

The “One Up” Rule for Real Estate Investments by Brendan O’Brien

In his classic book on stock market investing, One Up On Wall Street, legendary investor Peter Lynch showed a clear path for making money in the stock market. The way to find great stocks, Lynch said, was to focus on the fundamentals: to invest in great companies making great products.

There are fundamentals in real estate investing as well. The most basic is this: invest in properties where people want to live and work, in cities and areas where they want to live and work. And, in fact, this is an exact corollary of the Lynch method of stock market investing. (Think of areas, cities and properties as companies. What is the product they offer? A place to live or work? Is the place a desirable one? Then the property is worth owning.)

The “One Up” Rule

Invest in properties where people want to live and work, in cities and areas where they want to live and work. Doing so will put you one up on any real estate investor who doesn’t follow the “One Up” Rule. Other investors may do better than you on one particular deal, but they won’t beat you long-term.

It sounds so simple, doesn’t it? It really makes more sense than any of the other real estate theories you’ve heard. It makes so much sense that you’ve already thought of this for yourself – you didn’t need my help. Of course you’re not going to own bad properties, right? You’re not going to invest in miserable towns, are you? No way.

Since this is so obvious, there must be some reason why so many of us real estate investors aren’t doing it – why so many investors aren’t making any money in real estate. I think there are two reasons.

Reason One

Some investors are spending all their time looking for the perfect deal, or looking for one where the advantages don’t have anything to do with the fundamental “One Up” rule I mentioned above. They either never make a deal, or they make a deal that looks good for reasons that again, don’t have anything to do with the property’s desirability.

These investors may also get into trouble by following gurus whose business is selling books and courses. If my business was selling books, it would be in my interest to convince you that there was some magic formula to real estate, and that the only way you could find it was by – right! – buying my books. Of course I’d be wrong – there is no magic formula – but not everybody knows that.

Reason Two

Other investors have been told, again and again, that real estate is a guaranteed investment. There’s no way you can go wrong with real estate! They do the opposite of

the nervous, badly focused investors who never find the perfect deal. These folks think that every deal is perfect.

Think Long-Term

Now obviously there are complexities behind the “One Up” Rule. The biggest is that in almost all real estate investments, you need to be thinking long-term – even if you only plan to keep the property for one year or less. Why? Because as a short-term investor, you need a buyer and that buyer probably will be thinking long-term. If your buyer doesn’t plan to keep the property for many years, he will need a buyer – who will probably be thinking long-term.

Deals that look great on January 1st, 2008, may have looked terrible on January 1st, 2009. In the course of that year, everything can change about your property, except (probably) the cost of debt service. You could be in a great situation, in which your rents went up a lot, but your utilities, insurance, maintenance costs and taxes didn’t. That would mean that as long as you paid a reasonable price for your property, you’ll make a profit. (You could also be in a stable situation, which is fine – it just means you’ll have to wait a little longer to get paid. The money will come.) Or you could be in the opposite situation.

The Perfect Deal

Let’s suppose Perfect Deal X is right next to the railroad tracks, in a town with one large employer that is laying people off a couple miles from a beautiful new apartment complex that is renting for close to what you need to get for rents. I can almost guarantee that this deal will be much less perfect a year from now. People won’t want to live in your property or in your town – the only way you’ll be able to get them is by lowering rents. However, all of your other costs will go up. If you’re making a lot of money on January 1st, 2008, you’ll be making much less on January 1st, 2009. And again, I can almost guarantee that when you go to sell your property, it will sell for less than you paid for it.

This disaster scenario might not take place over one year, either. Most real estate investors believe that if they just wait long enough, they will eventually make money on every a terrible property. It’s probably true! However, it might take 75 years for that to happen. Even if it takes 25 years, you’ll probably have significant yearly cash losses that make that eventual payday seem much less sweet.

Now let’s consider another deal, this one in a thriving community, where jobs are being added. The property looks pretty good too. There’s only one potential problem; the price is quite high. It’s so high, in fact, that you’ll lose money for the first few years, but eventually you know rents will rise to the point where you’re doing fine. Right?

The danger here is that rents won’t rise nearly fast enough to get you into the black until five or 10 years down the line. In the meantime, a lot can change. You might need the money you sunk into the property for something else. That would make you a very motivated seller – and you’ll probably get beat. Again.

I'm making it seem like there aren't any good deals, but actually they're just hard – not impossible to find. And this brings us back to the stock market. If Peter Lynch's strategy isn't that hard, then how come most people aren't making millions in stocks? Peter was willing to put in the hard work to find the good deals, and he had the resources to weather some bad ones. You can do this too. Find properties that will give you a positive cash flow now, in communities where long term growth is likely, and you'll do fine.

A landlord himself, Brendan O'Brien is the creator of Property Master™ online property management software. Property Master™ software lets owners or managers manage their rental properties from any computer, anywhere, anytime, over the Internet. For more information, please visit their website www.pcpropertymaster.com.