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Should you buy a home now?

The drop in prices may mean it's time to jump in. Or is it too soon? Experts offer pros and cons.
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Southern California median home sale prices are down about 30% from their peak. That's about as far as they fell in the 1990s real estate downturn, and enough of a decline to have many asking: Is it time to buy? ¶ Some are already answering with their checkbooks. In the inland areas where prices have crashed hardest, buyers are slowly returning. ¶ But many of those who study housing markets say the worst is yet to come for real estate. Buy now, they warn, and you'll regret it as prices continue falling. ¶ Others contend that prices are low enough that renters who aspire to own should buy now so they can start building their equity. ¶ Predicting price trends is a dodgy business, and there's no one right answer for everyone. But if you are thinking about buying now, here are some pros and cons to consider.

Buyer beware

The main argument against buying a home now is that values are still spiraling downward. Stay on the sidelines and you'll be able to buy that dream home for a much lower price than now -- about 25% less in Los Angeles County, predicts Celia Chen, director of housing economics for Moody's Economy.com.

Chen bases that guess on several factors, including the high inventory of unsold homes and the gap between current prices and income.

During the housing boom that began in the late 1990s, the relationship between home prices and incomes grew increasingly out of whack. Mortgage lenders offered subprime loans with low introductory teaser rates, as well as "no-documentation" loans that didn't even verify a borrower's income.

This allowed people to buy more expensive homes than they could afford, helping inflate values. But many of those loans have gone into default as teaser rates expired and borrowers couldn't make their payments. And lenders are no longer handing out loans to people who can't demonstrate their ability to repay them.

That has made the relationship between home values and incomes relevant again, economists say.

More than half of the adults in the Los Angeles metropolitan area own their homes. But because of the price run-up that began in the late 1990s, fewer than 11% of adults in the L.A. area earn enough to buy a median-priced home of $412,000, according to a National Assn. of Home Builders index.

As recently as 2001, when the median was lower, that figure was about 38%.

Los Angeles economist Christopher Thornberg believes that home prices will stabilize when homes are affordable to about 25% of the adult population. For that to happen in Southern California, home prices would have to come down 20% to 35% from their current levels, Thornberg said.

"There's no way in hell the house you buy now will be more expensive next year," he said.

Home prices are also relatively high compared with rents. The ratio of home prices to annual rents in the Los Angeles area was 20 as of March 31, meaning the median home sale price was 20 times a year's rent for a comparable property, according to Moody's Economy.com.

The 15-year average ratio in Los Angeles is 16.4.

It's true that rent checks don't generate returns. But renters can take the money they would have spent on a down payment and invest it in stocks, mutual funds or other investments (20% down on the median-priced Los Angeles home would be about $82,000) and are spared the costs of home maintenance and repairs.

Another reason not to buy is the current economic uncertainty. The mortgage payment that looks affordable now will be harder to make if you lose your job.

"You want to have enough savings or cash flow to weather a downsizing in the workforce," said Judi Martindale, a San Luis Obispo financial planner. If not, she said, keep renting.

Those who would depend on their homes as a form of retirement savings also should hold off, Martindale said. A house is not liquid, and relatively few who plan to generate cash by downsizing to a cheaper home in the future actually do so, she said.

"It's very difficult for people to move down" when the time comes, she said.

Why wait?

Those who say now is a good time emphasize the benefits of homeownership. The market may or may not be near the bottom, but take that off the table, these people say. Instead, consider the advantages of owning versus renting.

As long as you can afford your mortgage, for instance, you won't be evicted. With a fixed-rate mortgage, your payments remain the same over time, while rents generally rise. Over time, you can build equity in your home and own it free and clear -- and then won't have to worry about monthly payments at all.

There's also the advantage of living in an environment that you control, where you can remodel or decorate as you please, without having to seek a landlord's permission.

"Houses are lifestyle assets, not investments," said Brent Kessel, a Pacific Palisades financial planner. Kessel believes that those waiting for a market bottom may be approaching homeownership the wrong way. As long as one stays within one's means, the financial risks of homeownership diminish over time.

"Make a purchase decision based on your lifestyle, not the market," he advises.

Margaret Smith, a Claremont financial planner and former university economist, takes it a step further, saying that a home is almost always a smart investment, even if values do temporarily decline.

Smith and her husband, Gary Smith, a Pomona College economist, say buying is practically a sure bet when you would pay less for a monthly mortgage and other home costs than what it would cost to rent the home.

They call that monthly savings the "home dividend" and say it will offset a short-term decline in a home's value. The monthly rent savings not only is money in your pocket but also can be invested elsewhere.

Even if your mortgage payment and expenses start out higher than comparable rent, the payment becomes relatively cheaper as rents increase -- provided it is a fixed-rate loan. "You can certainly turn a negative into a positive over time," Margaret Smith said.

In addition, mortgage interest and property taxes can be deducted from income taxes, potentially shaving thousands off annual home costs.

Even though mortgage rates have crept up, lower prices mean you could actually pay less monthly for a home than you would have a few months ago. The typical monthly mortgage payment in Southern California for a home purchased in June was estimated at $1,671, according to DataQuick. That's based on the median price for Southern California and a 20% down payment. That was down 35% from the same month last year and, adjusted for inflation, was the lowest in five years. That monthly payment does not include taxes, insurance and maintenance costs.

By Smith's formula, the home dividend for someone who buys a $355,000 home (the Southern California median) would be nearly $1,000 after one year compared with renting a home for $2,000 a month.

That is, the buyer -- even with the added expenses of homeownership -- would spend less on his or her housing costs than rent because of mortgage interest deductions.

"Stop fixating on short-term price moves; think about long-term rent savings," Gary Smith said.

If someone delays buying a house that would produce rent savings to hold out for a better price, the delay would mean losing those savings -- and the loss could be compounded if prices went up instead.

"Buying a house is risky, but waiting is risky too," Gary Smith said.

Words to the wise

Whether you decide to buy a house now or wait awhile, real estate experts say you should keep in mind the following:

*** Don't count on price appreciation.**

If you can't afford a house now, don't presume you'll be able to tap an increase in your home equity to refinance it -- that's a mistake made by many people who are now in foreclosure.

Likewise, don't divert retirement savings to buy more house than you can afford, expecting to make up the shortfall later through a jump in home values.

*** Don't expect a house to make you financially stable.**

Experts advise home buyers to have a steady and reliable income stream; don't buy in the belief that simply owning a home will provide financial stability.

*** Don't buy if you think you may be moving soon.**

If you're not sure how long you are going to live in a house, move slowly. If you are forced to sell after a short time, any price appreciation may be outweighed by closing costs and agent commissions -- and prices could decline.

Typically, people should avoid buying a home unless they plan to live in it for at least five years, advises Richard Green, director of USC's Lusk Center for Real Estate, but a safer target these days may be seven or eight years.

Green, who recently relocated from Washington, D.C., is wrapping up a home purchase in Pasadena. He's not worried about prices falling further because he and his wife plan to stay at least 20 years.

"This was the house we wanted to live in," he said. "A house can be like a car, something you use and enjoy and have for a while. Whether it goes up or down in value may not be so important."

Even Thornberg sees that there may be good reasons to buy now, regardless of price.

"Maybe you have a baby coming up," he said, "and don't want to be in an apartment."

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