MY MIND ON MORTGAGES

NEWSLETTER

Content by Evan Swanson, CFP® NMLS 120856 *August 12th, 2011 VOLUME 1/ ISSUE 3*

MY CASE FOR HOME OWNERSHIP *By Evan Swanson, CFP®*

It was Isaac Newton who put forth the third law of motion, which states that for every action there is an equal and opposite reaction. Although Newton's field was physical science, he may as well have been talking about the nature of markets.

Easy credit, low interest rates, and a robust economy sent housing prices in motion beginning in the early part of the last decade. According to the Standard & Poor's (S&P) Case-Shiller Home Price Index, home prices in Portland rose by nearly 66% during the five years leading up to the peak in April 2006.

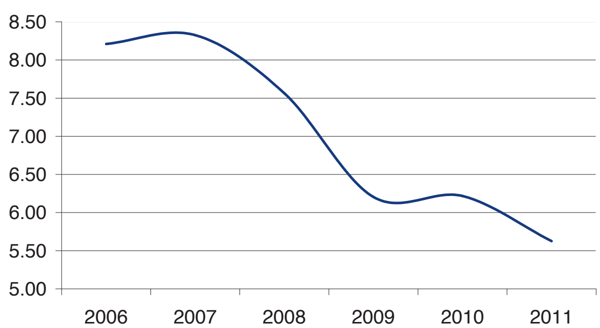
It was a rapid ascent that created an equal and opposite reaction that has since sent the housing market, jobs market, and national economy into an unprecedented tailspin. **Action→Reaction→Action→Reaction.**

Fortunately for us, the story doesn't end here. It is my feeling that the pendulum has swung to the opposite extreme. The case for home ownership hasn't looked this attractive in years. Let me share with you some evidence.

Affordability:
Home prices as a ratio of income have fallen by nearly 33% since peaking in 2007. According to the Case-Shiller for Portland, the average home price has fallen from nearly $360,000 at the peak to $260,872 in May 2011, a 27% decline. Meanwhile, average wages in Portland have held steady, hovering around $45,000, according to data from the U.S. Bureau of Economic Analysis.

As a ratio, average home prices equated to over 8 times average annual wages in 2006-2007 and have since fallen back to 2002 levels of around 5.5 times the average annual wage.

Ratio of Average Annual Wages to Average Single Family Home Price for Portland, OR (2006-2011)



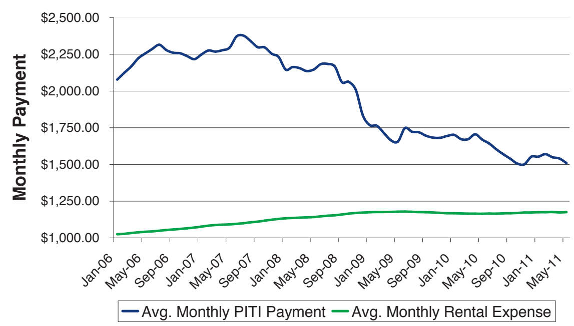
Mortgage Payments Versus Rent:
The case for home ownership also looks more attractive when you compare estimated mortgage payments to rental expense. Fixed mortgage rates have been hovering at or near historic lows since the fall of 2010. Currently, conventional 30-year fixed-rate mortgages are available below 4.50% (APR: 4.61%).

For a home-buyer with a 10% down payment, the monthly PITI (PITI= Principal, Interest, Property Taxes & Homeowner's Insurance) mortgage payment for the average home purchase price has declined by 37% from $2,377 in July of 2007 to $1,509, as of May 2011.

Meanwhile, the cost of renting a home or apartment is rising. According to the U.S. Bureau of Labor Statistics, the cost of renting a primary residence is 12.85% higher than it was five years ago. The real estate website Zillow.com lists the average rental expense for Portland at approximately $1,175 per month.

As the relative monthly payments for renting and owning converge, buying a home is becoming more and more attractive, especially when you factor in tax benefits, equity accumulation (Even if the home doesn't appreciate, a home-buyer is paying down principal.), and the security of having a fixed principal and interest payment versus annual rent increases.

Avg. Monthly Mortgage Payment vs. Rental Expense for Portland (2006-2011)



Keep in mind:
I'm not suggesting that the housing market is going to come roaring back to 2006-2007 levels anytime soon. It won't, and we should be thankful for that. I do, however, believe that the housing market is at the very beginning stages of a modest and sustained recovery.

Home prices may move a little lower or a little higher month-to-month, but I believe that five years from now we'll look back and view this time as a prime opportunity. Having said that, if people think they'll need to sell their home inside the next five years I would advise against buying. The transaction costs and market time for buying and selling real property are too high.

Who should look into buying?
First-time homebuyers can be obvious beneficiaries of current market conditions. Currently, minimum down payment requirements are as low as 3% for conventional mortgages (3.5% for FHA mortgages), and, in some cases, we can avoid monthly mortgage insurance expenses.

Investors can also prosper under the current conditions. Many duplexes, triplexes, and 4-plexes purchased during the boom time have since been foreclosed on and are coming back on the market at very low prices. As I pointed out earlier in this article, rents have been rising, making it easier for investors to create attractive returns. Investment property loans currently require a 20%-30% down payment, so anyone interested in this needs to be in a financial position to bring a significant amount of equity to the transaction.

Lastly, believe it or not, those with a recent short sale on their credit history can be eligible to buy again within 24 months with a 20% down payment. If 20% down is not feasible, then after 36 months an applicant with a short sale on record can buy using FHA financing with a minimum 3.5% down payment. Some of those who suffered significant economic loss through the crash can now take advantage of current conditions to put themselves in a position to prosper moving forward.

If you or someone you know would benefit from evaluating the available home-buying options, I would love to be a resource. Please contact me so I can help you today!

WHY SOME THINGS IN YOUR FINANCIAL LIFE AREN'T AS EASY THEY SEEM

By Evan Swanson, CFP®

Have you ever wondered why some things in life aren't as easy as they would seem? Many pearls of financial wisdom seem as though they would be easy to put into practice, but the following are just a few examples of areas where people in the United States clearly have trouble.

Spend less than you bring in. For much of 2005-2007, U.S. consumers collectively spent more than their disposable incomes, pushing the national personal savings rate into negative territory and setting the table for economic catastrophe. (source: U.S. Bureau of Economic Analysis)

Buy low, sell high. According to a 2010 study, the average retail investor paid approximately 22% more for mutual funds than the fund's average price over a 10-year period. In other words, investors bought when the markets were high and sold when the markets were low. (source: CNNmoney.com)

Avoid spending money you don't have. As of May 2011, households across the United States collectively owed $793.1 billion in revolving consumer credit card debt. (source: The Federal Reserve)

Let's face it; having healthy financial habits isn't a matter of knowledge. We all know what we're supposed to do but sometimes have trouble following our own advice.

So why is it that we all know what we're supposed to do but have trouble staying on task?

The answer lies in your head.

In fact, there is a relatively new field of study called "neuroeconomics" that is attempting to answer this very question. Neuroeconomics looks at how our emotions and biological make-up affect our financial decision-making.

It turns out that the human body and psyche are not designed for optimal financial decision making. If you consider the evolutionary process, this shouldn't be much of a surprise. Humans have evolved over millions of years and only for a small sliver of that time have money, markets, and rational thought been explicitly present.

Our ancestors who were around a million years ago were trying survive the harsh realties of their environment and were not concerned about their household budgets or rebalancing their retirement accounts. In fact, academics who are studying in this field believe that many of the subconscious emotional responses that helped our evolutionary ancestors survive actually hinder our ability to make productive long-term financial decisions.

Unfortunately, we can't change the biological deficiencies that hamper our ability to make good financial decisions all the time. However, being aware of the ways in which our minds can interfere can help immensely.

I am happy to announce that neuroeconmics will be one of the topics discussed at Mortgage Trust's next Wealth-Building Event, which is scheduled for the evening of **September 22nd** and will be held at Bridgeport Brewery in the Pearl District. We are honored to have Brian Farr, a nationally recognized professional counselor who specializes in treating chronic financial behavioral problems, at the event.

Brian will be helping couples who attend this event effectively communicate about financial topics. I've met Brian personally and am confident this will be a great event! If you would like to attend, send me an email and I will make sure you get an invitation.

I look forward to seeing you there!

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