

## **Real Estate Prices Will Go Up! (The American Dream and Real Estate Cycles)**

*By John V. Kamin*

A smart young friend had just moved his family to Orange County, CA, renting a house near the coast, \$2500 monthly, moving to a new job. His plan? The “strategy” was to rent for a year or three, wait for the “100% certain” real estate collapse on home prices in Southern California, then buy a house. He expected prices to plunge 25% to 50%. As a non-subscriber to the Forecaster Moneyletter, when he expected my approval on the deal he'd already done and his strategy, I shocked him.

- 1.** I told him that he had chopped off his chance to make a capital gain on a house; told him he couldn't make a capital gain on real estate (home purchase) as a renter. Several examples: since he rented that house late 2005, it's probably already gone up over \$50,000.
- 2.** I told him of a second example: since he rented that house, prices here in the San Fernando Valley, have edged up 2% to 7.8% just in 2006. A \$600,000 house rose from \$12,000 extra to \$36,000 extra, depending upon neighborhood.
- 3.** I didn't want to press him to subscribe to the Forecaster to get our weekly forecasts and predictions, as a casual friend. But he should have, it would have meant many \$1,000s to him.
- 4.** As a young family man, I should have told him that the San Fernando Valley houses I was recommending at \$25,000 in 1972 (4 BR 2 BA) in the suburbs, now go for \$625,000, after 35 years of providing rental income or living rent free to the owner, worth about \$20,000 per year cash flow, over 35 years to 2007.

Uncle (Sam) Wrote the Tax Benefits

- 5.** I did tell him that he had cut himself off from any tax benefits as a renter instead of an owner. Since he's a hard worker and earning good money, as an owner he could have deducted property taxes, mortgage interest, upkeep, depreciation and repairs on rental housing (especially if he lived there now and moved later, renting it out later).
- 6.** But since he was a non-subscriber, I felt precise strategies were better directed confidentially to readers.
- 7.** He seemed really surprised when reality set in, that house prices not only went up instead of down (although more slowly), but were more likely to go up more over the next 10 years than to drop the 25% or 50% that he anticipated...even if there were a high rate of foreclosures.
- 8.** I could have told him that the big profit gains are made in buying houses (particularly in distressed periods of the business cycle, at a discount from whatever the current “highball” appraisal is) rather than expecting merely the general business cycle and the high rate of 2007 foreclosures to get him half-priced houses. The real money is made in negotiating individual deals, although it helps to have a good understanding of the economic cycles, forecasts, and predictions.

History Demonstrates Long-Term Profit Cycles

Example: In 1933 to 1937 you could buy a good working farm with plenty of acreage in the Midwest for about \$1500, plenty available. A new 1936 full size six-passenger

Chevrolet sedan listed for \$595. By 1940, a new Olds 88 with hydramatic transmission, the latest development, could be purchased for \$900. By 1945, you could buy a nice suburban brick two-flat in suburban Chicago (live in one flat, rent out the other, and probably get a second rental on the basement, as many did) for \$5,000. The same brick two-flat duplexes had been available in 1940 for \$2,500.

But my young friend, though he's known about the Forecaster successes for two decades, did not get any of this information, even though he needed it, because he couldn't bring himself to "turn the corner" and subscribe!

I did point out to him that he was dropping some \$30,000 per year, \$90,000 rent money over 2005-2007 by paying rent, while getting no appreciation, no capital gains, and no tax benefits as an owner.

Forecast: I predicted that his rents were sure to rise over time, as his leases were up.

#### Current Strategy. Free College?

I've been advising young adults in this area not to buy a house now, but instead to buy a triplex or four-plex for a little more, live in one unit while their families are small, let tenants pay off their 15-year fixed rate mortgage! Then, in a few years they'll have lots of equity, and a choice of places to live plus cash-flow income property, building net worth for them, as their kids grow. You'd be surprised how fast equity builds on a triplex or four-plex on a 15-year FRM. Before the toddlers are grown and off to college, you own the joint!

#### Property Cycles

My experience is that real estate cycles last usually around seven years, but may last 10 years.

Even though the Great Depression began in late 1929, properties had not fully recovered even by 1939. By 1940, big-city rents were but \$15 monthly on a nice modern four room or five room , two bath apartment. Weekly industrial wages for, say, a factory worker or a waiter/waitress were \$12 weekly, \$2 per day for a 6-day week. The rent on a nice apartment soaked up 1¼ week's wages. Bread was 5¢ a loaf, hamburger 10¢ lb, two years before WWII rationing began.

#### What Does It All Mean?

**1.** Real estate cycles move slowly. After the January 17, 1994, earthquake in Southern California, you couldn't sell a house in the San Fernando Valley for seven years, until about 2001. But after 9/11/2001 many people started buying houses, they wanted the security of their own place, not some multi-unit building that might tumble and be destroyed in an earthquake where the owner carried no earthquake insurance! Those were factors over which the displaced renters had no control.

Suddenly, a massive housing shortage developed while insurance companies tried to figure out how little they could pay on claims!

**2.** Those suburban San Fernando Valley four bedroom, two bath houses that had been selling in 1994 for \$225,000 did drop to as low as \$180,000 median price by 1999, a few years after the 1994 earthquake. But you still had to pick, choose, and negotiate your deals to make money. Renting was easier, as so many tenants had been displaced by the 1994 earthquake and aftermath. That was a unique situation where, even though there

had been a shortage for several years of rental space, a shortage of houses for rent, very few vacancies, not enough new houses had been built and were being built.

3. New building codes found many property owners uninsured, or without big enough insurance checks to cover the new strengthened code changes.

4. Many contractors had gone bust in the overbuilding boom 1984-1990, which led to a massive glut and high rate of foreclosures across the USA by 1990. The Resolution Trust Corporation had to be formed to take over failed S&Ls and failed banks who had too many foreclosed properties on their books. RTC auctioned them off. The 1989-1994 glut in the marketplace had pushed many contractors out of the business, into other lines of work.

#### Turmoil Creates Opportunities

Clients who bought during those times of turmoil, after-earthquake chaos, made huge capital gains. It was easy to borrow money on new houses and resales that were ready-to-go!

The 2000-2001 mini-recession that accompanies Clinton's exit from office and Bush's beginning of term number one, had convinced the Federal Reserve to push interest rates way down. Banks and other lenders were practically giving away loans at 4½%, 4-¾%, 5%, and 5¼%. Some refinanced five times, to get ever-lower interest rates on existing mortgages, better terms, built equity. They did very well indeed! Good for them! The Forecaster was recommending refinancing, getting rid of older, higher-cost 30-year mortgages, replacing with low-interest 15-year FRMs.

The point is that owning and holding property is a long-term proposition to make huge capital gains. Subscriber Dr. David Schumacher, author of several books including Buy and Hold – 7 Steps to a Real Estate Fortune showed precisely how it is done, and how it is done, and how he did it.

#### Weird Markets, Cycles, Probable

Second, you need seed money to lock your deal, buy the property. But you also need another 10%-30% extra capital, above the purchase money, to cover first few years of holding. The market bottom may be one to three years away from where you thought it was, a longer cycle than you expected. You might have to pour extra money into holding/keeping your property, and preparing it for an eventual long term capital gain (LTCG).

#### What's Ahead 2007 to 2057?

Today's higher foreclosure rates are buoyed by many people who made little or no money down payments, who didn't have the extra money strength necessary to hold on for the big gains. No equity. They got in with 0% down, 2% down, negative amortization loans, minimal credit checks, no-doc mortgages, Second and Third Trust Deeds, down payments surreptitiously gleaned from 16% interest credit cards, and the like.

Forecast: I expect a lot more foreclosures before this real estate cycle bottoms out, as property passes from weak hands into stronger hands.

Prediction: I expect the population of the USA to double by 2057-2061.

Forecast: I expect people will look back 20 or 30 years from now and say (as I hear every day), “Why didn’t I buy more income units, rental homes, properties, when you told me to, when I had the chance!?”

We’ve been around a few business cycles, and not only have spent more than a decade in formal economic training at various universities, but are now celebrating our 45<sup>th</sup> Forecaster Anniversary. So, we’ve been through a few booms and busts, and have helped many people make profits, long term capital gains, cash-flow income on rental properties. We hope to continue serving you! Make money, have fun Author T. Harv Eker, author of bestseller 17 Secrets of the Millionaire Mind says, “Ready, Fire, Aim.”

The timing will never be 100% perfect for you to finally sink in your money. If it is, be a Contrarian, be a bit suspicious, and check more carefully.

Don’t wait 10 years, 20 years, 30 years to finally “pull the trigger” on your first income property speculation.

You say you’ve already looked at 10 to 40 properties and you couldn’t find a good buy? I think you’re not working hard enough on weekends.

Typically, if I look at 100 carefully pre-screened properties, I may find five to seven properties on which I may consider making an offer, of which I may enter into serious negotiations on only one or two. And remember, I’m using multiple careful screening devices on the first 100 properties I even look at, out of maybe 500 that the brokers want to waste my time with, (priced full ticket) without any NTS (Need-To-Sell) component.

*John Kamin is a Consulting Economist and publisher of The Forecaster, 19623 Ventura Blvd., Tarzana, CA 91356, (818) 345-4421. \$180 per year. For more money-making ideas, order his latest book Active Money Strategies & Hidden Wealth Builder 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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