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Home prices are rising fast. Should we be worried?

by Mitchell Hartman
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Home prices are on a tear -- up 10.9 percent in March, compared to one year ago, in the 20 big metro areas tracked by the S&P/Case-Shiller Index. The 10-city index was up 10.3 percent, and the national index was up 10.2 percent. For several months, the index has shown prices rising in all major cities in the country.

That's despite the fact that -- with the exception of the stock market -- no other sector of the economy is improving at this rate. Certainly wages and new-job creation aren't on this kind of up-slope.

The last time home prices were rising at this rate was spring 2006. Soon after -- in the summer of 2006 -- home prices peaked, before they came crashing down.

Is the economy at risk of another boom-bust cycle in housing? Or is there a healthier, more sustainable tint to this new housing surge?

Most economists agree that at the current rate of increase -- 10-percent-plus per year -- home-price inflation is good for pretty much everyone. Certainly, it's good for home sellers, who finally get a break from bad news, and increasingly get to sell at a profit. Other beneficiaries are realtors; appliance manufacturers and salespeople; remodelers and homebuilders and their suppliers; and state and local government, which are seeing more money flow in from property taxes and real-estate transaction fees.

Even first-time homebuyers can benefit as prices rise -- as long as they jump into the market before prices have gotten too frothy, or interest rates rise too much.

Economist Patrick Newport at IHS Global Insight says this trend is likely to keep going for a while. “I think what’s going on right now is that prices undershot on the way down,” says Newport. “And to some extent they are climbing back to their fundamental value.”

Newport says what we’ve got now is definitely not a housing bubble. It’s old-fashioned supply and demand. Twenty- and 30-somethings sick of renting or living with mom and dad, empty-nesters ready to downsize into a townhouse or apartment -- there are too few homes for these people to move into.

“New-home construction is depressed in 49 states -- North Dakota is the exception -- and because of that you’re seeing shortages in 49 states,” says Newport. “And that’s why you’re seeing across-the-board increases in home prices, in some places at double-digit rates.” Newport points out that the rate of new-home completions is approximately 700,000 per year right now, while underlying demand exceeds 1.3 million new homes.

“In 2006 we were riding a bubble and the bubble was bursting,” says Newport. “Right now prices are going up because we’re experiencing shortages. Actually it’s a good thing prices are going up—even if they’re going up at 20, 30 percent rates -- because we need prices to go up to get builders to build new homes. That’s good for the economy.”

It’s especially good, says **Bernie Baumohl at the Economic Outlook Group,** because of the timing. “Housing did not lift this economy out of recession,” says Baumohl, noting that a housing recovery often kicks off an overall economic recovery. “Housing came in much later. Which means, housing is going to give this economic expansion a second wind.”

Baumohl sees no danger right now of a housing bubble developing. “There are a lot of factors that are driving the demand for housing," **Baumohl** explains. "Interest rates are still quite low -- around 3.5 percent for a conventional mortgage. We're seeing better employment news, more confidence on the part of consumers, more households are being formed." And **Baumohl** says banks -- which severely tightened their underwriting standards after the financial crisis -- are more willing to lend in a rising market. That's because the collateral behind the loan -- the home itself -- is likely to be worth more, not less, over time.

The current home-price surge has taken hold in some of the real estate markets hit hardest by the housing crash.

Craig Lazzara is senior director at S&P-Dow Jones Indices, which puts out the Case-Shiller Index. "If you look at the places that have come back the most since the bottom, you get places like Phoenix, San Francisco, Las Vegas, Miami," says Lazzara. "And the places that went down the most from peak to trough, it's the same places. To a real degree, the metro areas that have come back the most were those that suffered the most."

But the specific sector of the market in those historically boom-bust cities that is coming back strongest worries Dean Baker at the Center for Economic and Policy Research. Baker, who warned early and loudly about the mid-2000s housing bubble, points out that the largest percentage increases in prices are in the bottom third of the market—for entry-level homes.

"These are moderate-income homebuyers," says Baker. "And a lot of the surge is being driven by investors who presumably understand what they're doing. If they don't, we can't play nanny. But I worry that if prices fall twenty or thirty percent, we could get in the exact same situation we were in back in 2010: a lot of people suddenly underwater, seeing everything they've worked for in their lives just disappear." Baker worries that as mortgage rates rise, which is almost inevitable at some point, home prices will stagnate or fall to keep houses affordable for consumers who aren't seeing much increase in their incomes.

There's still a long way to go, though. S&P's Craig Lazzara points out that even with the recent rise, home prices are well below levels reached in the housing boom. Nationwide, prices fell about 35 percent from peak to trough (mid-2006 to early 2009). They've gained about 11 percent since hitting bottom.

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