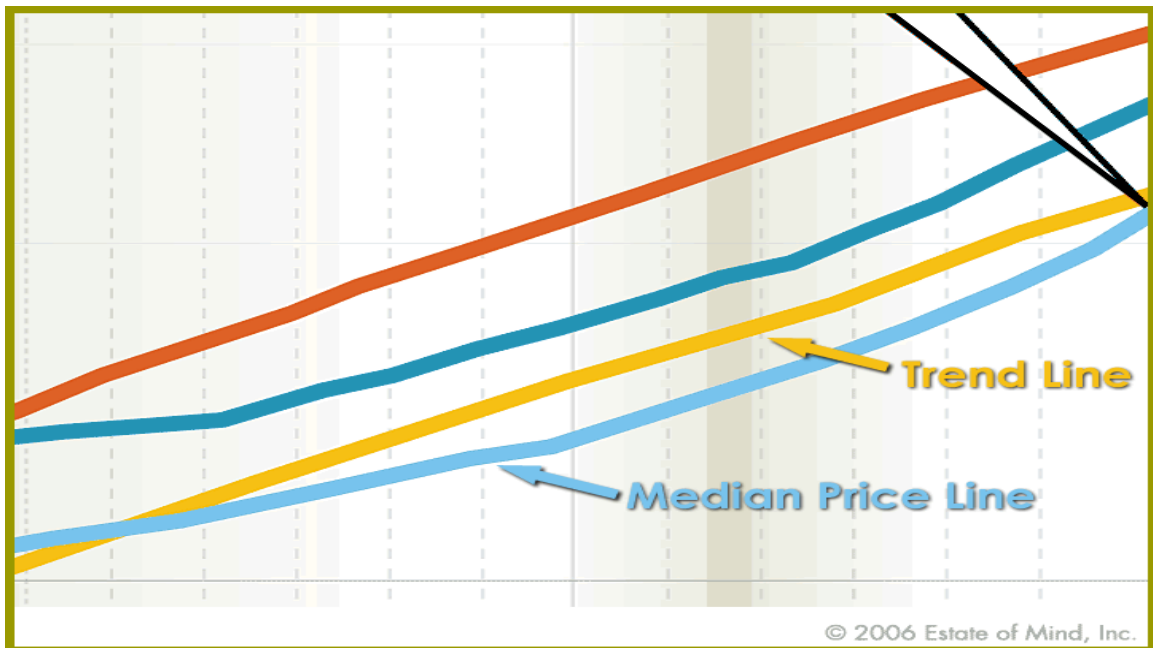


Trade Up Now? Why a Soft Market Deserves a Hard Look

By Brian T. Larrabee, CMPS

The general media has invested so much ink and airtime into perpetuating the notion of a “housing bubble” that it’s now time to turn that to your potential advantage. Just a short while ago, any buyer had to brave the auction style feeding frenzy, lick an envelope, submit their “sealed bid” cross their fingers and hope that their five percent over asking price offer was enough to do it against the dozen or so other interested parties. No doubt that makes for happy sellers. However, since we all need a place to live, don’t just about all sellers turn right around and immediately become buyers? And, if they were trading up to a larger home, didn’t that just mean that they were going to pay up proportionately higher on their next house to assure they didn’t just render themselves homeless? You bet it did. That brings us to the opposite conclusion applicable in today’s buyer’s market which is that taking a bit of a perceived hit on your sale means you’re turning around to enjoy a respectively larger bite of benefit on your purchase.

Given all of the current hysteria, it’s easy to lose sight of the fundamentals. Fortunately, having a market that’s cooled to a more historically normal pace allows you to actually think about that million dollar colonial before plunking down your cash; what a concept. For anyone still reeling from the recent figures sprawled across your television screen, the current national median price is still above the year end 2005 figure and the trend line in appreciation starting way back in 1963 is where median values have landed. So rather than a “bubble,” we have nothing more than a few good years that brought us back to where the market would have been if it were to progress at a steady rate rather than in cycles. The following chart illustrates this for national median prices. For average prices (the dark blue line) we’re still actually below the 42 year old trend line (red).



Let's look at a realistic example of trading up. Say your starter home has a respectable two bedrooms, bath and a half, the benefit of some sprucing up and new kitchen that you installed and would sell for around \$500,000 today. While in the heat of last summer's market, your friendly agent suggested you could sell it for \$550,000. You might be inclined to look at this as a loss of \$50,000. The silver lining is that the house you are interested in now to shelter your growing family might be reasonably priced to move at \$750,000 and that seller is licking his imagined wounds to the tune of \$75,000 below the \$825,000 he might have sold it for at the same time last year. The simple theory here, being that of relativity. Not the E=MC² variety, rather, just the simple fact that 10% of \$750,000 is more than 10% of \$500,000. So, if you're trading up in price, a slower market is the best time to do it because your gain is bigger than your pain.

There are other factors to consider as well, if you have an abundance of equity in your existing residence, selling for a little less at least reduces your capital gains tax liability. If you're single and have less than \$250,000 in equity or married filing jointly less than \$500,000, the opportunity exists for that money to be released without any tax consequence at all. Since that money can then be rolled over into your new property or even better, invested elsewhere to facilitate diversification and dramatically boost your return on invested equity, choosing to make the trade when the market is soft and the tax benefit still available keeps looking better.

Since purchasing a home is not only a major financial undertaking but involves a host of decisions relative to all of the inherent logistics, operating in a market that affords you the time to dwell for a bit on the decision before you actually dwell in the house is of significant benefit. It's always amazed me that we actually get to drive our cars before buying them and often dispose of them just a few years later, yet, we're never invited by home sellers to "come spend the night" before buying and investing or leveraging hundreds of thousands of dollars for what could be decades.

Yet another opportunity ripe for the picking is the ability of many in the position of having a highly appreciated property to sell, being able to rent it instead. There are plenty of homeowners that would like to become real estate investors that wouldn't take the plunge if they had to go out and actually buy something for that purpose. Yet, if they alter their thinking only slightly to buy something new to live in and simply rent out what they already own, it can make for not only a much simpler transition to that of true investor but a potentially more profitable one as well. First, having a comparatively small loan and at that, one that's likely to have been refinanced to a low rate over the past couple of years, it's quite common for the total monthly obligation to be less than the currently rising cost of renting. Just be sure to make sure there is a good prognosis for renting your house before buying another (check with your agent and scan the paper for comparables). Second, hanging on until the market digests the current supply of inventory can add back that extra sales premium that you might otherwise be walking away from if the property were sold today. As well, you know the condition of your house and have already had experience with the actual expenses of maintenance. This is a much better position to start from as a new landlord than buying an unfamiliar property. Tax wise, you still have an effective grace period to try out your new landlord status as you only need to have

occupied the property as a primary residence for two of the prior five years to avoid capital gains tax on the sale. Effectively, that means you can rent it for three years before selling and still avoid the gains tax up to your previously cited exclusions.

There is even greater potential benefit for those that will choose to proactively manage their equity to free up cash from their existing properties prior to vacating and renting then using only the minimum desired or necessary down payment on their new home. This not only puts the existing stored equity to work in the acquisition of another asset but also provides for an appropriate “acquisition basis” important to establish and protect the ability to maintain maximum tax deductibility on the new purchase. To learn more about this, read “Missed Fortune” by Douglas Andrew.

If this isn't all enough, interest rates are still scarcely above historical lows. Making a change when you can still lock in a low rate adds more fuel to the fire of opportunity. The economy is good, the stock market is good, unemployment is at 4.4% and at least recently, oil prices have been on the wane.

Add it all up, and it just makes sense, logistically, fundamentally and especially, economically. Then again, if you happen to like auctions and licking envelopes, you could wait until everyone else is ready too.

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