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Uncertain Market Raises Questions for Independent Owners

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We should have seen it happen. Everything was laid out in plain view; we didn't even need a crystal ball. Just a few short years ago, we were fat, dumb and happy. And now this.

Interest rates tumbling. People stepping over people to offer low cost loans to all sorts of people. Renters, realizing they can own cheaper than they could rent, flee as soon as the lease expires. And some before that.

Then the multi-housing folks offer concessions and deep discounts, and competition for the “getting-smaller-by-the-day” universe of quality renters forces lower. And lower.

Meanwhile, the falling cost of housing capital and the greatly increased number of homebuyers pushes prices to new highs, some to the point where the median price of a home moves higher past the underlying median wage. Throw all this in the pot, stir, and we have a rental housing market where prices are high, rents are low, and the game is changed significantly. Maybe for a long, long time.

For the person who enters this market in this locale today, an accurate generalization (but a generalization nonetheless) is that the days of paying 20 percent down for investment real estate and enjoying a positive cash flow are probably over.

What does this mean to the average investor? First, it moves the emphasis from stability and cash flow to speculation. Even with a huge reserve to compensate for a negative bottom line, a good business plan cannot ever call for continual losses without offsetting gains elsewhere. And that “elsewhere” is capital appreciation in the underlying property. Whereas before that was a relative certainty, especially over a long period of time, it is not now. One must buy smart, cut costs while maintaining the property, maximize rent receipts, be patient, and have a healthy dose of luck.

It is certain that one must review the numbers ever more closely than before. What kind of property are you buying? How likely is it to appreciate in the next 12 months? And over the next one- and five-year periods? Are the existing rents pegged to the market? Or are they above or below? If you have a negative cash flow, what kind support do you have from other sources to compensate for the expenses that are surely to come your way? Is your personal tax return such that you can currently write off property losses or will you have to postpone them to someday in the future? If you do have a negative cash flow, when can you reasonably expect that to change? Are you better off putting a much larger down payment on the property? Are you being realistic about your opportunity for eventual capital gains or are you throwing caution to the wind expecting a “rising tide to lift all boats?”

As you can see, the equation to owning and managing investment real estate has suddenly gotten much more complicated.

As a practical matter, at least from this corner, some conclusions can be safely assumed. One, if you are younger (under 55) and currently own rental property, you may certainly want to hang on to what you have. If you are older than that, and are looking for eventually turning your real estate into a steady stream of income while cutting down on the time you spend on it, you may want to consider selling into this high market.

If you don't currently own, or do but want to add to your portfolio, you will want to be very careful. Though it is extremely unlikely we will have a real estate "bubble," it is also unlikely that the current trend of double-digit annual appreciation will continue. Be confident that eventually, all quality real estate will increase in value. But be equally aware that "how much" and over what time frame can be expensive unknowns.

Step carefully and remember: You can't lose money by walking away.

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.