

GETTING GOING
By JONATHAN CLEMENTS

Don't Bet Against Your House

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After a couple of years of falling home prices, homeowners are understandably nervous about how they can protect what for most is their biggest asset.

For investors in stocks and bonds, successful strategies to combat the ups and downs of the marketplace are fairly straightforward. Have a diversified portfolio to balance risk, be disciplined about consistently saving money and don't chase returns or the latest fad.

Homeowners face a trickier landscape. Diversification, for one, isn't really possible. Owning ten homes, besides being very expensive, just multiplies the trouble in a falling market. Also, buying and selling homes isn't as easy as buying and selling mutual funds or shares.

But there are steps homeowners can take that can help you ride out the housing storm.

Take a Deep Breath

For starters, don't get too addled about the value of your home. Perspective, not panic, is always the first step in assessing the situation. Despite the scary headlines, the vast majority of homeowners are still sitting on decent gains, even if the value of their homes has declined over the past couple of years.

It's important to understand that home values rocketed in the early part of the century in a flukish way. Those kinds of gains won't be seen again anytime soon. Home prices, after the current shakeout ends, are most likely to resume their steady, nearly humdrum appreciation of value.

Moreover, homes aren't the great investments over time that many homeowners believe.

For all the ballyhoo of the early 2000s, the return on residential real estate has trailed stocks over time. According to research by Yale economist Robert Shiller, the average return on homes is about 3% a year, roughly on par with inflation. Stocks, on average, have historically performed more than twice as well.

These calculations focus on top-line gains -- the difference between the purchase price and the sale price. While shares don't require much maintenance, a home is an entirely different matter. A new roof, property taxes, the cost of your mortgage and various repairs and improvements all chip away at the investment value of a home.

Still, given the weak housing market, hunting for ways to protect the value of your home -- or to ameliorate losses -- is wise. It might be tempting to consider housing-specific solutions, but there really aren't any that make sense for most folks.

A Tool for the Big Guys

For instance, the Chicago Mercantile Exchange trades futures on indexes that track home prices in 10 cities and nationwide. These contracts can be used to hedge against home price declines. But these instruments are complex, expensive and aimed primarily at big players, such as home builders, who are looking for ways to hedge against the risks associated with hundreds of homes as opposed to a single residence.

Other housing-specific strategies involve exotic maneuvers such as shorting bonds or stocks that correlate with housing prices. In a short sale, you sell borrowed securities with the hope of buying the securities later at a lower price in order to return the borrowed shares. Again, this entails a high level of risk and is best left to the professionals.

Focus on Your Portfolio

But there are simpler ways to address your housing concerns. For starters, rather than worry about your home, focus on the rest of your portfolio as an overall hedge against falling home prices.

This would require steering clear of real-estate-oriented stocks such as real-estate investment trusts, home builders, mortgage companies and home-improvement stores. You should make sure the rest of your portfolio is well diversified.

And if you are more risk-averse because of your fragile home asset, consider adding to your bond assets.

You should also examine your debt, especially your mortgage. Interest rates remain low and you may be eligible for a refinancing, which is something a shrewd homeowner should always consider. If you are carrying expensive debt, such as credit-card debt, using a refinancing enables you to substitute cheaper debt for more expensive debt.

Ride It Out

In times such as these, simply holding onto your house and riding out the current downturn is important. It is a buyer's market and homes take some time to sell. If you are forced to sell quickly, you may get a really lousy price -- and if you haven't held your home very long, there's a good chance that you'll sell at a loss.

If you are struggling with the mortgage and refinancing is not an option, talk to your bank. While bankers are in a stingy mood, many will talk with you about reworking your mortgage if you are under particular stress. There are many negotiating options, such as paying only interest for a

period of time or making partial payments.

Banks would prefer to work something out, if possible, and keep you in your home rather than foreclose. They've got plenty of empty homes on their books already.

In addition, get creative about extracting more cash from your home. An obvious way is to rent out the basement or a room. Defer putting in that new kitchen, instead putting that money into your investments to build a larger cash cushion to weather the hard times.

Ultimately, if you need to sell, it's important to know that the housing downturn cuts both ways. You may not get the price you once could have, but buying a new place will come cheaper than in the past.

Courtesy of JB Goodwin