Puget Sound Business Journal
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IN DEPTH: RESIDENTIAL REAL ESTATE QUARTERLY

Market trends

Seattle homes exhibit bubble-resistant tendencies

Michael Sklarz and Norm Miller

Pity the poor homeowner. As if "irrational exuberance" and "infectious greed" weren't enough. Now we have rumors of a "bursting housing bubble" in the staid old residential real estate market.

Is nothing sacred?

Before we comment on the veracity of this notion we need to determine whether the word "bubble" truly applies to real estate.

Rarely does real estate exhibit the "bubble" behavior that we've come to associate with the stock market.

True, the San Francisco Bay area market experienced bubblelike implosions lately but that's only because certain cities, driven by dot-com mania, such as Palo Alto, Saratoga and Hillsborough, got way ahead of themselves. Consequently prices are down about 30 percent from the 2000 peak.

In these instances one could make the case that the bubble burst, but historically this is very unusual and applies only to a specific areas. Other locales such as Buffalo, N.Y., and Trenton, N.J., are undervalued by more than 9 percent according to our data and markets such as Spokane or Albuquerque, N.M., have been relatively flat in recent years and may remain that way for quite a while.

While it may fashionable to describe the emergence of speculative real estate bubbles in particular areas, one simply cannot characterize the entire U.S. housing market as being anywhere near bubble status.

With the nation consisting of literally hundreds of independent housing markets, it's more accurate to visualize the nation as a giant patchwork quilt consisting of tiny feudal real estate kingdoms all marching to their own laws of supply and demand.

This disparate set of domains are all subject to different economic

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influences such as population and job growth, availability of zoning permits and such.

There also are mitigating factors in the real estate market that preclude a 1929- or 1987-style stock market crash. Real estate by nature is illiquid compared to the equity and commodity markets. You don't just bail out of a house overnight the way you'd dump WorldCom shares.

Unlike stocks and commodities, there are no margin calls in real estate. If prices go down there is no call by the lender for additional equity for loan pay down.

The upshot is that home prices have historically been "sticky" on the downside. Prices may have moved up rapidly and now are slowing or even declining, but the typical owner will continue to stay in the house. A pure investor can move out of markets that are less appealing and into more attractive markets, but consumers still need a place to live and cannot separate the investment strategy from the consumption decision.

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