

## Kenneth Harney: As real estate market softens, players need to adapt

WASHINGTON -- Aug. 7, 2006 -- David Berson, chief economist for mortgage giant Fannie Mae, put it this way: One of the few immutable laws of economics is that "unsustainable trends eventually come to an end." And the end of the trend is pretty much where we are right now in housing.

Ben Bernanke, chairman of the Federal Reserve, was more opaque. In congressional testimony, Bernanke said, "the downturn in the housing market so far appears to be orderly." In classic Fed-speak, Bernanke managed to simultaneously soothe -- and unsettle -- his rapt listeners. An "orderly" real estate downturn sounds OK, right? But what about "so far"? What does that mean in practical terms for people who need to sell a house in the coming months? Could things unravel? And what about buyers -- could the property they buy be worth less a year from now?

Part of Bernanke's job description is to avoid specific predictions at all costs, so you won't get answers out of him anytime soon. But top housing economists such as Berson are paid to make specific projections and he offered them July 20 in a midyear forecast teleconference with Wall Street analysts.

Here is part of what he said, followed by some thoughts on what it all might mean for prospective sellers and buyers, or those already in the marketplace.

Berson thinks the Federal Reserve "is not done tightening" the ratchet on interest rates, and will move up short-term rates once again this month. After that, rates are likely to stabilize, bringing at least a temporary cessation to rising home mortgage rates.

He expects average home price appreciation, which had been running at a double-digit annual clip nationally for the past year, to drop to 3 percent or below by the end of the year. (On this point Berson is more bearish than most of his housing and mortgage industry colleagues, who project average appreciation in the 4 percent to 6 percent range.)

If speculative investors dump rental houses and second homes purchased during the boom years onto the market later in larger than expected numbers, Berson believes price appreciation could drop to a 1 or 1.5 percent annual rate -- a level not seen since the recession years of the early 1990s.

### **Swaths of Florida**

In a handful of markets where investors accounted for large shares of boom-time property purchases and where price increases soared for years, Berson believes "there is a good chance of declines" in average home values. Though he avoided naming all of the markets that Fannie Mae worries about, he did identify San Diego and parts of California -- "though not all" -- plus large swaths of Florida "but not Orlando."

Like many analysts, Berson says the weakest link in the housing market -- and the most vulnerable to price declines and investor dumping -- is the condominium

sector. Many markets are glutted with unsold inventories of new and converted condo units already, and Berson is concerned that significant price corrections could be just over the horizon.

### **The projections**

What to make of such sobering projections? Here are a few thoughts:

- Neither Berson nor Bernanke foresees widespread property value declines as part of the current down cycle. Only in those markets where speculation was rampant in 2003-2005, and where job and population growth are anemic, are there risks of price declines.
- Neither anticipates mortgage rates to rise significantly higher than today's rates, which are still on the low side by historical standards. As long as financing is available and affordable, buyers will find ways to purchase houses.
- For all-weather real estate players, a flattening market means changing one's tactics, not burrowing away to hibernate until the market warms up. For sellers, it means getting acquainted (or reacquainted) with the toolbox of techniques developed during the down periods of the 1970s, '80s and '90s to move houses. For example, seller financing, where you take back a second note on concessionary terms to push the sale, take back a first note if you can afford to, or "buy down" your purchaser's interest rate to lower monthly payments.

Experienced real estate brokers can fill you in on these strategies, along with their pros and cons. They can also guide you on how to price realistically to sell now, not five months from now.

For buyers, down markets often offer exceptional opportunities to acquire real estate at prices and on terms that were unthinkable just a few years before. Again, the message is: Don't go to sleep. To the contrary, get off your duff and scour the market for properties that may never be cheaper, or even available.

Heads-up real estate is, as the industry adage goes, the art of the possible. You've simply got to adapt to the changed market conditions. And probably work a little harder.

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