Credit crisis, property value crash — what they teach us

By Paul Hanks

2009 is a difficult year for everyone, not just from the viewpoint of an investor. Whether you invested in the stock market or in real estate, everyone has been affected by the happenings on Wall Street, and we will all suffer for it. Just before Christmas, as if the collapse of some of the world’s relatively honest financial institutions had not already been unsettling enough, hedge fund boss Bernard Madoff was accused of swindling the world’s smartest investors out of a grand total of $50 billion.

How, it was asked, could the world’s smartest investors have fallen for this? The answer, surely, is that they were all like him. They thought they had found a way of making money out of nothing. Unfortunately for them, the inefiable Madoff appeared to have found a way of making money out of nothing. But most of them had got their money the same way — by persuading people to give them money from other people who were trying to make money out of nothing.

You cannot get something for nothing. Surprised?

Now, reality has returned. One hundred percent mortgages are gone; 20 percent down payment is the norm and a minimum requirement — as is the need to be able to financially afford to invest. Gone are the days, thankfully, when I would be contacted by a person who had $5,000 and wanted to build a real estate portfolio.

Realism

I remember graduating from dental school and preparing to embark on a career that would make me financially independent. Indeed, I knew I was in the big league when the next day a financial advisor took every one in my class out and “educated us” on investments.

“Dentists are some of the highest paid professionals. Invest and you will be able to retire in 10 years,” was the opening gambit. How many dentists feel they can retire now? Where are the financial advisors now?

Oh, I know. They will be knocking at my door soon, saying stocks are down, invest now and you can retire in 10 years!

“It is disappointing that, for so many of us having worked hard to prepare for our future, we see all our plans and gains reduced through no fault of our own.”

So wrote one client of mine. He had become an orthodontic specialist and spent years building up his practice. He had two practices and was preparing for a fruitful retirement — looking at his 401(k) and investments with pride.

Now, however, not only with the economy in recession and his retirement funds decimated, he also has seen the attendance at his office fall (as a result of the economy). Currently, he has to work on a daily rate for a corporate body just to keep afloat.

You will appreciate how his investments are looking. Understandably, he is bitter about having saved for so many years, invested financially to prepare for a comfortable retirement, only to find himself back on the treadmill. The disillusionment that you can work hard for so many years just to have it taken away is found not only in those who are near the end of their careers, but also from those recently qualified.

How many of you have bought your own office because it seemed the thing to do financially and it will be a profitable nest egg to sell later?

Why bother?

For the majority of us, investing is about establishing security for ourselves and our families when we no longer choose to work and actively bring in an income. What this year has showed is that this conservative philosophy was replaced by greed — get rich quick.

People were blinded by making obscene amounts of money. They lost sight of the objective, which was to become financially independent. How much money is too much? It’s too much when you’ve already got all you could possibly need, and there’s nothing to do with it any more except count it.

What investing is about

Investing now is about cash flow! Whatever medium you choose to invest in, you need to think about what annual return you are getting not the end profit with nothing until then. Would you work in a dental office every day if you did not expect any income until a point 10 years down the road?

Now is not about a return in five or 10 years; it is about immediate cash flow. Future profit is an additional bonus. Doing nothing and hoping that over the next few years you will recover lost ground is not beneficial.

Take static funds (any funds that are not generating a good return — this could be your 401(k), your home equity, your savings) and consider putting them to use. Of course, everything has to be part of an overall financial assessment, and you don’t want to over commit. But investments or 401(k)s that are losing money can be put to better use.

Now is the time to invest in quality, income-producing real estate where you can choose the prime locations and acquire buildings at beneficial prices. Commercial apartment buildings should give annual returns of around 7 percent. This annual return translates into a monthly or annual cash flow — something I think will benefit every doctor who has seen a decline in attendance at his office.

I do not just mean go out and buy real estate. It needs to be sourced, and the rubbish removed. There is a tremendous amount of poor quality real estate out there. Sellers or their agents may not always represent the building financially correctly. I recently spent six months assembling a portfolio of four buildings for a client after reviewing and analyzing more than 50 buildings.

In addition, pooling resources adds to your armamentarium. I am now working with groups of doctors who want to pool resources with colleagues they know and ones they do not know. The advantages are they have greater buying power, can spread their investment funds over several properties and, by working together, are not over-exposed to unforeseen expenses or problems.

Real estate market is not dead

You may have read many negative issues regarding mortgages and real estate lately. The real estate market is not dead. Yes, there has been a major correction to many of our nation’s markets, but that is just the way that cycles work. The question becomes: Do you want to take advantage of the buying opportunities or sit on the sideline and wait for prices to head back up?

Investors who have cash are making huge buys right now and picking up some great deals. They recognize good deals when they see them and aren’t being frightened by the media. You make money in real estate when you buy it right. Buy low and sell high, not the other way around.

Remember, there is money out there. Credit is still very much available, but lenders are just a lot pickier about who can get it. A good credit rating matters. To get an affordable loan, you will probably need a FICO credit-rating score of at least 700 — but most likely higher.

Lenders today want to see substantial down payments on big-ticket items such as cars and homes. The days when you could buy a house on a whim with “zero money down” and mediocre credit are over. Be prepared to put down 20 percent for mortgages. The poorer your credit rating, the larger the down payment you’ll need.

So rather than let your investments or funds languish with little gain for several years, now is a perfect opportunity to gain a better return.

About the author

Dr. Paul Hanks, president of Portfolio Development Services, began his professional career as an orthodontist. His knowledge and experience with real estate was utilized on an increasing scale by colleagues. He became a real estate professional and is a real estate broker in California and Washington, offering clinicians a trustworthy and safe way to invest in real estate.

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