Latest Forecast, Outlook & Strategies for Cash Flow Rental Properties 2009-2011
by John V. Kamin

Admit it – the rental property scene has changed greatly just in the last six months. One out of 10 American workers is unemployed, more in certain states and locales such as Southern California, Las Vegas and Miami.

Forecast: Construction has ground to a halt on many large projects, some operators have filed bankruptcy, banks have pulled back lending for massive construction projects and partners are feuding. But commercial construction projects that are nearing completion are still coming on stream – projects that began three, four and five years ago.

Forecast: Vacancies are up in multi-unit residential properties in big cities during 2009 will continue rising into 2010.

Prediction: Interest rates are going up. It hasn't been easy to get new loans or refinance old debts for large buildings.

Forecast: No-pays are up. It is likely that no-pays and slow-pays will continue to increase in 2009, 2010 and into 2011.

Prediction: Expenses are up. It's simply costing you more for everything imported, plumbing supplies, electrical wire, appliances and repairs; all cost more due to continuing U.S. dollar devaluation. As the dollar is cheapened, prices of imported goods are expected to rise.

Expect pressure from governments to raise property taxes. For example, new attacks are predicted on Prop 13 in California, the tax limitation revolt dated from 1979 as California bureaucrats struggle with blown budgets, layoffs, and coming inability to pay spending bills.

Why Higher Interest Rates Shrink Cash Flow Rental Property Values

Simple. As alternative interest yields go up, people will pay less for cash flow rental buildings where rents cannot be raised. For example, in 1980 when T-Bill rates soared to 16%, rental property values fell. Apartment buildings at that time were yielding 8% to 12% cash on cash and yield simply wasn't competitive.

Many owners, rather than dealing with continued tenant problems, collection problems, rising expense and rising inflation, simply sold off their buildings at a loss. In order to compete with rising interest rates on alternatives, apartment buildings have to yield more. In terms of cash flow, profit, that means rental building prices have to go down, while rents have to go up, or both. In a difficult rental-increase climate, it is more likely that building prices will have to come down and become more reasonable to make competitive yields climb.

Forecast: There is new rental competition for rental properties among unsold condos, vacant houses, foreclosures and other types of for-rent properties that simply didn't exist two or three years ago. Either developers have to rent out those unsold properties to prop up cash flow or they can't make their mortgage payments and will risk foreclosure.

Prediction: It will be a good time in 2010 to 2012 to buy cash flow rental properties as prices fall … but not just yet; it's too soon.

Strategies for Profit

1. How long can you carry no-pay renters? 15 days? One month? Two months or longer? Most real estate attorneys advise not to accept partial rent payments. You need to adopt a consistent policy in advance for no-pays, slow-pays and partial-payers. If you don't, you'll be guessing and reacting to surprise individual cash flow interruptions when you least expect them, making poor decisions. **Forecast:** Rent reduction pressures will continue. You need to have a strategic policy when tenants ask you for rent reductions on their existing apartments. I suggest:
2. You get those month-to-month tenants signed instead to a one or two year lease in return for a five to ten percent reduction in rent; if they won't sign a lease, why bother? You're probably going to lose that tenant anyway, so collect full rent while the tenant is still there.
3. Have tenants move to cheaper units. For example, if you have one person and two person tenants occupying an expensive two bedroom unit, suggest they move to a cheaper, smaller unit instead of the outright rent reduction.
4. Don't just agree to a flat rent reduction; get something in return. In addition to a signed lease, move them to a cheaper, harder to rent unit, etc. Whatever you do, don't make a rent reduction upon tenants repairing or painting their own unit. That's a disaster in the making. Work may never be done or may be done unsatisfactorily and you're stuck forever after with discounted rent cash flows. This situation is ugly.
5. Refinance now, early if necessary, say if you have balloon payments coming up later in 2009, 2010 and 2011. **Prediction:** Interest rates are going to keep rising. Bite the bullet and do your refi while you can. Forecast: If this current recession lingers for another two years, rental and refinancing on commercial buildings could get even tougher. Don't wait until 30 to 90 days before your balloon payment is due to start shopping for a new loan or refinance. Do it earlier, now, while you can.
6. Build or buy? Buy one to four rental units cheaper than replacement cost; don't build. If you can buy rental properties at $50 to $100 per square foot that recently cost $200 to $350 per square foot to build – why build? Buy your modern properties especially in areas of great rental demand. Those foreclosed people who have lost their houses will have to live somewhere.
7. Screen new tenants carefully. Use credit reports and reference checks. Call employers to verify continuing tenant employment and other sources of income. Assume nothing.

8. If new and prospective tenants are overloaded with debts, say three car payments or lease payments, buying massive flat screen TVs, etc., make sure tenants know that paying rent comes first. I had a tenant who had a good job but who wasn't paying rent. He kept buying expensive one to two year old cars until he had payments on four or five cars. He told me he "couldn't pay rent" because he had so many car payments. I told him if he didn't pay the rent he'd be sleeping in one of those cars and parking them elsewhere. Make rent payments a priority.
9. If your rental building or commercial building has gone down in value due to the recession, file an appeal to reduce property taxes. 100,000s of property taxes in Southern California are being reduced right now. Do appeal for a reduction in property taxes. Get an experienced real estate broker to help you. Give him $50 to $100 on a small-valued property or $500 to $1,000 on a larger valued property to help you win appeal and reduce your property tax assessment. It's worth it. Cut your expense outflow, your yearly and monthly "nut". This is an important strategic move. If you can get your property taxes reduced, many benefits will flow.

The bureaucrats are unlikely to reassess you quickly, every year or two in many states if you've already fought and just won a property tax reduction. They'll go after other targets rather than the property tax tiger. Got it?

An experienced realtor can help you find comparable lower-taxed properties whose values have fallen, to support your case before the Property Tax Appeals Board. Just do it.

Summary

These forecasts, predictions and strategies of what's ahead and how to deal with them, cut risks and increase and protect your profits are a good start. We'll have more super ideas for you in upcoming articles. ***Remember, the actions you take today and this year can affect the money you make for years to come, every year from 2010 to 2020.*** Don't be caught half asleep, doing nothing. Devise your strategy and put it into effect.

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