

Timing the Next Real Estate Cycle: Boom to Bust?

By John V. Kamin

Experienced pros believe that real estate runs in seven to 10 year cycles, top to bottom to top. At least, that's what history seems to demonstrate on residential properties. Some cycles can be longer, such as during 1930s down cycles.

The length of the current real estate cycle has had two modern effects. Analysts have been predicting a real estate "bust" since 2000 - a "bubble". They've been wrong from 2000 to 2005 so far; very wrong, six years in a row. But experienced real estate pros know that eventually the cycle will reoccur. By Kamin's Law, I expect the market will tell us when it's ready to turn, rather than us trying to "force" the market to agree with anyone's preconceived notions. Bluntly, trends often carry further, faster and longer than anyone expects.

There are other rules that have served our clients well in the past to make them lots of money, six figures and more. Here's a few of them.

Another group of relative newcomers to the market (especially those who have made big money recently with huge gains - property flippers, and home buyers/sellers/traders) believe that "property is not cyclical". They expect home prices to continue up, a little faster, a little slower, but mostly up. Unfortunately, for these naïve observers/speculators, that's not the way property markets work. Keep in mind that real estate is illiquid; at least most of the time. Only in the very hottest of hot markets is real estate readily, quickly liquid, as in today's market.

Continuous Money-making Ahead, Possible?

There are other rules that have served our clients well in the past to make them lots of money, six figures and more. Here are a few of them.

1. 85% of the USA population lives within 50 miles (1 hour's drive) of a major body of water. This has been the trend for a century. ***"Go near the water"***.

2. ***Stick to major outlying metro job areas*** of 1 million populations or more. When resale time comes, you need plenty of potential prospects and bidders to find actual buyers for your property. While real estate is illiquid, the more prospective buyers and bidders that you have in a particular area can make it a little less illiquid.

3. Go for the growth areas. There are about 15 major growing areas, fast growth areas in the USA. This narrows your search area greatly. It also means that, even if you make a mistake, but you're in a growth area, eventually the growth can bail you out and make you money, covering up your blunders. ***Go for the growth.***

4. ***Shun non-growth areas.*** For example, I love the wild country and the open country; states such as Idaho, Wyoming, Nebraska, Montana, the Dakotas, and Maine. But I don't plan to buy property there because of troubling population trends. As the farmers tell me about their young ones who get some schooling. "You can't keep them down on the farm". Young adults head for the big cities for jobs, steady paychecks and excitement. Turn this 100-year-old trend to power up your profits, turn it to your advantage. Let the population trends tell you where to locate or relocate and search for property. Then, while real estate is illiquid, if population trends show that people are moving into the area, and population is increasing at a fast rate, then let the trend make you rich. I'm not saying you can't make money in a small town or in a non-growth area, if that's where all your assets are concentrated.

But you can add liquidity to further illiquid real estate speculation by going to the outlying suburbs of jobs-rich growth areas. By adding diversification so that your assets are not all concentrated in a low growth or no-growth area, it should make it a little easier to resell illiquid property, at different times in the real estate cycle.

5. Tip O'Neill used to say fondly, "All politics is local." Paraphrasing O'Neill, one might also say, "All real estate is local."

Therefore, **by concentrating on growth areas, and paying close attention**, as Andrew Carnegie advised, to watch your “basket of eggs”, monitoring all developments for the area, you will become better informed rather than lesser informed. You’ll be attuned to new developments (or lack of them) to make better decisions. Local knowledge can add to liquidity, if you know what’s going on very precisely in an area (or what is being stalled by local bureaucracy). When you make better decisions, your accuracy improves, and so do your profits, and so do your resale capital gains!

Troubling 2005 Signs That the Real Estate Boom is About to Shift

The real estate boom is still strong. Among the positive signs are a historically low three to four months supply of new homes on the market and second, listings levels are shrunken, low.

During a 2006/2007 downturn, one could expect listings to increase, and supplies of unsold new homes to increase. New home sales are still at record levels, down 17% previous month, but up 12 % current month. Probably weather related.

People tend to buy homes where the jobs are, so avoid the boondocks, to increase liquidity of illiquid properties. Where are the soft spots, or trouble spots, or red flag alerts?

A second sign troubling real estate pros is the rising level of interest rates. But rates are still historically low with a Federal funds rate of 3%. You might not run into mortgage trouble until Fed funds hit 4.5% to 5%.

Real Estate Markets Run on Borrowed Money

Watch for a third troubling sign, which is tougher loans, lightened qualifying. FreddieMac and FannieMae, the biggest mortgage suppliers to the real estate market have been in the news lately. Their troubles are matters of public record and are ongoing, and have come to the attention of Congress.

PREDICTION: If anything interrupts the free-and-easy making of new loans by these two gigantic mortgage lenders, it could throw a monkey-wrench into the real estate market and crunch the gears. Careful. Maybe, maybe not.

EARLY WARNING SIGNALS: Watch signs in the lending market that borrowers are being turned down for loans regardless of good or bad credit.

Lowdown on Little Downs

Another troubling sign: Dr. Alan Greenspan, head of the Federal Reserve Board, addressed a meeting of Texas bankers and told them bluntly, “Bad loans are made during good times.” He gently but definitely, bluntly, warned them.

The troubling signal is the plethora of new loans being made today at 0%, 1%, 3% down.

PREDICTION: Any trouble in the real estate market, a little sag, lending difficulties, or trouble making scheduled payments, (many of these 0% to 3% to 5% down-payers, buyers) will become “walkaways”. Those homes will be the first to become foreclosures! (No equity!)

One more troubling sign is the huge condo boom. As house prices rose, many buyers opted to buy condos instead of traditional houses. Condos were cheaper, easier to buy, low maintenance. But real estate is usually illiquid in most parts of the real estate cycle.

Among the huge property market, there are sectors that are more illiquid than others. Among the most illiquid are usually times shares. Less liquid are commercial land, vacant lots, and condo resales. Condos are usually much harder to resell than individual homes. Yet, what’s the hottest growth area in real estate today? Condo developments and condo conversions. This different troubling condo boom is one sign that you usually see at the top of the market.

Give Me Your Money Sight Unseen?

Another troubling sign: during recent months I have encountered people who are buying new homes “sight unseen”. Oh, they have photographs, webcams, but they haven’t “walked the dirt”. These buyers are not potential occupants, but people who are speculating that they will be able to sell the property for profits in coming 24 to 72 months.

Will it happen? My motto is, "If you can't afford the time and effort to walk the dirt, you can't afford to buy the property."

One more troubling sign is that people are buying in remote areas - new homes and used homes. Why? Cash buyers may feel that these slow-to-develop or less-developed areas have not participated in the strong boom in the same way, and therefore houses are "much cheaper". My reply? The houses are cheaper there usually for good reasons. Such as, few or no job opportunities in that area well above the minimum wage. Avoid zero or low—growth areas. Avoid boondocks, boulder and goat farms, and mountainsides. Avoid areas that are not job rich. Avoid areas that are more than one hour commuting distance from major job centers. Concentrate your efforts. Focus. For profits.

People who have decent jobs can get loans easily enough to buy your property.

People in areas with fewer or no jobs find it much more difficult to get substantial loans to purchase properties (to buy yours).

SUMMARY & FORECAST: It's quite possible that you are witnessing the top or near-top of the current real estate boom. Not all markets will move in exact tandem with the others. There will still be hot growth areas, even as other markets start to sag, and grow soft (rural Ohio? Indianapolis?). This economist's advice remains the same, "**Keep your best properties, but sell your worst properties now.**" By 2006-7 you may be facing a different part of the real estate cycle with less liquidity.

Are You Property Rich But Cash Poor?

Sell your difficult-to-resell properties now at full market! Sell the ones in slums, crime-ridden areas, boondocks, ones you can't even get a bid on in the down portion of the real estate cycle, the ones you can't even get a prospect out to inspect. Sell while people will buy anything!

But keep your best properties, they're likely to continue going up long term in a time of increasing population, increasing immigration, increasing longevity. Go for the growth areas. Diversify.

***Sell your difficult-to-resell
properties now at full market!
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Use some common sense. Don't buy uninspected properties, or those in remote areas that have few jobs, or in areas that have few prospects of growth.

Control your assets. Don't lose control of valuable properties by trading one overpriced property that you know for another overpriced property that you don't know (that may have hidden markups, hidden problems) in a 1031 exchange as a "Tenant-In-Common".

Tax-Cutting Strategy

Remember that the current 15% long-term Capital Gains rate is about the cheapest tax you may ever pay on huge-profits on commercial or rental properties.

Homeowners with huge profits can pass through \$250,000 of tax-free profits if single, or \$500,000 if married. You qualify usually by having lived in the property at least two out of the last five years. Then, you can do it again, if you wish, two years later with your newest residence.

FURTHER TIP: I do something that's contradictory to what most real estate brokers and realtors are used to. When I move to a new residence, I usually keep the old residence for profit and rental cash flow; I don't automatically sell it.

Over the years this has been a wonderful way to finance college educations for children at fancy, costly Ivy League schools, a great way to provide cash-flow rental income and make long-term capital gains.

In contrast, most brokers are used to buyers of another home reselling their old home fast just to make the new transaction. Keeping the old joint for capital gains or interim rentals saves commissions, saves hikes in property taxes, helps you hedge inflation, and has many other

benefits (such as depreciation of rental houses). In fact, in most major growth areas, there is now a shortage of rental houses in good neighborhoods with decent schools.

Make long-term trends work for you, not against you. You don't have to sell your old house just because you're moving to a new one!

Experience more profitable tips to help you make six and seven figures with smart property decisions in upcoming Forecaster articles. Don't miss them!

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