



DECLINING HOUSE PRICES – THE SILVER LINING

by Peter Dolezal [The Naked Homeowner](#)

January MLS sales figures confirmed a further decline of Greater Victoria's single-family home prices, to an average of \$526,000. This is a rather startling 16% drop from the historically record-high prices of last September. Many homeowners have become concerned, even frightened, by such a drastic drop. This is understandable. I hope however, that this article will put such fears in perspective and even highlight some not-so-obvious benefits.

THE PERSPECTIVE

The heady highs of last September were the culmination of a totally unsustainable doubling of house prices over a brief period of only five years. Unless you bought near the peak and are now forced to sell your home, the recent price drop should be viewed more philosophically as a cyclical adjustment toward a more sustainable level of home values.

Few of us worriers recall that a mere 30 years ago, in 1978, the average single-family home in Greater Victoria sold for slightly under \$64,000. Despite several downturns in the intervening years, the January, 2009 average selling price of \$526,000 was a rather healthy \$462,000 higher than in 1978. If we assume that the typical buyer of an average home in 1978 had a down payment of 25% (\$16,000), the actual gain on his initial investment becomes \$510,000. This value increase, over 30 years, works out to an annual, tax-free, compounded rate of return of 12.3% - a rate of return almost impossible to equal, over such an extended time frame, in any other investment. Even had the buyer paid cash for the full price in 1978, his compounded rate of return would still be a very respectable 7.3% annually.

THE SILVER LINING

- 1. Mortgage Renewals:** I suspect that greater numbers of homeowners are renewing a mortgage in 2009, as opposed to those needing to sell their home. For these refinancing homeowners, current mortgage-renewal rates represent a huge financial benefit.

Today, many Banks are posting 5-year fixed-rate mortgages at 5.79%. Some even advertise further "special" rates as low as 4.49%.

Two mortgage brokers in Sidney are able to offer clients the same mortgage; one for 4.24%, the other for 4.29%.

Many homeowners, whose mortgages are up for renewal this year, typically have been paying rates of 6% or more. Upon renewing for example, a \$300,000 mortgage today at 4.24%, as opposed to his previous 6.0% (both on a 25-year amortization), a homeowner's monthly payments would now drop from \$1,920 per month, to \$1,620. Over the new 5-year mortgage term, the homeowner's total payments would, incredibly, amount to \$18,000 less than in the previous five years. If, instead of pocketing the savings, the homeowner chooses to keep his payments unchanged, his 25-year amortization period will be drastically reduced.

- 2. Purchaser Affordability:** The combined effect of lower home prices, plus record low mortgage rates, results in a drastic improvement in home affordability for all buyers, most particularly first-timers.

For home prices to stabilize and eventually, to return to upward growth, more buyers must enter the housing market. Improvement in the affordability index is a key precondition to increased buyer interest.

The recent Federal Budget has also provided assistance, especially for first-time buyers. Each first-time buyer may now withdraw, without penalty, up to \$25,000 (previously \$20,000) from an RRSP, toward a residential down-payment. Even though such withdrawals must be repaid to the RRSP over the next 15 years, they nevertheless are a helpful source of funds for buyers struggling to put together their minimum 5% down payment.

The Budget also offered all first-time buyers a \$750 tax credit toward closing costs on their home purchase.

- 3. Quality of Real Estate Agents:** With many fewer sales in recent months, distributed among more than 1300 agents in Greater Victoria, we can expect several hundred marginal agents to leave the business. This serves to upgrade the caliber of the remaining realtors. This winnowing process serves the best interests of the public. The agent we hire should be capable of making a decent living in any market condition.

The key messages from the above are:

- Don't be overly concerned about the headlines regarding falling home prices. Over the long term, our home remains one of the finest investments we will ever make, particularly since we have to live somewhere. It's clearly better to have mortgage payments building equity for you, rather than rental payments building equity for a landlord.
- 1) Whether renewing your mortgage or obtaining one for the first time, shop around for the best rates. By all means check with your banker, but never commit to a renewal until you have compared the rate available through a mortgage broker.
 - 2) If, on renewing your mortgage, you determine that your mortgage payments are about to be reduced, consider keeping your previous payments unchanged, thereby dramatically reducing the number of years before your home is mortgage-free.
 - 3) If you are a potential first-time buyer, recheck the amount of mortgage for which you qualify. Between today's much lower interest rates and the lower home prices, you may well find that your first home is affordable much sooner than you had thought possible just a few months ago.
 - 4) Whether buying or selling a home, take great care in selecting the best possible realtor to represent your interests.