

Out of State Investing – Part II

by Tim Elliott

My last article discussed some reasons to consider investing in multi-family property in another state. The next question is where to invest. The answer for you depends on your objectives. Is your objective appreciation or cash flow or a little of both? Is your investment time frame near term or long term? Do you prefer a major metropolitan area or will you consider secondary or tertiary markets? Do you have friends or relatives in another state that you would like to visit or that may help you look after the property? Would you prefer to buy near a vacation spot? How far are you willing to go? These answers will help determine what market may be best for you.

Before we discuss any specific markets, here are a few things to consider:

1. Follow the People

In the next 20 years, 50 million people and trillions of dollars will head south. This prediction was made in American Demographics Magazine, Sept 2004. That means about 2.5 million people a year will move from northern states to southern states. Even if the actual number is only half of that estimate it still represents a huge population shift and is a trend you should keep in mind when selecting your investment. The 2006 Census data shows that from 2000 to 2006 all but 2 states (Louisiana and North Dakota) increased in population but southern states increased significantly more than northern states. From 2000 to 2006 the US population grew by 6.4% but states like Michigan, Indiana, New York and Ohio averaged only 1-2% gain. Nevada gained 25% and Arizona gained 20%. Other states near the top were Georgia, Florida, Texas and North Carolina. Interestingly, three western states made the top 10, Utah, Idaho and Colorado. The explanation is in the next paragraph. Keep in mind, when the population shifts, so does the money and power. Federal aid is sometimes allocated by population and so are Congressional seats. New York State lost two Congressional seats in 2000. Landlords in lower growth states may struggle with lower rents and higher vacancies.

2. Follow the Jobs

Of the top 50 major metropolitan areas for job growth in 2007, only one is in the northeast (Mercer County NJ). There are three in the Pacific Northwest (Bremerton, Olympia and Tacoma WA,) three in the mountain states (Ogden & Provo UT and Boise ID) and all the rest are in southern states (Moody's). Florida has 14 metros in the top 50, California has seven. Forbes just updated their list of Top 10 Cities for Jobs in October 2007 and none are in the north. The list in order is Salt Lake City, Raleigh, Phoenix, Jacksonville, Orlando, Tulsa, Austin, Albuquerque, Wichita, and Oklahoma City. Be advised though that some cities have moved up or down this list by 10 or 20 spots from year to year so these are general indicators not absolute decision criteria. Forbes also publishes lists of the most business friendly cities and states. The three western states mentioned above are all in the top ten. You can review the data on the Forbes website (www.forbes.com). These lists are helpful but they don't tell the whole story. Alabama is 35th on the list of business friendly states but they have attracted many businesses. Did you know that Honda, Hyundai, Toyota and Mercedes now have factories in Alabama?

3. It's Hard to Find Income in a Growth Market, and Vice Versa.

Property owners in growth markets usually know they are in a growth market and if they don't their broker will tell them. So capitalization rates (Net Operating Income / Purchase Price) are usually lower in these areas than in non-growth or moderate growth markets. It's like stocks and bonds. You buy stocks for growth and bonds for income. Likewise you buy property in growth markets for leveraged appreciation and you buy in low growth markets for income. Don't expect to find much cash flow in Southern California, Phoenix or Las Vegas.

4. There are Good Deals in Bad Markets and Bad Deals in Good Markets.

In other words, picking a city you like because of demographics trends or job growth is just the beginning of your qualification process. Even in a high growth area, like Raleigh NC or Austin TX, there are good and bad areas and there are sub-markets within those markets that will grow faster than others by attracting more residents and businesses. I own an apartment complex in Cedar Rapids, IA. I did not want to invest that far north and I was looking for a larger metropolitan area. But that property was near one of the largest employers, near a new mall with major retailers like Best Buy, near restaurants and hotels and a new Home Depot. Companies like Home Depot and Best Buy spend a lot of time and money researching where to open their next store and it's smart to piggyback on their marketing and demographic analysis. The bottom line is you can pick a few areas you like but the real decision will be based on a specific property in a specific sub-market. You really need to spend a day or two in your target cities and get to know the sub-markets and path of progress. If you will be in a tax exchange and you may not have time to wait for that perfect property in your ideal market so you better have a few others in mind.

Growth Markets

If your objective is leveraged growth it will be hard to find any market in the country that will perform better than California over the long term. In fact Los Angeles, Orange, Riverside, San Bernardino and San Diego Counties are expected to be among the best areas to invest for appreciation. However many investors are not expecting much appreciation in California over the next few years and they want to park some money elsewhere until Southern California starts to grow again. You already know the major growth markets because they are in the news every day. They include Phoenix, Tucson, Las Vegas, Salt Lake City, San Antonio, Austin, Raleigh, Washington DC, and many cities in Florida.

If you are looking for growth and are comfortable with smaller metropolitan areas you should consider secondary markets such as Boise ID, Fort Meyers FL, Fayetteville AR, Orem UT, Olympia WA or McAllen TX. What, you never heard of McAllen? McAllen is the fastest growing city in Texas and one of the fastest growing cities in the country. McAllen is on the Mexican border and has benefited greatly from NAFTA and the Maquiladora. Many American companies have built manufacturing plants on the Mexican side and management/distribution facilities in McAllen.

Income Markets

If you are investing for income you should look in cities with moderate but steady growth and that have been largely overlooked by most investors. Those cities tend to be pretty far from California because for many years Californians have been buying up large amounts of real estate to the east and north like Arizona, Nevada, Utah, Oregon, Washington, Colorado, New Mexico, etc. Most of the property in these states has already been "bid up" by California investors and will not provide much net income. Not as much of that California money has made it's way to the middle of the country and that is why I favor that area for income investments. But this is changing quickly. I have talked to several brokers in the Midwest recently that say half of their sales are to Californians and many buyers are from Florida or New York.

I prefer metropolitan areas with at least 100,000 people for two reasons. One is in case a major employer or industry has problems the economy should be diverse enough to be only mildly affected. The second reason is you want a large enough selection of property management companies so that if one does not work out you have several others from which to choose. In smaller metro areas it is best to look for employment base that is fairly stable including government, education and health-care sectors.

So where am I looking? I am looking far enough from California that property values have not been bid up too high, far enough south to benefit from the next great migration, and in states that seem to have a business friendly environment to attract jobs and people. Putting those together my target states are in the southern central part of the country: Tennessee, Missouri, Oklahoma, Mississippi, Alabama, Arkansas and parts of Texas.

There are many sources of information to research this further. Money Magazine compiles many lists like Best Places to Retire, etc (www.money.com). Forbes Magazine publishes many lists of cities in categories like best job growth, best for business, etc. Go to (www.forbes.com). Kiplingers also compiles similar lists (www.kiplingers.com). One site I like is Sperlings Best Places (www.bestplaces.com) which has statistics on many cities. Demographic information is available from the US Census (www.census.gov).

When you decide on a few target areas, get on the Internet and start reviewing the properties available. Start educating yourself about the properties and markets in other states so that you will recognize a good opportunity when it is presented. LoopNet (www.loopnet.com) and Property Line (www.propertyline.com) are national listing sites for apartments and all kinds of commercial property. Start getting familiar with prices, cap rates, vacancy rates, sub-markets and demographics in your chosen markets. Compare what you find to listings in California. Don't get too excited by the Pro-Forma returns estimated by the listing brokers. These tend to be very optimistic because the potential income is estimated too high and the expenses too low and sometimes entire expense categories are left off. You will need to get very familiar with reading annual operating statements.

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