# Apartment MANAGEMENT

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## TRI-COUNTY APARTMENT ASSOCIATION RENTAL HOUSING CONFERENCE & EXPO


**Wednesday, March 3, 2004**
Santa Clara Convention Center
5201 Great America Parkway
Santa Clara, CA

**Your Guide To Getting the Most From EXPO!** page 14

**New State Laws Impact Your Rental Housing Business** page 19

**What's Fueling Sales in the Multi-Family Market** page 23


Tri-County Apartment Association
A Chapter of the California Apartment Association

http://www.tcaa.org

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# What's **Fueling Sales** in the Multi-Family **Market**?

As a Commercial Investment Broker, I hear it all the time: "Why should I invest in rental property in Silicon Valley? The prices seem high, the rents low, and I can get better returns in other parts of the country!"

Perhaps you've said this yourself and then, like so many others, went on to purchase property locally. What gives? Why would seemingly rational people who have a grasp of investment fundamentals, purchase in an area that has been repeatedly called some of the most expensive real estate on the planet? It's simple, really, and can be attributed to three basic reasons:

1) Real Estate investments can be more predictable and may offer a better rate of return than the stock market.
2) Interest rates are low.
3) The long-term outlook for the Bay Area is bullish.

## Real Estate investments can be more predictable and may offer a better rate of return than the stock market.

Witness the chart below. Real estate has held much of its value throughout this recession. Yet stories abound of people who have lost 50%, 60%, or even 70% or more of the value in their securities-based portfolios. Perhaps you're one, I know I am—and this has left an indelible mark on our psyche. I'm sure few remember the stock market crash in 1929, but all know the effect it had on individual families and the economy as a whole. It took many years for the stock market to regain the trust of the investing public. But then, memories can be short.

So here we are in 2004, and the Bay Area is recovering from the worst economic recession since the Great Depression, and again, many have lost years worth of their hard-earned savings.

Combine this loss with the fact that over the last 60 years, real estate in the Bay Area—and especially Silicon Valley—has skyrocketed in value. Many see real estate, "good 'ole bricks and mortar," as one of the safest investments around. Indeed, there has been an influx of first-time rental property buyers in the last few years, many of whom are looking for a safe harbor for what remains of their investment portfolios. These buyers typically purchase smaller properties, perhaps 2-10 units, thereby enabling former owners to exchange into larger property types. I know, I've worked with quite a few over the last 18 months. This rash of buying is one reason property prices have lost very little value despite a lackluster local economy and the recent drop in rental rates (in some areas up to 40%).

Of course, one can't dismiss a basic fundamental of investing in capital markets, that is, investment dollars typically follow the highest rate of return. Putting the entire security issue aside, at the time of this writing it is difficult to find an investment vehicle other than real estate that offers anything better than a nominal rate of return.

## Interest rates are low.

Anyone who owns property understands this concept: the lower the interest rate the lower the cost to borrow money. This manifests in two ways: 1) People can borrow more money based on the amount they have available to pay the principle and interest on the loan, and 2) An owner can reduce his/her cost of debt service by refinancing with a lower interest rate, oftentimes dramatically improving the bottom line. For most owners, the greatest expense, operating or otherwise, is debt service. Lower interest rates enable an owner to refinance and reduce the debt expense, or pull money out to purchase more property. Both new and existing owners have been taking advantage of the lowest cost to borrow money in the last forty years.

Indeed, despite the recession, many lending institutions have done extremely well due to the number of new and refinanced loans purchased over the last year. Moreover, lenders have capitalized on this demand by offering a wide variety of loan packages to accommodate almost every conceivable need. Gone are the days of just the 30 year fixed or the 5 & 7 year ARMs. Borrowers now have so many options that it's difficult to stay abreast of them all.

## The outlook for the Bay Area is bullish.

Say what you like about Silicon Valley, but the economists don't agree. In fact, despite our current downturn and the staggering amount of lost jobs, what they see is an area that in coming years will lead the nation in growth from numerous sectors, including:

- High-tech and Bio-tech Manufacturing
- Healthcare Information Systems Services
- Financial Services and Venture Capital
- Telecommunications/Networking
- Multimedia and Entertainment
- Internet and Software Programming
- International trade and Tourism
- Construction and Engineering Services
- Education and Government Services
- Defense

Coupled with this growth is extremely low housing affordability, a scarcity of developable land, high concentrations of wealth, a, a high quality of life, and a growing population of Empty-Nesters and Baby-Boomers. You don't have to be an economist to predict the affect these trends will have on local real estate.

## So who's buying?

You'd be surprised: Small investors, large investors, very large investors, and yes even real estate brokers—including myself. Most are buying for one reason: long-term capital appreciation and cash flow. Real estate in the South Bay is not a short-term hold (unless you're renovating property for a quick sale). It may take another 12-18 months before rents begin to rise again. Why? Simple economics: rents are driven by demand. The more jobs there are available, the more people move to the area, and the higher the demand for housing. Since the predominant industry in Silicon Valley is high-technology (typically one of the last industries to benefit from a recovering economy), it may be some time before we see the demand pick-up in housing.

While it is true that other areas in the country offer better returns, many purchase locally because they are familiar with the area and can ensure that their property is being properly managed.

## So who's selling?

The same group as above: Small investors, large investors, very large investors, and real estate brokers—including myself. Why? The reasons abound and could easily fill another article.

## So what should I do?

Whatever you do, don't make your decision based upon reading one article. First and foremost, follow a sound investment strategy. Don't have one? Then it's high time you did. With a sound investment strategy one can accommodate—even prosper—during the highs and lows of both the real estate and stock markets.

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