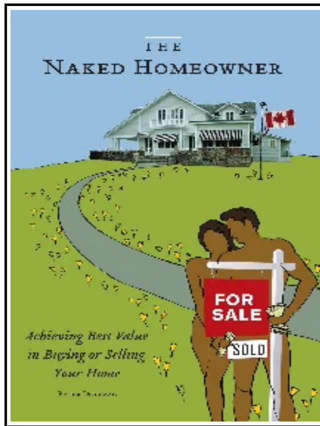

REAL ESTATE MARKET TIMING

by Peter Dolezal   The Naked Homeowner

Today's topic arose as the result of a query sent by a local reader. Her question was:

"I'm wondering if I should sell my house in Sidney while prices are still not too bad, and move into a rental apartment for one year, before buying again. I would then buy a smaller house once prices drop some more. Would I profit by doing this, especially considering that I will need to downsize anyway within a couple of years?"

I'm sure similar questions have crossed the minds of many trying to make the most of a softening market. Here in essence, is my response.

Obviously, everyone should do what feels most comfortable. However, were it myself making the decision, I would not, for a number of reasons, pursue the option suggested:

- A sell-rent-and-repurchase strategy relies on one's being able to predict, with more precision than possible, the real estate market.

- A lower-value home price tends to fall by a smaller percentage than does a higher-priced one. It usually follows as well, that once the market turns, a less expensive home will recover price faster, as first-time buyers reenter the market.

Unless one is able to buy the lower-priced home at the very bottom of the price curve, any upward price momentum represents a major risk to a buyer.

1. Rent is paid with after-tax dollars. However, income generated by investing the proceeds of a home sale is taxable. That means for example, that if your rent is $1200/month, you must generate close to $1700 of before-tax monthly income (at a 30% marginal tax rate), simply to cover the rent. At today's best guaranteed rates, you *might*, if you are lucky, earn 3% on your investment. Unless the proceeds of your home sale were greater than $700,000, investing the proceeds in no-risk financial products won't even cover the cost of your rent.

2. The cost and inconvenience of moving twice - first to a rental property, and then back into a replacement home - can be quite considerable. Furthermore, with our present extremely low vacancy factor, finding rental accommodation in the right location, and of the quality you desire, is not easy.

So how does one minimize the financial risk of selling one home and buying another, whether scaling down in price or moving up to a more costly home?

The only sure way of minimizing timing risk, is to remove timing from the equation. As soon as you receive a firm sale on your existing home, be ready to purchase a replacement property.

Only then are you selling and buying in precisely the same market, regardless of where on the scale the market happens to be, or the direction in which it is moving.

When downscaling in price, you will, by following this approach, always be left with an excess in cash which you can invest. If, by separating the selling and buying processes in an attempt to time the market, you guess wrong, you may well, when the dust settles, end up worse off.

On the other hand, if you are moving up in price, selling and buying at relatively the same time, you are probably better off to do so in a softer market such as we are now experiencing. As earlier mentioned, this is because higher-value home prices generally drop by a greater percentage than do the lower-priced. The astute buyer, moving up in this circumstance, should actually gain more on the value difference, than he might in a more stable market.

With interest rates at historic lows, today's cost of moving up in value, in terms of both overall home price difference, and monthly payments, is very unlikely to get much more attractive than it is today.

The bottom line: Timing a market, whether in real estate or financial investments, is very difficult, and fraught with major economic risk if you guess wrong. It's best to not try.