

Vacancy Wars in Rental Properties! Strategy for Rental Property Owners

By John V. Kamin

Forecast: Turmoil is about to change vacancy rates in rental properties. If you own, buy or sell such cash-flow rental properties, you will be affected.

Here's what's happening. Displaced former homeowners, unable to pay their loans will become renters. You would think they would rent a house, but many of those repossessed houses are not available for rent, for various complex reasons. Assumption: more renters equals lower vacancies.

Therefore, most of these displaced homeowners will try to rent *larger* apartments. The hidden problem? If they couldn't pay their mortgages and became dispossessed, how are they going to come up with first month's rent and security deposits for a substantial apartment? For example, in Los Angeles County, the average apartment rents for \$1,432 per month and the trend is that rents are rising. Also in this area, are other former homeowners displaced by the fires near San Diego and elsewhere, where some 1,600 estimated homes were lost.

Prediction: Many fire-displaced former homeowners will need to rent (at least temporarily) for a while, but most of them will have the money from large insurance checks.

Effects of Recession

Some 85,000 jobs were lost recently. Many of those jobs are low seniority to entry level (think renters). Many former job holders now on the dole will be seeking new quarters, trying to save money on rent. Some will double up; others will move back with Mom and Pop for free rent, meals and "nurturing" in recession times.

But many will seek to move from higher-cost apartments to relocate to lower-cost apartments, perhaps in cheaper areas. More turmoil ahead. And, if they've lost jobs recently, HOW are they going to pay the rent, even on cheaper places?

One reason rents have stayed high and kept increasing in Los Angeles and other metro job centers is that demand has been high and USA economy has moved forward under Bush. But that may change over the next 12 to 24 months.

How Long Will Recession Last?

The National Bureau of Economic Research, (NBER), the official arbiter of when recessions begin and end, has suggested that the last two recessions lasted about eight months. But, they're using different measurements than this economist. NBER measures recessions from peak to trough, high point to low point.

I like to check the length of recessions from peak to trough to full recovery, or peak again, (PTP), which can be twice as long or more. For example, the 1973-74 recession

was brutal, a fast fall. But it took eight years to recover to the former peak after Reagan took office.

By my estimate, the average recession peak to trough to peak lasts about 37 months; a short one would last a minimum of 18 months PTP. A longer recession might average around 55 months PTP. Therefore, whether you are using MBER measurements, or Forecaster estimates, it's good to make sure the media announcements are measuring the same thing as we are. If you don't compare apples to apples, your planning will be short-circuited, using different length yardsticks.

What's Ahead?

Prediction: Recessions can increase vacancy rates on rental properties, and will.

Forecast: There's going to be a lot more moving around, mobility, in the coming 2008-2010 economy as people search for employment; displaced jobs, and displaced homeowners, etc.

Prediction: Returning Vets from Iraq from 2009 to 2010 will cause even more mobility. Many of their jobs will have changed, been displaced or maybe even disappeared by the time they return from their long absences. While, historically, USA government always tries hard to help returning Vets, there's no question that many Vets will need mobility and assistance to try to get their lives back to normal on their return from Iraq, Afghanistan or elsewhere, under a new President. Fortunately, if they have saved their military pay or get other USA help with subsidized loans, home buying and new mortgages, they'll have some money to spend.

Forecast: Meanwhile, inflation will continue from 2008 to 2010 and increase. Plan accordingly.

Strategy for Rental Property Owners

A. With all the displacements and moving around and the likelihood of vacancy rates rising, you're going to have to check your tenants and applications more carefully rather than making assumptions. Talk is cheap; put agreements in writing.

B. Do you have some informal rental arrangements? Better have those folks fill out applications, check references, employment and I.D and collect security deposits. You don't want them suddenly moving out after midnight on a weekend leaving you stuck for back rent and trashed premises. If you have no formal agreements, you can't even chase them to try to recover the money that you've lost.

C. Do not accept checks you cannot deposit or cut corners on security deposits. Do not cut rents or make agreements with tenants to "fix up" and paint the premises in exchange for rent discounts. (**Prediction:** The fix-up will be unsatisfactory and remain undone for long periods of time, but your rental discounts will go on, until the tenants move. Bad management.)

D. When buying properties, physically inspect, interview and check for occupancy rates and vacancy rates – yourself. What’s down on paper may be overly optimistic (lies and exaggerations?) or even relatives and friends living there. Physically inspect signed copies of past property leases for present tenants. Do it now.

E. Due to constant inflation ahead, make repairs, renovations and upgrades promptly. With higher vacancy rates, you don’t want your building to deteriorate while repair costs go up.

F. Evict “rough trade” and destructive, combative tenants early on to save yourself costly hassles.

G. Make improvements while contractors and homebuilders are not so busy, negotiate estimates and take advantage of sales or discounts. During recession times (such as in homebuilding), cash talks loudly.

H.

You’ll have to compete with other rental properties on appearance and amenities as well as rents when vacancies go up. Make your properties easier to re-rent. Replace carpets, add central air conditioning, go green with solar heating on the rooftops and take advantage of utility rebates, etc. On jobs running four figures or more, I get at least three competing contractor estimates. On a recent plumbing re-connection, one “bargain” plumber’s estimate was \$1,075, while another plumber who did the job charged \$525. It was the same job with the same water connection replaced. Get those competitive estimates while times are slow. Assume nothing. Get those estimates in writing, pay your written bills with a check so that you can tax-deduct the cost next April 15th against rental income. Stay legitimate for your own protection - don’t use unlicensed contractors for cash, those will be non-deductible expenses.

Remember, when you improve your properties and increase rents, you increase the capital gains value of your building upon eventual resale. Don’t let second rate properties turn into third rate undesirable properties that attract undesirable tenants. Instead, change second rate properties into first rate properties with added improvements, repairs and amenities as well as cosmetic refinishing improvements. Improve management.

Prediction: You will be approached by prospective tenants who have proven troublesome in the past and will prove to be troublesome in the future. Weed out the troublemakers early, make no assumptions, strive for first rate tenants who will pay their rent on time, every time, and improve the resale value of your buildings for future capital gains and easier resale!

Debt Addicts

How many people, consumers, voters, neighbors of your, are debt-dependent? They couldn’t live without debt. They’ve become debt addicts, are addicted to credit card spending, often making just minimum payments.

The real estate markets are 100% dependent upon borrowed money. Get a little subprime shakeout, or lender tightening of qualifications, and suddenly the debt dependent cannot buy or sell real estate. You see it happening every day. Foreclosures are going up among debt-dependent borrowers who took out adjustable rate loans. Also among subprime borrowers many probably got loans that shouldn't have been made in the first place, and now cannot keep up with the escalating payments.

Forecaster has already mentioned one long term but new trend. This may be stated as the newly married or newly graduated, who want everything new. They must lease a new car. When married, they need a new fancy home. They need credit for new furniture and new appliances, they can't make do with used, unlike their parents and grandparents. Grandma probably told you, "Pay cash for what you need. If you have to borrow money to buy it, you probably don't need it that badly."

The new trend may be put another way, "When the tide goes out, you see who has been swimming naked". It's not a pretty sight. When there is turmoil in the credit markets, you find out who has been buying and borrowing beyond their ability to repay. It's not a pretty sight. Then, calls spring up for Congress to "do something" when the high-lifters and other borrowers are caught living beyond their means, on OPM...Other People's Money. Taxpayer bailouts are requested.

Did you know, as an aside, that most new baseball stadiums are paid for by taxpayers? Ever wonder how those ballplayers can get multi-million dollar signing deals? The team owners neither pay for the new stadiums (taxpayers pay instead), nor do team owners pay property taxes on the new stadiums. Ever wonder why it costs an average of \$175 for a couple of people to go to a major league baseball game, and eat a couple of hot dogs, etc.? Certainly, ticket prices have escalated about 130% over the last few years, since the 21st Century began. My question is: Why should taxpayers be saddled with the cost of building new sports stadiums?

What Does It All Mean?

Prediction: You are going to have credit turmoil for quite some time - maybe years.

Prediction: Those who have been living beyond their means with sloppy credit and upon borrowed money are going to find some of their toys taken away. Could be cars, houses, jewelry, fancy vacations, whatever. They will be forced involuntarily to economize. Some will be forced to file bankruptcy, give up their plastic temporarily. Their debts will be passed on to others (credit users, and the innocent will be forced to pay for the debts of the bankrupts and the others through higher assessed rates and fees).

You don't have to wait years to see this, it's happening daily, right now, the newest trends.

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