Forbes.com

Investment Guide

Moving In

Victoria Barret 12.08.08, 12:00 AM ET

Randy L. Perkins amassed a nice fortune in real estate, life insurance and investment banking in southern California over the past 30 years. Since May he has sunk $5 million of it into the one place most investors least want to be: housing.

Perkins has bought two dozen homes in the San Diego area through his Westview Financial Group. One was a dilapidated three-bedroom stucco in Escondido for which Westview paid $158,000--a 61% discount from the previous selling price of $408,000.

Westview chased out a couple of squatters. Then, even before it could finish fixing up the place, prospective renters started showing up on the doorstep. Many were people looking for a place to live after losing nearby homes in the property bust.

Westview eventually spent $40,000 on acquisition costs and improvements. Then it rented the home for $1,800 a month, netting about $18,000 in annual profit after property taxes, maintenance and insurance. That's a 9% return on the acquisition cost before income taxes (which are modest on real estate, thanks to depreciation writeoffs). If Perkins is condemned to sit on this property for a long time, waiting for the market to come back to life, he won't suffer. That 9% cash-on-cash yield is more than triple the 2.9% dividend yield on the S&P 500.

"I got my real estate broker's license at age 21," says Perkins, now 54. "I've seen these cycles before, but I've never seen price drops this dramatic."

San Diego had one of the bubbliest markets of all, with home prices tripling in the decade through 2006. Since then it's been all downhill. The Fiserv Case-Shiller index says prices have fallen 31% in the past two years. Currently one in every 32 San Diego homes, a total of 34,854 units, is in foreclosure. That ranks it as the 21st-most-troubled housing market in the nation (California's Stockton area gets the booby prize, with one in 12 homes in foreclosure).

Now first-time buyers and investors like Westview are offering a glimmer of hope. In September the number of San Diego homes sold rose 56% from a year earlier to 3,366, according to DataQuick. More than half were bought out of foreclosure, indicating that Perkins is far from alone in seeing promise amid the wreckage.

"San Diego is a microcosm of the California market," says Christopher Thornberg, founder of Beacon Economics, a Los Angeles economic consulting firm. "It was one of the first to crack and is now one of the first settling into a landing pattern."

Perkins and his son, Robert, stumbled upon the idea of buying busted homes when a friend showed them two residences in a town in northern San Diego County that he'd bought from banks, fixed up and rented out. Robert, 26, put together a business plan and showed it to agents and others knowledgeable about the market.

Robert hired his former college roommate, Brian Archambault, to spend two months chatting up barkeeps and shop owners in various neighborhoods to get a feel for the market. Westview used that intelligence to home in on the northern San Diego neighborhoods of Escondido and Oceanside, where Camp Pendleton, the Marine Corps base, provides jobs and limits urban sprawl. Currently on Westview's do-not-go list: southeastern San Diego, especially Chula Vista, where the skeletons of unfinished homes dot the landscape.

Westview has paid an average of half the previous selling price (in cash) for its two dozen homes over the past six months. It has also hired two more employees, Harlan Wilkie, Robert's brother-in-law, and Jeffrey Badelt, a 25-year real estate veteran, to help scout, buy and oversee renovation of its holdings.

Guidelines: Properties must be free of graffiti, which can be a sign of gang activity; separated from multifamily housing, with its noise and high turnover; and on a block where residents care enough about appearances to display potted plants and keep up paint jobs. Westview avoids houses selling for over $300,000, which are hard to rent at a profit.

Others see promise in the market, too. Brokers say homes listed below $200,000 are attracting multiple offers. Westview recently competed with 25 bidders, nearly all investors, for a three-bedroom home in Escondido.

Most of the agents on an October home tour said they represent clients looking to buy multiple foreclosed properties. Six months ago such clients were scarce. Gregg Alexander, a ReMax agent, is touring foreclosed homes with a half-dozen potential investors. He has also purchased five for his own portfolio this year.

Silver Portal Capital, a San Diego real estate investment bank, is raising $100 million to $200 million in institutional capital to buy 1,500 homes. It is biding its time for the next month or two, however. It expects San Diego's unemployment rate to rise from its current 6.4%

"Some areas have probably bottomed," says Burland East, the firm's principal. "But this isn't like a one-day sale after Thanksgiving. We're expecting a shallow, saucer-shaped bottom."

Westview, meanwhile, is doing just fine renting out its properties. Most are in lousy shape when it takes ownership. One in Escondido had lost copper plumbing and wiring to scavengers. At another the deck was stripped to concrete and chicken wire.

The company has assembled four crews to replace fixtures, apply paint and restore garages (several of which had been converted into rental rooms by former owners in last-gasp bids to keep up with mortgage payments). Upgrades add as much as 20% to purchase costs. Badelt, Westview's real estate veteran, makes sure to upgrade kitchens to appeal to prospective female tenants.

One of the biggest impediments to moving homes more quickly: chaos at the banks, which are swamped with real estate workouts. "I've seen banks refuse an offer and then a few weeks later lower their asking price to that same offer price. It's absurd," says Glen Brush of Brush Real Estate in San Diego. "Often it takes months for these guys to respond to an offer. By then the buyer has moved on."

Perkins the younger says Westview will pick up its buying pace this winter. He expects it to be in the rental business for five to ten years and eventually sell its homes at a substantial profit. "Lots of multimillionaires will come out of this," he says.

Buying to Rent

Some hard-hit parts of the country offer decent yields on residential real estate. But the best returns aren't necessarily in the most down-and-out spots.

CITY	FORECLOSE RATE*	AVERAGE HOME PRICE DECLINE**	CAPITALIZATION RATE***
Atlanta	2.4%	7.2%	6.3%
Chicago	2.4	10.8	6.1
Cleveland	2.8	13.8	8.6
Dallas	1.4	0.0	7.7
Denver	2.6	8.7	7.3
Detroit	4.3	27.3	8.6
Miami	3.0	30.4	7.7
Phoenix	4.0	32.5	5.7

Sacramento	4.3	39.8	5.8
San Diego	3.1	29.6	5.8

*Foreclosed homes as a percent of housing units as of Sept. 30. **Percentage drop from peak prices to current prices. ***Net operating income divided by property cost (excluding debt servicing) for multifamily housing units. *Sources: RealtyTrac; Fiserv Case-Shiller Index; Real Capital Analytics.*