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3 Of The Top 9 Reasons That The Real Estate Bubble Is Bursting

If you own real estate or are thinking of buying real estate then you better pay attention, because this could be the most important message you receive this year regarding real estate and your financial future.

The last five years have seen explosive growth in the real estate market and as a result many people believe that real estate is the safest investment you can make. Well, that is no longer true. Rapidly increasing real estate prices have caused the real estate market to be at price levels never before seen in history when adjusted for inflation! The growing number of people concerned about the real estate bubble means there are less available real estate buyers. Fewer buyers mean that prices are coming down.

On May 4, 2006, Federal Reserve Board Governor Susan Blies stated that "Housing has really sort of peaked". This follows on the heels of the new Fed Chairman Ben Bernanke saying that he was concerned that the "softening" of the real estate market would hurt the economy. And former Fed Chairman Alan Greenspan previously described the real estate market as frothy. All of these top financial experts agree that there is already a viable downturn in the market, so clearly there is a need to know the reasons behind this change.

3 of the top 9 reasons that the real estate bubble will burst include:

1. Interest rates are rising - foreclosures are up 72%!
2. First time homebuyers are priced out of the market - the real estate market is a pyramid and the base is crumbling
3. The psychology of the market has changed so that now people are afraid of the bubble bursting - the mania over real estate is over!

The first reason that the real estate bubble is bursting is rising interest rates. Under Alan Greenspan, interest rates were at historic lows from June 2003 to June 2004. These low interest rates allowed people to buy homes that were more expensive than what they could normally afford but at the same monthly cost, essentially creating "free money". However, the time of low interest rates has ended as interest rates have been rising and will continue to rise further. Interest rates must rise to combat inflation, partly due to high gasoline and food costs. Higher interest rates make owning a home more expensive, thus driving existing home values down.

Higher interest rates are also affecting people who bought adjustable mortgages (ARMs). Adjustable mortgages have very low interest rates and low monthly payments for the first two to three years but afterwards the low interest rate disappears and the monthly mortgage payment jumps dramatically. As a result of adjustable mortgage rate resets, home foreclosures for the 1st quarter of 2006 are up 72% over the 1st quarter of 2005.

The foreclosure situation will only worsen as interest rates continue to rise and more adjustable mortgage payments are adjusted to a higher interest rate and higher mortgage payment. Moody's stated that 25% of all outstanding mortgages are coming up for interest rate resets during 2006 and 2007. That is \$2 trillion of U.S. mortgage debt! When the payments increase, it will be quite a hit to the pocketbook. A study done by one of the country's largest title insurers concluded that 1.4 million households will face a payment jump of 50% or more once the introductory payment period is over.

The second reason that the real estate bubble is bursting is that new homebuyers are no longer able to buy homes due to high prices and higher interest rates. The real estate market is basically a pyramid scheme and as long as the number of buyers is growing everything is fine. As homes are bought by first time home buyers at the bottom of the pyramid, the new money for that \$100,000.00 home goes all the way up the pyramid to the seller and buyer of a \$1,000,000.00 home as people sell one home and buy a more expensive home. This double-edged sword of high real estate prices and higher interest rates has priced many new buyers out of the market, and now we are starting to feel the effects on the overall real estate market. Sales are slowing and inventories of homes available for sale are rising quickly. The latest report on the housing market showed new home sales fell 10.5% for February 2006. This is the largest one-month drop in nine years.

The third reason that the real estate bubble is bursting is that the psychology of the real estate market has changed. For the last five years the real estate market has risen dramatically and if you bought real estate you more than likely made money. This positive return for so many investors fueled the market higher as more people saw this and decided to also invest in real estate before they 'missed out'.

The psychology of any bubble market, whether we are talking about the stock market or the real estate market is known as 'herd mentality', where everyone follows the herd. This herd mentality is at the heart of any bubble and it has happened numerous times in the past including during the US stock market bubble of the late 1990's, the Japanese real estate bubble of the 1980's, and even as far back as the US railroad bubble of the 1870's. The herd mentality had completely taken over the real estate market until recently.

The bubble continues to rise as long as there is a "greater fool" to buy at a higher price. As there are less and less "greater fools" available or willing to buy homes, the mania disappears. When the hysteria passes, the excessive inventory that was built during the boom time causes prices to plummet. This is true for all three of the historical bubbles mentioned above and many other historical examples. Also of importance to note is that when all three of these historical bubbles burst the US was thrown into recession.

With the changing in mindset related to the real estate market, investors and speculators are getting scared that they will be left holding real estate that will lose money. As a result, not only are they buying less real estate, but they are simultaneously selling their investment properties as well. This is producing huge numbers of homes available for sale on the market at the same time that record new home construction floods the market. These two increasing supply forces, the increasing supply of existing homes for sale coupled with the increasing supply of new homes for sale will further exacerbate the problem and drive all real estate values down.

A recent survey showed that 7 out of 10 people think the real estate bubble will burst before April 2007. This change in the market psychology from 'must own real estate at any cost' to a healthy concern that real estate is overpriced is causing the end of the real estate market boom.

The aftershock of the bubble bursting will be enormous and it will affect the global economy tremendously. Billionaire investor George Soros has said that in 2007 the US will be in recession and I agree with him. I think we will be in a recession because as the real estate bubble bursts, jobs will be lost, Americans will no longer be able to cash out money from their homes, and the entire economy will slow down dramatically thus leading to recession.

In conclusion, the three reasons the real estate bubble is bursting are higher interest rates; first-time buyers being priced out of the market; and the psychology about the real estate market is changing. The recently published eBook "How To Prosper In The Changing Real Estate Market. Protect Yourself From The Bubble Now!" discusses these items in more detail.

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Mr. Hill received his undergraduate degree from the University of Florida with a double major in Finance and Risk Management.

For the past several years he has been working in a South Florida commercial real estate lender that specializes in financing real estate developers. Mr. Hill has seen firsthand the challenges and pitfalls that real estate developers are experiencing, and how the real estate market has been deteriorating rapidly. He is also a professional consultant to professional real estate developers and investors.

Previously, he was in management consulting. Additionally, he was a professional trader in the stock market and witnessed the stock market bubble bursting in 2001 and now is concerned about the real estate bubble.

Mr. Hill is very active in many civic groups and charities.