

## Is Your Equity Working For You?

by Ashley Ragovin

Any investor who currently owns multifamily property in California would likely consider himself a savvy one. While it is now evident that, ten years ago, you could have thrown a dart at a piece of California property and made a killing, that wasn't necessarily common knowledge then. Those of you who were astute enough to jump into the market during its rising moments should congratulate yourselves; what may have been a risk at the time has likely rewarded you handsomely. Even those who bought as recently as two to three years ago have probably amassed an enormous amount of equity. But has that equity made you rich? Have you actually been able to reap the benefits of this so-called fortune that you've made?

This is where many California investors get stuck. The theory goes: buy real estate at the right time, make money. Therein lays the confusion. Equity does not automatically generate a liquid fortune. We all know cash flow in California is about as prevalent as a rainy day in August. The key is to make your equity *work* for you. Any experienced investor is familiar with the concept: buy, hold, trade up. But we are also aware of the impossibility of this plan in California. If you do trade up, what are you going to buy at \$180,000 per unit? Even if you thought you could find a "deal" of this type, could you do it within the 45-day time constraint of the IRS 1031 Exchange rule? If not, would you be okay with paying capital gains tax on all that hard-earned equity? This leaves building owners feeling quite mired - sell a property and risk not finding a satisfactory up-leg replacement property, pay enormous taxes, or hold onto that equity and let it do nothing. There is a solution. There is a way to eliminate the 45-day exchange "gun" so to speak, so that you can sell your property, take as long as necessary to find a replacement property, and still take advantage of the 1031 tax deferral. And it gets even better than that. Imagine selling your property and earning 20% on your equity while looking for your replacement property in an undervalued, rising market.

While normally most building owners are fearful of even listing their property, now you can do so with a secure parking place for your money. Oil and gas royalties have been a recent investment trend. However, most opportunities of this category are high risk because they are founded in exploration. In other words, your investment dollars go towards drilling and exploring new wells; if a dry well is drilled, there is no return. The other common option is investing in a productive well, however there is still the likeliness of the well eventually being tapped out, impacting returns as well.

There is a method of investment that is perfectly geared to real estate investors doing an exchange. When your building sells, instead of worrying about identifying a replacement property within 45 days, your investment dollars can be placed in oil and gas royalty property that qualifies as a 1031 like-kind property. There are no expenses to purchase, such as closing costs or transactions fees. This will probably be one of the most hassle-free investments you will ever experience. You will get a deed with your name on it, and you are buying a share of approximately 70 already-producing wells. This means no exploration costs or high-risk. It is simply a way to earn double-digit returns while taking your time to look for a new multi-family property. As soon as you locate an investment, you can liquidate and exchange into the new purchase (the minimum holding period is around two weeks), all while still conforming to the IRS-1031 like-kind guidelines.

Which brings us to the next issue: finding that second property. The market in California presents a tough situation when you consider that you have to put more than 50% down just to stay out of the red. This clearly isn't the best way to leverage your money. A buyer in the multi-family market in California is banking strictly on appreciation, and accepts very little, if any, cash flow. Furthermore, while appreciation in California will always be a constant market element, it is a far cry from what we saw even three years ago.

Even if appreciation was at its highest, what about the cash flow? There is no question that both cash flow and appreciation go hand-in-hand when defining the ideal investment. The key to achieving both of these goals is to invest in a rising market, particularly in the C+ asset category, which has proven to be the most lucrative investment class. The key is getting in at the ground level, because C class properties are a finite market; you cannot build a C property, but you can add value to it and generate great cash flow and appreciation over a relatively short period of time so that you can then trade up. This is the ideal, rising market climate - not characteristic of California at all.

The solution is to buy in a rising market. Right now, Dallas / Fort Worth has been identified as a phenomenally primed market for multi-family investment. It is not enough to simply just decide to invest out-of-state. The essential determinants of success must be in place first: experienced property management, local lending, and knowledgeable brokers are all requisites of a remote investment's success.

You got into the California market at the best time possible. It is necessary to consider, though, when to get out. With no worries about not satisfying the 45-day exchange dilemma, and an entire infrastructure in place in arguably the best rising market in the country, it is possible to capitalize on the next hot market and buy in under market, just as you did in California.

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