

Condomania: Will Boom Continue or Fade Then Bust? **by John V. Kamin, Economist**

No question about it, condos and condo construction are booming! So are condo-conversions from apartment buildings.

Evidence: In a small growth area alone, Las Vegas (Clark County), 29,000 new condos (already approved projects) are scheduled to be built and sold between 2006 and 2010! Also, 35,000 hotel rooms are to be added 2006-2010. Undoubtedly, those numbers will increase though some approval projects may be pulled before completion.

Flippers and Flops

Indications are that from 30% to 50% of the un-built condos are being pre-sold to property-flippers. They are being sold to people who put down a small deposit then await construction and completion for a profit of an (anticipated) six figures! E.G. Would you put down \$5,000 or \$10,000 on a \$500,000 condo not yet built that the salesperson suggests will be worth \$800,000 at completion? A \$300,000 potential profit for a \$5,000 deposit? Very tempting! (Not recommended.)

Then, the developer, with all these "pre-sold" contracts in hand plus cash deposits, can go to the lender and borrow the construction money even before the bulldozers arrive!

Prediction: Many 0%-5% down loans will generate "walk-aways" (foreclosures) who can't pay the mortgage in a real estate down cycle.

But, what if all the new units are not sold? Then developers rent out the surplus to keep the cash flowing. What if the developer yanks the project (deposits returned?) or fails to complete building as promised?

What if the builder's budget explodes (due to higher inflation) or the lender gets cold feet? Clearly, there are lots of risks. What if real estate goes into the dumper and becomes illiquid instead of continually booming and breaking higher?

What's Behind the Condo Boom Besides Flippers?

1. Easy money is fueling the boom. Lenders appear anxious to loan money on condos; just about as anxious as they are to lend money on single-family free-standing houses! Lots of money to be made! The questions? Will interest rates rise, lenders tighten scrutiny? Will there be a cash crunch in a year or three? There are risks.

2. Foreign buyers are fueling the condo boom. Lots of buyers from London, Bonn, Paris, Rome, Tokyo and other places like the idea of owning a condo. Foreign buyers are flooding into developments in Boston, NYC, Chicago, Las Vegas, and especially Miami! In cities where hotel rooms routinely go for \$300 a night, owning a two room or three room condo can be attractive to foreigners who spend 15, 30 or 60 days per year in the U.S. on business and pleasure. The surge in foreign buyers is a new development, where many condos are planned to be empty up to 10 months per year! Some will be rented out, many not.

3. Dropping dollar discounts prices 34%. Since the U.S. dollar dropped against the Japanese ¥, the British £, the euro, and other major currencies, to foreign buyers it's like getting a \$500,000 condo for the equivalent of \$300,000 in their own currency! Or, a \$1 million condo for \$650,000. Looks like a great bargain, especially if you can borrow 80% or 90% of the money at low interest rates from the U.S. lenders; repay your mortgage with ever-cheaper U.S. dollars (assumption) gleaned from higher conversion rates of the euro and the yen and other major currencies!

(E.G. The USA is importing 60% of its oil, up to 12 million barrels per day (near \$60 a barrel), and oil sellers from Latin America, Arab countries, North Sea producers, and even Canada like the idea of putting some of their money in USA real estate and specifically condos in Miami and Las Vegas. The big question: will foreign demand for U.S. condos dry up if the U.S. dollar rises or

if U.S. interest rates double?)

Easier Prices?

4. Most condos being bought are cheaper than homes. If you're a U.S. homebuyer, but either can't qualify or can't find the home you like in an already built-up community, perhaps you'll consider a condo. Many do. Some condo buyers are people who can't find a home to buy (due to shrunken listings "for sale"). Some workers hate extra-long commutes and high oil prices, which have about doubled.

Increased Commuter Demand

Traffic gridlock and pain-at-the-pump are fostering U.S. buyer demand for closer-in condos. Commuters desire to cut distance, and potential house-buyers who can't qualify for a huge loan on escalating single-family (pricey) homes buy condos instead!

Low downs! Latest reports indicate that in major metro areas some 30%-70% of new first mortgages are originated with 0%-5% down! These loans are riskier in real estate downturn.

Prediction: Many 0%-5% down loans will generate "walk-aways" (foreclosures) who can't pay the mortgage in a real estate down cycle.

Long gone and badly shrunken in number are traditional 20%-30% down first mortgages; a flashback from yesteryear.

2005 Rent Increases are Pushing up Demand to Become "Owners"

5. Condo demand is increasing from converted apartment renters. As traditional older apartment buildings are converted to condos, renters become owners, often at lower payments and on favorable loans! Then, as owners, they get tax deductions that the landlord used to grab! As renters, they could be evicted, kicked out and forced to move. But as owners, they have property rights.

Prediction: There will be an increasing demand from traditional renters to become condo owners, particularly when mortgage payments are roughly equal to the rent they were paying or less and when tax advantages are "preached", new tax deductions for which they could not qualify in the past as renters!

What Does it all Mean, Boom or Bust? The American Dream

While condos are increasingly popular, it remains to be seen if they remain popular in an escalating interest rate environment.

It remains to be seen if the U.S. dollar will strengthen (drive down discounts to foreigners).

It remains to be seen if uncompleted projects and planned developments will be carried to full completion and 100% occupancy!

And while the USA is experiencing a boom now, it remains to be seen if a future recession with rising unemployment will allow condo buyers and flippers to keep up their payments as developers and builders run into trouble!

Foreign property buyers often don't get much for their money at home in London, Paris, Rome, or Tokyo and often must lease the unsold land under their building.

Don't forget! Real estate traditionally is cyclical, illiquid, subject to cash crunches and lender squeezes and affected by economic conditions such as recession and booms.

Summary: I have nothing against condos, but I'm not recommending them. I am more traditionally oriented toward cash flow from office and small commercial buildings, stores, apartment, triplexes and the like.

I think it's great to own one's own freestanding home, a duplex or triplex. Home ownership is the American dream!

While some condo boards are checking out new owners before giving approval, I'm of the opinion that many condo boards are inactive, powerless and have absentee owners who are reluctant to vote on every new buyer.

Therefore, if you're seeking quiet retirement, you may have no control over whether your neighbor is "Perpetually-Partying-Pete" or whether the condo on the other side is used by an absentee owner as a "safe house" or for some questionable activity.

Still, a condo is better than renting. But owning a condo is a secondary solution rather than the primary solution to wealth-building: owning cash-generating rental properties and one's own primary home!

Editor's Note: Make sure to come and hear Mr. Kamin's "Predictions for Profit" in his FREE SEMINAR at the Los Angeles Convention Center on Tuesday, October 18th!

John Kamin is a Consulting Economist and publisher of The Forecaster. 19623 Ventura Blvd., Tarzana, CA 91356. \$180 per year. For more money making ideas, order his latest book, Active Money Strategies & Hidden Wealthbuilder Secrets For Young Adults: What They Were Afraid To Teach You In School. If They Ever Knew! \$20 + \$4 s&h Add \$1.65 tax. 95 pages.

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