

The latest bulletins from Realtors and home builders sound reassuring: The house party will rage on in 2004.

Cheaper mortgages have helped get the housing market off to a fast start this year. Most forecasts suggest prices will rise substantially again in 2004, albeit at a slightly slower pace than in the past few years. The National Association of Realtors reported Monday that sales of existing homes in December rose a stronger-than-expected 6.9% to a seasonally adjusted annual rate of 6.47 million units. The national median home price in December was $173,200, up 6.7% from a year earlier. For the full year, sales hit a record 6.1 million homes.

But the local market can be much different from the national average, and risks remain for people who have bought recently or are thinking of buying in some West Coast and East Coast markets. Price increases have been particularly dizzying there in recent years.

In a paper to be published soon in the Brookings Papers on Economic Activity, house-price gurus Karl E. Case of Wellesley College and Robert J. Shiller of Yale University find that the national measures of market trends can be very misleading. In most of the country, house prices tend to rise gradually, in line with personal income, they find. But California, New Jersey, New York, New England and Hawaii -- all of them short on land for building new homes -- are prone to lurch from booms to busts or periods of stagnation.

The upshot: Buying a house in a popular, land-starved place doesn't necessarily mean you will gain more in percentage terms over the long term. In the 21 years ended in the first quarter of last year, Messrs. Case and Shiller found, prices in Milwaukee more than tripled, about the same as in Los Angeles. The difference was that prices in Milwaukee rose steadily, while Los Angeles rode a roller coaster.

Now much of California is on another wild ride. Median single-family home prices in the San Diego area have surged 60% over the past three

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years, according to Fidelity National Financial Inc.

DANGER ZONES

These are the 20 metropolitan areas that have had the biggest run-ups in median single-family home prices during the past three years. That could make them more vulnerable to stagnant or even declining prices.

AREA	3Q 2003 (in thousands)	CHANGE FROM 3 YEARS AGO
West Palm Beach-Boca Raton, Fla.	$245.73	76.90%
Providence-Warwick-Pawtucket, R.I.	234.97	73.5
Nassau-Suffolk, N.Y.	370.73	72.9
Sacramento, Calif.	248.04	68.7
Monmouth-Ocean, N.J.	291.64	68.7
Bakersfield, Calif.	186.31	64.5
Riverside-San Bernardino, Calif.	226.9	64.5
Los Angeles-Long Beach, Calif.	361.54	64.3
Redding, Calif.	292.99	63.7
Fresno, Calif.	214	62.7
Miami	232.77	61
San Diego, Calif.	428.7	60
Fort Myers-Cape Coral, Fla.	152.49	60
Merced, Calif.	220.45	58.7
Orange County, Calif.	499.35	58
Washington DC	289.41	56.8
Fort Lauderdale, Fla.	233.82	55.7
State College, Pa.	218.36	54.8
Stockton-Lodi, Calif.	263.9	54.3
Chico-Paradise, Calif.	260.09	54.1

Source: Fidelity National Financial Inc.

Vanessa Bachman, a paralegal, calls that number "terrifying." Even so, she and her husband, Richard, a radio-station promotions director, have just agreed to buy their first home, a $200,000 condominium, in the San Diego suburbs. "We kept waiting for [prices] to go down," Ms. Bachman says. "We finally decided to go for it."

Traditionally, falling prices have been the exception. The more common pattern is that a period of frenzied price rises in a city or neighborhood is followed by years of flat prices; buyers lower their offers, but most sellers hold out, waiting for better times rather than selling at a loss.

But even a leveling off can be painful for people who have stretched their finances to the limit and are counting on a quick killing in real estate to produce college or retirement funds, says Mike Sklarz, chief valuation officer at Fidelity National Financial Inc.

Nationally, the decline in interest rates has made housing more affordable for most people in recent years, even though house prices have risen. But Fidelity National's affordability index for some cities is worrisome. The index shows that the typical consumer in Miami can afford only 83% of the city's median house price. The readings are even scarier in Los Angeles (68%), San Diego (65%) and San Francisco (63%). Those numbers suggest that lots of people are getting priced out of the market, which eventually should help restrain prices.

Few housing pundits see much risk of a national plunge in house prices. Indeed, according to David Lereah, chief economist for the National Association of Realtors, there has never been an annual decline in the national median price in the past four decades. Even in the recession of the late 1980s, he says, prices edged up slightly.

January is likely to be another busy month because the recent drop in interest rates allows people to buy more house for the same monthly payment. The average 30-year fixed mortgage rate stood at 5.64% last week, the lowest since last July and down from 8.3% four years ago.

"It's very hard to concoct a scenario where housing is going to fall out of bed anytime soon," says Mr. Lereah. Demand for housing generally exceeds supply, he says. The recent numbers have been so strong that he is considering an upward revision in his forecast that the median house price will rise 4.6% this year and that sales of existing homes will total 5.8 million.

Home builders, returning from their annual show in Las Vegas last week, also are whooping it up. The National Association of Home Builders predicts that housing starts this year will be almost as strong as last year's record pace, despite earlier talk of a slowdown.

On a local level, though, prices do sometimes fall. For instance, data from Fiserv CSW Inc. show that prices in Los Angeles dropped about 29% from 1990 to early 1996. (Adjusted for inflation, the drop was 40%.) San Francisco had a decline of 14% in the early 1990s, and Boston slumped 16%. More recently, some Bay Area cities, such as Saratoga and Cupertino, have suffered steep drops, according to data from Mr. Sklarz.

Coe Lewis, an agent at Century 21 Award who represents the Bachmans of San Diego, says some people worry too much about prices. "They get paralyzed," Ms. Lewis says. "They almost overthink the process. They think there's got to be a dip. There's not going to be a dip. I'm not afraid at all of a bubble in Southern California."

Messrs. Case and Shiller, however, see signs that a bubble mentality has developed in some of the hotter markets. Last year they surveyed 700 people who had recently bought homes. The survey found that many of these people had very high -- and probably unrealistic -- expectations of how much home prices would keep rising. On average, respondents in the San Francisco area thought prices would rise nearly 16% a year over the coming decade.

Another sign of self-delusion: Some people surveyed thought prices in places like San Francisco and Boston should continue to rise faster than those elsewhere because they are such attractive places to live and there is little space for new housing. Those factors do explain why home prices in those cities are relatively high, the authors note, but they don't mean that prices should keep on rising at a faster rate.

Alas, write Messrs. Case and Shiller, "the single-family home market is a market of amateurs, generally with no economic training."

Corrections & Amplifications:

The median house price in State College, Pa., in 2003 was $164,500, up 23% from three years earlier, according to the local Realtors association. In a table accompanying this article, the figure was incorrectly stated as $218,360, up 54.8%, because of an inaccurate estimate provided by Fidelity National Financial Inc.

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