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CAPITOL ASSETS

America's Real Estate & Mortgage Update

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SPRING MARKET 2018 REPORT

Consumer confidence is at a 14-year high. Unemployment is at a 17-year low and appears on track to drop below 4% this summer. Interest rates are still near historic lows. That should be the foundation for a fabulous housing market, right? In fact, spring home sales look to be very solid, just not great.

After worrisome dips in December and January, existing home sales bounced back in February, despite the headwinds of low inventory and ugly weather. The four severe nor'easters that plagued March may also wind up depressing that month's sales numbers. Whatever the monthly ups and downs, though, we look on track to exceed 5.5 million homes bought and sold in 2018, a bit higher than last year and the most since 2006.

Make no mistake, there are ***plenty*** of potential home purchasers who want to buy (Realtors say traffic has been picking up where and when weather permits). There simply aren't enough homes available.

As a result, successful homebuyers (there are still lots of them), have had to be patient and, often, aggressive in their pursuit of the homes available. The National Association of Realtors says that this could prove to be the most competitive spring in years.

On the other side of those transactions, most sellers have been having little trouble finding a buyer for their home this spring. Finding one to purchase themselves is another matter, though. All because of inventory issues. A balanced market is six months' worth of inventory and we had just 3.4 months' supply in February.

Most sellers have been having little trouble finding a buyer for their home this spring.

Inventories are low because, for one thing, Americans appear to be very satisfied with their current homes. The National Association of Home Builders recently conducted a survey and found that, of owners who have been in their present residence for 10 years or more, 70% said they have stayed because they like their home and are comfortable in it.

However, another significant group of respondees, 21%, said they just didn't want to go through the hassle and expense of selling and moving. Come on people, it is less stressful right now than usual for home sellers!

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Properties stayed on the market for just 37 days in February on average, and 46% of those that sold had been on the market for less than a month. That is about as stress-free as a home seller could hope for. Homes were averaging 45 days on the market in February 2017.

Clearly, the positive environment for home sellers remains a challenging one for buyers. Home buyers will find the conditions troublesome, but not insurmountable.

The National Association of Realtors recommends that spring buyers "should start conversations with a Realtor now on what they want in a new home."

"Even with the expected uptick in new listings in coming months, buyers in most markets will likely have to act fast on any available listing that checks all their boxes." Realize that what appeals to you will likely also appeal to other buyers, so be prepared to act swiftly when the right home is finally located.

This especially applies to first-time homebuyers, who are in the segment of the market where homes are hardest to come by. As for purchasers in most strata of the market, a mortgage pre-approval is essential in their quest.

New-home building insufficient still

Home buyers can and should look to new construction as an option to fill in the gap between the demand for homes and the supply. We were hopeful early in the year as housing starts shot up in January, but then disappointingly sagged in February.

So it now appears new homes will not be purchasers' salvation in 2018, as output will remain below what we need.

It is important to understand builders' hurdles. One of the biggest complaints builders have is the lack of buildable lots. Site development and the local-government approval process can be expensive and lengthy, especially in the more prized locations where buyer interest is greatest.

Building in farther-flung suburbs can be an easier process, but will buyers follow? Just wait for self-driving cars to be the norm. Then the dynamic is likely to change dramatically. Until then....

We don't usually expect new homes to help restrain prices; usually the opposite is true. But builders are facing cost pressures from a lack of skilled workers (making the ones they do hire more expensive) and rising timber prices, partly due to hefty tariffs on Canadian softwood.

So, both new and existing home prices will continue to go up this spring. Neither the low inventory levels of existing homes or the rising cost imputs for new homes will do anything but contribute to, rather than curtail, the march higher of prices.

The NAR reported that the median existing home price in February was $241,700, up 5.9% from February 2017 and was the 72nd consecutive month of year-over-year gains. Median home prices, understand, reflect the mix of homes being sold, not price increases for individual properties.

Real estate analytics firm CoreLogic, which does follow repeat sales of individual homes, reported that, year-over-year, home prices rose 6.6%, nationwide, in January.

Eventually, though, this rate of price increases can't be sustained, most market analysts agree. However, they have been premature in predicting just when that slowdown will take hold.

For the year ahead, to January 2019, CoreLogic, which updates its predictions every month, projects that prices will increase 4.8%. However, that is the same prediction that they had for the 2017-2018 period and they were way off.

While incomes are starting to rise faster, home prices are rising even more rapidly, an unsustainable long term trend. Eventually, if mortgage rates climb as expected, affordability will be eroded and the buyer pool shrink. Then, price gains will slow for certain.

For now, though, sensibly priced homes this spring will continue to attract buyers, often multiple buyers that can take a selling price higher, while over-priced homes can languish without a visit.

Flood insurance needed extension

The National Flood Insurance Program has been operating on a series of short-term extensions included in continuing funding legislation for the government. Along with many other programs in the bill, the NFIP was due to expire March 23.

Without an extension, closings in the 22,000 communities that have flood risk would be put in jeopardy, since lenders usually demand flood insurance coverage. Some 40,000 transactions a month could be affected by a lapse in the program, the National Association of Realtors estimates.

Keep an eye on the current status of the NFIP extension if you have a sale or purchase that relies on getting a flood insurance policy. There could be either a straight extension (short- or long-term) of current law or one that includes substantive changes to the program that could increase the cost for some flood insurance policies.

A term to know: "Greenwashing"

With the growing interest in energy-efficient and environmentally friendly "Green" homes, comes an unscrupulous effort to capitalize on their new popularity. "Greenwashing" is touting a home as being green while it has few such features, according to an investigation by NBC news.

Understand, say experts, being green is about more than just energy efficiency. It also encompasses facets of the design and construction process.

If purchasing a green home is important to you, make sure that you and your Realtor seek assurances that the home incorporates the six elements of green design: proper siting and site development, water and energy efficiency, indoor air quality, use of sustainable materials and low-impact home operations and maintenance features.

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Realize, it is a rare market watcher who expects rates to return to their 2017 levels. Most of them counsel caution for purchasers/refinancers. "Lock early to avoid risk" is the message we see repeated frequently.

Still, if we are able to hold at or near the current level of mortgage rates, buyers should have a good spring, at least insofar as the cost of their mortgages are concerned. The ease of obtaining one is another subject.

Understand, the mortgage business is expected to be a bit of a bust this year, because the refi market is drying up, even as purchase mortgage originations are at low levels. As a result, you may find that your lender is able to expedite processing of your mortgage application.

One might reasonably expect that lenders would loosen their underwriting standards a bit in an attempt to generate more volume, but the trend toward relaxing standards appears to be slowing.

Already in 2018, millions of American homeowners have lost whatever advantage they might have had from a refi. Nevertheless, those who haven't refinanced in a couple of years would do well to contact their trusted mortgage adviser to see if they would benefit from a refi before rising rates erase their opportunity.

Understand, there are several reasons for a refinance that hold even with 30-year rates slightly higher:

(1) Replace an FHA mortgage (or any other loan that carries a monthly mortgage insurance premium) with a loan that allows you to dump your mortgage insurance.

(2) Take cash out at a very low cost, even if doing so under current law would mean all the interest would not be tax deductible.

(3) Switch to a 15-year or other shorter-term mortgage and possibly still manage to reduce your current interest rate.

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straightforward examples. It left a number of questions unaddressed.

Fortunately, the Service has already looked at some of these issues and discussed them in its Publication 936, Home Mortgage Interest Deduction.

The current version is for 2017 tax returns, so we will have to wait for the 2018 revision later this year. However some of the principles should carry over to the new law.

For example: What if you refinance your 1st and 2nd mortgages (which would include a home equity line of credit) into a single 1st mortgage?

"Any secured debt you use to refinance home acquisition debt is treated as home acquisition debt. However, the new debt will qualify as home acquisition debt only up to the amount of the balance of the old mortgage principal just before the refinancing."

And what is a "substantial improvement to the home?" The IRS says it is something that adds to the value of the home, prolongs the home's useful life or adapts the home to new uses.

Repairs that simply maintain the home in good condition, such as painting, don't qualify as a substantial improvement unless it is part of a renovation.

Still, there are some questions that we can only speculate about. What about homeowners who had existing home equity loans prior to the new law, including those grandfathered at the old $1 million mortgage limit?

Is all their home improvement debt interest deductible, provided that it is below the $1 million limit? How do taxpayers show what portion of their equity debt was attributable to home improvement (hope you kept good records!)?

For the definitive answers to these open questions, we will have to wait for the 2018 Pub. 936. Should you have a question before then, you will want to consult a tax professional.

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insurance, homeowner's or condo association dues and necessary maintenance as part of their ongoing obligation of ownership.

Repayment is generally required once the borrower sells the home, passes away, moves out or fails to meet their loan obligations.

What is the catch? The younger the purchaser, the bigger the downpayment required. For those just turned 62, as much as 60% or more down will be required, since the calculation is based on the life expectancy of the youngest borrower. Usually this will come from sale of the previous home.

HECM purchasers will also find that their interest rate and closing costs will be a tad higher than with a regular mortgage and there will be a mortgage insurance fee.

The loan interest that accrues can eat into your equity over time if you make no payments. However, a borrower can elect to pay however much they want toward that accruing interest.

Happily, because a HECM is a non-recourse loan, the borrower or their heirs will never be liable for additional payments even if the amount owed is greater than the home's value.

However, a HECM for purchase gives seniors a chance to retain assets that would be required for an all-cash transaction or avoid qualification issues that might arise were standard financing to be used, instead.

Some financial advisers see it as a unique and potentially very valuable cash-flow preservation tool for retirees. Using a HECM for purchase also allows a homebuyer to increase their buying power over what could be possible with an all-cash transaction.

This might be the perfect time for a retiree to use the program to purchase in a housing development for seniors. Developers have overbuilt for the expected demand and now there is a glut in that housing sector.

WILL MORTGAGE RATE CLIMB TAKE A SPRING PAUSE?

Spring homebuyers are facing mortgage rates that have climbed steadily this year. Finally, toward the end of March, the weekly uptick in rates stopped, but there is good reason to be concerned that any such pause this year might be short-lived.

The widespread expectation is that rates will most assuredly be higher by the end of the year. The exact path rate increases will take is the big question mark.

By the end of March, lenders were offering 30-year fixed-rate conforming mortgages at 4.44%, according to Freddie Mac's weekly report (other gauges have reported slightly higher numbers, just north of 4.5%).

At the same time in 2017 rates were less than 1/4 of a percentage point lower, not a big difference, but rates spent much of 2017 below 4%.

Anticipation that there will be big Treasury borrowing needs as the year progresses, along with a smattering of Federal Reserve rate increases are the primary reasons for a generalized rise in rates.

At its late March meeting, the Federal Reserve raised short-term interest rates by 1/4 of a percentage point, exactly as the markets had anticipated, and indicated that it could do so again another two, and possibly as many as three times in 2018.

The market's reaction to the increase was pretty tepid. Optimistically, it is very possible that rates have already factored in what is immediately ahead and could stabilize at this level for a while, perhaps for long enough to carry us through the spring buying season in good shape.

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IRS CONFIRMS HOME IMPROVEMENT DEBT IS STILL DEDUCTIBLE

In the wake of the passage of the tax reform bill late last year, there was widespread uncertainty about the deductibility of home equity debt when the proceeds were used for home improvement. Most of the stories we saw early on said ***all*** home equity debt would no longer be deductible.

We thought otherwise, having been pretty well versed in the basic rule for the treatment of home equity loans when they are used for substantial improvements to the home. The rule has been that such debt is treated as deductible acquisition debt, the same as if it were for a home purchase.

Now, to everyone's relief, the IRS has confirmed that interpretation. The IRS says that taxpayers can still deduct interest on home equity lines of credit or other second mortgages so long as the funds are used to buy, build or "substantially improve" the home that secures the loan.

The IRS emphasizes that the new $750,000 overall limit on the size of mortgages qualifying for the mortgage interest deduction will apply. So any new home equity financing, added to the existing first mortgage amount (on a main home and a second home) cannot exceed that threshold.

The IRS notes that the total amount borrowed cannot exceed the cost of the home(s). And understand that the lien for the loan must be on the property to be purchased or improved. You can't borrow money on one home to buy or fix up a different one.

What if the total loan amount exceeds the $750,000 limit? In that case, a proportional amount of the loan interest would be deductible.

In its recent guidance, the IRS gave a bare bones explanation of how the rule will be applied and offered three rather

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USE A REVERSE MORTGAGE FOR A PURCHASE

There are concerns about how long the government's reverse mortgage program can remain viable in its current configuration. Changes may be coming before long that would make the program less attractive for participating seniors.

That is one reason why older homeowners might want to think seriously about using the program now to buy a home with no mortgage payments required!

The FHA HECM for Purchase program is an underappreciated way for seniors age 62 and up to purchase a home while avoiding the burden of a mortgage payment.

The FHA Home Equity Conversion Mortgage is best know as a way for homeowners to access their home's equity without a refi or using a home equity loan (whose interest is now nondeductible except for substantial home improvement purposes).

The borrower need not make monthly principal and interest payments, but can elect to pay toward the interest being accrued.

The home must be intended to be the primary residence of the borrower. Eligible properties include single-family homes, two to four unit homes, HUD-approved condos, and FHA-approved manufactured housing.

Last fall, FHA made a change that make it easier for borrowers to purchase new construction. Previously, a certificate of occupancy had to have been issued before an application could be considered. Now, the certificate can be supplied any time before closing.

As with any mortgage, the borrower must demonstrate that they will be able to afford their property taxes,

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