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Real Estate 2011: House Prices in Chicago and the Suburbs

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Early this year, with the housing market in its deepest ditch in a decade, Linda and Mark Paternostro decided to sell their Glencoe home of four years and move to another town. They put the five-bedroom house on the market at $1.149 million—$101,000 less than the $1.25 million they had paid for it in 2007.

Stung by the idea of losing money, Mark had advocated starting out above the 2007 purchase price, just to see what might happen. But having watched other houses in the neighborhood linger on the market for a year or more because their asking prices reflected rosier (and long gone) economic times, Linda wouldn't have it. "Prices had been plummeting, and I'm a financial realist," she says. "The reality is the reality."

A month after putting the house up for sale, the Paternostros cut the price to $1.099 million; two weeks later the place went under contract at $970,000, or 22 percent less than what they had paid for it four years earlier—and that doesn't include roughly $1,000 spent on small repairs and cleanups to put the house on the market in sparkling condition. Despite the losses, Linda feels "exceedingly lucky. It could have been a lot worse," she says. "It could have taken a very long time when we were ready to be somewhere else."

It wasn't only luck that worked for the couple. It was their hard-nosed take on the dreadful state of real estate. They started out by accepting the primary rule for sellers in today's market—that it simply doesn't matter what they paid for the house—and took strategic steps to get the property sold. With a downward tilt that has now persisted for almost five years and has drained a larger percentage out of home values than the Great Depression did, the rules of buying and selling have changed dramatically.

Back in October 2000, with the economy still riding the dot-com-fueled boom, *Chicago* published a story called "The New Rules of Real Estate." At the time, I reported that because everything was going up so quickly, past prices weren't much help to would-be sellers trying to determine a sale price for their home. As for homebuyers, they couldn't spend days pondering an offer because properties were getting snatched up so fast. Several years of explosive growth followed, but by the spring of this year, Chicago-area home prices had dropped back nearly to where they were 11 years ago. Clearly, it's time for a new set of rules.

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RULE NO. 1

Yesterday is gone.
The cardinal rule for sellers in today's real-estate market is that what you paid for your home is irrelevant when you are setting an asking price. "If you're hoping to get what the Joneses got, I'd like to get gas at 80 cents a gallon," says Michael Parent, managing broker of Coldwell Banker's St. Charles office. "I can drive around all day looking for it, but it's gone. Forget what you paid four, five, six years ago."

Local home values have dropped more than 30 percent since their peak in September 2006, according to the Standard & Poor's/Case-Shiller Home Price Indices, and despite the earnest optimism of many homeowners, they have not shown signs of a fast rebound. Foreclosures, job losses, steep increases in the cost of living, and, in Illinois, a crushing public debt are all diminishing economic good cheer. Over the summer, economists were forecasting that home values would finish 2011 at least 4 percent below their already depressed 2010 levels and wouldn't be growing steadily again before 2014.

Watching your biggest investment wither is dispiriting, and as the downturn has dragged on, the number of people who retain any hope of seeing a price rebound has withered too. But many real-estate agents say they still encounter homeowners who either can't or won't believe that so much of the equity they used to be sitting on has evaporated. "We hate to be the ones to tell you that what you paid [for your house] has nothing to do with its value today," says Joe Siciliano, the branch manager in Coldwell Banker's Lake View office. "But if you need to move and you want your house to get sold, we're going to have to tell you that."

Even some sellers who get it don't get it. There can be a disconnect between understanding that real estate is in the dumper and the emotional attachment to one's own home. "Often there's a little bit of a feeling that 'it doesn't apply to my home; my home is unique,'" says Janet Owen, a Prudential Rubloff agent. "Learning that, no, your house is like everyone else's is painful."

RULE NO. 2

Don't play the "let's just see what happens" game.
Some sellers who still don't get it—or who do but have a tough time accepting the fact that they are going to lose money—figure they might as well *try* putting the house on the market at an inflated (i.e., nostalgic) price, just to see if they get any nibbles. Every credible real-estate agent I have spoken with over the past year has adamantly discouraged that approach. A home's first exposure to potential buyers is its most opportune, many of them say, and today's educated buyers recognize an unrealistic price right away.

"When sellers tell me they're not in a hurry so they just want to try out the price, I would rather have them wait until they're ready and price it right," Owen says. In her stratum of the market—high-end properties in the Gold Coast and Lincoln Park—sellers sometimes suggest that maybe a New Yorker transferring here won't blink at a high price because prevailing prices are so much higher in Manhattan. "But these buyers are savvy about the market," she says.

That's true in more moderate price ranges as well. The blizzard of real-estate statistics and news from the media, combined with the ease of Internet-based property research, has made many buyers discerning appraisers of home values in their targeted neighborhoods or towns. "Most people can tell a bad price—or their agent can," Parent says. That's not to suggest they can pinpoint the exact ultimate sale price of a home, but they know fat in an asking price when they see it.

Owners who intentionally assign a high price to their home are a key example of what Parent calls being *on* the market but not *in* it. A house that is in the market, he says, is priced to get sold, not to test someone's optimistic pricing theory. "If you're in the market, you're in the game to play it, not sitting on the bench hoping somebody comes along who wants to give you extra money." Sellers who ask too much, he adds, are "getting in the way of the people who are serious about selling their homes."

RULE NO. 3

The right price sells fast.

Last spring, the owners of a seven-year-old Bucktown home put it on the market at $799,000, just 79 percent of the $1.007 million they had paid for it in 2006. Eight days later, it was under contract at $800,000. Those sellers were clearly *in* the market. There may have been some late-night teeth gnashing over the $207,000 lost in the deal, but at least they got their house sold and could move forward.

"A compelling price gets you sold, and if moving is your goal, you need to get sold," says Mabel Guzman, president of Envision Real Estate and the Chicago Association of Realtors. How to determine a compelling price? "Know the inventory you're up against," she says. Do a serious, clear-eyed study of the comparable properties in your neighborhood that have sold in recent months and carefully tot up your home's pluses and minuses compared with those. (This is also something a qualified real-estate agent can do.) Then cut 1 to 2 percent off your price. You were probably favoring your own home, knowingly or not.

"Studying the comps is an eye opener," says Beth Burtt of Hinsdale's Brush Hill Realtors. "If you're being diligent about it, your price becomes pretty obvious." As your economics professor used to say, the marketplace speaks clearly if you're listening.

Not all homes start out at the right price for today's market, but when they get there, you will know. The 20-room Gold Coast mansion of Jamie Dimon, the former Chicago banking executive who left to become chairman and CEO of JPMorgan Chase in New York, went on the market at $13.5 million in April 2007. It sat for three and a half years, even though its asking price drifted down to $9.5 million by mid-2010. But when Janet Owen, the last agent on the house, cut the price to $6.95 million, it moved within a few weeks, finally selling for $6.8 million. "When it got to where the market perceived it to be priced correctly," Owen says, "it sold."

ILLUSTRATION: DANIEL STOLLE

RULE NO. 4

Low-ball offers are insulting—but don't get insulted.
The dark underside of a marketplace that rewards competitive pricing is the low-ball offer, the scourge of many a home seller. Some cocky buyers, their heads filled with images of sellers desperate to get out of their homes, see the chance to snare a once-in-a-lifetime bargain and swagger in with startlingly low offers. It's their version of the seller's "let's just see" game.

How low the ball can go has changed as house prices have slumped. At the height of the market five years ago, Siciliano recalls, "you offered 5 to 7 percent less than what they were asking. Ten percent less was blasphemous"—and sale prices frequently wound up above what the sellers had asked. Now, he says, it's common to see a first offer at 10 or 15 percent below the asking price, and sometimes it's even lower. While buyers certainly have the right to try to puncture what they believe to be an inflated price, throwing out a very low price just to see if it sticks is not a smooth move, he says. Guzman agrees. "If you want to negotiate a good deal," she advises, "start out amicably."

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Remember, many sellers are already digesting the idea of losing substantial money on the sale. Antagonizing them with an offer that makes that loss even greater could sour them on working with you. "Don't make the sellers hostile," Guzman says.

Nevertheless, the low-ball offers continue, so Owen encourages her sellers to maintain a Zen-like calm in the face of a ridiculous first bid. "Any offer is a starting point," she says. "You might be surprised by it, but don't take it personally." If the offered price isn't flat-out absurd and the terms other than price are good—the financing and closing date, for example—Owen advises sellers to counter conservatively to show that they are willing to negotiate but not to give the house away.

"There's a distinction between a smart buyer and a bottom feeder," she says. The smart buyer may start lower than expected but then come up to a more reasonable price range; the bottom feeder is scavenging for steals and won't respond to a conservative counteroffer because there is no whiff of desperation in that.

RULE NO. 5

Honesty is the best policy.
It's as true in real estate as it is in politics: There are no secrets anymore. Buyers have access to an enormous amount of information. On the Internet, details about what a home last sold for and how much it now might be worth are usually only a series of clicks away. Where sellers might once have coyly declined to say what they paid for a house, sellers and buyers can now assume that each has most or all of the information the other has. "I tell my sellers that the buyers are going to look at all the same facts I've [given] them in the listing presentation," Owen says. "There's no way to hide it."

Some sharp real-estate agents have been capitalizing on the newfound transparency, playing to buyers' understanding of the market. They may trumpet the size of the bargain, such as the listing for a St. Charles home sold in June that announced the asking price of $1.249 million was "$1 million less than seller paid in '06!" A Lincoln Park home's listing sheet blared that the $1.75 million asking price was well below both the original asking price of $3.65 million and the appraised value of $2.5 million. For another residence—this one in Lake View—the agent confessed that the home "was overpriced for much too long." Those revelations might spark pangs of humiliation in the sellers, but at the same time, they send a clear signal to buyers: Game on.

Honesty is essential in another aspect of the home-selling process. When first meeting with a real-estate agent, sellers should be up-front about their financial status. As Parent explains, there are markedly different routes for selling a home that is in or near foreclosure, one that will be a short sale—where the lender agrees to let the homeowner sell for less than the amount owed on the mortgage—or one that will be sold conventionally. Many agents have trained in the differences, and they will ask potential sellers tough questions, such as when they last made a mortgage payment and whether their homeowners' association dues are paid up. Sellers who aren't current on one or the other then get a fuller examination of the financial status of their home.

Parent acknowledges that some sellers become annoyed when asked these things. "It's like going to the doctor and being asked if you smoke or drink," he says. But, as with doctors, real-estate agents need to know the risk factors so they can respond accordingly.

RULE NO. 6

Shop the distressed properties.
Distressed properties (foreclosures and short sales) are in virtually every neighborhood and every price range now, and most experts forecast that their numbers will swell once banks better understand how to deal with them—and as more homeowners who have been struggling financially finally let go.

To many sellers, distressed properties might seem like sorry substitutes for a well-maintained home that can be bought without lots of extra paperwork. That may be true, but distressed properties are the competition now, no matter how nice your house is. Ignore them at your peril.

And, as Guzman points out, knowledge of the local landscape can help sharpen your own marketing efforts. If, for instance, the foreclosure down the street has appliances missing, your listing sheet can highlight the difference. It wouldn't make a direct jab at the other home, Guzman says, but would say something positive about your own residence, such as "well-applianced kitchen." (Rely on a real-estate agent to tell you what can and can't be said in a listing.)

As for homebuyers, many of them have found great bargains in distressed properties, leveraging the low price to step up to a larger or better-located home. But distressed properties have downsides, such as the expense of restoring a neglected house and the long and often tortuous process of getting an offer accepted by a bank or other institutional seller. "It goes to your tolerance for anxiety," Siciliano says. "If you have the ability to sit around and wait for a long time, if you have a place to live and don't have to get out, you could get a smoking deal in a distressed property." (Foreclosures frequently sell for about half their peak market value; the discount on short sales varies based on what the seller owes and what the bank will accept, but it often decreases by double-digit percentages below the market value.)

If, on the other hand, you need to move soon or have very specific location demands—or you're simply not the patient type—a distressed property may not be for you. "The negotiations are kind of crazy and drawn out," Siciliano acknowledges. "You can wait months for a response [to your offer], and then it might be negative, and you're back where you started, without a house. I've had three or four people try it and then say, 'I'm done. I want a good old-fashioned resale.'"

RULE NO. 7

Buy for the long term.
If the collapse of the housing market taught us anything, it's that a home shouldn't be used as a short-term investment. "Everyone thought for a while that there was a guarantee that a home's value would go up," Burtt says. "Now people realize that it's a fluctuating market, like any investment." Flipping homes for quick profit may have been fun back in the boom years, but in this moribund economy, it's time to go with a buy-and-hold strategy.

That entails looking at a property not as it is today but as it will be ten or more years down the line, when a family's needs may have changed. "Ask yourself, 'Can I grow into this house?'" counsels Burtt. "'What space will I need if my family grows?'"

It's even more important to be realistic about what you can and cannot afford. "People are reviewing," Burtt says. "Do they need to spend so much on their home? Do they need to have quite as much in terms of square footage or amenities as they once thought? Does every child need a separate bathroom, or can they be more flexible on that?" In today's subdued real-estate market, ratcheting down expectations—whether about the number of bathrooms or how much a home is really worth—is an essential tactic.