Episode #42
Now is a Good Time to Transact
July 23, 2008

Mosca: Real estate, if purchased well continues to be the single best investment one can make. Welcome to Income Property Investment Talk, a program dedicated to providing investors eager to invest well in real estate, with the knowledge, the resources and the tools to generate increased wealth. Each week we bring the powerhouses of commercial and residential real estate to our program for you to learn from and to call at 1-866-472-5790. My name is Peter Mosca and my co-host just happens to be one of those commercial real estate powerhouses, Dean Essa. Dean.

Essa: How are you Peter?

Mosca: I'm doing very well Dean. Dean, if we have an investor out there with under performing properties, a homeowner who might be on the fence of selling or renting or staying put, or someone with cash or IRA funds looking to generate wealth in real estate, we have one of the nation's premier wealth planning advisors on today's show, Rich Arzaga. Rich is the professor of real estate at UC Santa Cruz and he's here to discuss your portfolio concerns and share recommendations and advice on how you can reach your personal financial goals. Arzaga, an instructor in the financial planning certification program at UC Berkley and 2008 Instructor of the Year will analyze lost opportunity costs associated with holding real estate assets, the fundamental differences between commercial and residential real estate, and the bottom line if you have any questions whatsoever, give Rich a call at 1-866-472-5790. Before we begin, if you want to learn more about Mr. Arzaga or how to immediately start generating wealth in real estate, go to today's show page at incomepropertyinvestmenttalk.com/072308, that's right, today's date, incomepropertyinvestmenttalk.com/072308. Rich welcome back to our show.

Arzaga: Thank you. Thanks for having me back. I appreciate that.

Mosca: Rich, listen, let's start out with the fact that you are professor of real estate at UC Santa Cruz. I'm curious to know, can you tell us a little bit about the subject matter that you cover there and what the students see and how they feel about our economy today, about real estate as investments, and maybe give us a general look at the minds and hearts of tomorrow's leaders.

Arzaga: That's fair enough. Regarding the class itself, it's a 30-hour course and that's 30 hours in class and then there's probably another 20 or 30 hours outside of class, kind of like a lab. It's broken up into thirds, the first third is spent learning about the fundamentals of real estate and that's really what drives success in real estate, understanding the fundamentals and applying them. So if you learn about the fundamentals as the students do and by the way the students are mostly second career. They're changing careers into real estate or they are average age, perhaps in their late 30s, early 50s. These are not kids out of high school wanting to get into the business, these are folks who really want to improve their positions in life and see real estate as a way to do that. The second third of the class is spent doing a project identifying a piece of real estate, commercial real estate five units or more or any other sort of commercial real estate and they're expected to do the due diligence on that property. They do a lot of work knocking on doors to verify rents, they call around to get mortgage information, and they verify the taxes, all the other expenses, income opportunities. They spend a lot of time out there on the street identifying and putting together a proposal for a specific property.

Essa: That's nice because there are a lot of courses out there that are really good courses but they don't have the hands-on factor. Sometimes there are a lot of amazing courses sitting on people's shelves.

Arzaga: Dean, I agree with you. The best course work I've seen out there and I think Peter was just out there helping these folks out is the CCIM curriculum. They do a great job of four or five weeks of training people how to evaluate real estate but you never actually get out there on the street and apply what you learned. That's what this class does, that's the difference with this class.

Essa: John T. Reid has, I don't know if you ever heard of this website, but he has this website that he analyzes, I guess he calls them the real estate gurus. He has everyone you ever heard on late-night TV from regional guides and he lists them by name in alphabetical order and he either recommends them or he doesn't recommend them. When he doesn't recommend them, he says why so he gets into the nuts and bolts of their personal lives and everything and he only recommends a handful out of hundreds of real estate experts, and you were one of the ones that he recommends. I thought that was pretty cool.

Arzaga: That's very nice. I've had a chance to meet him a few times and in fact I've asked for him to come down to the course and drove him down there to spend a night with us there at the UC Santa Cruz program. He hadn't really spoken publicly about real estate in several years although he writes about it all the time and that was really the first time in quite a while that he took about an hour to speak to the students about how the fundamentals, in his mind, work for real estate. It was quite an honor. He's a very smart guy. I like John T. Reid a lot.

Mosca: Rich, let's take a turn now and talk a little bit about where you see today's market. Where do you see today's real estate market, what is happening, and maybe if you could look into your crystal ball, what do you see over the next 12, 24 months?

Arzaga: Let's see, I guess the first observation I have around today's real estate market and it's interesting, a year and a half go real estate was still getting to its as people would define in their minds, its peak. I still think there's good stuff out there today but the people loved real estate and they pursued it and they wanted to learn more about it. As real estate is going through its cycle right now, people still want to learn about real estate. It's fascinating. This is one asset class where whether it's doing extremely well or whether it's having some rough times in some areas, people want to learn more about it. That's the first observation I would make is that people are still interested and passionate about this asset class.

Essa: Don't you think there's ways to make money in any real estate market if you know what you're doing and align yourself with the right professionals?

Arzaga: I agree. It's kind of what the work that you two do with clients; it really is based on the fundamentals. There is always something out there to purchase as long as the fundamentals work for you. The fundamentals include the ??? of the property, the cash flow, rate of returns, cap rates, and then going beyond that to see how solid those numbers stand up. There are opportunities out there. There are people making good investments, some decent investments out there, they are just a little bit harder to find right now. Frankly, with the market it depends on what sort of real estate you're talking about, whether it be residential or truly commercial but frankly I see the commercial real estate market actually in a much better condition than it was two or three years ago because you do have a lot of folks that have left that commercial real estate market with their money, unplanned, not very well thought out strategies and they're not over bidding or over buying these properties. Now that the fundamentals have come back around for commercial real estate and actually it's a better time today than it was two or three years ago when everyone was there throwing money at properties. I guess going forward what I see is it depends on what you talk about, residential real estate I think there will be pockets of the US where we are going to continue to have a decline in value for residential real estate, where people live, and there's commercial real estate where I think it's actually gotten better in the last couple of years and I think it's gotten better all around the country. Certainly in the Bay area where three or four years ago buying commercial real estate didn't make much sense, today it actually makes a little bit more sense.

Mosca: We are going to bring up, in fact I just got something from the National Multifamily Housing Council on some good news for apartment and landlords and commercial real estate investors. We'll touch on that a little bit later but what I wanted to flow into now is you just gave us a healthy look at what's happening in the real estate market in your eyes. Now all of a sudden one of our listeners gets to Rich, he goes to incomepropertyinvestmenttalk.com/072308, contacts Rich, what's the first thing Rich that you do with a client? Is there some kind of a planning process that you go through? Are there steps that you work through, goals, portfolios, etc.? I assume you do this together, right?

Arzaga: Yes, exactly right. You really can’t do this by yourself because if an advisor does something like this by themselves it's unbelievable when you don't have the participation of your client. You're right, planning is a process and that's really the key word there, process. The first part of the process is to determine what the need is, what the drive is behind the real estate and frankly, what the suitability is. I've had people come to me with little or no money to say I want to put everything I've got in real estate and if anything happened to their lives that was different than what was happening today, they had to add some sort of capital expense to that, they'd be sunk. So for some folks it may not be suitable, for others it's just a matter of figuring out the most suitable approach. So the first thing is to figure out the motivation, figure out the resources, figure out what their objectives are and figure out what their mix is. It's good to have a healthy mix and some people don't have any real estate and they want to add some. Some people might have too much and they are at stake with one asset class. So we get to that initial process then we get to the point where we say what makes sense for this client. By engaging them throughout that process and by having them help answer these questions and seeing what this looks like you really have a much better investor at the very end of it making better, well-informed decisions on what to do with commercial real estate or investment real estate.

Essa: What I think is interesting, I don't know if you ever heard of Jim Cramer up on CNBC, he’s a kind of wild man. He used to be the former hedge fund manager, the Cramer Berkowitz and they were getting 24% returns for 15 years in a row at his firm, and he's an optimist and he has always been the one to suggest always to find a good investment in stocks, if some segment falls there is always something behind it but you can go ahead and put your money into. This is the first time ever that he came out on July 9th and said sell everything. He said nothing works. He said get out of the stock market. If that's the case, where are people going to put their money.

Arzaga: You know what, I think he’s got the initial point you made; in any market there's always drivers and some of the drivers today are around commodities and fixed assets. One of the fixed assets is real estate. So I think that making a blanket statement like that is maybe a little bit too aggressive because if you can find an individual purchase or investment that makes sense fundamentally than you've transcended any sort of statement like that and can actually beat that idea. Of course, if you put your money on an index fund and the whole sector, the index goes down, then I see what he's saying but on an individual basis you can make some hay making some good choices.

Mosca: No doubt about that, Rich. When we get back from this short break we'll talk more with Rich Arzaga, professor of real estate at UC Santa Cruz.

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Thanks for tuning in today to Income Property Investment Talk. If you have a question for Peter or Dean call now, listener lines are open. The toll free number is 1-866-472-5790. That number again is 1-866-472-5790. Now back to Peter and Dean.

Mosca: Rich, last week we were talking about the media's role in creating this Fannie Mae, Freddie Mac commotion. Bottom line in this show's opinion, or this host's opinion it appears as if the media is focused a lot on Wall Street and is backing Wall Street instead of Main Street and we feel Main Street is more like the real estate investor. We know that most Americans today have their wealth built inside of real estate and one of the things that we focus on here at Income Property Investment Talk is the multifamily and apartment marketplace. There is a lot of numbers out there to support this theory that multifamily and income properties are almost recession proof. In fact, one of the things that we looked at during the last week or so is that Fannie Mae and Freddie Mac hold their guarantee about $5 trillion in mortgages which is nearly half of the nation's total. You couple that with Ginnie Mae, the Government National Mortgage Association, and they hold about $157 billion in multifamily debt, but all of their portfolios right now in the multifamily side of things are doing quite well. In fact, I think Fannie Mae, the most recent numbers, Fannie Mae's multifamily mortgages were less than 1/10 of 1% and Freddie Mac was .04. So, it seems like money being lent to multifamily and apartment investors is still very strong and doing very well. How do you feel about multifamily and that as an investment right now?

Arzaga: I think that similar to the statement earlier I made, multifamily has gotten much, much more attractive, much better over the last three years or so, two years, and I'm not surprised to hear. First of all I agree with what you're saying, I think that looking to put a blanket over the entire economy to say that everything is going poorly really doesn't give some of the asset classes the credit they deserve. I would agree that, for example, I own commercial real estate myself. My wife and I are part owners of several commercial property shares in the west side of the United States. Our cash flows, our mortgage is fixed, our cash flows are steady, the rents are increasing and we're having no issues in today's market and it goes back to the idea that if you buy well, you can have that experience. But I agree with you, I think that the fundamentals are much, much better. I have a term for what the media does with people's minds out there with this economy and the term I use with clients and students is I call it "financial pornography". The more they see out there, everything is a wreck out there, bad news sells, whether it be the Internet or the radio or the TV. So bad news sells and so when folks are seeing this, it causes them to react and do things they probably shouldn't do. When I get calls and my clients are partially in equities, partially in real estate, partially in commodities, oil and gas, it's a nice mix. We are not really participating wholly in that down stock market.

Mosca: Again, I look a lot and try to do as much research as possible, find out what's happening in the marketplace, gather as much knowledge as I possibly can but as a single investor, there is no way I can do this as well as reaching out. We've talked about this numerous times on the show, how important relationships are.

Arzaga: Yes. You know what, this business is all about relationships and it's one of the things, it's funny, you asked about the students earlier and the big take away from that class after they've done the project is a couple things. One is to do it on your own is very, very difficult because you really don't have the expertise, the insight, or the instinct for this. The second thing is this business is all about relationships. For a lot of these students the very next step for them is to participate in a group or join CCIM meetings to be able to build, start building those relationships because they really are exactly what you say, this is what really creates the formula for success in terms of investing in real estate. I absolutely agree with that statement.

Essa: I know that with me personally because of the people that I associate with, I'm put in front of people that I never would have met. I mean just the other day I took a $62 million listing and I would've never been able to walk through the front door had not a friend of mine who's a retired state Senator been a friend of this other person. That happens over and over again. You've got to get yourself, especially if there are realtors listening; you have to associate with those people that can help take your business to the next level.

Arzaga: That's a good point too. One of the things I see, especially in today's market where the residential market is soft, residential realtors are looking for ways to raise income for their families and I understand that, is they start venturing into areas that they're not very skilled in. One of the first passes of that is commercial real estate say at a five-plex level, a small apartment complex and there's so much to that you just cannot do that, it's a real disservice, to their clients to be able to say I can do that for you and not have any experience or even credibility. They have to partner, the big opportunity for them is to take this time now to partner with somebody, to refer off to somebody else who knows and to watch and learn what this process looks like.

Mosca: If there are realtors out there in the residential and even in the commercial side of the business, if you do go to incomepropertyinvestmenttalk.com, click on the video of Blaine Walker and that could open up a whole avenue of additional revenue for you if you listen to what he talks about with tenant in common investment opportunities and so on down the line. I would suggest you go to incomepropertyinvestmenttalk.com and watch that video. Now Rich, in terms of relationships and acquiring the knowledge and I think a lot of times we look at real estate in the wrong light in that we all call it a market. I think the stock market is a market but real estate, there's a reason why they call it location, location, location. It's very important to know what is happening all the way down to the sub market in the local level. There's going to be a lot of people out there telling you that there's buys available, that there is excellent opportunities to buy, buy, buy in these markets but as you are well aware some of these markets might have what are called shadow markets where there's unsold houses and condos that are going to be coming on to the rental scene in some of these sub markets across the country. Can you talk a little bit about location investing and how important that is to someone who is looking into multifamily and apartment investing?

Arzaga: That's a good point. Part of the due diligence that folks do learn in my class and frankly, that very good organizations like yourself are able to do for their clients is the feasibilities part of it. The feasibility part of that includes figuring out what the absorption rate or what the need is, what the demand is for inventory in that marketplace. It's really something that is quite often overlooked. Folks look at the numbers very quickly, perhaps they work, perhaps they don't and they mostly think that they work and they really don't work but they really don't dig too much deeper beyond that. To be able to figure out what the local economy is doing, where the demand is going to be and to figure out where people are going to be moving to and living is quite a way to help solidify an investment’s position as a very good investment. If you’ve seen a trend away from an area then obviously there's going to be some issues with supply, oversupply and under demand and the rents might go down and it may not be a great place but if you're able to go ahead and figure out and determine through a process that you use what's going to become in higher demand and what looks like it's going to be stable for awhile then you have a much better experience. I agree with you, certainly the whole feasibility area is something that's missed by most everyone out there buying who isn't associated with a professional or process like yours but missed by most people out there.

Essa: I know that we analyze markets all over the country and when we’re bringing an investor into one of these markets, we have to get our economists on there and spend a substantial amount of time and capital to get down to all of those fine points that you're referring to in that feasibility study. Not only is it important to bring those people to the right market but like you said, there's a lot of people who try to jump into that sector without having a good professional there to help them. They don't understand cap rates, they don't understand rate of return or cash on cash or return on equity and all of those things. If you don't understand those concepts inside and out, you can't buy a building because it's pretty.

Arzaga: Exactly right. It's like giving a stockbroker money and saying just put me anywhere.

Essa: Exactly. Now, on that note too, I know we talk about wealth accumulation a lot on this show but I've always felt because I also have estate planning background, not anywhere near as much as you, but I've always felt that it's equally important not only to accumulate it but the tax ramifications and the asset preservation and protection sometimes is equally as important. What good does it do to accumulate all the wealth if it's coming in the front door and then sneaking out the back door?

Arzaga: I agree with you.

Essa: Can you talk about that for a little bit? Maybe talk a little bit about tax strategy; maybe give our listeners some little jewels. Any hot tips in this market?

Arzaga: Well, I guess a couple things. When you talk about tax strategy most people want to save on taxes rather than spend more taxes so we'll operate on that side for a moment. About saving taxes, you can do that two main ways. One is while you're alive and the second is after you pass. So what most people can control, most of the listeners probably on the station here, the clients that you work with, they are mostly concerned about deferring taxes while they're alive and preserving their wealth for their family. One of the most common strategies that are used for that is called a 1031 exchange. I think you've talked; you've had my friend I think and her boss on the show a few times. The 1031 exchange is a very, very nice way to go ahead and perhaps move from one property, improve your position, perhaps improve your cash flow, lighten the management, it depends on what sort of property are getting into and move it forward to another investment, have a better experience and not pay capital gains. That can be done by the way over and over again until somebody passes. Once somebody passes, then that property actually steps up in basis, which means that the beneficiaries get it at the current market value. You actually never have to; if it's suitable and it's done appropriately or well, you actually will never, don't have to pay taxes, capital gains taxes on real estate growth.

Mosca: Rich, when we get back from this short break, I want to further talk about these different strategies that an investor can have focusing on when they're here obviously alive and well and doing well with their investments versus leaving those investments to family members as they move on from this life. So when we get back, we'll talk more with Rich Arzaga, professor of real estate at UC Santa Cruz.

BREAK

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Mosca: Welcome back. We're here with Rich Arzaga, professor of real estate at UC Santa Cruz. Rich, a couple of things, number one you had mentioned a 1031 company, friends of yours, friends that I know that you've been working with a long time. Let me just say their names, it's Mary Cunningham and Teresa Moss at Chicago Deferred Exchange Company. You can find them online easy, not a problem. Secondly Rich, we had a text message come in to the studio, a caller called in and he wanted to know how he could get into those classes or she, I don't even know, get into those classes that you offer in Santa Cruz and how he could sign up.

Arzaga: If you go to the UC Santa Cruz website and type in investment commercial real estate, it will take you to an area to sign up. The next class starts on September 9. So that's one way to do it. The classes are held in the South Bay of the San Francisco Bay area so they're in Sunnyvale so the downside for many people is that it's too far away. The upside is that probably in about a year or so we'll be able to do these classes live on the Internet. I know the school is working on a way to do that.

Essa: That's excellent. What about this thing, I was reading this morning, I was searching all over the globe about you and reading up and I could see that you have a lot of fingers in business with a lot of different people. What is this thing about the real estate whisperer? I saw something about it on there but I couldn't find it.

Arzaga: That's funny, that's actually a new domain name. So what I do is I'm a financial advisor and I'm a wealth-planning advisor and a lot of my business comes from other advisors. Other advisors in the business for quite awhile with good clients who wanted advice to help their clients on real estate. So, the Real Estate Whisperer is a website that'll come up probably in the early fall or so that is catered to financial advisors, PFPC, and attorneys where they can come in, take a look at what I do but what they'll end up doing is calling me and saying I've got this case, here's what's going on, what do you suggest or can I have you meet my client. I do a lot of joint work with a lot of other advisers and it's been quite a thrill working with not only other advisers but their clients and having really strong impact, having a positive impact on people's lives. Like you're doing in your business, this is really what this is about for me. So you just basically got something, I don't know where you found that but good for you. You got something that's a few months early. That's coming up, the Real Estate Whisperer. You know the term whisperer means it's somebody who has influence and knowledge that helps somebody out so that's where that's at.

Essa: Excellent.

Mosca: Absolutely, and if any of our listeners are wondering how we got that text message question in, that's because that listener went to radioreminder.com and downloaded a small resident memory program that pops up on their laptop or desktop every week to remind them of the show, who's going to appear that day, and it also gives you an opportunity to ask a question instantaneously, an immediate question. That's how it was asked. If you want to be in touch with the show and be alerted to who is coming up and when the show comes on, go to radioreminder.com and download that small resident memory program. It doesn't hold anything basically on your computer, so you don't have to worry about that. Rich, in terms of investing and what a real estate investor should expect today versus the commercial real estate investor of yesterday, should an investor temper their goals and be somewhat more realistic? I have family members; I have friends who have their monies in CDs and mutual funds and some even in stocks where their portfolios have actually gone down over the last 12 months. With real estate, can you expect the same returns today as you were getting 5, 7 years ago?

Arzaga: Let me explain. I want to get the first pass of that question is it really depends on the investment. If you make a good investment, it will be a good return rate or a better return rate. If you make a bad investment, if somebody makes a bad investment or choice out there which happens quite a bit unfortunately without the proper help than they can expect the same experience as the market but perpetuated for five or 10 or 15 years. That's really what that looks like. But to answer, if someone were to go out there and deliberately make a good choice, work with somebody, go out there and make a good property, actually as I mentioned earlier, the fundamentals are better, the cap rates which drive value for the buyer are actually a little bit higher than they were a year, year and a half ago. So, the cap rates are higher, the cash flow rate for commercial real estate is about the same if not slightly better, this is in general by the way, this is based on a good choice, is slightly better. The only thing I would say is that it's more important to work with somebody upfront because what’s gotten a little bit tougher is the financing. So, the financing market for both residential and commercial has gotten a little bit tighter, in fact a lot tighter especially on the residential side. It's not as easy as it was before to go out there and get this money to leverage that property. That's where you really need to make sure to qualify first, upfront; with the person you're working with and move forward based on what you can qualify for.

Essa: Normally every week and maybe even this week, you never know, he may still call in, but we have what is called a mortgage minute where we have Stan Hanks from RealSource Commercial talk about rates and talk about strategy for commercial financing. He is on the cutting edge of and the relationships that he has are still getting some phenomenal rates. He agrees exactly with what you said that it is tightening and tightening and that's why it's important to align yourself with a professional on the finance side to make sure that you're still getting good rates and be able to come in with a reasonable LTV.

Arzaga: It’s so important because people are willing to put down a big chunk of their assets, their capital into this investment so to feel that you can do the best deal and they can do the financing themselves to save a point or so is a little bit short sighted. This is a large amount of money for many people and it’s definitely worth it to do it well and to hire people that you trust.

Mosca: Rich, we’ve been doing this show, Dean and I, for a long time now, well it feels like a long time, but we love doing it every week. You’ve been a good friend to our show and what I did was I went back to last October when you were on with us last and you mentioned something to the effect of investors might say to themselves "a year from now I wish I would've started today." So looking at that, if you took an investor and I guess I'm throwing a little math at you here so be ready but, if an investor took your advice last October when they listened to you and maybe put $100,000 into a tenant in common or their own personal income property and maybe were getting 7% return or 6% return, whatever that was and appreciating at 20%, what would that $100,000 look like today? What kind of leverage would the investor have say today, three years from now, five years from now, that type of thing?

Arzaga: A good question. I think that if somebody did that then fast forward a year later if the property and I feel like I'm disclosing all the time that as long as the property is purchased well and expressing a poor disclosure because frankly real estate for most people on their own is mostly not done very well and so going back to disclosure, if done well here is what happens a year later. A year later, rents increase. Now if it were an average market rents would increase three to 4% or so, expenses increase as well, they follow but rents increase a bit. In this last year, the rents have actually increased in many markets much higher than they have the previous five or 10 years. They would've had an increase in income. So that's one good thing is that they would have had not only the original income they had in the beginning but a little bit of increase this time a year later. The second thing that would've happened is they would've seasoned their debt a little bit which means that they would've on interest only they would’ve kept on paying the interest but on a traditional PMI loan, you would have paid down some of that principle, so they would've had a little more equity then they would've had. The third thing is that because the increase, going back to the income, because the income has increased over the last year and if someone were to value that cash flow the same as they did a year ago, they would actually have a higher valued property. You see, valuations for commercial real estate depend on the cash flow and not the demand. Residential real estate is based on supply and demand, commercial real estate is based on the cash flow and what someone would be willing to pay for stream of benefits, which would include cash flow. So an increase on cash flow increases the value. That's a nice thing and the other thing is that a year ago they would've gotten financing that was a little more favorable than today. So the consequences of waiting a year, that's what happens. Now, going from here to next year, the market will change but the same things apply for the most part with the exception of the financing. If somebody made a good choice today and they were able to increase their rent and keep everything managed well around expenses and so on, they're going to see an ongoing stream of income and also a continued increase in value as long as somebody values that cash flow the same or better.

Essa: I like what you said. I also like what you just referred to regarding expenses. I analyzed about two weeks ago 21 multifamily properties for a client. They wanted to buy into a seven cap and they pulled up properties on their own and they found out that about half of them were seven caps. I ran them through our custom multifamily software and guess how many out of all of those 20 some odd properties were a true seven cap? One. They didn't understand the expense. They quoted on the expense factor a figure that I could clearly see that it was an incorrect figure and people will do that and people will look on there on LoopNet or whatever and look at that property and say look at that it's a seven cap and trust that those expenses are real.

Arzaga: A couple quick things on that. In the classroom, one of the biggest disappointments for most people is the realization that what they get from a local, commercial broker in terms of a packet is not the truth. So some people think in their state, the state of California will protect me, the agent must be honest about their due diligence but for example, in the state of California with five units or more, the requirements to disclose are not there. There is no requirement for the seller to disclose anything five units or greater. It's basically buyer beware. So what the students realize is that when they go out there and they collect these kits from brokers with very big names and brands, they realize because in the end it's really about the individual broker, not the brand of the company that you're dealing with, they realize very quickly when they do the due diligence that it is basically the expenses are low on the projections, the income is from three years from now and that's optimistic, and they realize it's a much different experience. It's a huge learning that you just can't take a packet and take it for its word. The further experience for these students is when a property ends up on LoopNet; it is really picked over quite well. By the time it ends up on LoopNet, the local broker and the relationships who have decided to pass on that and it's right up there for somebody else to grab.

Mosca: Rich, that music indicates that we're coming up on our last break of the program. When we get back, we'll talk to Rich more about multifamily, apartments, financing, and your questions, 1-866-472-5790.

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Thanks for tuning in today to Income Property Investment Talk. If you have a question for Peter or Dean call now, listener lines are open. The toll free number is 1-866-472-5790. That number again is 1-866-472-5790. Now back to Peter and Dean.

Mosca: A couple of things before we get back to Rich Arzaga, professor of real estate at UC Santa Cruz. If you are interested in learning more about what's available with financing, you can contact Stan Hanks at Stan@RealSource.net or go to incomepropertyinvestmenttalk.com/072308, today's date, incomepropertyinvestmenttalk.com/072308. Rich, before we left we were talking about multiple things in around the multifamily sector. The National Multi-housing Council just released something that came across my e-mail about 20 minutes ago that talks about the fact that the financial consequences of the foreclosure crisis is not spilling over into the apartment sector. Now, we talked a lot about rents and rent increases and this is good news for the investor who is looking to have his properties be able to increase those rents so you could increase your income and so on and so forth. In fact, Doug Bibby who is the president of the National Multi-Housing Council said this "much has been made about the flood of former house owners into apartments but we're not seeing that. Instead the primary effect the housing downturn is having on the apartment sector is a dramatic slowdown in the number of renters leaving to become owners. This in turn is raising the credit quality of rental applicants and helping insulate the apartment sector from the financial woes the single-family sector is currently experiencing."

Arzaga: This is what we were saying earlier in the show is that there is not a high relationship at all between commercial and residential. I'm surprised that message has missed is that in fact rents have actually gone up. Not only has it slowed down the number of people leaving and you have higher qualified applicants or tenants, but also the rents have actually gone up quite a bit. A lot of my clients who have multifamily are having great experiences around increased income levels from those tenants.

Essa: It's funny; I have this one client who's renting a single-family home. He actually owns seven of them and I was going to put three or four of them on the market. He said I'm so nervous, I'm afraid if I put them on the market my tenant will immediately leave. Well, he was getting $1100 a month in rent on this and he said it would be devastating right now if one of my tenants leaves. So, we went online and I pulled all of the current reg. tops in his neighborhood. The rents jumped to $1350 and he didn't even know it.

Arzaga: That's a good point. Most people don't realize how much more valuable their rentals have become in terms of an income stream. I agree with that. There is a statistic that measures the correlation of equities, which is what everyone is talking about on the news, the stock market, to real estate, commercial real estate. If the correlation of the S&P is 100 and real estate it's about 10, which means that there's a 10% correlation between real estate and equities. Now, if you look at bonds, there's roughly about a 40% correlation between equities and bonds. It's not negatively correlated, but it's non-correlated to the equity market place.

Essa: Can you say that one more time and elaborate on that for our listeners?

Arzaga: Yes, I'm sorry about that. It might be kind of unclear but basically we talked about real estate being different and behaving differently than the stock market and the way that that's measured is by looking at the correlation. In other words, if the stock market does this, will the real estate market follow? So the answer to that question according to the last study I saw maybe in the last year or so is that there is a 10% correlation between what the stock market does and what the real estate market does. In other words, there's very little chance at all that the real estate market will follow the behavior of the stock market. Actually, that's been quite consistent for maybe the last 10 or 20 years.

Mosca: That's a great point Rich and one of the things I don't believe we really elaborated on is the tax tips, the tax strategies. We have about 4 1/2 minutes left to the program. Can you go off and talk a little bit more about tax tips, tax strategies, what makes sense?

Arzaga: Very briefly, we talked about the 1031 exchange and then there's a second version of that that's out there because some people say what if I want to get out after three or four years. There is a strategy called at 1031 721 where in some cases they can actually liquidate in partials and units these pieces of their holdings. That's a much more longer, advanced discussion but I just will let people know that there is a way to get some liquidity out if they're using that strategy. It's in the IRS code 1031 721.

Essa: Can you give an example of that?

Arzaga: An example of that is somebody goes from a piece of property to very briefly a warehouse, a nice cash flow for a couple of years, 6%, 5 1/2, 6 1/4 something around that and then after about three years or so the way that that particular property is structured is that it goes into something called a non-traded rate and what that will do is it will basically diversify that one property into dozens of different properties. Also, they have a piece of many different properties and if they choose to get out after certain time, three years or so, three years plus perhaps, they choose to get out of just a small section of that, they can pick off one or two properties to get out of and still have those other ones producing for them and only pay taxes on those properties that they've actually withdrawn from. That's called at 1031 721. There's a strategy by the way for well-intentioned people who are out there who pursue the 1031 but miss. The big concern, the big fear is what if I miss it, what if I'm going to have to pay the taxes? Well for some clients, actually for many clients there are strategies out there around energy, oil and gas that allow you to go ahead and re-coop basically about 90% of what you invest in that and oil and gas. So if you have a big tax year whether it be income taxes or capital gains taxes, by taking some of that and investing it in oil and gas, you have a nice revenue stream, a non-correlated asset class but you can actually write off 90% of that investment and it will help you save on your capital gains tax. There is a way, as long as someone knows early in the year, the first half, the first two thirds of the year, there is a way to manage taxes if they unintentionally missed the 1031. People who are afraid of that should understand what the backups are before they go ahead and assume that there's nothing more than they can do around missed 1031s. That happens once in awhile.

Mosca: Rich, we're up into that point of the program, a good friend of mine, Jackie's favorite part of the show where I say is there a golden nugget that you can leave with our listeners here today?

Arzaga: You know what, I think the golden nugget is something we just talked about earlier and I think that I don't think we talked about this as much on the previous show or shows but I think this business is all about relationships. The Internet is great, it’s a great warehouse for us to draw a lot of information from, and all that is is data. The insight and the knowledge and the instinct comes from relationships that you have. It's just really about who you hang out with and that's really the golden nugget -this business is all about relationships.

Mosca: And if anyone listening to today's program would like to start a relationship with Rich today, please go to our website at incomepropertyinvestmenttalk.com/072308, today's date, 072308. Rich Arzaga, professor of real estate at UC Santa Cruz, we thank you for coming on the show again.

Arzaga: It's been fun. I appreciate the time with you.

Mosca: Dean, next week we're going to have Pankaj Shukla, CEO of T-Rex global, who's going to discuss many ways for investors to save time and money as they manage their finances through technology. He's going to talk about his company's solutions. He has something called Defer’Em, Simplify’Em, Depreciate’Em and various other real estate tax tips. So, next week on Income Property Investment Talk.