Fast Forward Investments, LLC™

FAST FORSIGHT™

29 June 2012 FFIDN: 162912

In This Issue

Related Insights

Do You Really Want Your Bank To Be Your Landlord?

Most People Will Only Accept What They Already...

Not If, But When

You Don't Know What They Haven't Told You

Related Help

www.ffinow.com/Predicting the Future.html
Can you predict the Future of Your Business?

http://www.ffinow.com/Services
The help you need to get the job done.

Contact Us

http://www.ffinow.com

info@ffinow.com

Why Real Estate Prices May Fall Even Further

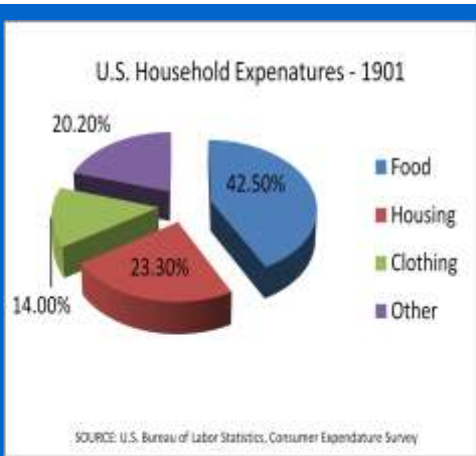
Human beings often tend to act like pack animals. We tend to want to fit in with other groups of humans, whether it is with regard to the cars we drive, the homes we live in, or the clothes we wear. Many of us do not want to appear to be too different from our friends and neighbors. So when friends get together socially, many conversations tend to involve the things that people are interested in obtaining. Cars, homes, swimming pools, the latest golf equipment—nothing is off the table, in this regard. Naturally, when discussing things that we want to buy, talk soon gravitates to issues of money and how to make it. Being the pack animals we are, if one of our brethren claims to have discovered the ideal money-making situation, people within earshot strain to hear what is being said.

Modern Day Gold Rush

Today, it seems that *many* people are searching for ways to earn higher returns on their savings. With unemployment levels and job market uncertainty high, people are searching for anything that could help them augment their income. The stock market swings up and down, while yields on most interest bearing instruments are at historic lows. Quite often, the subject of real estate investing comes up as a way for people to make higher returns on their money.

Upon hearing the ubiquitous water cooler conversations regarding real estate, many first-time *investors* are convinced that they can make big money flipping homes—that is, buying distressed properties on the cheap, remodeling them, and then selling them for quick profits. Often, these *speculators* get disillusioned once they start receiving estimates from contractors for the needed repairs. Others think they can do the work themselves, but upon attempting it, quickly realize that rehabilitating a property that has fallen into a state of extreme disrepair may not be an easy task. Add the costs of doing the job right (obtaining required permits, using licensed contractors, etc.) and flipping properties is not nearly as easy as it may look when portrayed on television.

Many self-help style books and infomercials have also described ways that individual investors can make money *buying and renting out* properties. What many of the *experts* tend to not focus on, are the often high costs associated with buying and maintaining a property that will earn a positive cash flow (one that won't lose money every month, because operating expenses exceed income from rents). Maintenance, repairs, and property taxes are only a few of the costs that, when added together, may exceed what landlords are able to charge for rent each month.



Many Self-Appointed Experts

Over the years, we have heard many wild comments from novice investors. According to one guy: "Real estate is a great investment, even if you lose money every month, because over the long term, the value of the property will go up." Really? In our opinion, if something loses money every month, it is a liability as opposed to an asset. Your unpaid credit card balance is an example of a liability (It is a liability to you. To the credit card company, it is an asset). According to another self-appointed expert: "If you can negotiate a low enough monthly mortgage payment, you can earn a positive cash flow on the property, even if it is only a few dollars a month... If you replicate that formula many times over, you can get rich." Really? What happens when you, as the property owner, get hit with an unexpected $10,000 bill to repair a leaky roof or a broken sewer line? How many years will it take to pay off that expense if you are only netting $50 per month after mortgage interest payments and property taxes?

Why Real Estate Prices May Fall Even Lower

Recently, we have starting to hear an optimistic buzz: *"Prices have hit bottom. The market is turning around. Home sales are increasing."* That is, until we speak with real estate professionals. Right now, people in the know are saying we are looking at a typical spring market. They say that home sales usually pick up in the spring and then like in recent years, will be flat for the rest of the year. Realtors in many markets do not seem to be sharing the same optimism as others.

So, why do we believe that real estate prices will fall even further? In a word, the issue is *inventory*. According to multiple sources, many banks are still relying upon TARP funds as they continue to sit on a vast inventory of foreclosed homes that they have not yet listed for sale.

Recently, we made what we believe were very reasonable offers on homes that will require thousands of dollars in repairs to make them habitable again. In one of these cases, the bank asked us if we would waive termite inspection related repairs or other contingencies, but in the end they *still refused to accept our offer*. Instead, they are holding out for offers above their asking price that have not yet come. We have seen this and other homes like it listed in the MLS as available, week after week.

We can only imagine some MBA grad student working at the bank's home office, looking at photographs sent to them by a realtor and saying *"No, someone will eventually offer us more money for that home*. After all, it once sold for $XXX,XXX (back in 2007) *and we can afford to continue to incur the expenses every month* to maintain the property while it is vacant".

In one recent example, the bank told us that they would only accept *all cash* offers for the property and we would have to waive all repair costs that the seller would normally pay. This bank knows that no mortgage company would be willing to loan money for a home that will certainly appraise for less than the bank's asking price. We know of cases where prospective home buyers have made offers that were contingent upon obtaining a loan with the very same bank that owned the property, but the bank is holding out for all-cash offers. Our questions are: 1) How many prospective home buyers can afford to pay $500,000 *cash* for a home in the first place and 2) Why would the bank not want to earn interest on a mortgage for a property that is costing them money to maintain each month? The government has made it possible for them to do so with taxpayer money.

Is it really good for the fragile economy to keep home prices artificially propped up by limiting the number of homes available for sale? Not when there are still so many people behind in their mortgage payments. On some level, some people must be thinking that a home is a person's largest asset, so if the value of that home drops significantly, the owner may be more likely to walk away from the mortgage and this scenario may be repeated many times over, which would result in another market crash.

Home Prices vs. Average Annual Expenditures

The problem with trying to artificially maintain high home prices, is that wages are not keeping pace with inflation. Due to the poor economy and the currently high unemployment rate, many companies have discovered that they can offer people jobs at much lower wages and many job seekers will gladly take them. As much as many loan sellers would like borrowers to believe, a person with less than $50K in annual income most likely cannot afford the payments on a home with a sales price of $400K or more.

According to the U.S. Department of Commerce 2010 Consumer Expenditure Survey, the average annual total household expenditure was $48,109. Of that amount, 16,557 was dedicated to housing. This number represents 34.2% of total annual expenditures. Compare that to the year 1901, when housing costs represented only 23.3% of average annual expendatures. Today, with interest rates being what they are, a person with $50,000 in income before taxes might be able to afford the roughly $2,000 per month payments on a $400,000 home with little or no money down, *if* they had no other expenses for food, clothing, automobiles, or other typical household items.

Besides looking at key economic indicators such as unemployment rates, retail quarterly sales numbers, new loan applications or finance rates, there is one key indicator that means more to us than any other. It is the number of home owners that are behind in their mortgage payments and are about to face foreclosure. According to Realtytrac.com, 1 in every 639 housing units received a foreclosure filing in May. ForeclosureRadar.com reported that 6,960 homes were sold at auction during the month of June in California alone.

What Will Happen?

What will happen, when real estate speculators and investors lose their primary sources of income due to corporate down-sizing, layoffs, or further economic downturn? If they are not earning positive cash flow on their rental properties, they will be forced to sell, which will further drive prices down.

In the current election year, there is much uncertainty regarding our economy, the real estate market and the impact that these things will have on all of us. So what can individuals and organizations do to prepare for the possibility of a further decline in real estate prices? The first thing to remember is that real estate is a market like many other markets. It has its ups, downs and sideways movements. Our belief is that one should take a long term approach. One of our highly valued real estate industry clients once told us: "The real estate market has a 19 year cycle: 9 years up and 10 years down." If this is true (and we believe it is), it means that at the time of this writing, we are in year 5 of the 10 year down cycle for real estate. For many people, this represents a tremendous opportunity. For others, it may be cause for concern. What you do with this information is entirely up to you.