Dealing with falling home prices

If you're a homeowner, how much trouble can you expect from the bubble?

Sometimes I think we bring these things on ourselves. The latest example is all the chatter about a "housing bubble." Depending on who's doing the chattering, it is either: (A) bursting, (B) leaking a little, or (C) just a figment of our collective national imagination.

Whether there is or isn't a housing bubble is almost beside the point. The fact that so many people are talking about it is bound to have some effect on would-be buyers and how much they're prepared to pay for the glories of home ownership.

There's little disagreement that housing prices have fallen of late in some parts of the country and that they may continue heading downward. An October 2006 study of 379 metropolitan areas by Moody's Economy.com found that 100 had a significant probability of price declines in the coming year. The median price drop for existing homes would be 3.6 percent, according to the report, with some areas, such as Las Vegas, Reno, Nev., Sarasota, Fla., and Tucson, Ariz., facing drops of 12 percent or more.

For prospective retirees, this is both a good thing and a bad one. If you are planning to buy a new retirement home, you might get a better deal now than you would have a year or two ago. However, if you have a house to sell, you might have to scale back a bit on your profit expectations. In other words, no need to bring your wheelbarrow to the closing.

So if you are a homeowner looking toward retirement, what should you do? Here are three variations on the theme:

▶ ***If you're planning to sell your home soon.*** None of the financial planners and other experts I consulted saw any reason to wait. Where housing prices are dropping, either a little or a lot, nobody expects to see a quick rebound. "A typical down cycle is five to seven years," says Eric Janszen, co-author of "America's Bubble Economy" (Wiley, 2006), one of the current crop of bubble books and far from the gloomiest and doomiest. He adds, "This market is so extreme in some places that it could be 10 years."

ILLUSTRATION BY BOB ECKSTEIN

Is the housing bubble a figment of our collective imagination?

Selling soonest makes particular sense if you are counting on the profits from your house to supply the bulk of your living expenses. Delay and you may have to scale back or postpone retirement, or move to an area where costs are much lower.

If, like many retirees, your goal is to sell your home and buy a smaller one in more or less the same area, it'll basically be a wash. You'll get a bit less for your current place, but you'll also pay a bit less for the next one. Where the gaps are bigger—say you're going from a city where home prices are suffering double-digit declines to one where they're just blipping down—you might have more to worry about.

Wherever you're headed, it's probably smart to sell before you buy, especially if you would otherwise end up with two mortgages on two homes, both of which might be declining in value.

One solution would be to rent for a time in the new area, which is often a wise idea anyway, especially if you're moving to a place where you've never lived before. Or, suggests Jane Young, a certified financial planner in Colorado Springs, Colo., make the contract for the new home contingent on your selling the old one.

▶ **If you intend to sell in the next couple of years.** Most of the experts I talked with said to do it sooner rather than later, assuming your goal is to snare the best price. "Go ahead and sell now, because it will get worse," advises Don Martin, a certified financial planner in Los Altos, Calif., an area that has seen its share of house-price ups and downs. In a typical housing recession, he argues, eager home buyers will jump in once prices dip, which will cushion the initial decline. But as other houses go on the market, the supply of eager home buyers will eventually run out, resulting in deeper price declines.

If you're on the fence, Young suggests toting up your other assets and sources of income. If you don't need to get the equity out of your home to support yourself, you can probably sit tight for a while. But if the choice is between selling your home and depleting your retirement accounts, selling may be the better option. Remember, too, that the capital gain on your home is tax-free up to certain limits (currently $250,000 for singles, $500,000 for couples), while the gain on many types of retirement accounts is taxable.

▶ **If you expect to stay put for a while.** You can probably ignore all the talk about bubbles and just go about your business. Odds are, the housing market will rebound someday, as it always has. And if you happen to be in the market for a second home and have the cash to swing it, this could be a great time for some bargain hunting. Just don't expect to sell it at a profit anytime soon. **$**

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