

# Investing in a Volatile Real Estate Market

By Brett Ellen, CFP®

From ongoing headlines on the subprime lending crisis to lingering For Sale signs on neighborhood lawns and favorite local restaurants closing their doors, signs of the down real estate market are all around us. In particular, the loss due to foreclosures is staggering. According to the [Center for Responsible Lending](#), 2.2 million families with a subprime loan issued from 1998 through 2006 have lost or will lose their home to foreclosure in the next few years. That amounts to a projected maximum equity loss of \$164 billion.

In a volatile market, successful investing in real estate requires more than adherence to the industry's mantra of "location, location, location." Today, protecting your current real estate investments and taking advantage of emerging opportunities requires careful attention, detailed research and a good dose of patience.

To keep your real estate holdings up in down market:

- **Stay informed.** You may stay on top of your local market, but it's also important to understand what's going on in Washington D.C. where lawmakers are working to stretch a safety net under the failing housing industry. In fact, on July 30, 2008, President Bush signed the Housing and Economic Recovery Act of 2008. For homeowners facing foreclosure, the program permits eligible borrowers who have defaulted on their existing mortgage to refinance into FHA-guaranteed loans. Importantly, the Act also establishes a new regulatory agency to oversee Fannie Mae, Freddie Mac, and the Federal Home Loan Banks; gives the Treasury Department the authority to extend credit to these government-sponsored enterprises; and modifies FHA loan limits. Additionally, the Act includes multiple provisions targeted to assist homeowners, including temporary refundable tax "credit" for first-time homebuyers, a temporary additional standard deduction of real estate taxes for non-itemizers and a new limitation on the home sale capital gain exclusion.
- **Focus on home sweet home.** Although it is not an asset you think about trading, your home could be your biggest investment and, as such, is worthy of attention. Surprisingly, however, many homeowners fail to conduct a simple annual home-owners insurance review. To ensure that your home is insured for at least 100% of its estimated replacement cost, ask yourself: Have I recently remodeled my home? Has the rate of inflation risen since my last appraisal?

Note that if you currently are planning major renovations, from a pure return on investment perspective, your timing may be a little off. According to the recent "Cost vs. Value" report from *Remodeling* magazine, this year homeowners won't recover as much of the costs for remodeling as renovators did in the past. For example, although in 2005 most projects returned at least 85 cents on the dollar, today less than a quarter of home renovation projects return the same amount. In particular, high-end renovations may be viewed as over-improvements that future buyers won't want to reimburse you for.

Although you may decide to table major renovations, routine maintenance from cleaning out the gutters and downspouts to keeping trees trimmed away from your home is essential to ensure your home holds its value.

- **Play by the new rules for buying or selling.** The bidding wars of recent years where homes sold for more than the asking price are history and in many markets house flipping has turned into house flopping. However, there are winners in this new environment. First-time homebuyers who have nothing to sell have plenty to gain as sellers stress over the glut of homes on the market. Although signing the purchase and sale agreement may leave you feeling flush at having cajoled a boatload of extras out of your builder or negotiated a steal of a price with a desperate seller, keep in mind that the home you purchase today may not increase in value and may even decrease in value in the years ahead. Accordingly, it's wise to take a conservative approach to financing. For example, this may not be the best time for an interest-only mortgage.

If you are selling your home, you will have to commit to working harder. Sure, the traditional sprucing up the yard with a few potted plants may indeed increase curb appeal, but that may not be enough of an investment to generate the level of interest you need to sell. In a slow market buyers are especially unforgiving and won't overlook peeling paint or leaky roofs, so make these major repairs before putting your home on the market.

On a smaller, but potentially more time consuming scale, de-clutter and de-personalize your home by removing items such as family pictures, books and magazines, and your infamous to-do list. Don't just stash these materials in closets as ample storage is an important selling point. You might also consider hiring one of a growing number of home stagers who will visit and re-arrange furniture and offer suggestions to maximize the appeal of your home. In fact, as staging has increased in popularity as the market has stumbled, your local library or bookstore undoubtedly have a number of staging books. You also might research the variety of services that help you decide which local broker is the best match for your property. Finally, you might follow the lead of homebuilders and consider throwing in extras, such as your appliances, or the third car you've had in the driveway since your son went to college, in order to make the sale.

- **Take advantage of the current 15% capital gains rate.** If you are thinking about selling your home and are concerned that it has lost some of its value, all may not be lost. If you have gains, for example, remember that they will be taxed at the current capital gains rate of 15%, a rate many believe is likely to increase in the future. Accordingly, it's worth calculating potential tax savings and measuring that against what you think you may lose in a sale price, especially if you qualify for maximum exclusion which can be up to \$250,000 of the gain or up to \$500,000 if you are married and file a joint return.
- **Scoop bargains with care.** Foreclosures abound, but keep in mind that many require major renovations. Without doing your homework, you could end up making some costly mistakes. Rather than chase subprime fallout, you might research local developers who might be feeling the market's pinch and would be tempted to dump new construction at a significant discount.

- **Consider becoming a landlord.** As you watch property values fall, you may be thinking about buying that second home and renting for the weeks your family isn't vacationing in it. Although you initially may prefer a small house, look for one with adequate land to accommodate future expansion. And while in vacation mode you may be thinking about proximity to recreational activities, a good school district is always a plus. Or maybe you have your eye on a two-family home in your area. In that case, you benefit from your knowledge of the local market and have the advantage of being close enough to keep an eye on your property and get to know your tenants.

Of course in a booming housing market if you set a rent that covers your mortgage, taxes and includes a profit, as your property appreciates over the course of the mortgage, you create a reliable, inflation-proof income stream. However, because values may not be on the rise anytime soon, today's successful landlords know that they need some financial reserves. That is, if you spend your entire cash surplus on the property itself, you'll have nothing to fund that unexpected \$10,000 roof repair.

Before you put on the landlord hat, you should also think carefully about your own skill set and the amount of time you can dedicate to managing your investments. What will you do if a tenant calls at 3 am in the middle of a snow storm to report the heat is not working?

- **Use the right REITs for the right reason.** Real Estate Investment Trusts (REITs) invest in commercial properties such as office buildings, shopping centers, apartment complexes and hotels and are bought and sold on the major exchanges just like stocks. Because REITs must pay out 90% of taxable profits in the form of [dividends](#) to avoid paying corporate income tax, they are an ideal choice for investors who want regular income. Additionally, REITs function as a portfolio diversifier as they tend to zig when equities zag. Those benefits aside, however, REITs' last seven years of market beating performance—before last year's plummet—has investors overly-focused on return.

While declining property values and credit woes sparked by the subprime crisis continue to keep potential REIT investors jittery, there are opportunities in the wreckage. For example, with home ownership rates dipping, apartment living could be on the rise, spelling opportunity for apartment REITs. However those REITs could also suffer in a prolonged recession with stalling job growth. Also worth exploring are privately traded REITs.

**Keep a long-term view.** Throughout our nation's history, investing in real estate has been one of the fastest ways to build wealth, but the sector always has pitfalls and risks. In particular, as the subprime lending mess complicates the market, beneficial real estate opportunities may be more difficult to identify. That makes it all the more important to do through research, understand the role you expect real estate holdings to play in your portfolio and, as real estate is cyclical, keep a long-term view

### **About Brett Ellen and American Financial Network**

Brett Ellen, founder and president of American Financial Network, is a financial planner and investment advisor representative with Securities America Advisors who specializes in wealth management and corporate benefit planning services. Additionally, Ellen established and is an active part of the Financial Solutions Alliance, a network of financial service providers from

across the country that work collaboratively to address the financial and business needs of their clients. Unprecedented in his ability to serve both individual investors and corporate planners, Ellen is recognized by Securities America as their top advisor.

As a California native, Ellen believes strongly in giving back to his community. He and his firm actively support a variety of non-profit organizations. In 2008, the Muscular Dystrophy Association awarded Ellen the prestigious Humanitarian of the Year Award for his philanthropic endeavors and dedication towards making a difference. In 2001 he and his wife, inspired by their children, formed their own non-profit. TKOHelpingHands.org (Turn Kindness On) promotes community involvement and social responsibilities in young children. For more information about Brett Ellen, visit [www.afn-net.com](http://www.afn-net.com).

Securities offered through Securities America, Inc. member FINRA/SIPC, Brett Ellen, Registered Representative. Advisory services offered through Securities America Advisors, inc., an SEC registered investment advisory firm. Brett Ellen, registered investment advisor representative. American Financial Network and Securities America are unaffiliated.