



## **Real Estate Investment for the Rest of Us Strategic Investment Strategies for Optimizing Real Property Returns**

If you have ever invested in real estate, you know that it is not for the faint of heart. For every fantastic story about making \$89K in a month or two by “flipping” a property during the boom years in the early 2000s, there are many more people sitting on a depreciating property with low-to-non-existent rents, no buyers and the mortgage due. Even if you don’t indulge in some of the riskier strategies such as flipping, the purchase of a property for development or long-term rental is not a guarantee of a high return on investment.

Why is real estate attractive? Because when done thoughtfully, it offers a lower-risk highly leveraged investment opportunity. Or, in layman’s terms, you can put down \$100,000 on a \$500,000 property, and if you can rent it at breakeven for a year and it appreciates only 3 percent, you have a 15 percent return on your \$100,000 investment. Real estate is traditionally less volatile than the stock market, so someone who might hesitate to invest using a margin account may still feel comfortable leveraging an investment in real property. In addition, there are tax advantages to growing your real estate investment portfolio that beat stock market capital gains provisions hands down.

Many people become real estate investors by holding onto their previous homes when they purchase new ones, or by purchasing a vacation home and at some point renting it out part time or full time. Often this is a reasonably satisfying experience, in large part because these investors know a lot about the area in which their property is located – what the neighborhood is like, the local economy, the demand for rental housing, and, perhaps, even who the best property managers are.

However, we now live in a much broader economy. The best investment opportunities may not be around the block or even in a nearby town. At any given time, there are real estate markets that are booming (and may bust), others that are appreciating steadily over a long period of time, and others that are stagnant, declining, or so heated that it is impossible to achieve a decent ROI unless the property is purchased to be flipped, or the investor is willing to “feed” a negative cash flow in the hopes of reaping later rewards from appreciation. To optimize returns and meet planning goals, investors are looking farther afield – to a neighboring state or even another country.

For busy professionals, with or without growing families, it is close to impossible to find the time and energy to adequately research and oversee investment property – particularly when it is remote. The emerging field of real estate investment service companies offers substantial benefits covering individualized **financial goal planning** that takes into account your objectives, assets and risk tolerance, through **property acquisition**, property performance **oversight and analysis**, and finally **strategic asset re-balancing**. Real estate investment advisors have specialized experience in both financial planning and real estate evaluation and management, and they provide an invaluable service for real estate investors.

Real estate investment analysts can provide performance-based real estate investment services – that is, they use their financial analysis skills to remove some of the guess work about real estate investment by evaluating and tracking an investment in ways that parallel how professional investment advisors, with extensive training and tons of easily accessed information, work with marketable securities. The end result is to make real estate investing much safer and more profitable for the individual investor.

### **Why Real Estate is Different**

Real estate is different from stocks. When you purchase a stock, or even a mutual fund, you are protected by the SEC, which holds a government mandate to standardize reporting and to punish those companies that seek to bypass the rules. Real estate investment, alas, is not as highly regulated, and sophisticated investors have to do a considerable amount of research on their own if they want to reap the rewards of investing in real estate in a promising, but not necessarily local, market. Real estate transactions are always “buyers beware”.

In the highly regulated marketable securities market, information regarding a potential investment is public and easily accessible, and the price of a stock at any given moment is the same for all interested purchasers. In real estate the price is subjective. Two identical properties may sell at very different prices, based on a variety of factors including seller motivation, buyer interest level, maintenance level, and current tenants.

Real estate agents, mortgage brokers, and local newspapers and websites are important resources for the potential investor looking into “remote” real estate, but it is important to understand both their strengths and their weaknesses. Real estate agents know what is for sale, can offer value comparisons, and can help you with the inspections, negotiations and legal requirements of a property purchase. Mortgage brokers can advise on the types of loans available and which ones you qualify for. Print and e-publications can give you a general impression of the market, although it takes some careful reading between the lines over an extended period of time to see the true macro-economic picture.

However, none of these resources have the mandate and training to evaluate your net worth, financial goals, risk tolerance, and cash flow to recommend the optimum investment and loan package. None of them will spare you from the cost of frequent visits to oversee your property once you have purchased it. And none of them will monitor your investment and the markets and advise you when to make adjustments to your position.

Below is an outline of the four key steps of effective performance-based real estate investment that explains both the investment process and the value of having a trusted advisor in your court: **financial goal planning, property acquisition, oversight and analysis, and strategic asset re-balancing.**

### **Goal Planning**

A cardinal rule of performance-based real estate investment is: Never make an investment without first understanding your financial profile and setting realistic investment goals. The basic questions to consider before any real estate is purchased are: (1) what type of returns should you anticipate over what period of time and (2) how are you going to collect and monitor the information that will support and validate your expectations over the life of the investment? Real estate investment requires the same careful evaluation as a marketable securities program laid out by a financial planner.

An easy mistake for real estate investors is to make an emotional decision to buy a property that is in a “nice” neighbourhood, is painted the “right” color, or that seems ideal after a day or two house shopping in a new city or neighbourhood. In the more structured world of stock purchasing, few serious investors choose a company because they like the color of the logo or think the president is a nice guy.

Financial planners and investment advisors ask a lot of questions about you and your financial situation so that they can recommend investments that best fit your profile. Your real estate investment advisor will do the same thing. During the goal planning process he or she will help you assess your overall investment goal, including the time you have in which to build wealth and the risk levels you are willing to tolerate to achieve your goal. Even if you currently own real estate, it might not be performing in an optimum manner to meet your financial objectives.

A real estate strategy is more challenging than a stock strategy because in addition to having assets available for the purchase of the property, you will need to evaluate your personal cash flow (i.e. net at the end of each month) since most properties will require some additional cash outlay from time to time. While any income property will provide a positive cash flow if the down payment is high enough, it is important to make sure that the investment is worth the return.

When planning a real estate investment strategy, it is important to match a potential property investment with your risk tolerance level. This could mean having more rental units to minimize the vacancy risk, determining the percent down and the loan instrument that will provide a comfortable level of cash flow, and other personalized factors. As with a stock portfolio, investors have different requirements in terms of dividend production, growth, and volatility, and your real estate investment advisor will have these variables in mind as you move into the next stage of the performance-based real estate investment program.

### **Property Acquisition**

A financial planner will recommend stock strategies based on goals and risk tolerance, and the same should happen with real estate. Because real estate growth parameters change from region to region, city to city, block to block, and time to time, it is important to have current, in-depth information about the area in which you might make a purchase. This requires knowledge not only of the macro market conditions in a city such as job growth, population growth and urban living conditions, but also the micro markets that vary from neighborhood to neighborhood.

Making an investment based on macro market information is similar to investing in, say, a high tech company because the high tech market is currently a high growth market sector. As many investors have discovered, you can't just pick any high tech stock and expect it to do well just because the high tech market continues to prosper. To successfully invest in real estate, you – or your real estate investment advisor – must identify and understand the variables that may affect your investment positively or adversely. Unlike researching stocks, obtaining information about real estate is challenging and time consuming.

A benefit of working with a real estate investment service is transaction volume. These services work in several carefully researched areas, and have relationships with real estate, mortgage and property management professionals that are based on volume. This leverage works in favor of clients who do not bring the same volume or consistent contact to the transaction.

Real estate investment advisors work with trusted real estate professionals on an organized basis to draw out and quantify economic information the agents and brokers have accumulated from years of market experience. The advisor researches properties that may meet your goals and narrows them down without your having to leave the comfort of your home. Investing in property becomes the same kind of disciplined investment as investing in stock, and investors may rarely even travel to view the properties they will purchase.

Once potential properties are identified, a real estate investment advisor initiates a due diligence cycle to ensure that you are paying a fair price. In addition to understanding the financial potential of the neighbourhood, it is also important to carefully evaluate the specific properties. In remote areas, it is hard for you as an individual investor to evaluate inspection resources – typically a real estate agent has a “favourite”, but what does that mean for you? A real estate investment advisor will work with companies he or she knows to get thorough pre-purchase property inspections. It doesn't benefit you to get a “good deal” if you discover an expensive flaw such as faulty electrical wiring, failing furnace, leaky roof, or unstable foundation after you have signed the closing documents.

As an individual investor, it is not always possible to have the clout to get a reputable property manager involved before you actually own the property, yet their professional opinion is invaluable. They can assess the condition of the property and the quality of the tenants that are currently in the units and provide a valuable data point when assessing the operational potential of the property for both the short and the long term.

Real estate investment advisors also help you to identify the best financial package to meet your goals. Mortgage brokers are trained to shop for the best loan package for which you qualify, but few have the training or time to work you on mapping out your risk tolerance and investment strategy. Without a thorough financial analysis based on goals and holding periods, it is difficult to determine the optimum down payment, and whether you will be best served by an ARM, a 15- or 30-year fixed loan, or some other program. Nor will you be able to calculate the relative benefits of paying points up front to achieve a lower long-term interest rate.

### **Property Oversight**

The real estate investment service business model adds a new level of service to real estate investment by continuing to oversee the property and market conditions throughout the life of an investment; much like a money manager manages an asset portfolio to maximize returns over time.

A real estate investment advisor continuously works with trusted real estate professionals to monitor the macro markets and micro markets in the areas in which their clients have investments – regularly re-evaluating short and long term performance. As with any investment advisor, the objective is to manage investments with the objective of achieving performance at or beyond the market growth rates.

Monthly cash flow is an important component of the overall performance of the investment. By working with trusted property managers, the real estate investment

advisor oversees the property to maximize monthly cash flow, monitor tenant behavior, adjust rents, minimize vacancies, and manage and schedule maintenance.

### **Investment Re-balancing**

Because any property investment is a component in an overall real estate plan, there will be a time when it makes sense, for example, to refinance a loan or draw cash out of an investment and expand the portfolio. A real estate investment advisor, who has stayed involved over the life of the investment, can offer options and ideas for re-balancing, saving the investor the time-consuming and ongoing analysis necessary to identify key times to make changes to expand or re-balance the portfolio.

### **Summary**

Real estate analysis is a complex task that requires input from a number of disciplines. Unfortunately, real estate investments are often made based on attractive price points with little evaluation of true potential. Low price and positive cash flow in an investment lower risk, but they don't necessarily ensure that the property is a good investment. If a property that provides positive cash flow of \$100 a month but has no appreciation over a 5-year period, the net result would be a positive \$6,000. However, with a \$200,000 down payment, this would represent a 3 percent total return on investment. A CD at a local bank that paid 4 percent per year would provide a rate of return close to an order of magnitude higher over the same period. In addition, any property ROI calculation needs to include the high transaction cost (typically up to 10 percent of the sales price) of selling the property.

Real estate investment advisors monitor general CAP rates in an area, interest rate fluctuation, gross rent multipliers, price per square foot, and other factors to guide an investor toward a solid investment, based on individual financial profiles and goals. In addition, they provide a valuable service by pre-screening the various providers and options involved in a real estate investment to offer their clients a well-thought-out proposal aimed at optimizing the investment.

A real estate financial services company works individually with clients throughout the entire holding period of their investment and is accountable for the performance of the asset. Having an experienced advisor in your court not only saves you time and money researching investments, but also provides an ongoing monitoring service that maximizes the overall return on investment. The real estate investment advisor plans an important role in performance-based real estate, helping to simplify the real estate investment process and making it easier for the individual investor to grow wealth from this exciting and highly leveraged market.