

Real Estate Report

2012

REAL ESTATE:
AS A PART OF YOUR PORTFOLIO

- UNIQUE BENEFITS
- DISTRESSED PROPERTIES
- POSITIVE LEVERAGE
- CURRENT OPPORTUNITIES
- YOUR REAL ESTATE TEAM
- MARKET TRENDS

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R E A L T Y

UNIQUE BENEFITS

1. **Leverage:** You can use debt to acquire larger properties and increase your cash on cash return in properties with positive leverage.
Residential: Up to 90% Loan to Value
Commercial: Up to 75% LTV
Apartments: Up to 80% LTV
2. **Insurance:** If it burns down you can rebuild it, often with income while re-building.
3. **Depreciation:** You can depreciate the value of the building over the course of 27.5 years for residential and 39 years for commercial. This helps shield income from taxes. Using cost segregation you can sometimes accelerate the amount you depreciate.
4. **Income:** You can rent the property and collect income.
5. **Tax Deferral:** Using a 1031 exchange you can defer taxes when trading like kind properties. That includes real estate in the USA held for business or investment purposes.

DISTRESSED PROPERTIES

For the last few years you have been hearing about distressed properties. But what does that really mean to you as an investor?

REO (aka) Bank Owned:

1. Condition: Many REO [real estate owned by a bank] properties are in pretty tough shape. They almost always have the water and heat turned off so do not expect a warm fuzzy feeling when looking at an REO. These houses might also have fixtures and appliances missing so factor that in to what you are willing to spend.
2. Disclosure: Banks are exempt from giving the buyer a property disclosure. Make sure you get a thorough inspection of the property.
3. Shorter inspections and higher costs: To inspect a home you need the utilities on and that cost is passed on to the buyer with most REOs.
4. Financing: Some banks offer financing deals on REOs but many don't treat these any differently. If you are using a loan make sure there are not broken windows or holes in walls – this will cause problems with an appraisal unless you are getting a rehab loan.
5. Look at everything: Just because it says REO does not mean it is the best deal – look at all available properties before making a decision.

DISTRESSED PROPERTIES

Short Sales:

A short sale is where a lender agrees to let a seller sell their home for less than what is owed on the property. That is the basic idea but the reality is more complicated and the process often times takes quite a bit longer than a traditional 30 day close. Expect 30-120 days for a response from the lender and accept that many short sales end up in foreclosure even if they receive offers. Patience is the name of the game. Many banks also try to put restrictions on what you can do with the property once you own it, so make sure to carefully review all contracts.

POSITIVE LEVERAGE

One of the main reasons to use debt is to create positive leverage. Positive leverage exists when the cost of money [your interest rate on your loan] is lower than the return on your investment. This is also known as a “cash on cash” return.

Example:

You buy a \$500,000 apartment with an 8% return. Interest rate on a loan is 6%

Pay Cash: Your cash on cash return is the same as the return on investment, 8%.

50% Down: Cash on cash return goes to 10%

25% Down: Cash on cash return goes to 14%

As you can see, using positive leverage in this current real world scenario can take an 8% return and increase it 75% to a 14% return.

CURRENT OPPORTUNITIES

In the time between 2004 and 2007 there was a manic nature to the market and many people were buying property on speculation that double digit increases in value would continue indefinitely. During the last 4 years the market has corrected to levels where affordability is at a sustainable pace. This is a good thing for the long term health of the market.

The biggest opportunity in the market I see is in apartments and residential rentals. The vacancy rate for apartments in Portland is at a very low 3% right now and new construction is far behind the pace needed to supply the demand. Pricing has dropped significantly and many investors and realtors are expecting a housing shortage in the near future. These overlapping trends create the opportunity to buy real estate for its income return alone, completely disregarding appreciation as a reason to invest and still getting a fantastic return on investment.

The expectation is that after another drop in value in 2011 [5% according to the Case/Shiller index] we should be at or close to the bottom in 2012 and then start seeing historically expected increases of 3% per year in value.

In this scenario a home would double in value in 24 years, about the same time the loan is almost paid off. Increases in rents are to be expected as well over this period putting you in a position of increased asset value, increased cash flow, and a lower loan to value ratio.

This huge opportunity is only expected to last another 12-24 months.

YOUR REAL ESTATE TEAM

Real Estate Broker: A good broker should be the main point of contact for your team. They need to know market trends and have a solid understanding of the continual changes in contracts, lending, disclosures, and types of inspections. When selling, your agent should have a current track record of success and use the latest tools and technology. An example of this is that I use HD video tours, a professional photographer and a listing syndicator which insures that my listings are on virtually every website that deals in real estate. A good broker will help you sell quicker and identify good deals when buying.

Lender: If you want to use leverage you need a lender or banker that can give you access to all the different lending programs. The speed at which these loan programs change is unbelievable so it is imperative that your lender be up to date on a weekly basis.

Real Estate Attorney: A good attorney can help with contracts but also with the more difficult processes like easements, partnerships, LLC, syndicates, tenants in common and more. The more complicated and large the deals get the more you'll need a great attorney.

CPA: Since there are huge tax benefits to owning real estate having a CPA that can help you take advantage of all of them will increase your ROI.

Title Company: These companies insure the title and also can help identify properties that might not be listed.

Property Management: Many investors love the idea of real estate but don't want to deal with calls from tenants and leasing properties. This is where a property manager can take a lot of the headaches out of owning real estate.

Contractor: If you plan to buy a value add property you will need a good contractor to give you a realistic expectation on how much money and time it will take to get the property rentable. This knowledge is essential if you want to compare a fixer to a well maintained investment.

MARKET TRENDS

Residential: The Portland metro area is down 7% year over year according to the Case/Shiller index – this includes Clark County in WA. According to RMLS Multnomah County is flat which might be signaling a bottom in the market.

Watch for the suburbs and tertiary markets to continue to decline close to double digits in 2012. Vacancy is low so investors are becoming more motivated to pick up deals to keep as rentals, adding stability to the market.

Commercial: The key word is bifurcated. Cap rates have actually gone down on Class A properties but they are being bought primarily by REITs and other institutional investors. Smaller local properties under the 5 million dollar mark are offering much higher returns to attract local buyers.

Vacancy and absorption in the suburban markets are working in the favor of buyers and tenants while in the CBD [Central Business District] vacancy is dropping and rents appear to be stabilizing.

Reports:

Attached are the latest inventory and sales volume reports.

***For updated reports every month check www.sellpdx.com**

Please consult with your CPA and attorney before making any investment decisions. Every person and company's situation is unique and this report is not intended to give, or be used for, any legal or tax advice.

INVENTORY

PORTLAND REAL ESTATE INVENTORY REPORT | Feb 15th, 2012

Inventory Remains Low

With new listings decreasing steadily through the last part of 2011 and sales spiking in December, inventories of homes have dropped to levels not seen since 2006. This is creating a seller's market and in many close in neighborhoods most new listings are getting multiple offers. Even suburban markets are returning to balanced levels.

DETACHED HOMES			CONDOS		
ZIP/NEIGHBORHOOD	INVENTORY (months)		ZIP	INVENTORY (months)	
97214 Ladds/Hawthorne	1.7	months	97232	5.6	months
97217 Arbor Lodge/Kenton	3.2	months	97201	4.1	months
97202 Sellwood/Eastmoreland	2.2	months	97209	5.9	months
97205 West Hills/Goose Hollow	4.8	months	97211	1.5	months
97212 Irvington/Grant Park	2.2	months	97210	3.3	months
97203 St. Johns	4.5	months	97206	2.7	months
97211 Piedmont/Concordia	2.2	months	97212	9.8	months
97218 East & West Cully	4.4	months	97214	2.3	months
97227 Overlook	3.6	months	97203	6.5	months
97213 Rose City Park/Hollywood	1.9	months	97219	6.3	months
97206 Foster/Powell/Brentwood	3.2	months	97202	5.5	months
97232 Kerns/Laurelhurst	1.9	months	97217	9.3	months
97210 Nob Hill/NW	4.7	months	97205	4.4	months
97219 Multnomah Village/SW	5.1	months			
97201 Downtown	7.3	months			
Gresham	4.6	months			
Happy Valley	7.5	months			
Beaverton	3.6	months			
Vancouver	5.2	months			

This localized home inventory report helps give context to the metro statistics that often make headlines. Real estate is a local affair and this report shows which parts of town and which types of property are selling and which ones are sitting. Inventory is figured in months with 6 months being balanced, less than 6 months favoring sellers and more than 6 months favoring buyers. I use current active listings and 6 months of sold data from the RMLS to create this report.

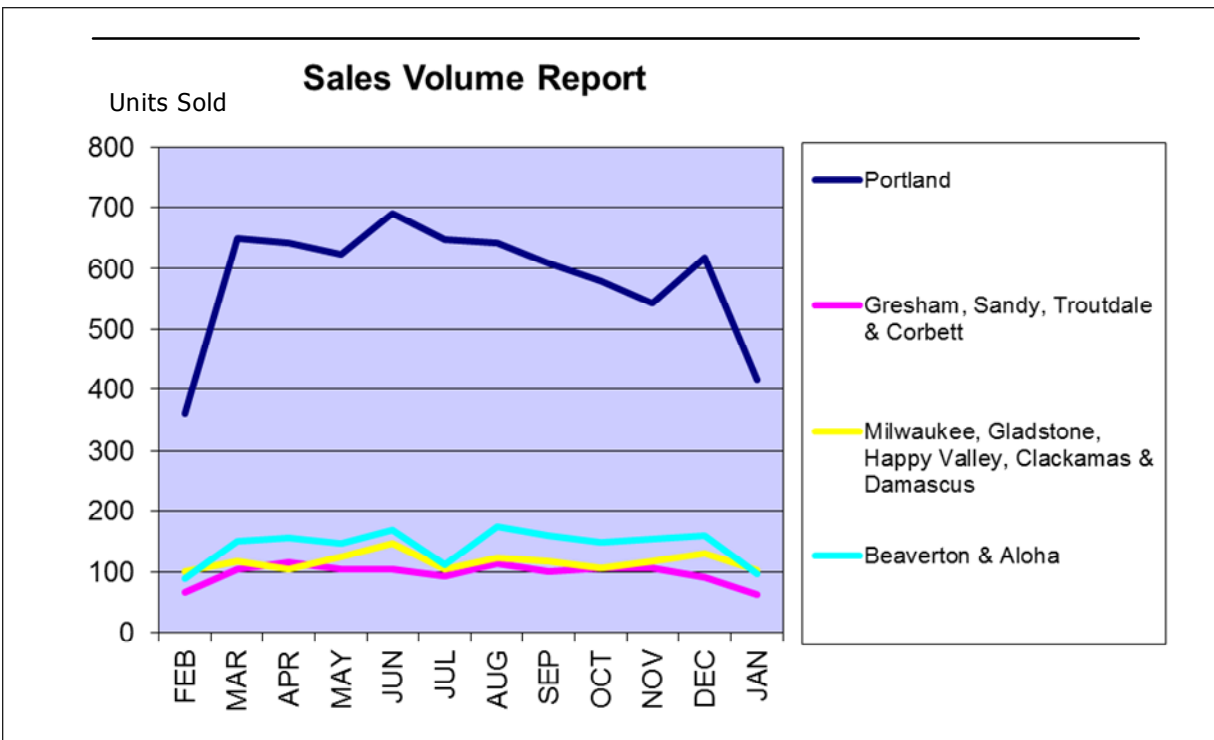
SALES VOLUME

January Slows Down

416 homes were sold in Portland in January, down from 618 in December.

Wild cards: Multiple offers are back with inventory at a 4 year low. 2011 looks to be the first year in the last 3 years to have a typical sales peak in Summer. Investor activity is hitting new highs with multifamily still the favorite among buyers.

I'm predicting around **450** closed sales in Portland (RMLS areas 141, 142, 143 & 148) in February. Seasonally speaking, average prices generally start to drop after the summer peak, bottoming out in winter.



Sales volume is a leading indicator for price. To help predict where the market is going I publish this sales volume trend report. The wisdom is that price follows volume so when you see a market trending higher in sales, prices will soon follow up and when sales volume is low, prices will stay flat or fall.