

# The Future of Real Estate

TRENDS IN REAL ESTATE INDUSTRY AND HOW THEY AFFECT US

MARCH 13, 2008

## Mind the Gap: Home-Price Downside

March 13, 2008, WSJ

By SCOTT PATTERSON

The economic balance hangs in large part on how much further home prices will fall. A look at one important measure -- the relationship between home prices and household income -- suggests we might not even be halfway there.

Over the long run, home prices and income should march along the same path. As households earn more, they can afford to pay for more expensive homes.

But the two can get out of whack. During much of the 1990s, incomes grew faster than home prices. The landscape shifted around 2000. From the start of the decade through the mid-2006 peak, home prices nearly doubled, thanks in part to falling interest rates. Over the same period, income per household rose just 26%, according to Moody's Economy.com.

In certain states, the disparity was extreme. Seven states, including California, Florida and Arizona, saw annualized growth in home prices outpace income growth by 10 percentage points from 2002 through 2006, according to housing expert Thomas Lawler.

The difference between income growth and home prices has started to narrow. Home prices were down 10% through the fourth quarter from their peak in mid-2006, according to the S&P/Case-Shiller national home-price index. But to bring prices in line with incomes, they will need to fall further. If incomes continue to grow in the next year as they have in the past decade -- probably an optimistic assumption -- it would take a 9% to 12% drop in home prices to bring the two measures in line with each other.

In states that saw bigger housing bubbles, the correction will be more severe, says Mr. Lawler.

It is also possible that home prices will overshoot on the downside, just as they did on the upside. Goldman Sachs economists say prices could fall another 15%. Merrill Lynch economists say they could drop another 20% to 30%. Both banks have been more bearish than others on the economy -- and so far look correct to have been so pessimistic.

### Retailing Likely Checks In With More Glum Numbers

Consumer spending is one potential casualty of falling home prices. When home values fall, households have less home equity to tap when they want to buy a new flat-screen television.

Today's February retail-sales report from the Commerce Department could provide evidence of that. Sales were up 3.9% in January from a year earlier. That paled in comparison with year-over-year gains of more than 6% that prevailed from 2004 to 2006. It was also less than the 4.3% increase in consumer-price inflation registered in January from a year earlier.

Economists don't expect strong numbers for February. On average, they

  


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...an increase of 0.1% from the month before. Auto makers and retailers reported a slow February -- with the exception of Wal-Mart Stores and other discounters, which benefited as shoppers tightened their purse strings. The Federal Reserve's latest "beige book" compilation of economic anecdotes described retail sales as "below plan, downbeat, weak, or having softened" in most of the country since mid-January.

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Tax rebates might temporarily boost spending again later this year. But consumers are walking into pretty stiff headwinds.

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Originally from Moscow, Russia, came to the US after college; have an MBA in Foreign Languages and Education; also have an AAS in Culinary Arts; currently involved in real estate consulting and brokerage. Freelance translator/interpreter.

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