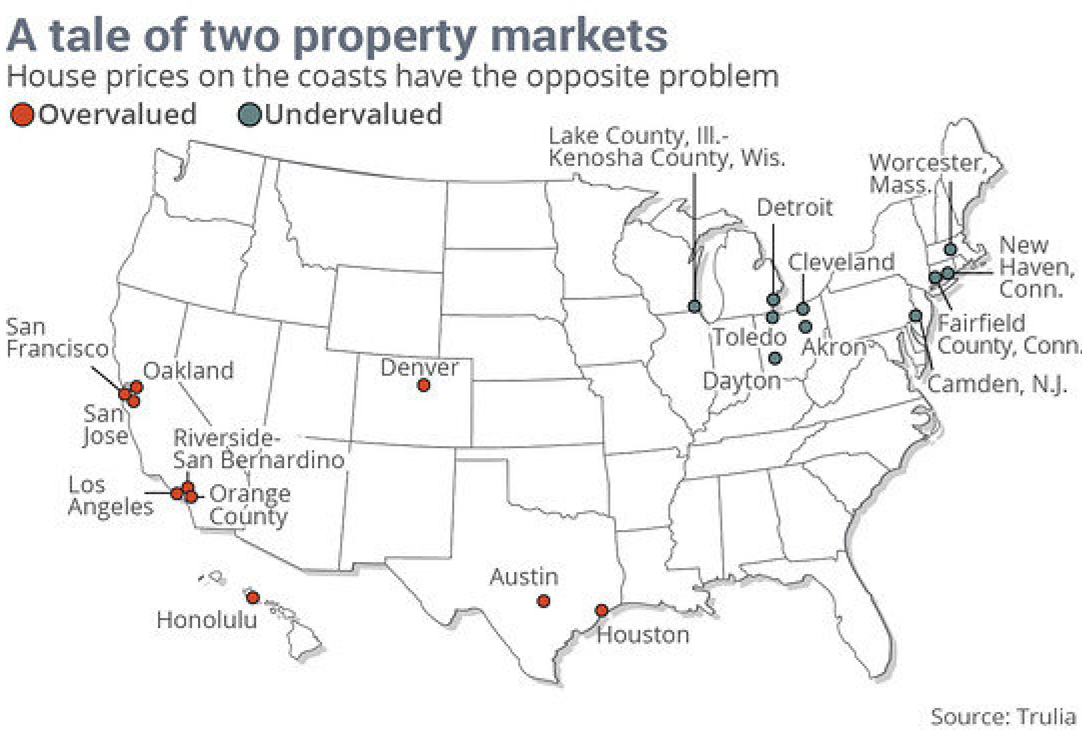
10 most overvalued (and undervalued) housing markets

By Quentin Fottrell October 1, 2014 9:15 AM

American house prices are undervalued by around 3% on average, new research finds, but they're still overvalued (and undervalued) by double-digit percentages in many metro areas.

Home prices are edging slowly back to normal in the third quarter of 2014, after being undervalued by as much as 5% on average last June, but they vary dramatically in the country's 100 largest metro areas, according to real-estate website Trulia. In the first quarter of 2006 at the peak of the housing market bubble, U.S. house prices were overvalued by 34% before dropping to 13% in the first quarter of 2012.

"The more prices are overvalued relative to fundamentals, the closer we are to a housing bubble and the bigger the risk of a price crash,"says Jed Kolko, chief economist at Trulia. But sharply rising prices themselves do not necessarily indicate a bubble. Instead, Trulia analyzed home prices in 100 metro areas relative to fundamentals such as jobs, income growth and household formation and rents.



The most overvalued market in the U.S. was Austin, Texas (overvalued by 19%), followed by Los Angeles (15%), Orange County (15%), San Francisco (12%) and Riverside-San Bernardino (11%). In fact, the median price for single-family homes in Austin jumped 11% year-over-year in August to $247,500 and the average price rose 9% to $311,414, according to data released last week by the Austin Board of Realtors.

Austin is actually more overvalued in 2014 than it was in 2006 (when it was only 2% overvalued); the same is true for Houston, which was overvalued by 8% in the third quarter of 2014 versus just 1% in 2006. Other overvalued markets have at least cooled in the intervening years: Los Angeles was 73% overvalued, Orange County was 66% overvalued and San Francisco was 46% overvalued in 2006.

Almost all of the most undervalued metro areas are in the Midwest and New England, Trulia found. Dayton, Ohio, was undervalued by 21% (versus 8% in the first quarter of 2006), Cleveland was undervalued by 19% (versus 13% in 2006) and Detroit was undervalued by 18% (compared with 33% in 2006). Price gains in the Midwest have generally outpaced those in New England.

Seven of the top 100 metro areas are overvalued by more than 10%, the highest number since the first quarter of 2009. The last time that many metro areas were overvalued was the second quarter of 2000, early in the housing market bubble. Still, Kolko says a housing bubble should not be a top housing worry in 2014, as the market is still held back by weak construction and young adult employment.