



Ultimate Inflation Hedge by Mitch Kossar CFA, Broker, CIG Realty and Loans

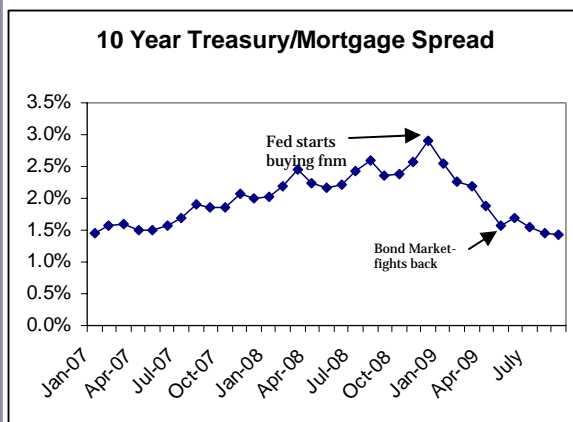
CIG Realty & Loans

1350 Old Bayshore
Suite 150 Burlingame,
CA 94010

O 650.931.8700
F 650.931.8701

Dear Friends and Past/Prospective Clients:

The biggest fortunes are often made during the tough times when fear outruns greed. What are the opportunities today that we will be kicking ourselves tomorrow if we do not act? Several months ago we asked 'Where is our bailout?' The chart below shows it (though it may not be obvious at first);



Since the election, the Fed has been trying to force rates down by buying up mortgage securities. By April, rates hit a record low. So our bailout are these super low rates, and we should take advantage of them.

Because they may soon disappear. Since April the market has fought back on both treasuries and mortgages, and rates have stabilized slightly higher than April. It's not clear how much longer the Fed can hold back the dam.

Our Bailout:

There are good reasons to buy investment property now. With real estate in many areas selling below construction cost and California seeing cash flow positive properties for the first time in decades, many argue the time is now.

Others feel that unemployment, massive consumer and government debt plus structural increases in government spending and regulation mean the worse is yet to come.

We feel both arguments actually point to the same answer: Invest. **Real estate is the ultimate inflation hedge.** Today we are in a deflationary environment. However,

- 1) Current account deficits increase risk to our currency
- 2) Both lack of drilling investment and a weak dollar will raise oil prices
- 3) The government is basically printing trillions of dollars.

Inflation must be in our future at some point. Certainly double digit inflation is within imagination. But try to imagine more. The United States is one of the only countries in the world (along with Britain) that has not seen triple digit inflation in its history, why do we have to think we will remain the exception not the rule? Will we have the global currency forever? Our country has been behaving a lot like a banana republic lately, we are not immune to the laws of macroeconomics. Not forever, anyhow.

Whether you take such an extreme position or simply believe a significant inflation will be coming soon, certainly we can see that a 6% 30 year fixed mortgage (for non-owner occupied property) is basically one of the easiest, most valuable tools towards wealth creation. Although it takes 30 or 35% down, the best thing to do right now is to buy as much real estate as possible with super low interest rates. When the dollar weakens later, we will be paying back worthless dollars, but getting rents in inflated dollars. The government has given real estate investors a bail out...if you qualify...

Don't get mad at us!

The loan process has become much more difficult lately. Everyone has to understand that underwriting conditions have become much tougher lately. It is not simply a matter of no more stated income or assets, and tougher loan to value and credit requirements. Every piece of the application is reviewed and re-reviewed with a fine tooth comb. Its back to "Napoleonic law" when it comes to mortgages: You are guilty until proven innocent. This means a lot of silly hurdles. The guidelines will rule over common sense when the guidelines are against you, but common sense will rule over guidelines if the guidelines are in your favor. Don't get too frustrated, after all the bank is giving away \$100,000s to you and that is how it should be.

The road to hell is paved with good intentions:

However some of the changes are maddening, as the government interferes with the every day basics of transactions. Competition declines as the government tries to drive brokers out of business. Further, there is one ruling, the HVCC, is causing havoc in the industry.

In the past, the broker orders the appraisal (the longest step in the process) and then picked the best lender when the file is complete. And we also don't order an appraisal until we discuss the property with the appraiser. The relationship between brokers and appraisals became too cozy during the bubble, so now that relationship has been completely severed. But relationships are necessary for business! Now, a third party is hired by the lender and paid up front. There are several complications:

1. We have no idea who the appraiser is, and often the appraiser is completely incompetent. We are not allowed to talk to the appraiser so there is no way to set him/her straight or even know if it's a waste of time.
2. Since the lender communicates with the third party, the broker is locked into a lender BEFORE a rate can be locked (allowing for MUCH less shopping).
3. The process takes so long and it is so uncertain, the broker can no longer forward lock the rate without risking the relationship with the lender.

So now, the loan takes longer to close, the rate is uncertain, and an incompetent appraiser can destroy the deal (particularly horrendous during a purchase). Luckily the real estate and lending industries are fighting this law. But more silly laws are on the way.

The lesson? There is no free lunch. The government has given us a gift: cheap money locked for thirty years before an inflation cycle. But as it always is with the government, there are strings attached. But if you pass through the hoops, the rewards are substantial.

- Rates are artificially low, but not for too much longer
- Inflation is coming
- California Real estate cash flows for the first time in decades
- Lock in 30 year fixed rates now before inflation begins.
- But realize, it will not be easy! Underwriting is difficult.