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Could declining home values affect your retirement plans?

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Homeowners who stay put and ride out the current slump in the housing market should not be overly concerned about the value of their homes or the long-term effect on their net worth. As the population continues to grow, the demand for housing and new homes continues to rise, just not as quickly as in past years, according to leading economic indicators.

If you have to sell in the near future, your house may bring less now than it would have a year ago. In addition, many borrowers may be paying additional fees on new mortgages. In December 2007, the Federal National Mortgage Association (Fannie Mae) added a 0.25% upfront charge on all new mortgages that it buys or guarantees. On a $400,000 mortgage, that would add $1000 in fees.

On the positive side, you will probably get a good value on the house you buy. Mortgage terms may be less favorable, however. With less credit being extended overall, even homebuyers with good credit ratings may find home mortgages harder to come by. There are tougher requirements for down payments and increases in mortgage insurance costs. In addition, the interest rate premium paid for "jumbo" loans, those above $417,000, has become much more expensive. Borrowers looking for a jumbo loan are paying more than a full 1% higher rate than the average smaller mortgage.

Jay Czarapata, CFP® is a Certified Financial Planner who practices in the Milwaukee office of SVA Wealth Management, Inc., Registered Investment Advisor, an affiliated company of Suby, Von Haden & Associates, S.C. For more information, call Wisconsin Medical Society Insurance and Financial Services, Inc. toll free at 866.442.3810.

Some Background

During the recession of 2001, home prices rose appropriately. The Federal Reserve reduced interest rates and kept these rates low until 2004. The low-rate environment from 2001 to 2004 and the foreign savings flowing into the United States kept mortgage rates low, making homes more affordable.

In 2004, former Federal Reserve Board Chairman Alan Greenspan argued there could be no housing bubble because the high cost and inconvenience of moving slows down speculation and price bubbles. But the continual home price appreciation may have given buyers and lenders an unreasonable sense of security. When mortgage rates began rising, buyers no longer could afford as large of a house, and that began the downward spiral we are experiencing now.

Recession on the Horizon?

In 2008, lower housing prices could have a dampening effect on the overall economy. According to Federal Reserve Board Chairman Ben Bernanke, for every dollar decline in home values, consumer spending decreases 4-9 cents. Decreasing home values also may discourage homeowners from borrowing against the equity in their homes to buy large-ticket items.

Declining home values, coupled with rising energy costs and uncertainty about a new presidential administration, create volatility in the stock market and feed speculation about a recession in 2008. In spite of the poor economic forecasts, the United States may avoid a recession because the housing market is a much smaller share of the economy than the business market that fueled the 2001 economic recession.

Buyer's Market?

When housing prices are low and the stock market is uncertain, some investors may be tempted to put their money in real estate.

Attempting to "time" the market—buying low, selling high—is nearly impossible to do, whether it's the housing market or the stock market.

Real estate investments are more complex now than in the past. If you do invest in real estate, consider a globally diversified real estate investment trust (REIT) fund that is actively managed by a professional fund manager. We generally recommend clients limit real estate investments to no more than 5% of their total portfolio.

Wise investors choose a strategy and stick with it. Periodically revisit your asset allocation and risk tolerance. In general, the farther you are from retirement, the more risk you can afford to take. As you get closer to retirement, you have less time to recover from a downturn in the economy, so you will want to move assets into more conservative investments.

Conclusion

Your home is a significant asset, but it's not a very *liquid* asset. When we advise clients about retirement income, we typically exclude home equity from their plans unless they are definitely downsizing their home in retirement. You will always need a roof over your head, so consider other investment options in planning for retirement.

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