Is There Another Housing Bubble on the Horizon?

Changing Demographics Signal Stable Market

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By Barry Bluestone

After more than six years of stagnating or falling home prices, many Greater Boston buyers were stunned this spring, summer and fall by the competition they faced when they entered the housing market. Realtors routinely recount stories of buyers having to offer up to 20 percent more than a seller's initial asking price to buy a home. Through the first six months of 2013, the median selling price of a single-family home in the Boston region was up an average of seven percent over 2012 and many expect prices to continue to rise through the end of this year and next.

This might seem eerily like the early stages of another housing bubble. Between early 1987 and early 1992, single-family home prices declined by ten percent in Greater Boston. During the following five years, prices began to recover, rising by about four percent per year. And then came the housing bubble. Between March 1997 and March 2002, the median price of a single-family home in the region skyrocketed by 76 percent. In the short span of the next thirty months, prices increased another 39 percent – a double-digit increase every year. Altogether, between 1997 and 2009, the typical home in Greater Boston doubled in price and then appreciated another 44 percent. Once the bubble burst, the median single-family home price collapsed by 20 percent.

Are we on the verge of another price roller-coaster in Greater Boston? Because of a battery of factors, the chances of another single-family housing bubble over the next decade are actually quite remote. These have to do with conditions in the mortgage market, in the economic circumstances of young households and, most importantly, in demographics.

The most immediate factor is the nature of mortgage markets. What led to the last housing bubble was a proliferation of easy-to-obtain mortgages during a time when household incomes were increasing. With little regulation, mortgage companies lowered their lending standards to the point where some had almost none at all. Encouraged by a heavy advertising campaign, all kinds of households were enticed into buying homes they ultimately could not afford despite some improvement in their incomes. The short-term demand this created far outstripped supply, leading many buyers to agree to pay a premium over a sellers’ initial asking price.

This time around, however, mortgage regulation is much tighter, reducing the effective demand for housing. Moreover, with interest rates almost surely to rise over the next few years, home purchases are going to be much less of a bargain.
Less Money, Less Demand

Even more important is the economic condition of Greater Boston households. The Great Recession capped off a decade (2000-2010) in which real median household income declined by 1.4 percent after rising by 4.1 percent. For renter households – many of whom in previous years might have considered a home purchase – real median income has plummeted by nearly 10 percent. And young households – those under age 25 – are unlikely to be in a position to buy at all as they reach what has traditionally been their home buying years. The cohort of young households in 2010 had 31 percent less real income than the same cohort in 2000. Moreover, if they went to college they are likely to be saddled with enormous debt. Over the past decade, the average college debt of a Massachusetts college graduate has increased from $15,400 to $25,500. If this were not enough to depress demand for single-family homes, there is mounting evidence that younger families are less interested in moving to the suburbs and more interested in living in denser communities with lots of amenities and a lot less commuting.

What about the supply side of the market? Here there are two factors that suggest the supply of single-family homes will be sufficient to meet demand over the next decade in most cities and towns in Greater Boston. One is the simple fact that the region’s population is aging rapidly. Between 2007 and 2020, according to Census projections, the number of households in Massachusetts headed by someone 55 or older will increase by 300,000. These are the aging baby boomers, most of whom are empty-nesters, and many of whom will be looking to trade in their large single-family homes for something smaller. Many will opt for smaller condos or apartments either in central cities or in suburban village centers – “aging in place” but not necessarily in the same home. As they put their old homes on the market, there should be a sufficient supply to meet the weakened demand we project, reducing price pressure.

The second factor is that the supply of new housing is actually increasing at a faster rate. This year, developers will pull more than 11,000 permits for new housing units, a total equal to the average annual production of housing during 2000 to 2006 when the housing market was red hot. Developers are reading the tea leaves and also see a need for fewer single-family homes to meet demand. Back in 2000-2002, two-thirds of housing permits in Greater Boston were for single-family homes. This year, two-thirds are for units in apartment and condominium buildings.

So for the time-being, buyers in the most attractive communities and neighborhoods will continue to face sticker shock in the single-family home market. But this time around, do not expect a full-blown housing bubble to emerge.

*Barry Bluestone is the director of the Kitty and Michael Dukakis Center for Urban and Regional Policy at Northeastern University and senior author of the recently released Greater Boston Housing Report Card.*