National housing slowdown could spell trouble

WASHINGTON (AP) - The nation's red-hot housing market may finally be nearing its peak, meaning the end of double-digit annual percentage price gains for homeowners and potential trouble for more recent purchasers who stretched to buy.

That's the assessment of economists, who concede they have been forecasting a cooldown in housing for some time only to be confounded as sales and prices continued to boom.

Sales have certainly been sizzling this year, putting the country on track for a fifth straight year of record purchases of new and existing homes.

Home prices have been surging as well. The government reported last week that prices jumped by 13.4 percent in the April-June quarter this year, compared with the same period a year ago, the biggest increase in 25 years. That is more than double the average annual price gains of 6 percent recorded over the past three decades.

But scattered among the statistics are some signs of a slowdown. In July, sales of existing homes fell by 2.6 percent even though the nationwide median price rose to a record $218,000.

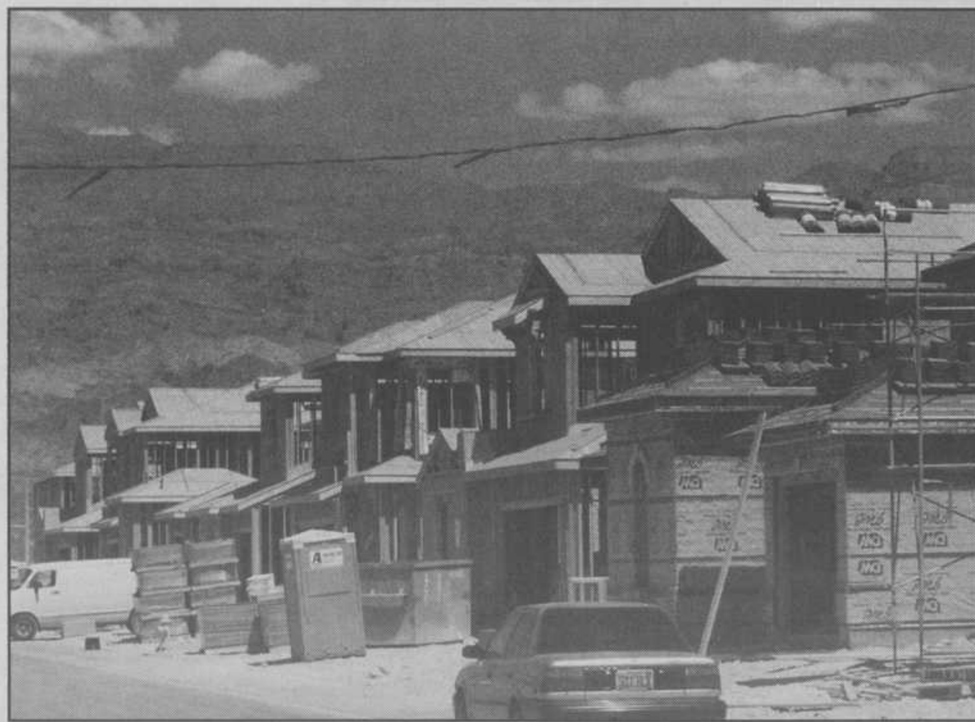
Homes in some areas are staying on the market longer before they sell and the Mortgage Bankers Association reports that its index of demand for home mortgages now stands 11 percent below a June peak.

And none other than Federal Reserve Chairman Alan Greenspan recently said that "the housing boom will inevitably simmer down" with prices slowing and possibly even falling.

The issue of how much of a slowdown will occur and whether home prices will fall or just not rise at double-digit rates will depend to large extent on the course of interest rates in coming months.

"I think what we have in store is a slow deflating of the housing bubble, not a bursting of the bubble," said Mark Zandi, chief economist at Economy.com. "But if mortgage rates rise more sharply than I am expecting, then the downturn in housing could be more severe."

The devastation from Hurricane Katrina could turn out to help the housing industry, mainly through falling interest rates. Investors pushed rates lower this week in anticipation that Katrina



Sentinel-Voice photo by Kathi Overstreet

The city of Las Vegas has experienced the most hyperactive real estate market in history.

and the resulting surge in energy prices will act as a drag on economic growth and could persuade the Federal Reserve to pause in its 14-month campaign to push rates higher. As a result, rates on 30-year mortgages dipped to 5.71 percent, down from a high this year of 6.04 percent set in late March.

David Seiders, chief economist for the National Association of Home Builders, said rebuilding from Katrina's devastation probably will not have much impact on the overall housing market since residential building permits for all of Louisiana and Mississippi last year amounted to just 1.8 percent of the national total.

But analysts are forecasting that housing sales will begin to decline from record levels by the end of this year and into 2006. The slowing sales pace is expected to end the super-sized price gains many parts of the country have experienced.

Richard DeKaser, chief economist at National City Corp. in Cleveland, said he believes 53 metropolitan areas, representing 31 percent of the country's housing market, were "extremely overvalued and confront a high risk of a future price correction."

And what might that price correction look like? DeKaser said over the past 20 years, 64 cities have seen home price declines of 10 percent or more over a period of two years. But all of those declines occurred along with a weak overall economy, something not present now.

But if rising energy prices spread into more widespread inflation pressures and the Fed feels it needs to raise interest rates more quickly, then analysts said housing could be in for a rougher landing.

Those most vulnerable in such a situation would be homeowners who took advantage of the growing popularity of various types of new mortgage products such as interest-only loans. They allow buyers to pay only interest initially while charging a lower interest rate that remains fixed for a certain period, often the first three years of the loan.

The problem comes when the introductory period ends. Then holders of these loans are faced with a double-payment shock. The interest rate they must pay is likely to rise and they will have to make not only interest payments but also begin paying back the principal.

Homeowners with already stretched finances may find themselves unable to make the new monthly payments, forcing them either to sell their homes or default on their mortgages. Either development would dump more supply into a slowing market and thus further depress prices.

But many analysts don't believe that doomsday scenario will come into play to any significant extent unless the economy seriously weakens. They note that even with the growing popularity of interest-only loans and various other types of mortgages that feature low down payments, the number of loans going into delinquency has been falling.

Some see a slowdown in home sales as beneficial

"If the frenzied buying levels off, the market will become more balanced between supply and demand" and help to ease price pressures, said Lawrence Yun, senior economist at the National Association of Realtors. "This will certainly not be like the stock market bust of 2000. We are just going from a rapid pace to a more healthy pace," he said.

With home prices in the stratosphere, many buyers have been forced into more exotic types of mortgages to be able to afford to buy a home. Here is some advice from housing experts on what people should consider in the current environment.

BUY OR NOT: Some people have hesitated to purchase a home, especially in the hottest sales areas, for fear they could buy at the top only to see home prices start to decline. Analysts say it is very hard to time the market. If you need to buy because you are being relocated and you plan to be in the new home for several years, the advice is to go ahead and buy. The chances are that even if home prices do fall for a year or two, they will begin rising and you will recoup your investment when you sell.

REFINANCE: For people who now have adjustable rate mortgages, the advice is to consider refinancing to a fixed-rate mortgage. Mortgage rates have been at the lowest levels in more than four decades for an extended period of time. The blow to the economy from Hurricane Katrina and surging energy prices may keep rates low for a while longer. But the expectation is that rates will eventually start rising again and could be above 7 percent by the end of 2006. Moving to a fixed rate would protect against seeing a sharp jump in a low introductory rate. If the adjustable rate mortgage is also an interest-only mortgage, there will be a second payment shock when the homeowner has to start paying interest and the principal of the loan.

INVESTORS: People who have been playing the hot real estate market by buying homes only to turn around and resell them at a profit should reconsider that approach. That strategy could prove dangerous if, as expected, home sales retreat from their current record highs and prices stop rising at double-digit rates.

OTHER IDEAS: People who find they are still priced out of a particular area might consider moving to a smaller house or farther out. For people 62 or older and in need of cash, they might consider taking out a reverse mortgage that would allow them to borrow against the equity in their home and never repay the loan as long as they live in the house.