Are Housing Bubbles Contagious?

name

RES 301 Principles of Real Estate

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Abstract

This paper is an analysis of the Case Study " Are Housing Bubbles Contagious? A Case Study of Las Vegas and Los Angeles Home Prices ," as assigned by Peter McCann, instructor of Ashford University RES 301 Principles of Real Estate class. This case study examines data from Las Vegas and Los Angeles in an effort to answer the question "Are Housing Bubbles Contagious?" in a study prepared by Mary Riddel. In her study, Mary concludes that the increased prices and income growth in the Los Angeles market did contribute to the bubble that formed in Las Vegas. Mary believes that pressures on housing prices can spill over into other related housing markets causing contagious bubbles, (Riddel, 2011).

**“Are Housing Bubbles Contagious? A Case Study of Las Vegas and**

**Los Angeles Home Prices”**

**Introduction**

What is a housing bubble? According to businessdictionary.com, it is a temporary situation brought about by unjustified speculation in the housing market in which there is a rapid increase in prices. Like most economic bubbles, it eventually expands until it bursts causing a rapid decline in prices. Since the economic conditions can change without any warnings, it is difficult to predict the end of the housing bubble. If the bubble expands to an extremely high level, the result of the burst could set the housing market back years, (businessdictionary.com, n.d.) According to Investopedia.com, investors experienced the most frightening markets of their life during the 2007 - 2009 housing bubble market crashes, (Beattie, 2004). Consumers are still feeling the effects of that housing bubble market crash.

**A summary of the case including the key players and background information.**

This case study questions "Are Housing Bubbles Contagious" and the analysis within is based on data obtained from Las Vegas and Los Angeles market variables from 1978 through 2008. According to Riddel, the large swings in residential home prices were not adequately explained by forces such as income, population, housing starts, and interest rates, (Riddel, 2011). Riddle examines the appreciation of housing prices caused by income effects driven by price effects, while controlling variables that affect prices for housing, such as employment, income, and construction costs, (Riddel, 2011).

Some of the key players in this case study are home owners, banks, investors, policy makers, speculators, and the media. Players that have played major roles in creating housing bubbles are speculators and investors. Supply and demand for housing, interest rates, mortgages, and foreclosures help create and burst housing bubbles. The 2008 crash pushed millions into unemployment and countries into the edge of collapse. How did it happen? Easy lending in the housing industry qualifying almost anyone for a home loan and the lack of government control. In her analysis, Mary's models of the bubble experienced in Las Vegas from 2001 to 2008 is linked back to the Los Angeles market, (Riddel, 2011).

**A description of the scope of real estate bubbles. (Are housing bubbles contagious?)**

Mary's full model showed that speculative activity was active in the housing market during the bubble years. Prices were not as affected by market forces so Los Angeles housing prices and income became more influential in pricing and growth in stocks. Her model shows a persistence in price that generated an acceleration in a bubble forming quickly. Interestingly, her model most importantly showed the positive, strong, and persistent relationship in relation to the growth in Las Vegas and Las Angeles home pricing. Consistent high prices in Los Angeles raised home equity allowing for more funds to flow into the Las Vegas market. This brought about new demand over expectations causing the Las Vegas prices to rise. The Los Angeles income growth also generated activity in the Las Vegas new construction arena. This model was effective in showing that housing bubbles are contagious, (Riddel, 2011). The revelation that housing bubbles are contagious implies that investors' interest in a market appears to bleed into adjacent markets, (Herring & Wachter, 2003). This reveals the scope of housing bubbles are broad and impact other markets.

**An analysis of the real estate bubble issue and ethical considerations**

The unethical issues that were related to the housing bubble crash were excessive leverage, completely disgraceful banking practices, lack of financial regulation by government, and the appalling agency performance rating. The government then took rash measures to rescue the issues by giving huge loans, the rescue of financial giants that were considered "too big to fail," forced acquisitions, tainted purchases of assets, converting investment banks into commercial banks, capital infusions, and TARP funds, (Shoen, 2016). The players involved in these unethical activities were mortgage brokers, overly complex bond investments, regulatory agencies that allowed extreme leverage of banks, bond rating firms, shadow banking and over-the-counter derivative markets, (Shoen, 2016).

The combination of all of these unethical activities contributed to the housing bubble. When it burst about four million homes were foreclosed and another four and one half million families were subjected to the beginning of the foreclosure process or very behind on mortgage payments, (Shoen, 2016).

**At least one recommendation on how the real estate industry, homebuyers, and other stakeholders can help in avoiding real estate bubbles. Real estate principles must**

**be used as support.**

Home owners should try to keep their total housing expenses below 25% of their gross monthly income. This should include principal, interest, property taxes, and insurance. They should have a 20% down payment and should buy a home for the right reasons. Do not jump into purchasing a home. (Vohwinkle, n.d)

**Conclusion**

This case study did reveal that the housing bubbles were contagious between Los Angeles and Las Vegas. In working to prevent housing bubbles, one should make efforts to detect price bubbles early, stop issues from spreading, examine hyper local data, and consider tailored responses to a crisis.

References

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