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Blowing Hot And Cold

The region's housing frenzy is due for a cooling trend, experts say, but few agree on how sudden or traumatic it'll be

January 10, 2003

Like many new years, the beginning of 1988 ushered in fresh hope - but also great uncertainty.

Scarcely three months earlier, the stock market had crashed, tumbling more than 508 points on Black Monday. Iran was at war with Iraq. Vice President George Bush was readying to fend off Massachusetts Gov. Michael Dukakis for the presidency. And I was looking for my first house.

While still single, I had grown weary of renting. In the course of 12 years, I had taken eight apartments across three states. I felt the natural trepidation of most first-time home buyers - especially in the face of a sizzling housing market.

But every cocktail party or dinner I attended seemed to generate the same conversation: Real estate was le buzz du jour. Sure, prices were crazy, people said. But you just have to jump in; next month prices will only go up.

So I jumped.

That spring, I bought what agents called a "charming cottage" in Huntington. The owners were asking $160,000; we finally agreed on $142,000.

For a few years I enjoyed the house and the camaraderie of the neighborhood. When I got married in the early 1990s, my wife - who had a co-op in Manhattan - and I needed to rethink our housing situation, either selling or renting out our properties.

That was when we felt the cold slap of reality: The real estate market had crashed. My house was appraised at $115,000, less than the amount of the mortgage, and we had little alternative but to rent it for some time.

Fifteen years after my foray into an overheated housing

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- Slightly upward
- Stay the same
- Slightly down
- Sharply down

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market, real estate is again at full crest. In the first half of 2002, Long Island led the nation in price gains of existing homes, with an annual appreciation rate of more than 26 percent, according to the National Association of Realtors, a Washington, D.C.-based trade group. While the overall rate of appreciation has slowed for the Island in recent months, all areas still showed double-digit gains in November compared to a year ago, according to the Multiple Listing Service of Long Island. North Nassau County had gains near 30 percent, and parts of Islip and Brookhaven Towns gained more than 30 percent, year over year.

Queens, too, has shown stunning gains, with the median value of existing homes in various regions of the county ranging from increases of 21 percent to almost 30 percent in November, compared to November 2001.

As housing nationwide has heated up, it has led to equally heated debate among experts about the controversial concept of a "housing bubble": that the high-priced U.S. real estate market, like the heady stock market a few years ago, is a bubble due for a resounding pop.

"There's a strong presumption of a bubble here," said Pearl Kamer, chief economist for the Long Island Association, the region's largest business group, in a recent interview. In the last four years, home prices have soared 81 percent, while household incomes have risen by only 14 percent, Kamer noted in a report for the Long Island Housing Partnership last fall. Low interest rates "are distorting the housing market," Kamer said, stimulating excessive consumer demand."People put too much money into housing in the past few years," adds Ingo Winzer, editor of Local Market Monitor in Wellesley, Mass., and a veteran housing analyst. "It's been more money pretty much chasing the same product."

"The late '80s will repeat itself," said Michael Moskowitz, founder and president of Equity Now, a Manhattan-based mortgage lender. "There is a nine- or 10-year cycle [in housing prices]. People said this time it will be different. Nothing is different."

But others sharply disagree.

"What bubble?" said Robert Wieboldt, executive vice president of the Long Island Builders Institute, an Islandia-based trade group. "We have tremendous housing demand out there. A bubble exists when supply exceeds demand and we have limited land supply. Nobody is going to create more of Long Island."

Bubble critics cite several reasons for a prolonged housing boom, besides tight supply and remarkable mortgage rates, which in recent weeks have dipped to their lowest levels since 1965, when I was a teenager. Among them:

A stagnant stock market, which continues to spur many homeowners to shift their investments into housing.

Strong demand from a wide range of demographic groups, from seniors to first-time buyers, including a wave of new immigrants.

The wide availability of mortgage money, low down-payment loans, and growth of government initiatives encouraging homeownership.

At the same time, many industry experts agree that the hot housing market will see some cooling off this year.

"We've seen significant appreciation in some markets compared to personal income that's not sustainable over the long term," said Van Davis, chief executive of Century 21 Real Estate Corp., which has more than 150 offices in the New York metropolitan area. "That appreciation will taper off. But that does not mean there's a bubble. The whole bubble analogy is a poor one. It tends to make people scared, anxious."

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Next week, dozens of housing experts and economists are scheduled to assemble in Los Angeles for a summit called "The Housing Bubble: Fact or Fiction?" convened by Inman News Service, a well-known real estate information services firm based in the San Francisco area. Among the speakers: Yale economist Robert Schiller, author of "Irrational Exuberance," which predicted the bursting of the technology-stock bubble.

Whatever the conclusion of the summit, there is already widespread agreement that some correction is due, or already in progress.

"Everybody believes that the rate of appreciation is going to be less" this year, said Joseph Mottola, chief executive of the Long Island Board of Realtors. "The question is, how much less?"

The Trouble With 'Bubbles'

The first widespread conjecture about a housing bubble seemed to emerge in the summer of 1999, with a Newsweek magazine story, "Through the Roof!" that stated "home values are on an unprecedented tear that, for the average American family, has bolstered bank accounts far more than the stock market."

The piece ended with the thoughts of one Seattle home buyer shrugging off worries that the market was overheated: "We're in a New Economy, he said, where the boom times will last."

Right.

As expected, the housing bubble drumbeat got a lot louder after technology stocks began their breathtaking plunge after peaking in early 2000.

With dot-coms bursting in air, a Forbes magazine cover in September 2001 questioned, "What If Housing Crashed?"

Ensuing months brought a bubble bath of stories, including ones in Barron's, Newsday, The New Yorker, The Wall Street Journal, The New York Times and Consumer Reports.

"Hardly a day goes by that someone doesn't say, 'This bubble's got to burst,'" said Frank Nothaft, chief economist for Freddie Mac, the large secondary mortgage company, in a speech last fall in Woodbury. "I don't think so."

Nothaft was speaking before several dozen real estate professionals at a Fox Hollow Inn breakfast sponsored by the Mortgage Warehouse, a Melville-based lender. It's "way too simplistic" to compare stocks to houses, Nothaft asserted. Common stock does have attributes conducive to a speculative "bubble tendency," while housing does not.

First, Nothaft said, stock is a pure investment play, where the returns are highly uncertain. With housing, however, there's a substantial consumption component - 92 percent of single-family homes nationwide are occupied by their owners, according to census figures.

Second, stocks are relatively low-cost transactions, easy to buy and sell. Housing, on the other hand, has considerable transaction costs.

Third, the holding periods for stocks can be very short, while the average family nationwide stays in its house for eight to 10 years.

Another industry expert, Michael Sklarz, agreed that the housing market has attributes that makes it harder for prices to crash.

"Home prices have historically been 'sticky' on the downside," Sklarz wrote in a recent research paper he co-authored, "The Bursting Housing Bubble?" Translation: When prices rise rapidly they inevitably slow down, but they tend not to plummet, said Sklarz, who is chief valuation officer for Fidelity National Information Solutions, a Santa Barbara, Calif.-based real estate research and consulting company.

Why? Because typical owners tend to stay in their houses even when prices decline - they still need a place to live. So even when prices are unsustainable, he said, they tend not to burst from an outrush of investors moving into more attractive assets.

Forever Blowing 'Bubblettes'

That's not to say that particular markets don't experience price declines, experts say, often the result of local economic conditions.

"It's still about location, location, location," Nothaft said at the Mortgage Warehouse breakfast. Despite the overall housing boom, some local markets are still feeling the effects of manufacturing layoffs, such as Indiana, and housing prices in such "bubblettes" are still modest, he said.

There were price slumps in Dallas and Houston during the mid-1980s oil boom-to-bust, as well as in Southern California, which, like Long Island, also experienced a stronger recession than the rest of the country when the aerospace industry sank in the early 1990s. And while home values in pricey high-tech regions such as San Francisco remain strong overall, some communities within these regions have seen price slumps from a year ago (the Belvedere-Tiburon, Calif. area, for example, has dropped more than 4 percent).

"A bubble is not likely in the U.S. as a whole, but some markets are seriously overpriced," said Winzer, who has been tracking about 100 local housing markets. Last year, Long Island was No. 12 on Winzer's list of 60 "overpriced" markets, where annual median price appreciation was climbing faster than the area's income. New York City was No. 14.

Last March, a Newsday analysis found that while home values in some middle-class Long Island communities had risen 30 percent to 40 percent since the previous year, a number of wealthier communities saw values stagnate or fall. The high-end communities included parts of the Hamptons, but also North Shore communities such as Manhasset, Oyster Bay and Jericho.

"I do see some leveling of prices," said Fern Karhu, an agent with Prudential Long Island Realty in Syosset. "The market has softened."

When I talked with Karhu a few weeks ago, she said her office had experienced a 9 percent decrease in sale prices since June. While some of the softening could be attributed to seasonality - the housing market traditionally slows between Thankgiving and New Year's - there was a different feeling emerging, Karhu said.

Now consumers are more selective. And banks, too, are being more cautious in their appraisals. "You never heard of appraisals being a problem before," Karhu said. "Now appraising the house before going to contract is the key to keeping a deal together."

But not everyone has found prices easing just yet.

"We're still seeing them on an incline," said Mary Adams, president of the Long Island Board of Realtors and managing partner of Century 21 Herrick Real Estate in Babylon. "We're selling $410,000 houses on busy streets. ... Compared to a year ago, houses aren't flying like they did. They may be sitting around for two months - but people are still getting their price."

The Ghost of 'Bubbles' Past

There is no question that the past five years have been the wonder years for housing. Yet despite the market's strong underpinnings, housing still goes through cycles of heating up and cooling down, experts say.

"It's geographically irregular, but more or less every 10 years, we have a correction," said Brad Inman, co-founder of Inman News. Sometimes the cycles are shorter, say seven years, and local markets tend to be more volatile than national trends.

On Long Island, for example, housing prices charged upward about 20 percent a year in the early 1980s, dipped to about 8 percent during the brief recession, then came roaring back, peaking at 28 percent around 1985, according to records by Freddie Mac.

Over the long term, housing price appreciation generally runs a few points above the inflation rate, said Roy Fedelem, principal planner for the Long Island Planning Board in Hauppauge. But the Island's housing prices suddenly tripled in the '80s, Fedelem said, in part because of a "fear factor" that drove people (like me) who were afraid prices were going to go up and up, so they jumped into the market.

When home prices on Long Island peaked between 1988 and 1989, the annual appreciation rate had already started sliding. "There was [consumer] demand, but not at that price level," Fedelem said.

Between 1989 and 1992 the region fell into recession, precipitated by the aerospace and defense industry meltdown. Median home values plummeted from $191,300 to $171,500 in Nassau County and from $153,6000 to $140,800 in Suffolk. They remained flat until late 1995, when consumers began to see single-digit price increases, month over month, from the previous year.

The next tipping point, Fedelem said, was September 2000, a few months after the stock market peaked, when the rate of price appreciation climbed into double-digit levels, where they have remained today.

Still, Davis of Century 21 questions whether recent price increases are that astounding. When you average them over a longer period, between 1991 and 2001, the annual average appreciation was 6 percent, he said. "Appreciation of the last few years," he contends, "was more of a catch-up than a run-up."

Home Economics 101

Many experts suggest that the local hot housing market can be viewed simply in terms of short supply in the face of strong demand.

Long Island has about 672,000 owner-occupied homes, according to 2000 census records, and that housing stock is not expanding much.

To offer homeowners a "healthy choice of housing," developers should be building or redeveloping about 3 percent of total housing stock each year to offer, said Wieboldt of the builders institute. "We can barely handle 6,000 units" a year - less than 1 percent, Wieboldt said.

Finding available land is practically a full-time job, said Cliff Fetner, president of Jaco Custom Builders in Hauppauge. "Land is tight, approvals are tough and demand is there with low interest rates," Fetner said. He doesn't see any softening of land prices, even for "knockdowns," or older homes he demolishes and redevelops as a larger, upscale houses.

So when builders build, buyers come.

Next month, The Beechwood Organization in Jericho will open its Country Pointe development in Kings Park, with 137 townhouses in the mid-$300,000s. So far, they have 800 inquiries, said Beechwood partner Leslie Lerner.

And in the past nine months, Beechwood has sold 300 of 800 units in the Bronx, which include three-bedroom condos for $200,000 and two-family houses for mid-$300,000s. "We don't even advertise," Lerner said.

The tight market has been a boon to real estate firms. "2002 was a banner year, the best since I've been in the business," said Dorothy Herman, chief executive of Prudential Long Island Realty, with 42 offices from Manhattan to the Hamptons. Herman, who began working for Merrill Lynch Realty in the early 1980s, bought the firm in 1989.

Nationwide, the National Association of Realtors expects existing-home sales to total a record 5.52 million units in 2002, up 4.2 percent from the previous year's record of 5.3 million. But for many home buyers, banner years also unfurl great frustrations.

Last week I caught up with Jon Muise, a buyer with whom I had talked in April. Muise, 32, a software company sales manager who is married with two young children, had been house-hunting for about a year, first looking to trade up from a Farmindale townhouse to a single-family home in the $300,000 to $400,000 range. Then he kicked up his search to the $500,000 range. After using 30 real estate agents, he finally found a home in Centerport for $575,000, closing in August. "It was a lot more than we wanted to spend," Muise told me wistfully in a telephone interview. "I'm just so happy I'm not looking now. ... I think we'll be here for awhile."

High-End Anxiety?

Several industry observers say that while more affordably price homes are being gobbled up, there may be some "bubble-like" weakness in the high-priced home market.

But what kinds of prices are we talking about?

Late last fall, I toured the Legends at Half Hollow in Melville, a gated community under construction, with 45 houses ranging from $1 million to $1.5 million. Mitchell C. Hochberg, president of Spectrum Skanska, the Westchester-based developer of the property, and Spectrum's vice president of marketing, Gabe Pasquale, explained that less than $2 million is not really high-end anymore - the level of the "monster house." In about a year, Spectrum has sold about half of these houses. "Long Island's been the strongest market in the tristate area in the last couple of years," Hochberg said.

A few days later I talked to Steven Tucker, a Manhattan attorney specializing in air and space law, who had bought a Legends house. Originally from Miami (his great-uncle was master builder Robert Moses), Tucker had been house-hunting for about five years. He and his wife, a Huntington native, trekked out from their East Side apartment to wide swaths of Westchester, New Jersey and Connecticut before deciding on the Island. The Legends houses "have level of quality not normally seen in high-end tract housing," Tucker said.

Some experts point to Manhattan as a sign of a deflating bubble.

In the most recent market review by Insignia Douglas Elliman, the large Manhattan-based real estate company, found that the median sales price for an apartment in the third quarter was $519,000, virtually unchanged from the third quarter 2001 price of $520,000. The total number of apartments for sale was only 3 percent above the prior-year quarter, but had risen 39 percent since the first quarter of 2002.

Mitchel Maidman, president of Townhouse Management Co. in Manhattan, developer and manager of luxury New York properties, said there is "a tremendous supply of super-luxury apartments coming on the market. At the same time he sees more weakness in the "middle sector of the market ... the $350,000 to $500,000 range where people are dependent on income - and are worried about their jobs."

Townhouse's projects range from luxury lofts on Third Avenue and 37th Street, starting at $4 million, to a $23 million property on East 63rd Street, fused from two former townhouses into a nine-floor, 20,000 square-foot mansion.

"We're looking for a unique buyer," Maidman said.

It's the Interest Rates, Stupid

With all the talk about supply, demand and location, inevitably the issues return to interest rates.

In recent weeks, the average 30-year mortgage rate has dipped below 6 percent, to the lowest level since Freddie Mac began tracking them in 1963. When I bought my first house 15 years ago, average 30-year rates hovered near 10 percent; seven years earlier, they averaged more than 16 percent.

"Even if rates are volatile, they're still rates we haven't seen in three decades," said Melissa Cohn, president of Manhattan Mortgage Co. "There is no reason not to buy."

But many observers also question whether these low rates have opened the window of opportunity too wide. "The banking industry has subsidized peoples' housing costs," said Jeffrey Forchelli, a real estate lawyer and partner of Forchelli, Curto, Schwartz, Mineo, Carlino & Cohn in Mineola.

In the high-priced housing market of the late 1980s "people at the low end gave up and said, 'I'll go to North Carolina," Forchelli recalled. But in recent years, "I didn't see any big exodus," he said, because lower interest rates helped cover the price increases.

That may change, however.

"If we get a turnaround [in the economy] and rates start going up," he said, "you'll see a negative effect on prices and there's going to be a lot of shaking out."

Freddie Mac economist Nothaft acknowledges that the combination of low rates, loosened lending standards and nation's economic slowdown have already weakened credit conditions. Foreclosures are up 30 percent from a year ago, although Nothaft concludes that such spikes generally occur, on average, a year after recovery begins.

Still, economist Kamer warned that when lower interest rates entice homeowners to take on larger mortgages there is potential peril as the market softens - especially when families are dependent on two wage-holders to pay their debts.

"The danger of a falling market like the early '90s," Kamer said, "is that the size of the mortgage will exceed the value of the house in times when the homeowner may have to sell out of economic distress."

So far, no one is predicting with any conviction that the economy is headed toward distress. At the same time, a robust recovery doesn't seem in the imminent future either, so there's little rationale for the Federal Reserve to raise rates.

Still, the economy is out of balance, Kamer noted: There is a booming housing market and no job growth. In the late 1990s, Long Island's surging economy saw 12-month gains of more than 40,000 jobs but in recent years job growth has slowed to a trickle. And in New York City, the economy is still staggering to fight its way out of recession, having lost almost 113,000 since Sept. 11, 2001, as of November.

Most economists expect small, if any gains in jobs for the region in the next year. And in general, that's not a good thing for housing.

"I've found job growth rate to be a pretty good leading indicator of where the real estate market is headed," said Winzer of Local Market Monitor. It's frequently the case housing prices drop as job growth drops, Winzer said. He is quick to add that a short dip in jobs with a rebound may not indicate anything, but it's important if job growth rate drops for a long time. (Remember, Long Island lost 88,000 jobs and the housing market sank in the recession of the late 1980s and early '90s.) If jobs are lost and not replenished, Winzer said, watch out.

Future Shock or Present Perfect?

From his high-rise office in the H. Lee Dennison Building in Hauppauge, one thing is clear to Fedelem of the Long Island Regional Planning Board - even on a recent snowy morning. The housing market is way out of whack, if you compare the region's median income to home prices.

Generally, Fedelem said, for an area's housing market to be affordable and stable, the rule of thumb is that the ratio of median home price to median family income should be between 2 and 2.5 to 1 - maybe as high as 3 to 1, in given the particular strength of our market. But on Long Island, the median income for a family of four is $83,000, while the median home price is $360,000 in Nassau County and $275,000 in Suffolk, according to the latest MLS figures. In Queens, the median income is almost $55,000 while the median home price is $289,000. (You can do the math; it's not fuzzy.)

So what's going to happen next? Well, here's a sampling of my "bubble barometer":

Fedelem believes there will be about a 30 percent downward adjustment in prices, but not a straight drop. In the course of the next year or so, he projects a 10 percent to 15 percent decline in sales prices, which will then remain stable for several years, allowing inflation to eat away at prices each year until the housing market is more in balance with median income.

Kamer believes that the biggest risk overall to the economy overall, including housing, is excessive debt. "If we're lucky, the housing bubble will deflate gradually, if the consumers can hang in there and whittle down their debt. It's not going to pop. But it is going to correct," she said, adding the price appreciation will slow to between 6 percent and 8 percent from current double-digit levels.

Moskowitz of Equity Now predicts that by the middle of this year "we'll see appreciation stopping ... and then drop of about 25 to 30 percent within three years. In Manhattan, rents are coming down, he said foreshadowing sales prices dropping about nine to 15 months from now.

Nothaft does not see a decline in prices, but a deceleration of housing price appreciation. Nationwide, he predicts the overall annual gains dropping from 7.5 percent to between 3 percent and 5 percent during the next decade (your local market may vary). The supply of homes still "lean" - partly because builders are more cautious after creating an oversupply in the 1980s.

Locally, agents such as Audrey Livingstone, owner of Century 21 Nanette's Realty in Uniondale and former president of the Long Island Board of Realtors, believe it remains a sellers' market, albeit slower. "Prices are still inching up a bit," she said. "Sellers are still asking their prices and buyers are paying them. ... It just can't keep going this way." Prices aren't going to go down, Livingstone said, but the market is going to stabilize at a certain level, depending on what the interest rates are.

Of course, there are always "wild cards" - events that can freeze the consumer with uncertainty.

The trend line is for growth over the next 10 years, said Mottola of the board of Realtors. "But if we're involved in long-term conflict in the Middle East, all bets are off."

Herman, the president of Long Island Prudential Realty, believes that the market has changed somewhat since she decided to go full-time into real estate, rather than become a financial planner.

"In the '80s everybody was bashing Long Island. People were negative about taxes, high costs. They were leaving, retiring to North Carolina or Florida," she recalled. "That's changed. ... The trend is no longer to leave and never come back. Their kids or their parents are here. ... Now people realize it's a pretty good place to live."

Those people include my family, with a mother and two brothers living in the area - and other members living within a reasonable distance.

After I sold the Huntington cottage in 1997 for $126,000, the price of the outstanding mortgage plus the agent's commission, we managed to buy another house in Glen Cove in 1994, when the housing market was still struggling, but past the bottom. Since then it has appreciated about 60 percent, according to Nassau County's recent reassessment, a healthy, reasonable rate of return - but don't break out the bubbly just yet.

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