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When Housing Markets Cool

If you think you've been seeing more for-sale signs on homes in your area, it's probably not your imagination. A June/July survey comparing housing inventory levels with the previous month found that inventories grew in 23 of 24 major metropolitan areas. Only Houston had a shrinking inventory (–3%).[1]

Granted, housing inventories were expected to swell in June as the high season for real estate got under way. This seasonal pattern may explain the moderate growth in places like Charlotte, N.C. (4%) and Dallas-Forth Worth (6%). However, it is unlikely to explain the explosive inventory growth in places like Los Angeles (175%), Phoenix (298%), or Orlando (397%).[2]

If you are familiar with the laws of supply and demand, you know that a rising supply of a product sometimes indicates a softening demand. And in a market where supply outstrips demand, prices tend to fall. So it comes as no surprise that the same survey found that housing prices declined in 19 of 26 major metropolitan areas.[3]

The good news is that the slowdown in the housing market has been orderly and not accompanied by a rapid growth in mortgage delinquencies or foreclosures, according to Federal Reserve Chairman Ben Bernanke. The other good news is that housing market activity is still relatively high by historical activity.[4]

And the bad news? That depends on your outlook.

It's Where You Live

A house is probably the biggest investment most people will ever make. But you might not want to think of your house as an investment. It's your home, after all. It's where your loved ones reside, where you make lasting memories, where you retreat from the hazards of the outside world. Your home is likely to have considerable emotional value for you and your family. Research has shown that people who are able to separate their emotions from decision making tend to make better investment decisions.[5] As you consider how to react to changes in the housing market, keep in mind that emotions and solid investment decisions don't make good bedfellows. There is a difference between what your house is worth in the real estate market and what it is worth to you in terms of shelter and security.

Timing, Timing, Timing

Timing may be among the most important elements in any decision about real estate. Of all the variables that affect the value of real estate, timing may be the one variable that you can control.

History shows that over long time periods, average real estate values generally have moved upward. Although there have been short periods during which prices have fallen, the best defense against such price declines generally has been the ability to wait for the recovery.[6]

Take the early 1990s, the last time average real estate prices suffered a meaningful decline. According to the Census Bureau, the average sales price for a new single-family home (a benchmark for residential real estate prices) fell from $149,800 in 1990 to $144,100 in 1992.[7] If you had to sell during this time period because you accepted a new job in another area or for some other reason outside your control, it's possible you would have lost money.

But if you were able to ride out the price decline, the average sales price recovered by 1994 — and by 2005 it had more than doubled from its 1992 low.[8] It's also interesting to note that the median sales price of existing homes has increased every year since 1990.[9]

Of course, there is a difference between national averages and your personal situation. If you were planning to sell in the near future, declining real estate prices could pose a concern. If you were planning to buy soon, declining prices could come as good news. If you have no plans to buy or sell, the current environment is unlikely to affect you.

Price fluctuations are an inevitable occurrence. When you see news reports indicating that real estate prices are falling, consider them in light of your long-term situation. You might want to think of your home as something separate from your portfolio.

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1–3) *The Wall Street Journal*, July 20, 2006
4) *USA Today*, July 20, 2006
5) *Journal of Financial Planning*, October 2005
6–9) Haver Analytics, 2006