

**Gliding to a Smooth Landing  
Housing Market Expected to  
Rebound After a Short Respite  
Trends  
December, 2006**

All real estate markets are local. I was reminded of that truth as I listened to the reports on residential markets across the United States at my Council meeting day prior to the start of the recent Urban Land Institute fall meeting in Denver. Real prices of new homes have been dropping across the country as builders buy down mortgage money, decrease lot premium prices and offer other incentives to counter the slowdown in absorption. However, the rate at which real prices have been dropping varies greatly between market areas and product types. Characterizing all these markets as "bursting bubbles" obscures these variances, and more importantly, their causes. While catchy, this characterization is just plain inaccurate for all but a few product-specific markets in areas where speculative fever attracted buyers with no intention of living in the units.

Real price declines for new and existing homes are small, with starts down only slightly in regions where the supply of housing has not been constrained by regulatory policies *and* both job and income growth remain strong. Metropolitan areas with such combinations of competitive markets and continuing economic strength include Austin, Houston and Dallas in Texas. The relatively low cost of housing and living in the Lone Star State enable skill-seeking, high-growth energy and high-tech businesses there to attract the young, professional labor that enables them to keep growing profitably.

By contrast, prices of condominiums and high-end townhomes have been dropping precipitously in South Florida communities, where the run-up in prices had been bolstered by a significant amount of sales to speculative investors. Prices of new single-family homes in that region also are sliding, because the pace of construction got ahead of the rate at which household and income growth added to the demand for housing. But in

markets such as South Florida, where the prospects for long-term growth are good, the current decline in starts will set the stage for future price stability and even further upward movement. In areas where the economic engine continues to be in sync with the demands of the 21<sup>st</sup> century, once the current inventory is burnt off, the future pattern of prices will be set by the emerging land-use policies. If, in the name of environmental protectionism, land-use policies shift the attention of home builders from markets to entitlement, prices will start up again in the next building cycle. If supply conditions in the area remain competitive, a relatively stable price pattern will follow.

In regions like the San Francisco Bay Area, where prices have been continuously escalated by land use policies that cripple supply additions, only a relatively mild decline in real prices has affected new housing markets. The prices of existing homes also have dropped from their stratospheric heights, but again, rarely more than five percent to ten percent, as homeowners who wish to sell hunker down to wait for the resurgence of the high-tech and biotech economy to bring them buyers. In similar supply-constrained regions, whether and how fast prices start up again will be determined by the interplay between the pull of strong existing job centers and the push of high living costs. To take an extreme example, when the size and strength of the existing financial and communication core of the global economy is as strong as it is in New York and northern New Jersey, the further escalation of prices is likely to induce crowding and complaining without jeopardizing the growth of jobs and income. But other areas, such as Texas, that have grown to a great extent because their relatively less expensive living costs have attracted new business and workers, the escalation of housing costs would slow economic growth.

During the third quarter of 2006, it became clear that the slowdown in residential construction dragged down the growth of the U.S. domestic product. The renewal of housing market growth will not be spread evenly across the country

or product types. We expect a slow, downward glide leading to another round of housing accommodation for a population that will grow by more than 35 million people between now and 2020. The downward glide will end in late 2007 for fast-growing regions with light inventory overhangs, while the soft landing will be further off in regions with big overhangs and slow growth. For all regions, the rate at which prices increase and the type of developments ushered in during the next takeoff will affect the manner and degree to which local economies adapt to the realities of the 21<sup>st</sup> century.




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**Claude Gruen is a Principal with  
Gruen Gruen + Associates, a research  
and consulting firm with offices in San  
Francisco and the Midwest.**

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