4 signs your home value could drop

Even if you have a stable job and can pay your mortgage, your house might not be safe from a dip 'underwater.' Look around to see whether your house is at risk.

[Related content: homes, home prices, home selling, housing, foreclosure]

By SmartMoney

Despite signs that the real estate market is bottoming out, millions of homeowners are likely to find themselves in worse shape within the next two years.

Search for more on first-time homebuyer incentives

Nearly half of the nation's 52 million mortgage borrowers will have negative equity by the end of the first quarter of 2011, up from the 14 million at the end of this year's first quarter, according to estimates in an Aug. 5 report by Deutsche Bank. With so many borrowers "underwater" -- or owing more on their mortgages than their homes are worth -- the risk is high that they'll default and their homes will go into foreclosure, says Mark Zandi, the chief economist at Moody's Economy.com. (Moody's Economy.com estimates that 17.5 million mortgage borrowers will be underwater by early 2010.)

Negative equity is the product of several factors. The most significant weight is the broad and persistent decline in home values. A Zillow.com index of home values fell 12.1% year-over-year during the second quarter, resulting in a total drop of 22.3% since the market peaked in mid-2006, according to an Aug. 11 report by the online real estate marketplace. Many buyers who bought their homes around the peak with a 20% down payment have lost that dollar amount.

"The continued decline of U.S. home prices will contribute to rapidly rising rates of negative equity," Karen Weaver, a Deutsche Bank research analyst, wrote in the report. "The most obvious implication is for mortgage defaults."

Current homeowners, or those shopping for a home and who are concerned that they'll end up underwater, should consider how long they expect to live in their homes. Being underwater doesn't affect homeowners unless they plan to sell, Zandi says.

Individuals who are staying put for at least the next five to seven years will likely recoup the lost value of their home, says Amy Bohutinsky, a Zillow.com spokeswoman. In addition, homeowners should refrain from borrowing against their mortgages, she says.

Those who find themselves underwater can turn to the federal Making Home Affordable plan, which can help you refinance or do a loan modification. You'll have to meet the eligibility requirements listed here.

Whether you're at risk for falling behind may have more to do with the economy and your neighborhood than your job, your credit or your income. Here are four warning signs that you're heading underwater.

Foreclosures in your neighborhood

The quickest way to end up underwater is to live in a neighborhood that's plagued by foreclosures.

When one home on your block goes into foreclosure, your home's value drops by 1%, Zandi says. But that isn't a one-to-one relationship. If two homes on a block go into foreclosure, your home's value will drop by more than 2%.

As homes go into foreclosure, they create a domino effect, lowering home values throughout a neighborhood in a cascade beyond homeowners' control. (For more, see "Foreclosure nearby? It's your problem.")

You can find neighborhood foreclosure listings at MSN Real Estate.

Homes lingering on the market

When "For Sale" signs linger in a neighborhood for three or more months, that may mean buyers and sellers can't agree on a price. In that environment, homes are unlikely to sell unless the sellers lower their asking prices.

"The time on the market is always a good barometer of demand for homes and for the price homes are transacting at," Zandi says. "The longer it appears that neighbors are taking to sell their home the more likely it is they're not getting the price they want and that prices are falling."

Compare the time it took for homes to sell in your neighborhood three years ago versus today; if it's taking weeks or months longer to sell, the prices homes can fetch are dropping, Zandi says.

MSN Real Estate's home valuation tool includes time-on-market information.

Increasing unemployment

In most cases, the cities where homes have lost the most value during the past year also possess the highest unemployment rates.

Homes in Merced, Calif., have lost 40.2% of their value year-over-year, the biggest loss of home values in the nation, according to Zillow.com. The city's unemployment rate is the fourth-worst among 372 metropolitan areas at 17.6%, according to July data from the Labor Department. El Centro, Calif., where home values plunged 37.6% year-over-year (the second-biggest drop in the country), has the worst unemployment rate at 30.2%.

Individuals living in areas battered by high unemployment are likely to see their home values drop further, especially if they live in areas dependent on dwindling industries -- like Central Valley, Calif., and the mortgage lending business or Detroit and the auto industry, Zandi says.

You can find the latest unemployment statistics for most metro areas here.

Homes in disrepair

Dented siding, peeling paint and broken porches could be signs that neighbors are having trouble making ends meet and can no longer pay to take care of their homes, Zandi says. Or they may have gotten an appraisal and discovered their homes have dropped in value and are no longer worth the cost of repairs. As the condition of homes in your neighborhood worsens, home values almost inevitably drop.

"The mere fact that they're not investing in their homes will affect you too," Zandi says.

What underwater borrowers have in common

Risky mortgages: Some 77% of option-ARM borrowers and 50% of subprime mortgage borrowers were estimated to be underwater as of the first quarter of 2009, according to the Deutsche Bank report. With option-ARMs, borrowers could make minimum monthly payments that didn't even cover the loan's interest. As the market declined, these balances grew. With subprime mortgages, borrowers often had poor credit scores and little documentation of their financial situation. In both cases, borrowers often ended up with a large mortgage relative to the house's price.

Date of purchase: Individuals who bought their homes between 2003 and 2008 are at risk of being underwater because they bought while prices were rising, Zandi says. The risk is greatest for those who bought in 2005 and 2006, as the market approached its peak.

Excessive borrowing: Many individuals borrowed against their homes during the bubble by taking out second mortgages or tapping into home equity lines of credit or home equity loans. This borrowing left their homes with less equity to weather the drop in home values.

Home's location: The areas that have been hit the hardest by plunging home values include the "sand states" of Arizona, California, Florida and Nevada because they brought the most speculation, easy credit and overbuilding during the bubble, Zandi says. Also hurt: the states where unemployment is especially high and manufacturing jobs have been eliminated like Michigan, Ohio and Indiana, Zandi says.

This article was reported by AnnaMaria Andriotis for SmartMoney.

Published Sept. 9, 2009