



## *Real Estate News & Information*

**Richland Properties**  
**Richland Home Mortgage Co.**

### **Market Update-Is there a Real Estate Bubble?**

As we head into the last quarter of 2006, there has been a lot of talk recently about a housing bubble and whether this bubble will burst. No one knows for sure if prices will correct downward in the coming months, but currently the real estate market does appear to be correcting slightly and prices have leveled off in a significant number of neighborhoods in the bay area. This doesn't mean that homes that are currently for sale that are competitively priced in desirable neighborhoods are not still receiving multiple offers. What this does mean is that the average or median sale prices of properties in certain markets is not increasing and in other markets average prices have actually decreased slightly as compared to average sale prices from the prior month. Comparing average sale prices from July 2006 to average sales prices in June 2006 can be a better indicator of the current direction of the real estate market than comparing average sales prices from July 2006 to average sales prices in July 2005. Many newspaper and television news clips still like to focus on the year to year change in average real estate prices.

Whether you believe that there is a real estate bubble or not or whether the perceived real estate bubble will eventually burst, I think that it is wise to consider taking some conservative financial strategies related to owning real estate because we do appear to be in a period of higher interest rates than just a few years ago and real estate prices may be in for a period of low or no annual appreciation.

**Don't borrow against home equity when possible.** This means don't take out home equity loans to pay for summer vacations, boats and other non-necessities. Additionally, consider undertaking a smaller home remodeling project that doesn't require a large home equity loan or that does not require large cash proceeds from refinancing into a new larger first loan. Most home equity lines of credit are currently around 8% which is up dramatically from 5% just two years ago. With the current inverted yield curve, short-term interest rates are as expensive as long-term rates and there is generally no longer a benefit to borrowing on a short term basis.

**Build equity through principal repayments.** For those people who have interest only and adjustable rate loans, you should be making the fully amortizing payment which includes a principal repayment amount. Reducing your loan balance will increase the equity in your property and will pay off over the long run. However, some borrowers may still be suitable candidates for making interest only payments if they can use their available monthly cash flow for either (1) a low-risk investment that earns at least a 1% to 2% higher yield than the interest rate on their mortgage loan or (2) a high risk investment that adequately compensates them for the increased risk.

**It is time to move away from adjustable rate loans.** Consider refinancing out of adjustable rate loans (ARMs) and limited duration fixed term ARMs and into a standard fixed rate loan. Once an ARM loan that had an initial fixed-rate period starts to adjust upward, the increase in payments to the fully adjusted rate will lead to new monthly payments that will most likely be substantially higher than what a fixed rate loan would currently be. The worst thing to occur to a borrower who has an ARM loan will be if home prices are declining in the future when their monthly mortgage payments are increasing. If prices do correct at some point in the future and you find that your home suddenly does not have the same amount of equity that it had today, then having a fixed mortgage payment can cushion the impact. You won't be at the mercy of trying to refinance at some future date if interest rates go higher and the value of your home goes lower which would make it more difficult to refinance your mortgage loan in the future.

**Buy for the long term and make a larger down payment.** When rates were at historical lows, it made sense to borrow as much as you possibly could at low fixed rates to purchase your property. Now with interest rates higher in general and on second loans in particular, it is probably not a bad idea to consider putting down more money when purchasing a home and scaling back on the size of the home purchase. Your home is an investment, but a long-term investment. Treating your home as a long-term investment will reduce many of the worries about a bursting bubble.

### **Review and Update Your Property Insurance Policy**

As many people may know already, construction costs have been escalating over the last several years. As a result, it is not uncommon for replacement construction costs to reach into the \$250 to \$300 a square foot range for many properties. Additionally, construction costs could even be higher for properties that have unique construction details such as Victorian and Edwardian homes and for homes that have been extensively remodeled with high-end kitchens, bathrooms and other amenities. Additionally, over the past several years, insurance companies have been reducing their policies' coverage particularly with respect to replacement cost coverage. Gone are the days of "guaranteed replacement cost" policies. Now, most policies have some type of "extended replacement cost" of say 120% or 150% of the face value of the policy limit that you carry. This means that if you had a total loss of your property that was covered under your policy, and the cost to replace the structure was more than the "extended cost" provision of your policy, then

you would not receive enough under your policy to cover your property's loss. It is now very important to consult with your insurance agent or broker annually to make sure that your policy has adequate replacement cost coverage and adequate "extended replacement cost" coverage. Additionally, for \$7.95, you can use a website provided by Marshall & Swift at [www.accucoverage.com](http://www.accucoverage.com) to check general estimates of construction costs. The only caveat with using general estimates is that construction and labor costs in the Bay Area generally run higher than the averages used in most construction estimating software or reference literature.

### **Grant Deeds versus Quit Claim Deeds**

In California, the two most commonly used deeds are the Grant deed and the Quit Claim deed. When and why would you want to use one versus the other? Generally speaking, a buyer will always want a Grant deed from a seller or transferor as this is a better type of deed for the buyer than a Quit Claim deed. A Grant deed has implied covenants or warranties that come with it. A Quit Claim deed only conveys any interest an individual may have in the particular property at the time of the deed and does not come with any implied covenants or warranties. In California, which is a community property state, title companies often times require that the spouse of a married seller execute a Quit Claim deed to either the buyer or the seller before they will provide title insurance for the sale to close escrow even though the spouse is not on the title to the property. Providing the Quit Claim deed ensures that any community property claim or interest that a spouse may have in the property will be conveyed to the buyer. A spouse who has never been on title to a property will want to use a Quit Claim deed to convey any interest they may have in a property and will generally not want to use a Grant deed. By using a Quit Claim deed, the spouse is not on the chain of title and will reduce their chances of having liability relating to covenants and implied warranties that arise from the use of a Grant deed. This article is not meant as either tax or legal advice and you should always check with a competent real estate attorney before transferring or deeding any real property interest as there can be significant income tax, gift tax, transfer tax and property tax re-assessment implications.

### **New Restrictive Condominium Conversion Law in San Francisco**

New legislation sponsored by Supervisor Aaron Peskin puts new, more severe limits on an owner's ability to convert their 2 to 6 unit buildings to condominiums in San Francisco. A building will be ineligible for conversion if a certain type or number of evictions occur after May 1, 2005. (This new law is in addition to the restrictions that passed in November 2004 regarding evictions of certain protected tenants) Ineligible buildings are those that have had 2 or more evictions (Ellis-Act, owner or relative move-ins, capital improvement evictions, illegal unit removal evictions) and those buildings where there has been an eviction of a senior (over 60 years old and a 10 year tenant), disabled or catastrophically ill tenant. If a building has one of these types of "tainted evictions" then a building could still possibly be eligible to enter the lottery after a ten year waiting period but would still be subject to very onerous hurdles to get through the condominium lottery. Additionally, 2 unit buildings with a "tainted eviction" would have to be continuously owner-occupied **by the same owners** for ten years to be able to bypass the lottery and be eligible to convert subject to the restrictions passed in 2004 on conversions discussed above.

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