I’ll let you decide whether news about price gains is good or bad. Between 1940 and 2000 the nation had experienced only two years in which the real dollar price of homes (adjusted for overall inflation) rose by more than 5% and right after those exceptional years we had a major market correction. But during this decade the national market has already seen four consecutive years of above 5 percent appreciation, capping that spurt with an unprecedented real dollar increase in home prices last year of more than 10%.
To see what the possible downside is of such “good news”, look at what happened to incomes during this same time period. Gains in home values for the last 5 years (here in current dollars) have soared far beyond the gains in personal incomes. Last year prices rose 13.8% while incomes rose only 5.5%. Even more surprising is that in 2002 prices rose 7.1% at a time when incomes rose less than 1%. Obviously, this trend cannot continue forever.
Already, housing affordability has shrunk from its most recent highs earlier in this decade to levels that are now about where they were when the last housing market correction began.
Of course, as we have documented in previous symposia, affordability varies dramatically by city. In some cities, prices have become surreal. In others, homes are a bargain. Houston is among the latter group, and while Houston doesn’t have the cheapest housing in the nation, given the average household income in this region, it is one of the most affordable cities in the country. An interesting study released a few months ago indicated that of the 10 most under priced markets in the nation 7 of them are in Texas.
Why this is important is because of the economics equivalent of Newton’s law - what goes up too much and too fast, must come down. With the exception of Dallas, most of the big losers during the early 90s correction were cities that had experienced the biggest gains. A doubling of prices in New Haven in just 4 years was too much of a good thing.