



## Economist's Commentary: July 29, 2008

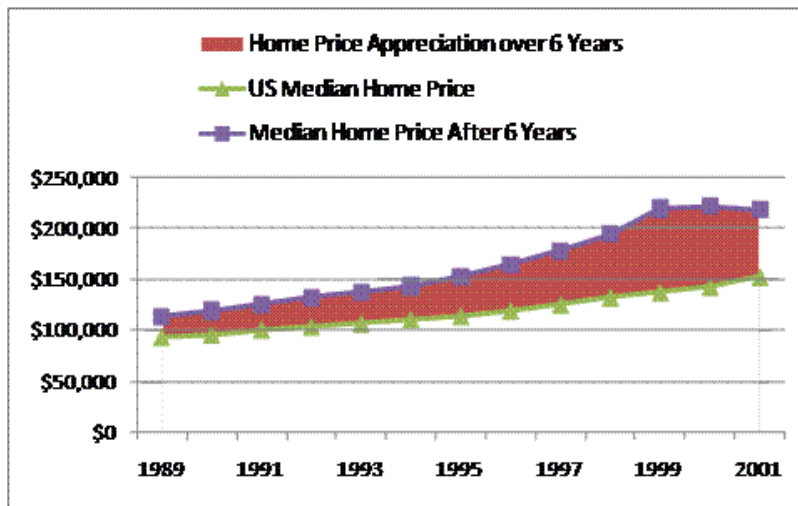
### Timing the Market?

By Danielle Hale, Research Economist



It is common knowledge that homes were great generators of wealth over the past few decades, and in this case, the data supports this conventional wisdom. According to NAR's 2007 Profile of Home Buyers and Sellers, the median tenure of a home seller was 6 years. What happened to homeowners over the past two decades who bought houses at the median price and held them for the median tenure? The chart below shows US Median Home Prices starting in 1989 in green, and above it, in purple, we see the median home price 6 years later. The distance between the two, shaded in red, represents the equity gain due to price appreciation that a buyer would have

experienced. We can see that those who purchased a house in this period and held it for 6 years saw an increase in wealth. We can also see that this equity gain varies over time. The distance between the lines gets bigger in more recent times, in other words, those who bought and sold homes more recently, made more money from price appreciation.



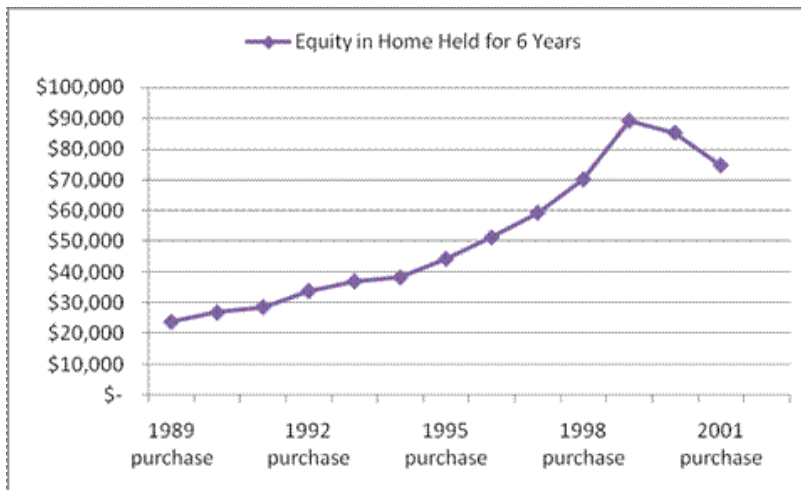
This idea of varying returns did not go unnoticed, and many have tried to take advantage. If you Google the phrase "Timing the Housing Market" you'll find a compendium of articles and advice on whether you



should or shouldn't attempt to time your house purchases to try to maximize the ups and downs in market prices. Some also offer secrets to help you pinpoint the best time to buy (usually for a fee).

Rather than add to the litany of speculations, in this commentary, we'll do a retrospective examination of what happens to the equity buildup in a home\* of one buyer as opposed to the buyer who waits another year to purchase a home. As we'll see, buying a home to live in that you will hold for a few years, as most homeowners do, is the best way to avoid the occasional ups and downs in the real estate market-and you don't have to pay anyone to tell you that secret.

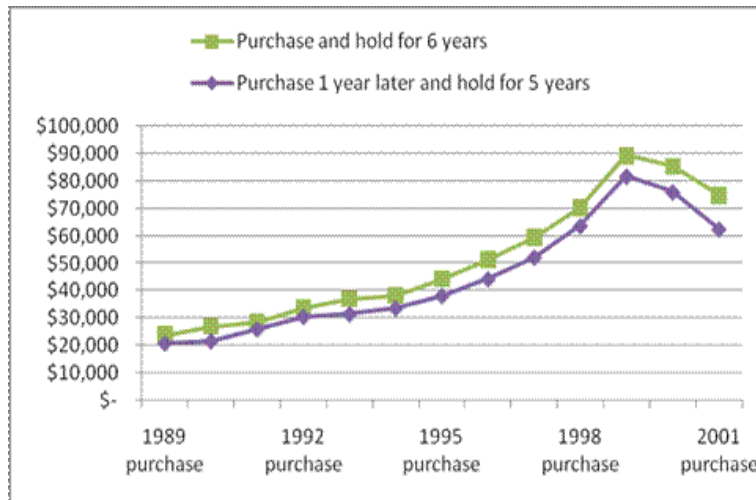
We'll actually run two experiments based on different scenarios. For the first, we'll assume that the decision to buy and the decision to sell are made independently, that is, you can choose when to buy and when to sell your home so that regardless of when you buy, you will hold it for a period of six years. As you can see in the chart below, gains to sellers who had delayed the purchase and were also able to delay the sale of a home, increased for purchasers through 1999. Those who purchased in 2000 or 2001 and held for 6 years have experienced greater equity build-up than those purchasing in any year prior except 1999.



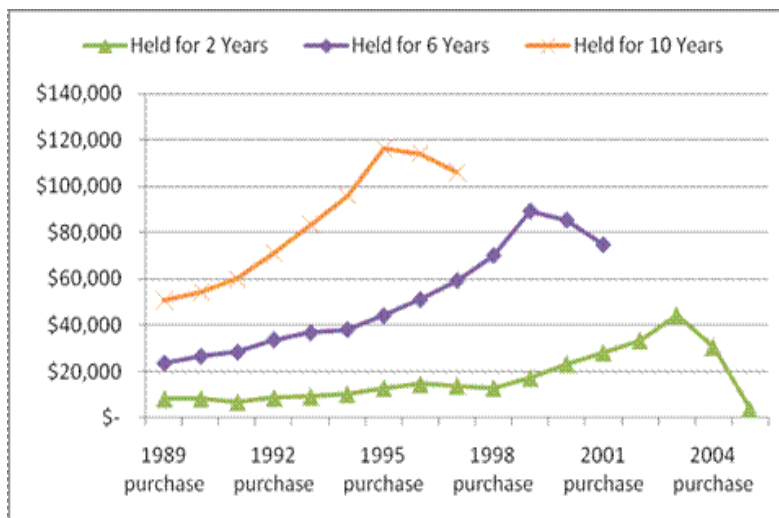
So until 1999, this chart shows that equity gains were greater for those who purchased later and sold later. Does that mean one should wait to purchase a house? For this second experiment, we'll consider a situation that probably more often approximates the real world. In this scenario, our buyer can choose to purchase now, or delay the purchase one year (presumably to wait for better price conditions). However, the seller is not able to "time" the sale and must sell at a given point (which happens in the real world



when job or family situation changes force a move). The sale will occur either 5 or 6 years after the date of purchase depending on whether our buyer initially delayed his purchase.



As we can see from the chart above, purchasing the home a year earlier so that it is held for a longer period of time leads to greater equity buildup in every instance. On average, holding the house for an additional year enabled an extra \$6,200 in equity. At its worst, the homeowner who held for 6 years had an additional \$2,500 in equity, and at best an additional \$12,400.





This meshes with what we see in the last chart above. While the pace of gains varies, holding a home for a longer period leads to a substantial accumulation of wealth over time. Is a home going to be your top earning investment? Not always. Will owning the roof over your head have financial benefits? If you're going to stick around for a while, probably so.

I say "probably so" because this has been the case given the trend of the last twenty or so years. As you surely know by now, the past few years in the housing market have not exactly been typical. Some homeowners who bought at the market peak two years ago have experienced painful losses in equity. Whether these buyers in the hardest hit regions will be able to recoup fully the losses of the past two years, even with a 6 year holding period, is unclear. The good news is that buyers this year are entering the market at a much lower point and therefore have much brighter prospects for positive equity gain. Furthermore, the [housing bill](#) - recently passed by both the House and Senate - will make more cash available to new buyers through a \$7,500 tax credit. However, new buyers should be careful not overstretch their budgets just to jump into the market. Recent lessons teach us that homeownership for those not financially or mentally ready can result in painful consequences such as mortgage defaults and foreclosures. Sustainable homeownership is what the homeowner and the country should strive for.

*\* In the latter experiments, the equity build-up will be equity from principle payments AND from price appreciation. The difference in equity accumulation due to principle payments captures the effect of changing interest rates.*