

Goal Setting for the Real Estate Investor by Clifford Hockley

As the residential real estate market slows down on a national basis, real estate investors are asking themselves, how will this affect me?

We know that there will be slippage as far as homeownership goes. Those people that are losing their homes will have to move somewhere. Most likely they will move home to Mom and Dad, or move into a rental house or apartment, while they fix their credit and recover from this devastating blow.

These homeowners will either be able to fix their credit, or will never be able to resolve their cash flow shortage problems and will need to file for bankruptcy. In the short run (next five years) many of these homebuyers will rent because their financial picture will not be good enough to buy another home.

Good News for Real Estate Investors

This is good news for real estate investors throughout the country, if you hold multifamily buildings or houses for rental purposes. New home real estate developers on the other hand will be hunkering down in most locations.

The marketplace will need time to adjust to changes in growth rate and population. One of the challenges in the marketplace is that many real estate investors were gambling and buying investments for a short term hold to flip. This created an artificial demand for housing and fueled a housing building boom especially with a focus on condominiums and homes.

What Does This Have to do With Goal Setting?

There are two levels of goal setting for the real estate investor (Micro and Macro).

1. At the Micro level the investor sets goals for each individual real estate investment regarding budgets and returns.

As an investor each property should have a set of goals that you are focusing on

- How long to hold (when to exit)
- Allot money to spend on improvements
- What kind of a loan am I going to take(terms, rate, etc)
- How much leverage I am comfortable with
- Capital improvements
- Do I have good onsite and offsite management in place
- Monthly financials and cash flow review of each asset

These goals then are reviewed in an annual planning session, with yourself or investment partners to make sure your investments are performing the way you want them to

2. At the Macro level you set goals for your whole real estate portfolio and what you want to achieve.

- How big of a portfolio do I want?
 - a. Calculate how much income you will need to have in place your retirement
- How am I going to get there?
- How long will it take to reach my goals?
- Do I have time to pay attention to my real estate holdings?
- What are my other options?

- How do I assemble the cash to achieve my goals?
 - a. Save money
 - b. Use money borrowed from family members
 - c. Use my self directed IRA?
 - d. Take out a second mortgage on my home

You also need to take into consideration tax planning, because Uncle Sam wants his share. Don't forget to consider the following taxes:

- Your standard federal, state and local income and sales taxes
- Short term capital gains
- Long term capital gains
- Depreciation recapture
- Alternative Minimum Tax

Risks

Clearly there are always risks in everything we do. The questions is can we insure ourselves for the downside. How do we recover? Are all of our eggs in one basket?

1. The Weather

- a. earthquakes
- b. tornados
- c. hurricanes
- d. floods
- e. forest fires

We can insure for many weather related risks, but you need to read your policies carefully and realize that insurance companies will not cover everything. Also, not all polices are the same. For example, compare the California Earthquake Authority's coverage to other general coverage from another organization regarding earthquakes. Their coverage is a bare bones coverage. All policies have deductibles do you have the cash to cover the deductibles.

2. The Economy and Lack of Tenants

What happens if you buy a multifamily property in a market like Houston, Texas or Oklahoma City, Oklahoma where there is limited land use planning and the cost of land and construction is inexpensive? In those markets apartment vacancies can run from 10 to 20% while in Portland Oregon the vacancy rate is running closer to 3%. Does your investment model tolerate such vacancy variations? Every market place is different, due to the local economy, land use and planning regulations. A real estate investor needs to watch closely to understand the market places they want to invest in.

3. Over-Leverage and Risk

Maybe you believe in 10% down and high monthly payments because you have a great income and can handle negative cash flow. What happens if you can no longer work, say your health fails, or you decided to retire earlier than you originally planned? Is there enough money available in cash flow or do you need to sell your investments to generate cash? Is the time right to sell or refinance your investments? Are the interest rates in a good place?

Summary

Clearly successful investing in real estate takes both short term and long range planning. If you buy real estate and then forget about it, depending on appreciation of the values to make up for any mistakes, I would encourage you to think otherwise.

Take the time to plan ahead and pay attention to your investments; it will pay off for you in the long run.

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