



Bill Fleckenstein

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The housing bubble has popped

Reports of falling sales and investors stuck with properties they can't sell are just the beginning. Property owners should worry; so should their lenders.

By [Bill Fleckenstein](#)

A recent story in the Wall Street Journal, "[Hot Homes Get Cold](#)" (subscription required) offered lots of its useful vignettes that serve as a microcosm of manic markets -- starting with the bravado-cum-denial displayed by a medical-equipment salesman in Stuart, Fla.

Concerned about his real-estate investment apparently going sour, he can't afford to reduce the price to what homes now sell for in his neighborhood -- which is about \$100,000 less than he's asking. Says the salesman: "If I got in a jam, I would have to drop the price, but I am not at that point." His game plan: Rent the house, so as not to "lose my shirt."

That's the mentality often seen in manic markets -- the belief that you can't possibly lose, and, when the price goes against you, you don't have to deal with it, because it will come back. This fellow (and millions more like him) is going to find out that his belief is a mistaken one, in the same way that folks did when the stock bubble burst.

Dwelling takes a little shelling

The story went on to note that many formerly hot markets in California, Arizona, Washington, D.C., and Florida are now "languishing without buyers or even prospects. Many once-booming markets are seeing double-digit declines in sales." The magnitude of the drop in Florida home prices (once the frothiest market in the country) is striking. Single-family home sales declined 20% in February, year-over-year. Similarly, California sales dropped 15%. Some of the hottest towns in those states were off twice as much.

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I loved the point that what seems to be really alarming is how "real-estate agents in some of these formerly red-hot markets have been surprised at how *suddenly* (my emphasis) market conditions have deteriorated in the past few months." Of course, that's what happens when manic markets and bubbles turn. Prices change radically and, seemingly, for no reason.

Many people will say that the real-estate market has turned due to higher interest rates, and rising rates have hurt. But the real-estate market ignored rates going up for quite some time. Its topping was caused by exhaustion. Same with the stock bubble -- many folks think it was rising rates that caused the implosion. That isn't true. The stock bubble ran until it popped in March 2000, having ignored everything up to that point.

Symptoms of the doldrums

To me, it's not debatable that the real-estate bust is starting to gather steam. The top was approximately when Time Magazine published its June 12, 2005, cover story: "Home Sweet Home: Why We're Going Gaga Over Real Estate". (For more, check out my June 13, 2005, column, "[Straight talk on what the Fed has wrought](#)," and my Aug. 29, 2005, column, "[It's RIP for the housing boom](#).")

After having leveled off for a while, the real-estate market is now starting to slide. We're seeing signs of sales slowing and inventory accumulating, which are all quite classic, even though the timing of when this would begin was not possible to predict in advance.

Continuing on, the article noted that Florida is "ground zero for the housing market" and as good a laboratory as any to watch. The real power behind the housing bubble, i.e., irresponsible lending, was "exacerbated in Florida." Quoting from Mark Zandi, chief economist at [Moody's Economy.com](#): "There were more lenders, more realtors, more foreign investors" than the rest of the country -- which is how a hot market gets *really* wild.

The story cited the plight of investors who'd purchased homes in formerly hot housing developments that now resemble "ghost towns." One such individual is Paul Zani (no pun intended, I'm sure), who'd bought a couple of condos, listed them for more than he paid and now can't sell them. However, he doesn't want to reduce the price (even though he'll probably have to). This mentality is an example that many real-estate "investors" seem to share -- heads we win, tails the bank loses. (Some people are sanguine these days because, as the article notes, "while sales are slackening, they aren't collapsing." To that, I would add: "Yet." They will.)

By and by, heartburn for the bankers

It is indeed the financial institutions that are most at risk in the real-estate market (which is not to say that consumers and speculators won't get hurt). The lenders will bear the brunt of the pain, because in many cases, they loaned the entire purchase prices of many homes. As I have said often, the housing bubble has been more a lending

bubble. It will be the impairment of the financial institutions that will stop the flow of credit to the real-estate market. In turn, that will accelerate the collapse in house prices somewhere along the way.

The story closed with a description of how slow the market has recently become in Florida -- via the following comments in an e-mail by real-estate broker Mike Morgan: "We went three days this week with not a single showing. That's incredible. I have 35 listings. We usually get 2-6 showings a day. ... I received more desperate calls from sellers than ever. One lady broke down into tears. Her husband bought two investment properties, and they are now going to lose their 'life savings' if they sell the homes in today's market."

Ladies and gentlemen, unfortunately, a lot of people around the country are going to be badly hurt as this bubble unwinds. And, after they have taken their losses, the financial institutions that were the engine behind this folly will take their own hits. 'Easy AI' Greenspan at the Fed tried to bail out one bubble with another bubble. While it bought some time, it will end in far-worse pain.

A vision of mean reversion

Finally, a recent edition of [The Liscio Report](#), the economic newsletter, put into perspective how wacko the current climate is. It said that the ratios of (a) stock value to GDP and (b) real-estate value to GDP are *both* nearly twice their averages from 1952 to 1970. As the report noted: "If mean reversion still has any role in market valuations, then both markets have plenty of room to fall."

Since the name of my investment partnership is the RTM Fund (which stands for "reversion to the mean"), I obviously believe that plenty of mean reversion lies ahead.

Bill Fleckenstein is president of Fleckenstein Capital, which manages a hedge fund based in Seattle. He also writes a daily "Market Rap" column on his [Fleckenstein Capital](#) Web site. His investment positions can change at any time. Under no circumstances does the information in this column represent a recommendation to buy, sell or hold any security. The views and opinions expressed in Bill Fleckenstein's columns are his own and not necessarily those of CNBC or MSN Money.

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WSJ's Michael Corkery discusses⁶ falling real estate values in hot cities.

But for cities like Fort Lauderdale, Fla., Phoenix and San Diego, the dropoff in sales and rising supply of homes on the market could soon put downward pressure on prices.

"In some places prices might fall. In others, price gains will slow," says David Berson, chief economist at Fannie Mae, the mortgage-finance company. The

price gains over the past five years, which caused home values to double in many of the hottest markets, "were not sustainable," he says.

The current slowdown reflects three broad trends, according to real-estate agents and economists. One of the most important is that many speculators have started to dump homes that were purchased as investments. In addition, high prices and rising interest rates have reduced affordability for middle-class families. Finally, the intensity of recent hurricanes has prompted potential buyers of second homes to pull back in places like Florida. Some even blame media coverage that has warned of a possible downturn for triggering a real downturn.

Nowhere are these trends more vivid than in Florida. There were more building permits issued for single-family and multi-family homes in Florida last year than in any other state, according to the National Association of Home Builders. Five of the 10 metropolitan areas with the strongest one-year price appreciation last year were in Florida, the Office of Federal Housing Enterprise Oversight reports.

"You could consider Florida to be ground zero for the housing market," says Mark Zandi, chief economist at Moody's Economy.com, an economic consulting firm in West Chester, Pa. He says the factors that caused the housing market to overheat nationwide -- such as "creative financing" offered to credit-risky buyers -- were exacerbated in Florida. "There were more lenders, more realtors, more foreign investors," than anyplace else, he says.

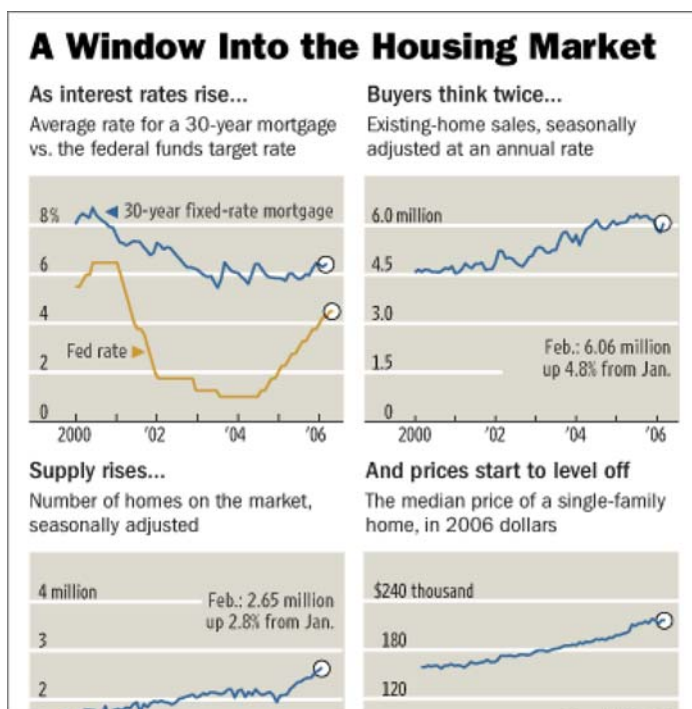
How investors react will have a big impact on how Florida's correction will unfold. According to San Francisco-based LoanPerformance, which tracks mortgages nationwide, 15% of Florida homes last year were purchased by investors, the most of any state. Investors are also critical, economists say, because in a slowing market they could be quicker to drop their prices to cut their losses than typical homeowners.

Speculative buying helped drive up prices in many Florida cities and shut out many nonspeculative buyers. Recent upticks in interest rates have put homeownership even further out of reach.

To be sure, the slowing in Florida could prove to be temporary. The state remains one of the fastest growing in the nation. It's growing, on average, by 1,000 people a day. Florida's economy is relatively strong and it continues to create new jobs. And while many Florida cities are seeing declines in sales, a smaller group of Florida markets is holding steady. Sales in Jacksonville were essentially unchanged in February year over year, and they were up in Tallahassee. But in many other parts of the state "things have slowed to a crawl," says Mike Morgan, a broker in Stuart, Fla.

Another factor that may be affecting sales is the appearance of some investor-dominated housing developments, some of which were built with minimal landscaping next to highways, cemeteries and mobile-home parks. Several of the housing developments snapped up by investors now look like ghost towns, with "For Sale" or "For Rent" signs in many windows. In some cases, the builders "were building for investors, not for homeowners," says Mr. Morgan, who is trying to resell several investor-owned homes with mixed success.

About a year ago, when the market was stronger, Mr.



Morgan sold homes to several out-of-state investors, who never saw the property in person. "It's really no different from the dot-com [bust]," Mr. Morgan says. "The people

who bought the [low-quality homes] got clobbered." He says he refused to sell poor-quality homes to his clients. "If I didn't have any ethics, I could have made a million dollars last year."

The swelling supply of condominiums is also causing concern. In Miami-Dade County alone, there are roughly 70,000 new condos either under construction or nearing construction, and an additional 25,000 units that have been announced but don't have final approval, says Michael Cannon, managing director at Integra Realty Resources-south Florida, which analyzes the local market.

"We believe that the condo market is more distressed," says Hank Fishkind, principal at Orlando-based Fishkind & Associates, an economic and financial consultant. "We are seeing a mismatch in timing. The projects started two years ago -- the delivery is accelerating, while closings are slowing."

Adding to that supply are the rental apartments that have been converted into condominiums. Mr. Cannon says roughly 150,000 rental apartments in South Florida have been converted or have begun to be converted to condos in recent years. Typically, the condo converter buys the rental unit, renovates it and then sells it to an individual, often an investor.

Paul Zani, an investor, is trying to resell two converted units he purchased in Orlando. He bought one condo unit in November for \$137,000 and had it listed for \$185,000; he bought the other for \$147,000 and it was listed for \$195,000. But he's been unable to resell either one. "We will probably come down on the price," says Mr. Zani, who lives in Nashville, Tenn. Some pockets of the condo market may fare better than others. Mr. Cannon says parts of Miami's downtown business district and the area north of downtown, which aren't directly on the ocean, "have the signs of being overbuilt. The jury is still out. We have to wait until they are completed," he says. Meantime, John Warsing, a broker of high-end Miami-area condos at Turnberry International Realty in Aventura, Fla., says "anything oceanfront is going to be fine," in part because well-heeled consumers from across the world are attracted to buying oceanfront property.

Other problems are rattling Florida's market. Home-insurance costs are rising, after the active hurricane season of the past few years. And real-estate agents say some homeowners are spooked by the storms themselves.

"A lot of people have that view of New Orleans in their minds and they are getting nervous. They are putting houses on the market," says Melissa Watkins, a sales agent with Michael Saunders & Co., near Sarasota. "They are not living here full time and [their home] is an investment. They want to pull their money out and hold on it."

Ms. Watkins says sales are slow, inventory is rising and listing prices are being reduced slightly. She says one recent deal almost fell through at the last minute when the buyer balked at the insurance premiums on a high-end, waterfront home.

Some Floridians blame the media and even Wall Street for scaring people away. Mr. Linsley recalled a headline in a local paper declaring that the local housing market was overvalued. The headline type was so bold that it looked as if the nation had just declared war. "The media is killing the investors," Mr. Linsley says.

Despite the current turmoil, some Floridians remain bullish, including Stuart Miller, the chief executive officer of Miami-based Lennar, one of the largest home builders in the U.S. But Mr. Morgan, the broker, says for him the market has slowed considerably. He wrote in an email late last week that "we went three days this week with not a single showing. That's incredible. I have 35 listings. We usually get 2-6 showings a day....I received more desperate calls from sellers than ever. One lady broke down into tears. Her husband bought two investment properties, and they are now going to lose their 'life savings' if they sell the homes in today's market."

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