

10 Things to Know About Real Estate in 2010

by Luke Mullins

Tuesday, December 29, 2009 provided by



Is 2010 the year to buy a house? It certainly looks that way: After a steep run-up in prices during the first half of the decade, home values have plummeted back to 2003 levels. Fixed mortgage rates are sitting near record lows. And the foreclosure epidemic--while painful for many home owners--has created some wonderful opportunities for bargain hunters. If that's not enough, Uncle Sam is handing out thousands of dollars in tax credits to nearly all first-time buyers and the bulk of existing home owners who close a purchase by June.

But while the 2010 outlook appears inviting, there's one key catch. "You need to have a stable job," says Mark Zandi, the chief economist of Moody's Economy.com. The economy is showing signs of life, but the unemployment rate is already at 10 percent and expected to go higher. And while those mortgage rates are attractive, buying a house makes sense only if you can bank on your income stream. So before you consider purchasing a home, take a hard look at your job, your company, and your industry.

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That said, here are 10 things to know about real estate in 2010:

1. Prices to bottom: After more than three years of falling, real estate values have shown signs of stabilization in recent months. At the national level, home prices slid nearly 9 percent between the third quarter of 2008 and the same period this year, according to the S&P/Case-Shiller home price report. That's a notable improvement from the second quarter's nearly 15 percent annual drop and the first quarter's 19 percent decline. This improvement will give way to a bottom in home prices--finally!--in 2010, but not before additional declines, Zandi says. Zandi projects home prices will hit bottom in the third quarter of 2010 after logging a peak-to-trough decline of roughly 37 percent, based on the S&P/Case-Shiller national home price index. "That means we've got another roughly 10 percent [decline] to go," Zandi says.

2. Mortgage delinquencies up: Amid falling home prices and a nasty labor market, roughly 1 in every 7 mortgages was either past due or in foreclosure by the end of the third quarter--the highest delinquency rate in the 37-year history of the Mortgage Bankers Association's National Delinquency Survey. Two factors are expected to drive delinquencies even higher next year.

First, nearly 1 in 4 homeowners currently owes more on their mortgage than the property is worth, which increases their odds of default. And secondly, the national unemployment rate--which already stands at 10 percent--will peak at about 10.5 percent in the first quarter of 2010, says Patrick Newport, an economist at IHS Global Insight. Additional job losses mean more borrowers won't be able to pay their mortgage bills. "The [delinquency] rate is going to stay up there for quite a while because the job market is going to be really weak for a while," Newport says.

3. Foreclosures move upstream: The number of foreclosure sales will increase to about 1.9 million in 2010, according to Moody's Economy.com. And while we've already seen a growing number of more expensive homes heading into foreclosure, Heather Fernandez, vice president of marketing at the real estate search engine Trulia, expects the trend to pick up steam next year. (Trulia is a *U.S. News* partner.) "We are poised in 2010 to see a surge of foreclosures from prime borrowers. Hundreds of billions of dollars in option [adjustable rate] mortgages are set to be recast" next year, Fernandez says. Option adjustable rate mortgages allow borrowers to make lower monthly payments for an initial period, after which the payments adjust--or "recast"--higher. For some borrowers, the new payments can be more than twice their initial payments. Combined with other factors, like the loss of a job, a recasting option adjustable rate mortgage can make borrowers more likely to default. "These are [properties] at higher price points [and] potentially in more desirable neighborhoods," Fernandez says.

4. Mortgage rates to rise: Anyone who purchased a home in 2009 was presented with some extremely attractive mortgage rates. Rates on 30-year, fixed mortgages fell to an average of 4.88 percent in November, down sharply from 6.09 a year earlier. A key factor behind the plunge was a Federal Reserve program, first announced in November of 2008, that purchased debt and mortgage-backed securities from Fannie Mae and Freddie Mac. But the program is slated to expire at the end of the first quarter, and if private investors don't step up, fixed mortgage rates could jump. (The Fed, of course, could always decide to extend the program.) The unwinding of this Fed program, the improving economy, and mounting concern over government deficits could push rates on 30-year, fixed mortgages to roughly 5.5 percent by mid-2010 and close to 6 percent by the end of the year, says Mike Larson of Weiss Research. "Almost all signs to me point higher," Larson says.

5. Buyer's market remains: With prices still falling, mortgage rates remaining historically attractive, and additional homes hitting the market in the form of foreclosures, the dynamics of the real estate market will continue to favor buyers over sellers in 2010. That means those looking to buy a home next year should not feel pressured to act impulsively. "You don't need to have a sense of urgency, but understand that as time progresses the balance of power as we get into 2010 is going to slowly but surely shift away from [buyers]," Larson says. "It is not going to be a strong seller's market, but it will be more evenly distributed as the year goes on." Data from the real estate firm Zillow show that home buyers are already losing the leverage they once enjoyed. While home buyers landed a median discount of 4.6 percent off listing prices in January, the size of the gap fell to 2.7 percent by October. Expect this gap to close further as 2010 marches on.

6. Modification plan could be modified: While the Obama administration has put nearly 700,000 borrowers into temporarily restructured mortgages, it had found permanent fixes for just 31,382 struggling homeowners through November. What's more, critics have identified two key shortcomings of the government's \$75 billion ant foreclosure plan. First, the program isn't much help for borrowers struggling to stay in their homes as the result of a job loss. And the rickety labor market is a key factor behind rising delinquencies. At the same time, the plan does not sufficiently address the issue of negative equity--owing more on your home loan than the property is worth--which also works to increase foreclosures. "The current modification program does not address negative equity and is therefore destined to fail," Laurie Goodman, a senior managing director at Amherst Securities Group, told a congressional committee in written testimony on December 8. "It must be amended to explicitly address this problem." Zandi says the government may move next year to overhaul the modification program in two ways: improving troubled borrowers' negative equity positions by writing down some of the mortgage principal, and helping to turn troubled homeowners into renters.

7. FHA lending standards may increase: While banks have jacked up lending standards in the face of mounting delinquencies, mortgages backed by the Federal Housing Administration--which come with a minimum down payment of just 3.5 percent--have remained accessible to a wide swath of borrowers. The FHA guarantees nearly 30 percent of new-home purchase mortgages today, up sharply from just 3 percent in 2006. But the rapid growth has occurred alongside an increase in mortgage delinquencies. As a result, the FHA's reserves have dipped below congressionally mandated levels. The development has put pressure on the Obama administration to beef up its requirements for agency-backed home loans. In early December, the Department of Housing and Urban Development announced that it would make several changes to FHA mortgage requirements: raising up-front cash requirements, boosting minimum credit scores, and perhaps charging more for insurance premiums. Additional new restrictions may be in store. Taken together, the developments could work to choke off the supply of mortgage credit to borrowers who can't get financing elsewhere.

8. Tax credit available through June: On top of lower prices and cheap mortgage rates, Uncle Sam is offering an additional incentive to get buyers into the market next year. In early November, President Obama signed a bill extending and expanding a popular tax perk for home buyers. The legislation gives qualified first-time home buyers a tax credit of up to \$8,000 if they close the purchase of a primary residence by the end of June. Meanwhile, qualified current home owners are eligible for a credit of up to \$6,500 when they buy their next principal residence. But while the tax perk may make a home purchase more tempting, would-be buyers should make sure they have the job security and financial wherewithal to handle the transaction before going ahead. "Don't let [the home buyer tax credit] be the thing that drives you to act," Larson says.

9. Markets will vary a great deal by region: The performance of the national housing market is much less important than the dynamics of your local market, and sales and pricing trends will vary a great deal from one area to the next in 2010. "There will be geographic pockets where the values will still continue to decline, and there will be geographic pockets where they increase," said Dale Siegel, a mortgage broker and the author of *The New Rules for Mortgages*. That means anyone interested in buying real estate next year can't just read the national headlines. Instead, find a good blog that covers the local housing market and consider speaking with a real estate

agent with experience in the area. Check out online listings--pay close attention to pricing and inventory trends. And make sure to head out to open houses to get a firsthand feel for the market.

10. Mobile maps can help: Advances in technology have enabled would-be home buyers to increase the efficiency of their searches. For example, Zillow's iPhone app allows home buyers to see the estimated values and listed prices of the properties they pass on the street. The app, which is free, has been downloaded more than 830,000 times. Trulia has unveiled a similar product that allows users to find nearby open houses as well. "If you are sitting in a neighborhood having brunch on a Sunday, you can very easily pull up your phone [and] walk into open houses," says Trulia's Fernandez.

Courtesy of JB Goodwin