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peak, renting, and then buying again when it seems prices have bottomed out -- can be advantageous in the real-estate market is advice we would be loath to agree with. Whereas the logic of selling short can be compelling in the stock market, where prices may be hundreds or thousands of times rational fundamental values, this strategy seldom works with real estate. Here's why.

Transaction costs in real estate are enormous compared to selling a stock-market investment. For example, if you sell \$200,000 worth of stock in one trade, the fee likely will run no more than \$1,000 or 0.5% of the asset value. But selling a \$200,000 house may cost 7% in fees or about \$14,000, plus the cost to clean and repair the home before listing it for sale; the time involved in finding an agent to sell it; the time and cost involved in planning, packing and executing a move; time spent changing addresses for mail and so forth.

Because of these transaction costs, short-selling strategies in real estate simply don't make financial sense unless the household involved is fairly certain that the average decline in home values will be well over 15% over the next two years. Such a decline is a rare occurrence.

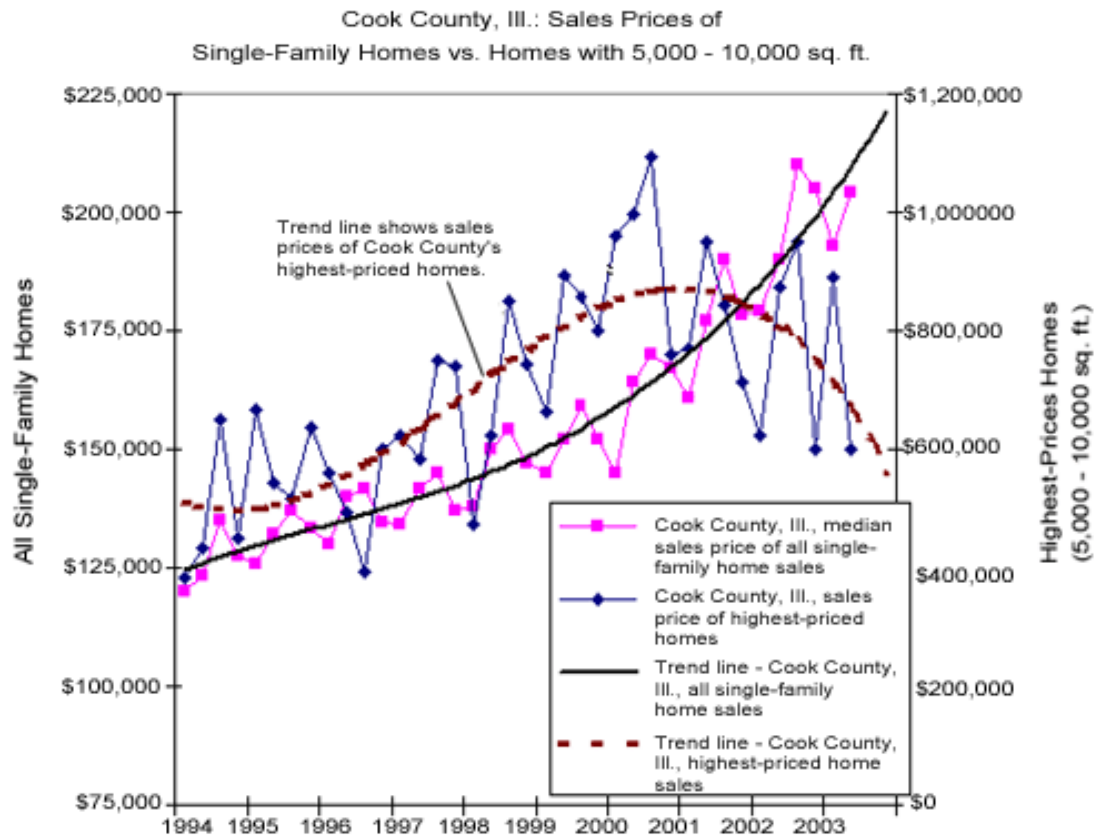
Will Higher Interest Rates Trim Home Prices?

Mr. Talbott correctly predicts that home prices can decline when interest rates increase, but this won't affect all homeowners equally. When interest rates increase, homeowners who locked in fixed-rate mortgages will see no increase in their mortgage payments. When rates go down, they refinance. Unless forced to sell, many homeowners ride out mortgage-rate upswings and wait for market stabilization. Prices in very few home markets will cascade downward because interest rates increase.

Too Late for a Cheaper Neighborhood

Some of the advice provided by Mr. Talbott, such as waiting to buy in selected home markets, makes sense. For example, we agree that the huge condominium supply coming on line in downtown Chicago over the next year may soften prices. But some of his other advice doesn't add up. For example, moving from a high-priced area to a low-priced area, at least in 2003, no longer makes sense. Housing prices in many luxury home markets already have peaked, so to sell now to move to a less expensive home would mean not selling at the top.

The data in the chart below illustrate this. Here are the home-price trends for greater Chicago's luxury real-estate markets, which we defined as the largest homes (5,000 to 10,000 sq. ft. living space). Even while median home prices climbed in 2002 and continue to do so in 2003, prices for an area's most expensive homes peaked in 2001 and have been softening, if not retracting, as the trend line in the chart shows. Prices for this area's most expensive homes started declining well before most people realized, and even before interest rates increased. This was simply a market adjustment, not unlike stock prices reverting toward more sustainable fundamentals. We have repeated this analysis of home prices in all major U.S. metro markets with fairly similar results.



Planning on Bankruptcy?

We agree with Mr. Talbott that consumers often have borrowed too much, but if a homeowner trades credit-card debt for cheaper, longer-term mortgage debt, we see that as progress. In this situation, mortgage default becomes less likely than when a homeowner holds a smaller mortgage and a large credit-card balance. We abhor personal-finance counselors who suggest using bankruptcy to eliminate past debts rather than taking responsibility for debt-incurring decisions. Bankruptcy may make sense for extreme cases, but better advice is to suggest building up some extra savings before taking on debt burdens of any kind.

Over the past few decades Americans have received some very appealing after-tax returns from investments in housing, especially on a risk-adjusted basis. Since 1986, the median home price has increased by 4.3% per year on average, according to the National Association of Realtors. This does not represent the total return from housing because owners also receive the "consumption benefit" of living in their homes. That is, houses provide such benefits as shelter and comfort even when property values decline. Where else can you find an investment that provides consumption benefits and maintains or exceeds inflation with so little risk? Housing remains a long-term viable store of wealth for many households and a solid investment for most.

Homeowners should relax and not lose sleep over predictions of a coming crash in housing prices. If the home you live in is among your area's most expensive, odds are your home's value already is down from a few years ago. It's too late to worry about selling at a peak. If you're a satisfied homeowner and interest rates do climb, be patient. Don't sell your home and start renting unless you simply like donating money to real-estate agents and landlords.

-- Dr. Norm Miller is an economist and holder of the West Shell, Jr. Professorship of Real Estate at the University of Cincinnati.

-- Dr. Michael Sklarz is a real-estate economist and chief valuation officer for Santa

Barbara, Calif.-based Fidelity National Information Solutions. He is also a consulting economist to The Federal Reserve Bank of San Francisco and Chairman of the Hawaii Council on Revenues.

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