

Where Are California Investors Putting Their Money? **by Michael Ragovin**

Many investors in the San Diego multi-family investment market are currently in what I call the sell-buy dilemma. People who have owned their property only two to three years have accumulated enormous amounts of equity and are realizing that this “dead equity” is not increasing their property value. Why? Because the increase in property value has nothing to do with the amount of equity. Property values increase when the proper market forces are in place and they have been in place in San Diego for a number of years. Great time to sell; not a great time to buy. If one sells in a seller’s market they will receive a great price. Now the seller becomes a buyer in a seller’s market. Not so great! If one does a 1031 exchange, the net result is a lateral move. If one decides to take the cash, a huge tax bill awaits.

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Most of us who have been around for a while are not willing to let our capital remain on “vacation” for very long. I believe my money should be working as hard as I do. The only way to achieve that is to use leverage. Unfortunately, in San Diego that is next to impossible. Banks have this strange requirement about cash flow called a debt service ratio. At the end of the day, the banks want to be as certain as they can be that the property will cash flow positively. In order to achieve that, San Diego investors are required to make down payments of 35%-50% most of the time. Now we are back to allowing our money to sleep on the beach.

Most people I encounter are moaning and groaning about how they are stuck with tons of equity and there is nothing they can do. There is most definitely a solution. As a matter of fact, for the past two to three years, millions and millions of dollars have been flowing out of southern California and into areas such as Arizona, Texas, Florida, etc. The savvy investor knows that it really makes little difference where their money is invested as long as they are realizing an acceptable return and the capital is relatively safe.

After being in the Phoenix multi-housing market for over two years and participating in approximately 50 transactions, I have come to know that market very well. Over the past two years I have seen incredible appreciation and more than acceptable cash flow. Appreciation has averaged twenty percent over the past two years and cash flow is in the seven to nine percent range. The good news is that on properties of five units or more the minimum down payment is twenty percent. This allows the investor to leverage their money, thus, eliminating “dead equity” as much as possible. If one combines the leverage along with the lower price per unit in Phoenix (\$50,000 versus \$150,000 per unit in San Diego) it becomes apparent why the value of one’s investment dollar becomes so much higher in Phoenix.

One client traded seven units plus \$100,000 for 97 units in Phoenix. His cash flow increased from \$2,000 per month to just over \$8,000 per month. Another client purchased a 14 unit building last January for \$580,000; I listed it two weeks ago for \$709,000 and we have already had a full price offer. Recently, we opened escrow on four four-plexes for \$224,000 each, which were purchased by the current owner for \$180,000 less than a year ago. Similar four-plexes have recently sold in the same area for \$238,000. Finally, another client opened escrow on a property that cost \$41,000 per unit. It is still in escrow and the value has increased to around \$50,000 per unit. The most frequently asked question is “How do I manage my property if it is in Phoenix and I am in San Diego?”

The key to success for an absentee owner is a reliable property manager. Most brokers in Phoenix can point you in the right direction. Investors look to local property managers, lenders, and contractors to develop long term relationships.

Investor interest in the out of state apartment market remains strong. With California CAP rates of 4% and down payments of 30-40% still earning negative cash flow, many investors are turning to other areas for better returns on their investments.

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