



Bill Gorman helps investors become financially independent by showing them how to recognize decision making opportunities.

BILL GORMAN'S

ORANGE COUNTY HEADS UP!

W.R. Gorman & Associates | P.O. Box 325, Brea, CA 92822 | (714) 255-9998 | wrgorman.com | Winter 2005

TIMING... TIMING... TIMING...

Where Do We Go From Here?

**I've FOUND
the ANSWER.**

TWO YEARS AGO, my computer models all projected unsustainable growth for residential real estate values and I declared that we were at or near the top of the market. However, subsequent low interest rates, a lack of investment alternatives and ensuing buyer euphoria delayed the peak by another 18-plus months.

Early in that interim period, I exchanged into prime, high-equity properties and took advantage of some other opportunities. As prices continued to escalate and cap rates plummeted, I became concerned. In the 90's, one of my properties experienced a \$9,000 per month negative cash flow. Never wanting to face that situation again, I sold my older and less desirably located, commodity-type properties – i.e. the ones that might not be cost-effective or fun to hold for another five to seven years.

My plan was to use the cash from these sales to take advantage of the discounted price opportunities that were apt to occur as the cycle reversed itself. Taking a page from the "Mad Hatter," I played the "what if" game to determine where I would be in five years. Using a current value based upon a 5% capitalization rate and a 5% interest rate, then assuming a 7% capitalization rate and a 7% interest rate for year five, my model projected that the net operating income (i.e. rents) would need to go up by 9% per year, just so values could stay the same.

With properties selling for such high prices and appreciation running at 20% or greater, investors have been accepting 5% or lower cash-on-cash returns.

However, we are moving out of the "euphoric" phase of the emotional cycle into that of "realization" and may well continue all the way into "desperation." Thus, there is a strong possibility that investors will demand even higher cash-on-cash returns – more like the 15% requirements sought in the 1990's.

Concurrent with the rise in values, the affordability factor for Orange County has dropped to 17%, which some prognosticate as a significant inflection point. Additionally, during the last few months, many properties have been purchased with financing terms that, at the end of three or five years, revert to variable rates. This could result in mortgage payment increases of 60% to 80% that could trigger another need to sell at reduced prices.

Even with deep discounts of 25% to 35% that may be possible in the future, given the time lag before a recovery; the return potential for this type of investment did not fit within my personal risk/rate of return parameters. With the objective of sustaining the 27% after-tax return that I have enjoyed since I began investing in 1968, I started searching for other options and found an area that offers market conditions similar to those that we enjoyed in California in 1995-1996.

At the bottom line, I believe that Southern California real estate is entering a downtrend. Is selling now, still wise? History has shown that the first reduction in price may be the best one to take.

(see Answer continued on back)

THE EXPERTS ASK THE EXPERT

AL GOBAR

Monday, January 24, 2005

See Back for Details



Answer continued from front

My recommendation is to run the numbers. I have created a computer program that allows you to compare the potential return of holding your property for another five years versus selling, even with a price reduction, and reinvesting out-of-state or in another type of exchange opportunity. There are some real estate markets that offer a potential 30% after-tax return, but you need to complete a sensitivity analysis to evaluate whether or not the return potential versus the risk fits within your personal parameters.

For my own portfolio, I have purchased four out-of-state properties. My plan is to return to California in five or six years, when the phasing of the real estate and emotional cycles both have a better upside potential.

I have available packages on several out-of-state properties and am now setting up meetings to "run the numbers" with individual clients. Anyone interested should call (714) 255-9998.

WORKSHOPS & SEMINARS

WHAT'S AHEAD FOR ORANGE COUNTY?

Monday, Jan. 24, 2005 / 11:30 p.m. – 3:30 p.m.
Brea Community Center – Plaza Room
(Lunch Included)

SESSION I (11:30 a.m. – 1:15 p.m.)

THE EXPERTS ASK THE EXPERT

Al Gobar

Renowned Real Estate Economist

Answers Questions about Orange County Real Estate from:

Wayne Foss

MAI Appraiser

Dr. David Schumacher

Author of Buy & Hold – 7 Steps to a Real Estate Fortune

Nick Lieberman

President of Bona Fide Mortgage

Jonathan Lansner

Business Columnist for The Orange County Register

Bill Gorman (Moderator)

Principal of W.R. Gorman & Associates

Hear Al Gobar answer the experts when questioned about the future of Orange County real estate as influenced by:

The Economy (globally, nationally and locally as well as by such factors as employment, outsourcing and the trade deficit),

Fiscal Policies (the Federal deficit, inflation, interest rates, proposed tax law changes and the availability of money),

The Market (supply vs. demand, affordability factors, cap rates, value estimators and the appraisal process).

SESSION II (1:30 p.m. – 3:30 p.m.)

TIMING... TIMING... TIMING...

An In-Depth Look at an Out-of-State Market

Real estate broker Lynn Taylor and his investment team (an attorney, lender and property manager) provide a first-hand perspective on one market with conditions similar to those enjoyed in California in 1995-1996. *Bring your questions and plan to attend.*

Seating is Limited. Call today – (714) 255-9998
or Submit your reservation under the Current Seminars heading on the wrgorman.com website.

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