PLAY THE BALL WHERE YOU THINK IT'S GOING, NOT WHERE IT IS

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EDDIE SPEED

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What are the most accurate tea leaves to predict where the real estate market is going? Follow the money!

The real estate industry is driven by credit availability because it's a finance game business. If people can't get financing due to unemployment, underemployment or strict credit guidelines, houses don't change hands.

MUCH LIKE 2008, WE'RE SEEING A CRASH IN SLOW MOTION

Those industry tea leaves have been giving some mixed signals.

I've been looking in my rearview mirror a lot lately. I remember how I felt back in 2008, and things didn't fall apart in 2 weeks. It actually started in early 2007, and it took almost a year to bottom out.

We saw dozens of financial powerhouses slowly tip over like dominos knocking each other down one by one.

I remind you of that because lots of real estate investors have seen the recent bump in real estate sales. In May and June existing home sales were up over 40%. Many investors breathed a huge sigh of relief, assuming the worst is behind us with blue skies ahead.

But have things really turned around? Should real estate investors start popping the champagne?

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I always keep my ear to the ground and listen to best advice I can find. John Burns is one of the world's smartest real estate consultants. The companies he advises are like a "who's who" in the global banking industry. Back in April, I was at a meeting of top real estate and hard money lenders, and he was called in to share his wisdom. When he talks, people listen! He said we could expect to see an increase in home sales in the near future (which happened exactly as he predicted), but he described it as a "dead cat bounce."

It means that even a dead cat will bounce if it falls from a great height. He said we'd see a small, brief recovery from the pent-up demand in home sales, but things would quickly flatten out again. When properties don't sell for three months, you'll see a short resurgence, but a dead cat only bounces once.

If you compared today's market to a Monopoly board, the Park Place and Boardwalk properties will continue to be in demand because those buyers will be able to qualify for mortgages thanks to their excellent credit ratings and solid income. The mortgage industry is currently slammed as they create loans for perfect buyers. You can do a refi for 3% interest IF you have great credit. But the working class folks shopping on Baltic and Mediterranean Avenue will be left high and dry. Traditional lenders don't want to take a chance on loaning them money with the economy still shaky because these folks are the ones most likely to suffer and have less savings to ride out the storm.

According to the Mortgage Bankers Association, the current mortgage credit availability is

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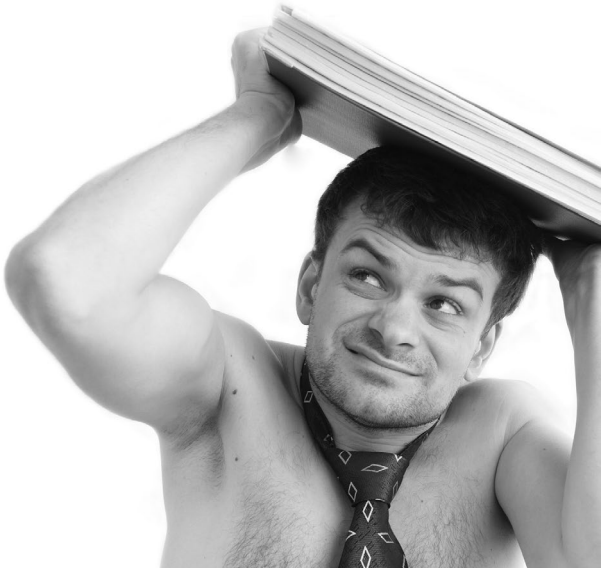
about 35% less now than in January. When you take 35% of the mortgage money out of the finance-driven real estate industry, that's going to have a huge impact on properties changing hands. Underwriting standards have changed significantly, so the guy with a 650 credit score can no longer get his FHA loan like in January.

WHICH WAY IS THE BALL HEADED? WHAT WOULD IT MEAN FOR YOU IF YOU WERE THERE WAITING?

I'm not making some bold claim that property values will decline like in 2008, with unsold properties flooding the market. While that's not out of the question, the market characteristics are just different now than then.



The inventory levels today are not as high as in 2008. There's still a shortage of inventory but expect some price depreciation.

If you look at the real estate industry as a whole, investors who buy properties at a discount don't represent the mainstream. But the real estate investor side of the business is more drastically affected than everybody else.

You gotta know where we've been to know where we're going. Prior to 2008, wholesaling was not a huge segment of the real estate industry. Investors were advertising to locate properties to buy at a discount, and had a successful formula for making money: Buy, fund, fix, and flip. High-volume investors stayed busy and did well, often flipping to a landlord as a rental property. It was also a good way for beginner investors to get their feet wet.

Then in 2008 we saw a gigantic reset in real estate prices and demand. Investors who couldn't put deals together lost their shirts.

Things plodded along until 2012 when a new player jumped into the business. Hedge fund managers looked at future property value projections and used their giant checkbooks to buy up houses thinking they could make a killing in a few years. They didn't have the marketing machinery in place to locate properties, so they bought from real estate investors. These investors who used to buy houses, fix them up, and sell them could now just buy houses and sell them to the hedge funds (for top dollar) without the headaches of fixing them up! This changed the whole business model for wholesalers to simply flip the contract and do more deals per year. It was essentially a market interrupter that made house buying more efficient for the investors. Less work, but with the same or more profit.

Around 2015 the hedge funds were losing some of their appetite for acquiring properties and started cutting back. But wait, there's more to the story, it only gets better for real estate investors. Because that's also about the time the

HGTV watchers got fired up about getting into real estate. The HGTV fans didn't have the financial discipline of a hedge fund pro with a fancy MBA and analytics; they knew nothing about real estate but they could qualify for loans and it looked fun on TV so they jumped in. Buying houses became an American pastime. Wholesalers started flipping properties to HGTV watchers for excessively more money.

The HGTV watchers bought properties with two simple exit strategies in mind. They would buy a property intending to either rent it, or intending to flip it. Neither option can work near as well today without reliable financing for their own loans or for the people who buy their properties.

What's your read? With today's credit availability crunch, does it produce a major speed bump for the HGTV investor? Do they struggle? Can they continue to buy rental properties with a hiccup in financing for landlords, or flip their properties to subsequent buyers where they get financing?

Will a much tighter loan approval criteria affect the HGTV buyer's aggressive pattern of buying from wholesalers?

So if the answer to any of those above questions is even a "MAYBE no", then which direction is the ball headed? If history repeats itself, then it's going toward creative financing to fill the gaps left by traditional lenders, and make deals come together for people who have been left behind. This is why I've always made more money in down markets than up markets. There are far more people who need help qualifying for loans in down markets, and that's where creative financing increases your competitive edge as a successful investor.

If you understand how to architect a deal using all the tools available with creative financing, the ball will be bouncing right into your hands.

NoteSchool

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