SELLING

Rating buyer enthusiasm in today's cooling real estate market

By Shelly K. Schwartz
BANKRATE

It's been a good run — for home sellers that is. In many markets over the past five years, anyone posting a "for sale" sign in the front yard was virtually guaranteed to ignite a bidding war. Buyers pushed prices into the stratosphere in a mad dash to nab record-low interest rates and roll the dice on one of the biggest run-ups in real estate history. Lots of sellers doubled their investment dollars in a few short years.

But appreciation rates in even the hottest markets, such as New York and San Francisco, are starting to soften. And in some rather chilly markets, including those in South Bend and Erie, Pa., single-family home prices have actually declined during the year ending in December 2005, according to the latest survey from the National Association of Realtors.

Slower appreciation rates are good news for the economy, experts say, as the real estate market settles into a more sustainable rate of growth. They're not great news for sellers, who might have to resort to some creative marketing tactics to set their homes apart.

Incentives for buyers

"Seller concessions have not been common in the last five years," said Walter Molony, spokesman for the National Association of Realtors. "Sellers haven't had to offer them. But as we become more balanced, especially in areas of high inventory, that's where you'll see the use of concessions become a bit more common."

Seller concessions are incentives the homeowner provides to entice buyers. They can include anything from a decorating allowance (think scuffed hardwood floors) to contributions toward closing costs.

Historically, concessions have been introduced during the negotiating process — often after an inspection reveals undisclosed problems within the house. But Quicken Loans Chief Economist Bob Walters said they can also be an effective way to attract buyers.

"In difficult markets, as it is here in the Midwest, the balance of power is shifting," Walters said. "If your house is already priced aggressively and you've updated the home and done everything you can for curb appeal, what's left? The only answer for many sellers, unfortunately, is to cut the price. But if you advertise in your listing that you can help buyers get a payment that's hundreds of dollars less per month than they would pay in a similar home down the street, you're really differentiating yourself."

Here's how paying buyer points becomes a win-win situation: On a $300,000 home, a motivated seller is likely to slash 3 percent, or $9,000, off the price to get his or her house sold quickly. By leaving the price unchanged, and instead using that money (or even less) to pay for mortgage points, you're helping buyers secure a significantly lower interest rate and resulting monthly payment. That makes your home more affordable — a big plus in neighborhoods where many first-time buyers are still priced out of the market.

LIQUID LIBRARY PHOTO

There are some concessions you can offer to keep your house from being on the market too long.

How much more affordable? In the example above, buyers would pay roughly $1,575 per month on the $291,000 home with a 6.5-percent five-year adjustable-rate mortgage, or ARM, and no points. At the $300,000 price, where the seller pays 3 points to lower the buyer's rate to 5 percent, the monthly payments drop to $1,250 on a five-year ARM ... a $325 monthly savings. Both scenarios relate to interest-only loans, common among cash-strapped buyers. (The incentive would not be as favorable for buyers who opt for a conventional 30-year mortgage, since paying 3 points upfront would lower the rate by about three-quarters of a percentage point.)

And don't forget, the buyer also gets the tax deduction on those points in April, Walters said, a $2,700 value if they're in the 30-percent bracket.

"Very few sellers bring that payment out first," he said. "They usually focus on the sales price, but sellers can really change the game by focusing on payments. Frankly, most buyers think in those terms already."

Other creative concessions

If you're in a community where comparable homes are selling slowly or you just need to unload your home in a hurry, there are a couple other concession strategies to consider.

As was common during the real estate crash in the late 1980s, you can always sweeten the pot by offering to pay out for some or all of the buyer's closing costs. But sellers should consult a real estate agent or attorney before making any offers. Lenders generally limit seller concessions to closing costs and prepaid fees, including loan-origination fees, credit reports, appraisals, certain taxes, points, deed recordings and home inspections. Sellers are also allowed to pay for the buyer's private mortgage insurance, or PMI, at closing. Furniture and other big-ticket items that the buyer wants left behind are not considered allowable.

If a concession is considered non-allowable, the lender could reduce the home price by the amount of the concession. That alone could scuttle the deal.

A buyer's down payment may also limit the amount of closing costs you can cover.

The Federal National Mortgage Association, referred to as Fannie Mae, and the Federal Home Loan Mortgage Corp., or Freddie Mac, which purchase home loans from lenders, place their own restrictions on seller concessions. On loans where buyers put less than 10 percent down, seller concessions are limited to 3 percent of the total sales price. The limit climbs to 6 percent of the sales price when buyers put between 10 percent and 20 percent down, and 9 percent on loans where the down payment is 20 percent or more.

Last-ditch tactic: Raise your asking price

One last concession strategy, in which sellers actually raise the property price to help the buyer, may also resurface as the market becomes more competitive. Here's how it works:

Once you and the buyer settle on a purchase price, you agree to raise the price of your home by, say, 5 percent, and give that money back to the buyer at the closing table. On a $250,000 home, that's $12,500 in the buyer's pocket — enough to cover all or most of the buyer's allowable closing costs. The buyer gets a loan for $262,500 and, in essence, gets to cover the closing costs through the mortgage.

Because of the higher purchase price, the buyer will have to cough up slightly more for the down payment and monthly mortgage payments, but it's easier for many to absorb an extra $75 a month than cough up a hefty lump sum at settlement.

Furhad Waquad, a long-time real estate agent and president-elect of the Michigan Association of Realtors, cautions such transactions can be risky.

"Most of the time it's a slippery slope," he said. "Sellers who say they'll give concessions back to buyers and then raise the price of their house send a message to buyers. The buyers just assume the house was only worth the lower price to begin with and eventually only agree to pay the original asking price."

Even when these deals do go through, he said, sellers end up paying more for the real estate commission and fees based on the higher home price, including title insurance and recording fees. And, most importantly, the bank must appraise the home for its inflated sales price in order for the buyer to secure the loan.

"If there is a good dialogue between the seller and agent, there should be no need for this type of concession," Waquad said. "The house should be priced fairly to begin with. In a softening market, you have to package your product in the best way possible. Curb appeal, cleanliness and lack of clutter are still things I'd consider more than anything else."

While many sellers today, who have never experienced a market where buyers called the shots, may balk at the need for concessions at all, Walters said it's important to remember that every month your home doesn't sell is money out of your pocket. When used correctly, he adds, such incentives can make the difference between closing the deal and going back to the buyer pool. And, by not lowering the price of your home, you've given your neighbors a parting gift.

"Any time you lower your sales price, you're establishing a lower value for the whole neighborhood," Walters said. "It's the lowest sales price that gets used as a comparable to future sales. That's why I love concessions."

HOME Q&A

Watch terms on construction loan

Builders Association of Greater Indianapolis

Q. What should I look for when applying for a construction loan?

A. The biggest difference is that with a construction loan, you are borrowing money for something that doesn't exist, which makes it a more complicated procedure.

Typically, there are three different processes involved: First, you get a loan to buy the land. Second, you get a loan to pay for the building of the home. And, third, you then get a permanent mortgage. But you no longer have to go that route. Instead of going through the three processes and having three different closing costs, consumers can opt for a one-time loan.

Not all one-time loans are the same, however. The main thing a consumer should look for is whether the lender will base the loan on the appraised value of the home with no seasoning. Typically, lenders will loan 95 percent of the cost to build. For example, if you are building a $250,000 home, they would loan you $237,500 and your down payment would be $12,500. But, newly built homes often have a higher appraised value than their basic cost. Loans based on the appraisal value of the home give the borrower the opportunity to build a home with no money down, taking advantage of the equity that will exist when the home is completed. Land is referred to as "seasoned" when the borrower has owned it for a minimum of a year. Some

lenders make seasoning a condition of the loan, while others do not.

Last of all, in this time of rising interest rates, don't wait until your house is built to lock in an interest rate. It may take a year or more to build a house and rates can be locked for as long as 450 days before completion.

— Noel Watts
Regional builder manager
First Horizon Home Loans

✦Boomers

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features designed for safety, such as bathtub hand rails and shower seating, and features that make life easier, such as electrical outlets located higher on the walls.

Meeting the demand

"Indianapolis, for a long time, has been a traditional single-family community," Pasquinelli said. "In the last five to seven years we have seen it expand into townhomes, paired ranch villas, etc. There is already more demand out there, but it is very hard to find opportunities to build this kind of home. Most of the communities still want traditional single-family homes."

Portrait Homes has paired ranch homes in The Oaks in Westfield, Avon's Oxford Park and The Links at Eagle Creek near Brownsburg and plans to build them in Grant Park and Persimmon Grove in Avon and Bainbridge in Greenwood.

A "paired" ranch home is a ranch that looks like one home but is actually two homes (duplex or double) with a front load garage and a side load garage.

Empty-nesters often desire to remain close to their current community, but if it isn't zoned for "higher-density" housing, that could present a problem for them in the future.

REAL ESTATE WATCH

Low-rate ARM plus low home equity equals danger

Holden Lewis

Real Estate Watch

Foreclosures will rise over the next few years, experts agree. While each foreclosure is traumatic for the family that loses a house, the coming wave of defaults won't swamp the system.

The borrowers who are in the most danger have two strikes against them. First, they are (or will be) underwater: owing more than the house is worth. Second, they have adjustable-rate mortgages with low "teaser rates." Eventually, the ARM enters its rate-adjustment period and the loan is reset with a higher rate.

Quite a few homeowners have these two strikes against them, and almost $200 billion in foreclosures will result, said Christopher Cagan, director of research and analytics for First American Real Estate Solutions.

Cagan prepared a report in February that measured the extent of the risk to the mortgage market. It's not a financial-planning guide, but here's what consumers can take away from it: If you have an ARM with a teaser rate of 2.5 percent or less, watch out, because the monthly payments could skyrocket — even double — after the rate is reset. And if, in addition, you owe more than the house is worth, you could find yourself in serious trouble, unable to refinance and unable to sell without a loss.

Pretty common-sensical, really. That's why Larry Goldstone isn't all that worried.

'People are good people'

Goldstone, president of Santa Fe, N.M.-based Thornburg Mortgage, said, "Generally speaking, I think people are good people. They borrow money with the intention of paying it back."

When the business cycle moves down and people lose their jobs, more of them default, Goldstone said; it doesn't matter much if the borrower gets a 30-year, fixed-rate mortgage or something nontraditional, such as a payment-option ARM, in which the minimum payment doesn't even cover that month's interest.

David Greco, vice president of credit policy for MGIC, the largest insurer of mortgages, agrees that the loan type doesn't matter much. A precarious mortgage, he said, is one "where the likelihood that they'll be able to repay it is low, and I don't think there is anything that is inherently risky about any loan programs that are out there today."

Accurate assessment vital

The risk comes from the possibility that the borrower and lender didn't accurately assess the borrower's ability to repay, Greco said. One person might be able to handle a payment-option ARM with aplomb, while another person might wilt under a 30-year fixed.

That's not exactly how the federal government sees it. Regulators have proposed guidance, essentially, a set of strong suggestions, urging lenders to be more careful with interest-only and payment-option ARMs, especially in cases where the homeowner has little or no equity in the house or when the borrower produced little or no documentation of income and assets.

"The agencies are also concerned that these products and practices are being offered to a wider spectrum of borrowers, including some who may not otherwise qualify for traditional fixed-rate or other adjustable-rate mortgage loans, and who may not fully understand the associated risks," the proposed guidance said. Bankers worry that the guidance could result in fewer loans to deserving home buyers.

"The question is, without these products, would we be better off? The answer is no," said David Herpers, chief marketing officer for Amerisave, a lender that specializes in customers with damaged credit. "I think, as a consumer, these emerging mortgage products are, overall, extremely beneficial."

Anthony LaGiglia, a financial planner with J.J. Burns & Co. in Melville, N.Y., isn't as sanguine about nontraditional mortgages.

"When you look at interest-only mortgages, they were for a very select group of people — a business owner or a Wall Street person who gets a huge bonus every year," he said. "But they're becoming more commonplace. A lot of people are utilizing them just to afford a house. A lot of people are getting in over their heads."

He wonders what will happen to people who got low-rate ARMs when the rates enter the adjustment period and rise dramatically.

"I think people have no idea what can happen when the loans reset at higher rates," he said. "People say, 'Oh, I'll refinance in the future.' But we've been at 30-year- and 40-year-low interest rates."

What will happen when borrowers' payments spike after ARMs hit their adjustment periods? In his paper, Cagen said there will be an extraordinarily high default rate among people who got teaser-rate option ARMs and who have less than 15 percent equity in their homes. But those people are a small part of the overall pool of homeowners.

"Nationally, I think it will be a common cold, if you will," Cagan said, acknowledging that it will feel much worse to the people who lose their homes to foreclosure.

"The people who bought in 2003 or sooner ... they generally have enough equity that they're going to do all right," Cagan said.