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Trapped by the mortgage meltdown

Tighter lending standards have put many home sellers, owners and buyers in a bind. Here's how to escape it.

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NEW YORK (Money Magazine) -- Whether you're a home seller, owner or buyer, by this point you've got to be feeling a little rattled. The bad news about the housing market seems never ending: Foreclosures have more than doubled over the past year.

Sales of existing homes are off 11 percent from this time last year. At that rate, it will take at least nine months to work off the inventory of unsold homes. And median home prices in July (the most recent figure available) dropped for the 12th month in a row.

Worse yet, all that happened before problems in subprime lending expanded throughout the mortgage market and beyond, creating what's popularly being referred to as the credit crunch.

While it's too soon to see the impact reflected in the numbers, the immediate future is clear: As lenders tighten their borrowing standards, fewer people will qualify for mortgages.

Fewer qualified buyers can only mean that housing prices will slump further. Worst of all, economists don't see much chance for a turnaround until mid- 2008 and possibly into 2009.

Ready for some good news?

Here you go: First, remember that all real estate is local, and some markets are doing just fine, thank you - in fact, more than half of the major housing markets in the country have yet to see prices drop.

Even if yours is in the grim half (or soon will be), there are steps you can take to minimize the damage if you're planning to sell your house anytime soon.

Homeowners who plan to stay put for a while may not have anything to worry about. And if you're a buyer - well, this market may be the opportunity of a lifetime.

Sellers: Get Realistic

Even before the credit crunch hit, softening home prices had turned into outright price drops in many areas, particularly markets that were red hot a couple of years ago.

In Las Vegas, for instance, prices have dropped 3.6 percent over the past year. In Sacramento they've fallen 6.3 percent. And the damage is in double digits in parts of Florida, like Sarasota (down 11.3 percent) and Palm Bay (off 15 percent), putting those markets on par with some of the worst real estate busts in recent history.

With mortgages now harder to obtain, resulting in even fewer buyers to sop up the homes flooding the market, forecasters expect the weakness in sales to continue. Prices of luxury homes, mostly immune to the slump until now, may be hit especially hard. Rates on jumbo mortgages (loans for $417,000 or more) have spiked to 7.46 percent, and some lenders are charging more than 8 percent.

At those rates, fewer buyers can afford a high-end home, and those who can have to jump through more hoops to get approved for a loan. But the sellers who face the biggest hurdles are those in a rush to seal a deal.

"If you need to sell your home in three months or less, you may have to discount the price 20 percent," says Jonas Lee, founder of Redbrick Partners, a private equity firm that invests in real estate.

The moral: If you can wait at least a few months to sell, until the panic phase of the crunch passes, do. Otherwise, take these steps to ensure the swiftest possible sale at the best possible price:

Make it look like a bargain. Your best shot at a sale is when you first put your home on the market, notes Jim Gillespie, CEO of Coldwell Banker. If the initial listing price is too high, buyers leave and may not come back even if you subsequently cut the price, he says - after all, in this market they've got plenty of other choices.

Instead of using the list price of comparable homes for sale in your neighborhood as a guide, check out what homes have actually sold for in the past month or two. Then price yours slightly below that level.

Use cosmetics. "A new paint job in neutral shades, replacing worn carpet and fixing up visible damage to the gutters and roof are steps that pay for themselves," says Gillespie.

Also make sure to remove clutter and personal effects before you show the house.

"Buyers have to be able to mentally picture themselves living in the home," said Barb Schwarz, a home stager in Concord, Calif. Family photos and souvenirs make that harder.

Offer carrots. To clinch a deal, consider buying down the mortgage rate. Your picking up an origination fee (or "point") of 1 percent at closing could reduce your buyer's interest rate by about 0.25 percent depending on the type of mortgage. On a $200,000 loan, that will cost you $2,000; but it could save the buyer nearly $12,000 over the term of the loan.

Owners: Sit Tight

If you have an affordable fixed-rate mortgage, bought your home before 2006 and aren't planning to move anytime soon, relax. The price declines forecast for the next year or so won't make too big a dent in the mega-gains most homeowners registered in the preceding decade.

Who should worry? Well, if you did purchase your home within the past year or two, it might now be worth less than you paid for it. (Even that's not a problem, though, as long as you plan to continue living there for a while.)

And if you've been using your house as an ATM, draining your equity to pay credit cards or buy cool stuff, in the belief that rising home prices would quickly refill the coffers, you're out of luck. Nor can you count on outsize price appreciation to help pay for retirement or your kid's college education.

"That strategy has come to an end," says Joseph Mason, a finance professor at Drexel University. Until the storm passes, take these steps to protect your biggest investment:

Downsize your expectations. Just as stock investors in the late 1990s came to regard 20 percent-plus annual returns as normal, so homeowners over the past few years have started incorporating double-digit annual price gains into their financial planning. Don't bet the house on it. Literally. Your home isn't a replacement for saving in a 401(k) or 529 plan and shouldn't be used as a piggy bank.

Keep up your curb appeal. To make sure your home retains its value, keep it in mint condition - lawn neatly mowed, shrubs trimmed, no peeling paint or loose shingles. Now isn't the time to indulge your individuality by painting the exterior mauve or adding a large, unusual addition. You never know when your plans could change and you might have to sell in a hurry.

Buyers: Hunt for Bargains

Sure, it's harder to get approved for a mortgage these days. But if you can clear that hurdle and have enough money set aside for a down payment (count on needing at least 10 percent, and increasingly as much as 20 percent), you're golden, with more listings to choose from, at better prices and with a lot less competition.

"These days you're in the driver's seat," says Lawrence Yun, senior economist for National Association of Realtors.

That said, don't trade the driver's seat for the hot seat.

Think longer term. If you expect to stay in a home for less than five years, don't buy. Rent. You could easily end up getting less than you paid if you have to sell within a few years, especially once you figure in closing costs. Flipping may have worked in 2002. Not anymore.

Avoid having to bridge. Similarly, you don't want to be stuck between two homes. While there are ways to finance the down payment on a new house while you race to unload your old one, this is no time to be a "motivated" seller. If at all possible, sell first, buy later.

Consider all options. Use the extra time created by selling first to shop around. "Buyers should be looking at every home that's right for them during this downturn," says Danielle Babb, a California real estate investor. Get a good sense of what's available in your price range, which features are important to you and what kind of concessions sellers are offering.

Make your deal. Remember, prices may continue to fall for another year or two, so once you have a handle on the market, bid low. If the seller won't budge, walk away. There's no shortage of homes for sale.

Don't be afraid to press for noncash concessions as well. Sellers may be willing to pay a portion of your closing costs or provide a home warranty covering repairs for the first year.

If you're buying a new home, your builder may give you a cash rebate, plus free upgrades such as granite countertops, a Sub-Zero refrigerator, hardwood flooring or a big-screen TV.

Builders are also more willing to pay closing costs or buy down the rate. For them this is a desperately tough market. But that's not your problem. At all. ■

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