Wealth Creation

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—Allen H. Neuharth, Founder, Sept. 15, 1982

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### Today's debate: Real estate prices

# Dot.com bust echoes in nation's housing boom

## Our view:

### Hot prices need to cool before they bring down the nation's economy.

In some parts of the country, it's hard to talk to a neighbor without the conversation turning to real estate prices — the house down the street that's on the market for twice what it went for in 2001, the friend who has made a fortune on the side buying and selling properties.

Sound familiar? A few years ago, the friend getting rich might have been a day trader rather than a condo flipper. And the surging prices were not in real estate but in stocks.

The Internet stock bubble ended badly. The same could happen, in slower motion, with housing prices.

A cooling of the real estate market is both desirable and essential, not only to make housing more affordable, but also to decrease the risk of a sudden downturn in the economy caused by a housing bust.

For the past several years, home prices have surged in select regions of the country, in part because developers, real estate brokers and mortgage lenders have spread the myth that they have nowhere to go but up. Small investors have put their money into real estate. Institutional investors have done the same, pouring cash into portfolios of loans, known as mortgage-backed securities. That has kept interest rates low and prompted banks to make riskier, more exotic loans.

In some cities, real estate costs have surged well beyond growth in salaries. The National Association of Realtors reported Tuesday that the median price of existing homes in the USA surged more than 14% — to $218,000 — in the year ending July 31.

Although the bubbles are concentrated in certain areas, they are tied to the health of the overall economy in several ways:

**Surging borrowing.** Housing-related debt has swelled from $4.8 trillion in 2000 to $8 trillion today, as buyers have struggled to get into pricey markets. That puts consumer spending at risk if interest rates rise.

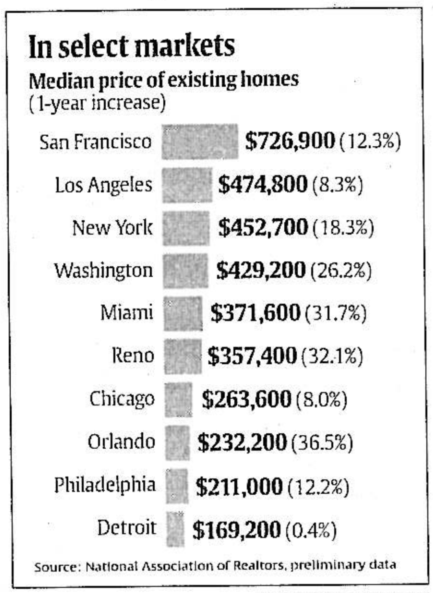
**Unbalanced economy.** Almost 56% of all new non-farm jobs created since the end of the recession in 2002 were in housing-related areas such as construction, finance and home furnishing, according to a study by Wells Fargo. If job growth is concentrated in one sector of the economy, it creates the risk of a sudden downturn if that sector falters.

**False sense of affluence.** Many economists see the same kind of "wealth effect" today with real estate that they saw with stocks in the 1990s. As homeowners' investments rise in value, they feel richer and are more likely to spend, often tapping into their equity. This behavior could reverse abruptly if prices retreat.

Those who profess to be unconcerned argue that today's sky-high prices are brought about by heavy demand and short supplies. They are correct — to a point. In places like the San Francisco Bay area, natural barriers and restrictive land-use polices make it difficult to build housing.

Even so, their argument ignores the increasingly global nature of the real estate industry. Today's prices are sustained by investors worldwide buying everything from mortgage-backed securities to Treasury bonds. If they get skittish about Americans' borrowing, they could pull their money out of U.S. debt markets, sending interest rates up and property values down. All of which is good reason for the Federal Reserve's steady push to nudge interest rates higher.

The housing boom has helped the economy. But if it doesn't take a rest, it will not only be a topic of casual conversation but also a matter of considerable concern.



By Julie Snider, USA TODAY