



Real Estate News & Information

Richland Properties

(Serving San Francisco, San Mateo and Marin counties)

Market Update - Where is the Market Going?

As we head into the last quarter of 2008, the real estate market in many neighborhoods in the bay area is softening and price declines are possible in the near future. Bucking this trend are highly sought after neighborhoods in counties such as San Francisco, Marin and San Mateo that have not experienced any significant price declines in the last year. However, In many outlying counties such as in the central valley, homes are continuing to enter the foreclosure process in record numbers. Home prices are very weak in these markets because these foreclosed homes end up back in the lender's hands and these lenders quickly put the homes on the for-sale market at prices to sell quickly. The resulting bank sales then become comparable property sales used by appraisers for determining home values in the neighborhood.

Additionally, many buyers who used adjustable Alt-A and sub-prime loans are finding it difficult to make their increased monthly mortgage payments. Compounding matters, many neighborhoods have homes that have gone down in value by as much as 30 to 40 percent in one year resulting in many homeowners having both (1) an adjustable Alt-A or sub-prime loan and (2) negative equity in their home. These homeowners with negative equity which is also known as being "underwater" are having a difficult time rationalizing paying their monthly mortgage payments when they can walk away from their mortgage obligation. These "walk-away" owners are becoming renters which is adding to the strong rental market in many bay area cities.

There may be some good news on the horizon for the real estate market in California as Congress recently passed and the President signed HR 3221 which is known as The Housing and Economic Recovery Act of 2008 "the Act." The federal income tax changes included in HR 3221 are separately known as The Housing Assistance Tax Act of 2008. HR 3221 probably contains more changes to federal housing policy than any single law passed in the last 20 years. Listed below are some of the more interesting provisions of The Act that could have both short and long term impacts on the real estate market in the Bay Area.

Fannie Mae and Freddie Mac Get New Regulator

Currently there are two large Government Sponsored Entities "GSEs" known as Fannie Mae and Freddie Mac. The GSEs are integral to the mortgage market because they facilitate the secondary market for residential mortgages by buying, syndicating and guaranteeing pools of mortgages backed by residential properties. Up until now the GSEs have been loosely regulated which has allowed them to grow larger and expand into more financial markets than some legislators felt were appropriate and financially prudent. Under the Act, a new government Agency will be formed called the Federal Housing Finance Agency. This new agency will be responsible for many provisions of the law, but one of its primary purposes will be to regulate the GSEs. Under the Act, there are new capital requirements, new lending guidelines and a host of new reporting requirements for the GSEs. Only time will tell if these changes help save the GSEs or they eventually have to become nationalized to prevent a complete melt-down of the U.S. mortgage secondary market. It is interesting to note that many sovereign wealth funds such as Japan, China and the countries of the Middle East own large amounts of debt issued by the GSEs. These owners have and will continue to put pressure on Congress to eventually acknowledge that the debt issued by the GSEs will be federally guaranteed.

New Conforming Loan Limits 1/1/2009

Currently in high-cost areas of the Bay Area such as San Francisco, Marin and San Mateo, the conforming loan limit for single family homes is \$729,750. This new increased limit was enacted earlier in 2008 and was temporary and only is in effect to 12/31/2008. The Act permanently raises the conforming loan limits in high-cost areas for single family homes and 2 to 4 unit dwellings effective 1/1/2009. The new conforming loan limit will be \$625,500 for a single family residence located in a high-cost area. San Francisco, Marin, Santa Clara and San Mateo should qualify for the new limit. The loan limits for 2 to 4 unit dwellings will also be increased. Other counties will be eligible for increased conforming loan limits but only up to 115% of a county's median home price.

New Federal Income Tax Law Affects Conversions of Personal Residences to and from Rental Properties

Under the Act, any gain from the sale or exchange of a principle residence that is allocated to periods of nonqualified use is not excluded from gross income. Nonqualified use generally means any period after January 1, 2009 during which the property is not used by the taxpayer as a principal residence. One exception to the new rule is when the nonqualified use (for example, renting out the property) occurs after the property has been used as the principal residence of the taxpayer. This new rule is primarily aimed at taxing those individuals who have rental properties and who then decide to convert these rental properties into their principal residence for 2 years and then sell them. Prior to the new law change, these taxpayers

generally could have excluded up to \$250,000 (single taxpayers) or \$500,000 (married filing jointly taxpayers) from the sale of a principal residence. The new law will still allow taxpayers who have used their home as a principal residence for at least 2 consecutive years to then temporarily rent it out for a period of up to 3 years and still sell the home and utilize the \$250,000/\$500,000 gain exclusion as long as there was no nonqualified use which occurred after 1/1/2009. Nonqualified use generally occurs when the taxpayer rents out a home (or doesn't use it as their primary residence) after 1/1/2009 and the nonqualified use occurs before the taxpayer moves into and occupies the property as their principal residence. This law sounds a bit complicated and it is. Before undertaking any sale of a personal residence that has previously been rented, you should discuss your plans with your tax or legal advisor to make sure this new law does not apply to you.

Calculating gain under this new law will involve at least 2 calculations. First, any gain attributable to depreciation taken after May 6, 1997 on the property, is not eligible to be excluded from gross income. This is the current law and does not change. Second, the percentage of the gain allocated to periods of nonqualified use is calculated using a fraction based on the number of years of nonqualified use divided by the total number of years the taxpayer owned the home. The gain allocated to nonqualified use would generally have to be included in gross income for federal income tax purposes and may be considered capital gain.

First Time Home Buyer Credit

Under the Act, a taxpayer who is a first-time homebuyer is allowed a refundable federal tax credit equal to the lesser of (1) \$7,500 or (2) 10 percent of the purchase price of a principal residence. The credit is allowed for the tax year in which the taxpayer purchases the home and is essentially an interest free loan from the government because the taxpayer must recapture credit as discussed below. The credit phases out for individuals with modified adjusted gross income of between \$75,000 and \$95,000 (\$150,000 to \$170,000 for joint filers) for the year of purchase. A taxpayer is generally considered a first-time homebuyer if such individual had no ownership interest in a principal residence in the US during the 3-year period prior to the purchase of the home to which the credit applies. The credit is available for purchases between April 9, 2008 and July 1, 2009 and is recaptured ratably over 15 years beginning in the second year after the year the home is purchased. For example, for a taxpayer who took a \$7,500 credit in 2008, 1/15 of the \$7,500 credit claimed or \$375 would be paid starting in 2010 in additional taxes for and continuing for each of the next 15 years. If the taxpayer sells the home (or the home is no longer used as a principal residence) the taxpayer must generally recapture the remaining unpaid balance only to the extent the taxpayer has a gain on the sale of the residence.

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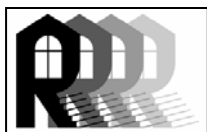
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New Tax Law for Converting Rental Properties to Personal Residences

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