

Outlook for Commercial Real Estate **by John V. Kamin**

Folks are wondering how commercial real estate is holding up; commercial buildings, office buildings and apartment buildings. Here are the answers to benefit you.

Commercial buildings are holding up very well because of their cash flow and income. Mortgages on commercial property are usually based upon the amount of net income generated. You don't find too many commercial buildings with 0% to 10% down. Most require 10% or so down payment – substantial equity.

Measurements Differ from Homes

The good news. Rents are still in a rising trend, therefore, as long as that continues, commercial buildings will do well. When and if rent trends shift downward, prices will fall, since the prices of commercial buildings are usually based upon cash flow income generated.

More good news. Vacancy rates are low in most metro areas; may increase when and if the USA goes into a severe depression. But, on leased space, leased for 1 to 25 years, there's often a time lag between an economic downturn and commercial rents downturn. So, unless the economy really tanks, over a long period of time, cash-flow income looks safe.

Final good news. As a Federal Reserve drives down interest rates, manipulates short term rates downward, the percent of returns on commercial buildings is looking better and better in comparison. If and when the Fed shifts to higher borrowing rates, commercial building buyers will demand higher returns and commercial building borrowers will have to pay higher interest expense on mortgages making net income decline. So far, that's not happening.

Now for the Bad News

1. A recession is predicted. Whether mild or miserable remains to be seen – more data is needed. A short downturn would have little-to-modest effect on commercial buildings and cash flow. But a lengthy downturn, or depression, could sabotage the pricing of commercial buildings.
2. First to drop would be office building prices. Why? In a severe downturn, firms renting commercial space consolidate and close offices. When that happens, they let people go and need less commercial space. That increases vacancy rates on office buildings rapidly.
3. Valuable indicator. Watch office building vacancy rates; office vacancies are the first to rise in a stubborn recession. Later on, retail stores may consolidate and close unproductive branches – become poor performers.
4. Closure of retail buildings, warehouses and even office buildings can present great opportunities to prospective buyers for capital gains as downturn inevitably turns into later upturn, a recovery. But that time appears far off, beyond 2009 say, 2010 to 2012. Therefore, if you intend to buy a commercial building at a bargain

- price, now is the time to accumulate capital, for cash down payments and distressed properties. That way, you later shop 2009 to 2011 and make lowball offers, if our business cycle timing is correct, as usual.
5. Apartment buildings are a little trickier. Watch the rising unemployment rate. Vacancies are low in apartment buildings now and major metro areas still have rents in a rising trend. But when apartment vacancies go up, prices grow more reasonable. Net returns are now excellent on apartment buildings compared to lower rates manipulated downward by FRB and FOMC. The bad news is that as many people are laid off in various industries, the work forces shrink and renters can't pay rents.
 6. FORECAST: Some double up, some relocate, others move back with Mom and Pop and others stay where they are but defer payments any way they can. This happened in past recessions and will likely happen in future downturns. It's normal and to be expected.

Rates Higher Not Lower 2009-2011?

Watch for the swing at FOMC (Central Bank) when they begin pushing interest rates higher, instead of knocking rates down, that will be your tip-off that it's time to expect rising apartment vacancy rates (after lag time) and start prospecting for purchases for future long-term capital gains.

Cash-flow properties are an excellent way to make time work for you. Why? Because rents go up over time, and when rents go up, your property's value goes up at a 10 times to 20 times multiple of the increased yearly rents! That helps you make long-term capital gains. It's fairly easy to get a loan when you're buying an income property, to leverage it. Unlike homes, an income property that throws off cash-flow rents, a modern building, is easy enough to borrow upon.

Do You Have Money Power?

The moneyless may use lack of extra cash as an excuse for doing nothing, for years, for decades. But you can buy repossessed properties with no money down, and even foreclosed properties, at today's bargain prices. You can buy a triplex, live in one unit to avoid paying rent and let your tenants pay off your mortgage.

If you own a practice or business, you can stop paying rent and buy your own small business building, rent out extra units to your peer group; rising rents will help you pay off your mortgage and on a 15 year FRM, you'll soon have huge equity in the building.

Another powerful force you can put on your side to make time work for you is OPM – other people's money. You may have some reluctance to use other people's money, but everybody does it. Everyone who has a mortgage, a credit card balance or a home equity loan is using OPM - depositor money, bank money, government money or plastic card issuer money. I can personally verify that it has never been easier, at least in the last half century or so, to get credit, get loans, get plastic money or low rate mortgages.

Sure, they want you to have a job or demonstrate income. But in the book How to Make Money Fast Speculating in Distressed Property, you'll find that there are dozens of ways to finance property acquisitions even if you have no job or are retired or have some physical handicap. Think about it. Try seller financing when you buy. Think about how Uncle Sam will help all those vets returning from Iraq in a year or two with easy money loans, OPM and taxpayer money. Other people want you to put their money to work to do good things. You can put time on your side, make it work for you with OPM and soon you'll have not just adequate cash, but plenty of money of your own.

Then, you'll be able to self-finance properties at tax sales and trustee sales and do a lot of things where you won't even need other people's money.

On March 6, 2008, Warren Buffet was asked why he was richer than Bill Gates. He replied, "I spend less than he does. I'm more frugal."

So, if spending money has been your occupation, to make time work for you, you'll want to reduce spending, reduce the monthly overhead nut, save more, put your money to work to make more money and reduce debts. These days, I never take on a debt and have vowed to keep it that way, *unless* the debt can help me make more money (such as seller financing on a building I'm buying).

These are powerful nature ways to make money work for you, make time work for you instead of against you. Most people do not realize the power they have to change their own circumstances and improve them. Even three to six small moves along these lines, harnessing powerful natural forces and trends can help improve your personal situation, greatly improve your lifestyle and long-term prospects.

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