Real Estate

America's Undervalued Real Estate Markets

Matt Woolsey, 11.13.07, 6:00 PM ET

When a market goes through uncertain times, investor caution reigns. And whether you're talking about the housing market or the financial services sector, there's been so much bad news lately that it makes sense for buyers and investors to remain wary.

But the good news is that market slumps often result in good buys, and solid investments get tagged with bargain prices due to the volatile market. One place to look for these deals is the housing sector, where worries about a continuing dip in home prices are keeping many buyers on the sidelines, and keeping a lid on prices. Looking across the country for undervalued markets, we came up with five picks for city markets or submarkets that are cheap based on what their particular market fundamentals suggest.

You're most likely to find undervalued real estate in cities where the real estate boom was driven by sustainable factors like job growth and economic expansion--like Charlotte, N.C. The city has quietly become one of America's leading financial centers: Its banking sector, anchored by Bank of America and investment subsidiary Banc of America, has continued to expand even as Wall Street takes its lumps. Airlines are rapidly adding traffic between Charlotte and New York--between Delta, US Airways, Continental and JetBlue, there are 26 daily non-stop flights in each direction.

So there's big money in Charlotte. But based on price-per-square-foot numbers from Radar Logic, a New York-based real estate research firm, the city boasts the third-cheapest real estate in the country, behind Detroit and Atlanta, Ga. Detroit's woes are well worn, and Atlanta has an inventory glut and a fast rate of home construction. But Charlotte is without an inventory problem and has a dipping rate of home starts, according to NAHB.

In contrast, throughout most of Florida, and especially in Miami and Tampa, the real estate market grew more rapidly than local economic growth would have suggested possible, and undervalued property is hard to come by. The same goes for San Diego. (Early on in the year--before the credit meltdown of the last few months--we picked San Diego as the nation's most overpriced market and Miami as the riskiest one, based on real estate market over-expansion and strained conditions in local credit markets).

But job growth doesn't always insure a solid market. Phoenix has had one of the fastest-growing job rates in the country over the last five years. In 2001, at the beginning of the boom, there were 43,600 housing starts, according to the National Association of Home Builders (NAHB). By 2005, there were 65,000. With so many jobs created by that housing boom--and many people are employed in the building of a house--consider what will happen to the Phoenix job market if NAHB predictions come true later this year, and new-home construction slows to 36,400 new starts.

Local credit markets also help create undervalued property. So far, the credit market seizure has mostly affected cities that are more reliant on government-sponsored enterprises--places with a high share of housing stock above Fannie Mae and Freddie Mac's $417,000 limit.

Take Seattle, where the median home price is $395,000, exposing a significant portion of the market to a non-GSE securitization shutdown. There isn't a national lending market, and local banks and lenders were pumping capital into Seattle, yet the securitization problems have affected the city.

Still, the latest Standard and Poor's Case-Shiller housing index numbers suggest Seattle prices are still strong. The numbers don't really tell the full story, though, since they're a running average, not a daily spot-price index.

They also fail to consider the condo market. Talk to builders or investment analysts about Seattle's condo or multifamily construction market, and they'll say there's no glut. In 2002 and 2003, the condo and A-class rental market experienced a huge inventory over-expansion from too much multifamily construction--which either became rental apartments or condos--and was in no position to grow during the tail of the housing boom.

Commercial real estate investment analysts like Los Angeles-based Marcus & Millichap are bullish about the Seattle A-class apartment-rental market for the same reason the condo market has done well: jobs are up, the tech sector is growing, migration patterns are favorable and there is less supply and less construction in multifamily homes in Seattle than the market can support. Commercial yields on Class-A residential properties were up 6.7% last year as a result, and based on Radar Logic figures, Seattle market condo prices are growing faster than New York's on a dollar-per-square-foot basis.