Should You Buy a Home Today or Next Year?

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Barron's recently devoted its cover story to real estate. The conclusion was that prices had fallen to "attractive levels" and that investors should think again about buying.

Wrong. We believe that residential housing has yet to implode.

We do, however, see strength in commercial real estate in key geographic areas of the country, especially in areas that will benefit from the baby boomers retiring and economic problems in Rust Belt states. These good areas remain in South Florida, Nevada and Arizona.

As for the residential market, it is important to remember that the real estate market is distinctly different than the more sudden changes typical in the stock market.

Most private individuals invest in the stock market with cash. Only a minority uses the leverage of "margin." The reverse is true in real estate, where most individuals use the leverage of a mortgage, commonly of up to 80%.

Therefore, the real estate market is sensitive to both interest rates and capital values or carrying ability to a far greater extent than the stock market. *A person's home is his castle only as long as he can "carry" it financially!*

Unlike the stock market, real property sales can be forced by a fall in price. Already home foreclosures are up 53% in the past year.

Initially, a fall in price is heralded by an absence of buyers. It takes time for sellers to accept that their liquidity needs demand a drop in their asking price.

During this waiting period, media and other market comment encourages potential buyers to be yet more circumspect and to lower their bids still further. They then check web sites such as www.zillow.com or www.thehousingbubbleblog.com. Seeing a fall both in sales and in capital values, they become fearful and may lack the confidence to proceed with real estate purchases and even to make other non-essential purchases.

Meanwhile, a price slide in property prices then feeds on itself, until it appears overdone and bargain hunters come in. But, unlike the stock market, this normally takes considerable time. It also takes considerable time to reverse and transform into a bull market.

We estimate it will take three to five years for the economy to absorb the new homes and condos put on the market during the current boom. Prices will decline and then remain flat for years.

One in Five Flippers Losing Money

One out of five flippers who sold a home from April to June of last year lost money on the deal, says HomeSmartReports.com. That's the highest ratio of losses in two and a half years. And it may get worse, says *USA Today*. 'In all but four of the last 23 quarters, the flippers who lost money lost a greater amount than the flippers who made money," says Mike Ela, president of HomeSmartReports.com.

“We’re bombarded with ‘get rich through real estate’ ads and infomercials that promise get-rich-quick opportunities,” Ela says to *USA Today*. “So much work needs to go into proper research to buy and sell.”

Investors, according to the National Association of Realtors, purchased one out of every four homes sold last year. They primarily bought in the bubble markets of California, Florida, Arizona and Nevada, says *USA Today*.

The paper points out that many flippers are still holding firm on their selling prices, hoping to get out with a profit.

“It’s different from the stock markets,” Edward Leamer, director of UCLA Anderson Forecast, tells *USA Today*. “When things get bad, there’s a mad dash for the door, and prices can drop rapidly. In the home market, the investors, rather than rushing for the door, are holding onto homes imagining the market will turn around.”

But it is getting increasingly hard to do that. “For Sale” signs are popping up everywhere and prices are coming down. Inventories for existing homes rose to a record 7.5 months. The number of new homes for sale reached a record high with 6.6 months of inventory on the market. Builders are offering big incentives to unload inventory. Flippers looking for new properties have dried up, slashing demand.

Leamer tells the paper that the current market reminds him of real estate in the 1980s. When that bubble burst, it took 10 years for the real estate market to come back.

Home Foreclosures Rise 53%

The number of homes in some state of foreclosure in August last year rose 53% in a year. Compared to the prior month, foreclosures are 25% higher than in July, according to a survey by RealtyTrac, an online marketplace for foreclosure properties.

According to RealtyTrac, 115,292 properties went into foreclosure in August. August foreclosures are second only to the 117,151 properties foreclosed on in February.

RealtyTrac defines a foreclosure as any property in any of the following three stages: “Preforeclosures – Notice of Default (NOD) and Lis Pendens (LIS); Foreclosures – Notice of Trustee Sale and Notice of Foreclosure Sale (NTS and NFS); and Real Estate Owned, or REO properties (that have been foreclosed on and re-purchased by a bank).”

Rick Sharga, RealtyTrac’s vice president of marketing, tells CNNMoney that the slumping housing market is contributing to the spike in foreclosures. Homeowners in danger of losing their homes could have unloaded their properties quickly in the housing boom. Or, they could have refinanced their ever-increasing property values. Now, those outs rarely exist.

Just take a look at the hard hit the previously red-hot markets are taking. Florida’s August foreclosures increased 50% in a month and 62% over the past year. In California, foreclosures surged a shocking 160% in a year. Nevada’s foreclosures ballooned a whopping 255% from last August.

Sharga also points to the proliferation of ARMs, which help lower a monthly mortgage payment but the rates and payments adjust after a specified amount of time. Homeowners with ARMs that are resetting will likely face higher payments, since interest rates have risen over the past few years.

Just three months ago, *MoneyNews* quoted Brad Geisen, president and chief executive of property tracker Foreclosure.com as saying, “ARMs are a ticking time bomb. Through 2006 and 2007, I’m pretty sure we’ll see a high volume of foreclosures.

In March, *MoneyNews* told you that Douglas Duncan, chief economist for the Mortgage Bankers Association warned the MBA was “expecting an up-tick in delinquencies due to a number of factors: the seasoning of the loan portfolio, the increased shares of the portfolio that the ARMs and subprime mortgages, as well as the elevated level of energy prices and rising interest rates.”

Says RealtyTrac’s Sharga, “The real wild card is the nature of the loans themselves. Historically, ARMs were underwritten pretty conservatively. There has been a loosening of standards with lower credit worthiness and small down payments.”