How to determine if your real estate market is in a housing bubble

A real estate agent based in Reno told me today that she has clients who are so traumatized by the severity of the last crash that they will not buy now out of fear Reno is in another housing bubble. She asked for help putting together information that will help people see there is little risk of a bubble in Reno.

It was relatively easy to walk her through what a bubble looks like and why Reno is not in one now.

No skill is more valuable than being able to show people if there is or is not a high risk of a bubble.

If your client misses out on a buying opportunity when risks are low, it can be life altering if they get priced out of a market. If your client misses out on a chance to sell before a market crash, it will be even more life altering when their equity is erased along with their plans for retirement.

Here are the key factors to look for.

1. Has the local price index been going strong with a solid upward path for more than a year?
2. Is the current level of the index well below the previous peak? If current prices are higher than the last peak, there is more of a chance the market has overheated and due for a correction.
3. Is the percent of houses rising more than 50 percent and going up or holding steady? This was the key harbinger of the last crash: The overall price indexes at the metro and ZIP levels were all rising, but the percent of individual houses rising was in sharp decline. In most markets, the percent of houses rising plunged within about 18 months from nearly 100 percent to below 50 percent. The market indexes continued to rise until the *percent* of houses rising crossed the 50 percent line. Once this happened they finally turned downwards.
4. Is the percent of houses falling holding relatively steady? Currently, nearly all markets are seeing the smaller percentages of houses rising. But the good news is that, in most cases, these houses are not joining the ranks of declining houses. Instead they are flattening out at around the inflation rate of 2 percent or below. (We define “rising” as going up faster than 2 percent per year).

The key takeaway is that, while prices may not be booming to the extent they have been in the past few years, most markets that are cooling off are doing so gradually rather than going up way too much and setting up a bursting bubble.

There is a lot of diversity in the housing market today, so it’s important to stay close to your market and not take for granted that the headlines can apply everywhere. It’s equally important to know

when your market has a high degree of safety so you can guide your clients to solid decisions that position them for more choices in the future.

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