

Latest 2007-2009 Forecasts & Predictions for Real Estate Investors

by John V. Kamin

If the general real estate cycle suffers a broad-based downturn, which individual sectors are most likely to suffer most? Keep in mind that most property is bought with borrowed money. Will all real estate suffer, or just certain sectors?

The main sectors of the real estate market in which our members are interested are: homes, rental housing, apartment buildings, retail buildings such as strip malls and larger properties.

What History Tells Us

In the 1969-1973 real estate downturn, home prices did not suffer that much, they mainly stagnated; a situation where sellers did not want to cut prices and where buyers made lower offers. That just dumped sand into the home/sales market gears and fewer transactions took place.

Most homeowners held on and didn't sell even though homes were basically illiquid. Those who looked for Need-to-Sell (NTS) deals did very well. Must-sell property deals included partnership split-ups, divorces, estate sales, foreclosures, court-ordered sales and repos (purchased from banks and other lenders who were willing to sell below market). Many NTS transactions took place while the general full-ticket home sales market lagged.

Prediction: Stagnation may well occur in the current 2007 and beyond market. The Wall Street crash of 1973-1974 pushed more money into real estate by disgruntled Wall Streeters, but lengthened the recovery period.

When I spoke to a huge audience at TRW and predicted that L.A. suburban tract home prices would rise from \$25,000 to \$100,000 by 1979, people laughed. They just couldn't believe (at that time, in the early 1970s) that four bedroom, two bath modern suburban houses listed for \$25,000 to \$27,000 in a glutted market would ever go that high that soon. But, that Contrarian prediction was proved correct and suburban L.A. homes did rise. At one point in 1979, those same houses were rising at a rate of two percent per month! Those same houses now sell at \$600,000.

Forecast: The easy availability of second loans, home equity loans and third loans during the first decade of the 21st Century has made credit even easier. Therefore, it is quite possible that instead of so many runaways, repos and previously overwrought sellers, that the current 2006-2008 downturn in the home sales market will be less severe more a stagnation and a stand-off between unwilling price-cutting seller and hopeful lower-priced buyers.

Instead of selling, homeowners may just tack on some extra loans to "carry" the property rather than give up their homes at falling market prices.

Office Sector

A second distressed sector of the real estate market has been the commercial office buildings sector. Often, the first to suffer the most and the most vulnerable sector to overbuilding, the office building market had some famous collapses. Among these were the 1985-1986 Japanese investors in USA trophy properties who were forced to resell

them at major losses shortly after purchasing in the mid-1980s. Vulnerable to enthusiastic overbuilding during good times and even more vulnerable to cyclical business downturns in the USA economy, office buildings had the widest swings – horrific downturns during the RTC auctions of the late 1980s and early 1990s. Office buildings are one (hi-beta) sector where much money can be made if bought when everybody hates them and unloaded during cycle tops when cyclical office rents are rising.

Running by the Numbers

Residential rental housing is entirely different. In major metro areas and job centers, there seems to be a perpetual shortage of rental houses. Much of this shortage is due to the apathy of rental house owners, who both fail to run their rental houses as a business, running them rather as a “when I have time” hobby with failure to charge full market rents. Rental house owners often neglect timely improvements.

Forecast: I expect rental houses to continue in short supply and be subject to owner/management blunders in the future as in the past four decades.

Rental housing/apartment buildings are a different story. Their sales prices are usually marked very close to the yearly GRI (Gross Rental Income minus expenses) cash flow they can generate.

Mortgage rates do fluctuate quite widely for multi-unit buildings and mortgage availability can be a big factor.

Schizophrenic Squeeze

Right now, apartment buildings are under pressure due to costlier interest rates one way and under pressure to rise as the rising rents trend keeps going (upside pressures). I expect rents to offset costlier mortgages for apartment buildings – a standoff.

Prediction: Prices will rise on apartment buildings if the ROMC turns tail then slaps interest back down, reversing the course in a 2007-2009 recession. But, I expect overhead and repair expenses to keep rising, sabotaging leftover cash flow in individual buildings. For example, rising rates for costlier copper repipes, rising roofing costs due to high oil prices, costlier lumber and costlier contractor labor.

Better Sector

Forecast: Among the most promising sectors in the current 2007-2008 changing real estate cycle are small business buildings; say 4,000 square feet to 10,000 square feet or so located in or near the suburbs of metro job centers. Demand is high and rents are rising both in the centers themselves and in the suburbs on small business buildings.

Forecast: The rising rents trend will continue. For example, many MD's are now opting out of monster medical buildings with super priced rents and instead going into converted storefront clinics, etc. where MDs own the buildings. Then they rent extra adjacent suites to peers to help pay down the mortgage.

The same is occurring for those with other practices such as LLBs, DDSs, architects and other professionals. Rather than rent high-priced downtown office space with no capital gains or no tax-deductible depreciation benefits, new owners come out better financially by buying their own buildings in the suburbs and occupying them while renting them to related businesses to pay off the mortgage. Using the 15-year FRM's at 5.8% they soon

build up equity and are on their way to owning their own buildings. This is a very promising sector indeed. For example – rather than chasing overpriced apartment buildings in say, Orange County, I'm recommending small multi-unit business buildings with frontage, with rising rents and no rent control!

Other Sectors

Small strip malls may prove promising once again, after the downturn has run for a year or two to 2008-2009 on busy main suburban thoroughfares. I like to buy property when everyone hates it and resell real estate when everyone loves it – especially cash flow income properties!

Newest Trend of 2007-2009

The latest trend is continued competition to and from major giant mall owners. Medium sized malls are trying to combine, to building bigger, build better and eventually raise rents. Larger anchors such as WalMart are squeezing the small businesses out of the giant malls with high overhead and high rents.

Prediction: Those small competitors are the same people who will soon be searching aggressively for lower-priced rents from new locations in smaller strip malls to cut costs and compete more efficiently with the giant Big Box retailers.

I suggest waiting a while; let the current “giant mall squeeze” run its course for another year or so through 2007, 2008 and 2009. Wait until the squeeze gets tighter and then make your below-market offers on strip malls and other small retail suburban locations to make big money as we approach 2009-2010 and beyond.

Cultivate a Certain “Profit” Game Attitude!

Contrarian speculators should have thick skins, ignore the first wave of sudden sellers until the negotiating climate improves for small business buildings, rental houses, NTS properties and strip malls. They can be great bets in high-traffic suburban areas with noisy frontage.

Avoid the boondocks, the side streets and cul de sacs though! Your time to make sound cash-flow moves will come. Don't miss our further Forecaster strategic hard asset/property reports for the future. Fortunes await those who make the right aggressive cyclical moves!

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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