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Housing Trends

America's Riskiest Real Estate Markets

Matt Woolsey, 03.31.08, 10:30 AM ET

There's roulette and there's skydiving. Then there's investing in Detroit and Cleveland real estate.

That's especially risky because those markets are in freefall. Lenders have fled, foreclosures are on the rise, homes aren't selling and local economies have stalled.

Given the state of the country's housing market, it wasn't hard to find others like them. To do so, Forbes.com looked at the country's 40 largest metros and combined data on foreclosures, from RealtyTrac, a foreclosure listing service; job growth from the Bureau of Labor Statistics; transaction volume data from Radar Logic, a New York real estate research firm; and vacancy and current inventory rates from the U.S. Census Bureau and ZipRealty, an aggregator of multiple listing service data.

The riskiest were those that had the highest foreclosure rates, slow job growth (or job loss) and a rash of listed homes. By these measures, Orlando has everything working against it. Other spots, Denver, for example, exhibit negative characteristics like foreclosures, lending problems and vacancies, but are adding jobs, a sign that the local economy can better handle these difficulties.

Risky Business

Before "write-down" entered the national lexicon, the biggest risk facing real estate markets was the prevalence of subprime loans and adjustable rate mortgages. Last year, before the shoe-drop of the credit crunch and the dropping value of banks' loans and debt, we identified ARM-heavy Miami, Fla., Orlando, Fla., and Sacramento, Calif., as the markets most at risk of further fall.

Subprime still matters, as do the concentration of adjustable rate mortgages. Transaction volume, however, especially over the next 12 months is becoming an increasingly important gauge of a market's health. This month the National Association of Realtors reported that sales volume of existing homes was up 2.9%, the first such month-to-month rise since July.

In cities like San Diego, one of five major metros where transactions rose, that's good news, assuming it's sustained. What makes transaction volume a good indicator is that it shows how easy it is for people to get loans and how much confidence there is in the market. If mortgages are available and buyers have some faith in the value of the home, they're more likely to buy.

San Diego's present conditions suggest that over the next half-year, prices may start to rise. That's because "there's usually a three- to six-month lag between when transactions go up and prices go up," says Jonathan Miller, president of Miller Samuel, a Manhattan real estate appraisal firm.

Another good sign for the coming year? Increased credit availability.

We took into account increased Fannie Mae and Freddie Mac (GSE) loan limits. The new legislation will open up credit in markets such as Sacramento and San Diego by boosting the GSE loan limit by 125% of the median price. That's a huge deal for San Diego, where 18% of the market will see improved lending conditions, based on projections by Radar Logic, a New York-based real estate research firm.

Not as fortunate are hard-hit foreclosure markets such as Denver, which saw 50,000 foreclosure filings last year, according to RealtyTrac, which comes out to a 2.6% foreclosure rate, ninth in the nation behind the likes of Las Vegas and Detroit. Here, GSE loan limits won't change to boost liquidity, though at the beginning of this year the local economy had added jobs at a rate of 2%, which is triple the national average, according to the Bureau of Labor Statistics.

The availability of jobs gets at the critical question of how much money is available within a market. A market with money on the sidelines has better recovery prospects because it means potential buyers are out there. A market without economic activity to generate buyers is simply sinking.

"People aren't pulling the trigger right now," says Steve Cesinger, vice-chairman at Dewberry Holdings, an Atlanta-based real estate investment group. "But it's a big difference if they're not pulling the trigger because the prices haven't declined enough or because they're waiting to catch the bottom."