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Considerations When Acquiring Property

Written by Jeff Young

If you owned investment property last January and still own it today, congratulations! You have made it through another difficult year for real estate investors. Interesting, but difficult.

The bad news is that we are probably in store for more of the same in 2005, with some signs that things are changing for the better. We see some relief from protracted vacancies, lower rents and fewer quality renters for the coming year. But all signs show we are still “climbing out.” And the fact that your property values may be up 10 or 15 percent on the year is small comfort when reserve accounts dwindle while marketing and advertising costs soar.

In Arizona, as in around the country, record low mortgage rates provided the impetus for many former renters to purchase homes, pushing prices skyward. It was a no-brainer: why rent when you can own for less?

In areas where residential prices hit levels that brought back vivid memories of the stock market’s “tech wreck” between 2000 and 2002, a form of arbitrage was ongoing: owners selling property in states like California to purchase in Arizona or Montana where prices are relatively low.

Other signs that the tough times are not yet a memory: new home builders shutting out investors and even second home buyers; some investors, impervious to the lessons of the late 1980s in Arizona, were bidding up property to levels not seen in quite a while; and multi-housing communities still having to offer concessions, though that practice seems to be abating.

In this environment, what is the Independent Owner who wants to purchase more property to do?

First and foremost, stay with quality property. “Quality” does not necessary translate into “expensive.” But one needs to own and operate rental property that is free from major defects, is relatively attractive, and most certainly, affordable. For the vast majority of landlords, the “sweet spot” are those properties rented from \$700 to \$950 per month. Many renters are eschewing lower quality property and are moving up the “rental chain” to take advantage of this buyer’s market. Simply put, renters are getting better deals for better properties. Those ultimately punished are those who buy lesser quality property. Besides the maintenance and repair problems, their vacancy rate increases as renters look to rent more attractive property.

Secondly, if patience is a virtue, it could also be a financially rewarding one for the real estate investor. There were many people over the last several years who received mortgages who may not have qualified in a different economic environment. As interest rates increase, those who are debt-laden in credit cards are going to feel a great deal of pain. We suspect that foreclosures will abound and the alert investor will benefit.

Joining that group will be the “impulsive money” that came into the state that bought rental properties whose rent will not sustain the costs. Many of these novice landlords will throw in the towel, further putting downward pressure on rental home prices.

One could argue that by waiting, interest rates will only rise, increasing the cost of money. True enough. But consider this: a \$150,000 investor’s loan at today’s rate of 6.375 percent requires a monthly payment of \$936. But if that same home suffers a 13 percent decline in value (certainly not a rare occurrence), and a buyer financed \$130,000 at a higher 6.875 percent, the monthly PI would be only \$854.

Obviously, waiting carries its own risks, and this scenario could turn out to be a mirage. But it is something the Independent Owner who is seeking more property may want to seriously consider.

And lastly, if you are insistent on buying in the near future, be wary of creative financing. Negative amortization and interest-only loans will require careful review and a practical eye prior to committing to them.

It will be interesting to see what this New Year brings. For you and yours, I trust it will be one of peace and prosperity. In that order.

Editor's note: The suggestions contained herein are meant as guidelines and are based on the experience of Independent owners. Please send your comments and questions to Jeff Young at First Financial Equity Corporation, 480-778-2041.