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THERE IS NO REAL ESTATE "BUBBLE" IT'S BUBBLE WRAP

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Over the past year, or so, the big "buzz" has been*, "When is the real estate bubble going to burst?"*

This "bubble bursting" theory that's been circulating since 2002 in reaction to the substantial increases in real estate values around the county, has recently grown into almost full-blown paranoia, largely fed by talking head media types.

This thought of the "bursting" of the so-called"real estate bubble" seems to be based on nothing more than the collective fear that real estate values throughout the United States may, at any moment, drop precipitously. However, there is no rationale or fact-based reasoning being put forth to support this fear; just that "prices are too high."

I can only assume, that those who believe in this "bubble burst" concept must think that such a catastrophic event will come about when, one day soon, everyone in the country wakes up and inexplicably decides that they're just not going to buy any more real estate.

Interestingly, those who've bought into this baseless position seem to have no understanding of the workings of real estate markets. Even worse, it seems they have completely bypassed all objective analysis of ***how*** or ***why*** such a thing could happen, and have gone straight on to discussing ***when*** this "ominous" event will occur.

Well, I don't believe there is a national "real estate bubble." So, it logically follows that I also don't believe there will be, or that there even ***can*** be a "burst" in real estate values throughout the country. Why? Because of a number of factual, economic-based realities about real estate markets in the United States that makes them more like a sheet of bubble wrap than one big bubble . . . Let me explain.

First of all, this belief in the idea of a national real estate market and market crash is born out of, what I call, "the stock market mentality." This stock market mentality is held by those whose fundamental investment experience has been learned by observing the uncertainties and wild gyrations of stock market values. Unfortunately, they have little, if any historical knowledge or understanding of real estate markets.

Further, due to their ignorance of the dynamics and functionality of real estate markets, these stock market refugees and their cronies in the media end up making serious false conclusions by applying their stock market principles and experiences to real estate markets.

In fact, there are vast differences between stock markets and real estate markets in both their respective purposes and functionality. These are the differences make the probability of a real estate "bubble burst" virtually impossible.

One of the most basic differences between the stock market and real estate markets is the manner in which real estate is bought and sold as compared to the manner in which stocks are bought and sold.

There is no Real Estate "Bubble" - It's Bubble Wrap
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Technically speaking, the stock market is an "efficient" market, the characteristics of which include, 1) that the stock of all of the thousands of listed companies is bought and sold in the same place and under the same controlled conditions for all participants; 2) all who wish to either buy or sell stock have, literally, all the same information about a stock and its issuing company that's available to them almost instantly for analysis before making a buy or sell decision; and 3) all participants in the stock market can execute a buy or sell order instantly.

But, real estate markets don't have ***any*** of these characteristics.

For example, real estate isn't bought and sold in a centralized marketplace; all inventory isn't known or even available to all market participants even in the most localized market; information about a given property for buyer analysis before purchasing must be sought out which commonly takes days; and, unlike stock prices, real estate prices tend to be based upon personal socio-economic preferences rather than upon cold, profit-based considerations.

Another important fact that argues strongly against the concept of a "real estate bubble" and makes it more like "bubble wrap" is the fact that there are literally thousands of different real estate markets throughout the United States. Furthermore, each of these markets tends to be autonomous, as real estate values in each are most directly influenced by events in its local economy.

Market individuality provides another degree of insulation to each local market from events that influence real estate values in other localized markets. And, usually, the more geographically distant one market is from another, the more insulated it is from value influences in the other market.

There's also great diversity among, as well as within each of these thousands of local real estate markets resulting from such value-influences as geographic location, geographic size, as well as economic size, in addition to economic diversity and stability. Then, there are other value influences, such as state and local governmental influences that include property taxes, income taxes, plus the level and quality of infrastructure. This is not to exclude quality of life factors, such as crime rates and the availability of quality of public education. All of these numerous differences further insulate real estate values in one local market from value influences in another.

Market diversity also recognizes that some markets cover large, sprawling geographic areas and have huge and diverse economies, such as the New York City mega market. This market area encompasses a 50-mile radius from the heart of midtown Manhattan, overlaps into two neighboring states (New Jersey and Connecticut), has a resident population of around 20 million, and has a large and diverse economy. In fact, as of the year 2000, New York City, alone, had a Gross Domestic Product (GDP) of $468 billion, representing 5% of the GDP of the entire United States and was the 12th largest economy in the world!

Then, there are other markets in isolated rural settings with local economies commonly dominated by a single industry, such as Deming, New Mexico. This is a desert agri-town in the southwest section of the state along I-10 about 60 miles west of Las Cruces and is the largest of the only two towns in all of Luna County. It encompasses about 9 square miles, and has a current resident population of around 14,650.

Examining the extreme differences between these two markets provides better insight into just how real estate values are influenced in different markets, and how those markets react to those value influences.

For a real-life example of the resilience of the New York City market area, we need only look back on the economic data surrounding the terrorist attack on the World Trade Center (WTC) that struck at the heart of its financial district on September 11, 2001.

Analysis of real estate sales data prior and subsequent to the attack provide no indication of a negative change in either the number of transactions, nor in the value of the real estate anywhere in the entire market area (save the immediate neighborhood surrounding the WTC where hundreds of businesses, some 50,000 workers, and several thousand local residents were instantly relocated out of that local neighborhood economy). In fact, real estate values throughout this market area have continued their upward trend uninterrupted at double-digit annual rates until today!

Now, looking at Deming, New Mexico, the local economy is solely based on the agriculture grown there. Consequently, as evidenced by the numerous vacant buildings, a 21.7% unemployment rate (March 2005), and the flat to negative population and real estate value trend, it's fair to say, as goes the price of the local crop, so goes the Deming real estate market.

Yet, another significant factor unique to real estate markets and never addressed by the doom and gloomers, is, that in those real estate markets which cover large geographic areas, there are also numerous sub-markets; semi-autonomous mini-economies within the greater economic market area.

Some sub-markets are created from locational considerations, such as towns, districts and neighborhoods, while others are created by the differing types of real estate uses that range from single family dwellings to the various types of commercial and industrial uses, as well as to golf courses, gas stations, fast-food restaurants, banks, and so on.

The importance of these sub-markets, is that each is a mini real estate market unto itself. As such, each is subject to value influences unique to its specific location, as well as its use. These differences also provide another, albeit thinner, layer of insulation between one sub-market and another.

At this point, it's important to acknowledge that none of these market dynamics alters the fact that every real estate market and sub-market in the country can be either negatively or positively affected by the growth or contraction of the national economy, as such events tend to increase and decrease business and employment activity.

But, even accounting for the extremes of explosive growth or severe recession in the national economy, these events have never caused a uniform value change on all real estate markets. This fact is just another nail in the coffin of the real estate "bubble" theory and more support for the "bubble wrap" similarity.

A recent example of this truth took place in the late 1980s and early 1990s when real estate markets encountered the 1-2 punch of a national recession and an epidemic of savings and loan failures.

During this time, the general economy slowed and the national annual average unemployment rate rose from 5.3% in 1989 to 7.5% in 1992. At the same time, various real estate markets around the county were over-supplied due to over-building by developers who were financed throughout the 1980s by savings and loans (S&Ls) that were flush with money and were exploiting new freedoms from previous regulatory restrictions to make loans outside of their geographic areas, and to make loans on commercial real estate.

Some of these S&Ls became the private piggy banks of their owners who financed virtually anything, commonly in "joint-ventures" for a percentage of the profit. In many cases, these S&L owners became blinded by greed, ignoring the economics of the projects they were financing.

Other S&Ls were operated by out-right criminals who literally stole from their depositors, while yet others were merely operated by incompetents.

Consequently, in 1989, the federal government enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), and simultaneously created the quasi-public Resolution Trust Corporation (RTC) that seized numerous S&Ls in an effort to stem mounting financial losses to the government, also while trying to maintain public confidence in and the financial stability of the greater banking system.

Although, I could write extensively about the inadequacies of the RTC, suffice to say, that in it's zeal to raise cash, the RTC began flooding already over-supplied markets with new inventory in many parts of the United States.

At the same time it was exacerbating the over-supply problem, the RTC also sold properties at prices far below their market value. And, to compound this already bad situation, it would also either arrange or create unusually favorable financing to go along with fire-sale prices to ensure a sale.

All these events were substantial negative influences upon real estate values, particularly in those local markets directly affected by the RTC.

Interestingly, however, the impact from the combination of a national recession, numerous S&L failures and the careless actions of the RTC didn't effect real estate values in the same way, nor to the same extent in every real estate market in the country.

Although, there was some serious value erosion in isolated sectors of specific markets, particularly in the northeast region of the county, there wasn't a major negative value impact throughout all real estate markets in the entire country. In short, even after the confluence of all of these serious negative economic events, there was no real estate value "bubble burst."

Analyzing data from the National Association of REALTORS® (NAR), in the 8 years following 1987 (the last year of the so-called "real estate boom" of the 1980s), through 1995 (perceived as the last year affected by the combination of the recession and the S&L failures), a survey of the median sales price of all single family residential resales in the United States reveals there was not a single year in which sales prices declined across the country. On the contrary; nationally, there was an increase in the median residential resale price in each of those 8 years, averaging +3.25% over the period.

These same data from NAR also indicate that the only region in the United States to suffer an overall average value decline for this 8 year period was the Northeast Region, which declined by 0.52% for the entire period. This resulted from 4 negative value-growth years, 3 positive value-growth years and 1 zero value-growth year.

And, with the sole exception of a slight decline of 2.81% in 1992 in the West Region, there wasn't a single

decline in any other region of the country for any year in this entire 8 year period.

In conclusion, based upon all of the previously stated facts, it’s my view that one cannot reasonably conclude there is a single national real estate market in the United States. Consequently, there cannot be a real estate “bubble.”

On the contrary. As we’ve observed by example, the heavy burden of a national economic stress tends to get distributed over the vast numbers of these real estate markets. And, due to their great diversity and relative autonomy, these numerous real estate markets tend to absorb and deal with such general economic stresses as the relative durability of their individual local economies allow.

This distribution and absorption of the burden of a national economic stress is dealt with by these numerous real estate markets in much the same way as individual air bubble cells share the burden of a heavy object, benefitting from their individual strength, as well as having the weight of that burden spread over a greater number of cells. Thus, the real estate markets are certainly more analogous to bubble wrap than they are to a single bubble.

Finally, while my “bubble-wrap” analogy may seem somewhat simplistic, let me leave you with this: I’ve never seen a strip of bubble-wrap destroyed all at once. And, I don’t know of anyone else who has, either.■

ABOUT THE WRITER:
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