

Yea! Home Prices Hitting Bottom. Now, the Bad News.

By Brett Arends

This is a great time to buy a home in many parts of the country. There are signs that the downward price spiral is bottoming out. Mortgage rates are at historic lows.

The next few years could well be remembered as the best opportunity for Americans to buy homes since the postwar baby boom.

But one group's opportunity is another group's problem. Tens of millions of baby boomers and other home owners have seen their equity shrunken or wiped out completely. Many were counting on their homes to help finance their retirements. Often they have been waiting for years for the market to turn. Now they find themselves on the short end of the deal, sellers into the buyer's market of the century.

"It's a really challenging environment to be a seller," says Lawrence Glazer, wealth adviser at Mayflower Advisors in Boston. "Unfortunately, many people planning to retire may have no choice."

So what if you are on the wrong side of the trade? As ever, there isn't a single, simple answer, but here's a checklist to help you out.

1 Don't hold your breath.

Yes, house prices nationwide have stabilized. Of the 20 cities tracked by the Standard & Poor's/Case-Shiller Home Price index, 16 are in the black for this year. But the housing market isn't like the stock market. Bouncebacks are typically slow.

The last crash took more than a decade to work through—and this market could take an especially long time because the huge accumulation of empty, foreclosed houses will hold down prices for all properties.

When adjusted for inflation, the Case-Shiller index didn't return to its 1989 peak until 2000. Some markets, such as New York and Los Angeles, didn't hit new highs until 2002. This time may be even worse because the bubble was much, much bigger. Some locations may not recover their inflation-adjusted peak in our lifetimes.

Harvard's Joint Center for Housing Studies calculates that there is a backlog of around two million home loans in foreclosure, waiting to come onto the market. Some estimates put the number much higher, especially when you include "shadow inventory" held back by banks.

Unless you are willing to wait for a long time, you may not want to get too hung up waiting for a big rebound.

2 Look at your local market.

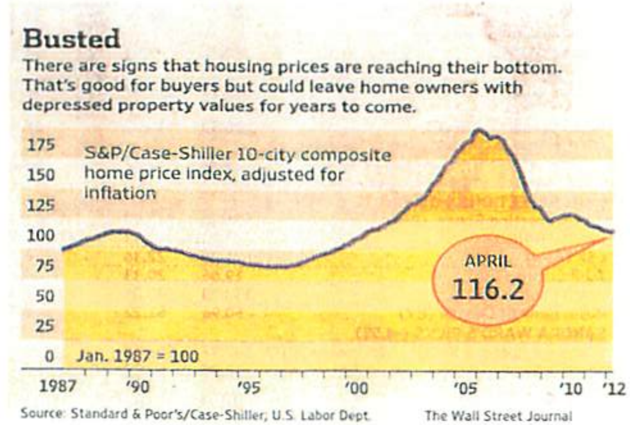
As the housing market recovers, expect to welcome back the old Realtor's adage: Location, location, location.

Don't expect all markets to rise at the same rate. According to Case-Shiller, Phoenix home prices are up 9% in a year. Meanwhile, Atlanta is down 17% and New York is down 4%.

Where will prices go from here? That's likely to depend on two factors: rents and valuations. If it's cheaper to own than to rent, and rents in your neighborhood are rising, you can expect prices to rise in due course. If it's cheaper to rent, or if rents are stagnant, it's another matter.

3 Be realistic.

The true value of your home isn't what you paid or refinanced for in 2006, but what it's worth now. And the true value of your equity isn't what you put into the home, it's what you would get if you sold it.



Money spent on that new kitchen? Irrelevant. The pool? Ditto. Too many investors get hung up on past or "sunk" costs. Don't hang around until you "get your money back." That money is gone.

4 Know your 'negative equity.'

Harvard's Joint Center estimates that 11 million American home owners are underwater on their mortgages—in other words, the loan is worth more than the home. Housing-data company Zillow puts the figure closer to 16 million—nearly one mortgage in three.

If you're in this position, you need to understand your legal status. Home owners who are underwater typically feel they can't sell until they are level again. But that isn't true. Your bank may be willing to accept a "short sale," where you sell for what you can get and they eat the loss.

In about half of the states, banks can't come after a mortgage borrower for a shortfall. Even in the rest, they can't take what you don't have.

If you are hoping to "get back to even" before selling, you will need to do some basic math. If your home is worth 20% less than the mortgage, you will need a 25% price rise from current levels to break even.

If your home is worth half the mortgage, as is the case in some of the worst-hit areas, you will need prices to double from here. So if you owe $400,000 on your Tampa home but it's only worth $200,000 today, prices would have to rise by 7% a year for 10 years just to get you back to even. How likely is that?

So, ask yourself: How long are you willing to wait? And how much will it cost you—in time and money—while you do?

5 Look at your cash flow.

Forget prices and the market for a moment, and look at your own cash flow.

Too many investors overcomplicate things. How much is it costing you per month or year to stay in your own home—in terms of mortgage, property taxes, fees, maintenance and other expenses?

Mortgage rates have collapsed to historic levels. Those with good credit can lock in a 30-year loan for less than 4%. As you can take a tax deduction for interest and property taxes, it may be costing you even less than it first appears.

On the other hand, how much would it cost to rent a home instead? If it is cheaper to own, which is true in many places now, it may make sense to hang on and wait for the market to recover. But if it is much cheaper to rent, you may be better off selling at a loss and renting instead.

6 Put your own finances first.

Smart financial management, like charity, begins at home. Investors need to put more weight on their own financial and personal needs than on national economic or other data.

Many home owners have put their lives on hold—such as delaying a move to a retirement community or taking a job in another city—as they have waited for a rebound in home prices.

This is time lost. It rarely makes sense. Economists would point out that these home owners are ignoring hefty, but invisible, "opportunity costs."

They are missing out on salaries, investments or life experiences that they otherwise would have enjoyed if they had sold earlier and moved.

7 Sell today, buy tomorrow.

You live in, say, Chicago. You want to retire to, say, San Diego, to be near your children and grandchildren. You've been on hold. Why?

Yes, prices in Chicago are down 36% over the past six years. But San Diego is down 39%. What you lose with one hand, you gain with another. In your new home you may be able to lock in a low fixed-rate mortgage.

The bottom line? The national housing market may take many years to recover. It's a buyer's market, but home owners hoping to sell need to do their math first.

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