

Investing strategies in a changing market

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These days, you don't even have to venture off the couch to be enticed into investing in real estate.

Whether it's a fabulous success story on TV's "Flip That House," blue-sky testimonials on some infomercial or your cousin phoning to brag about her latest score, someone always made a fortune without plunking down a red cent -- unless, of course, you count the cold cash paid to learn "the secret."

But "follow the herd" isn't necessarily the best move for a real estate investor, says **Elaine Worzala, professor of real estate at the University of San Diego's Burnham-Moores Center for Real Estate**. "Just because your cousin's [investing] in a particular area doesn't mean you need to." What about when it's not only your cousin but your cousin's cousin? At last count, The National Real Estate Investors Association, or REIA, had more than 37,000 members across the U.S., in at least 271 local associations and investment clubs. In the boom market of the past few years, the association experienced a huge jump in members, says Rebecca McClain, executive director of REIA.

REIA groups provide an overview of the business and give members a chance to learn from one another. "The education you get from the front of the room is important, but the education you get from the guy sitting next to you is more important -- because he will tell you his horror stories," McClain says.

As the market apparently does a flip, with higher interest rates, lower prices and longer stretches of time between "list" and "sell," a greater majority of those who have joined the real estate party line may well be in for a scare. "We happened to have a nice run over the last 10 years," Worzala says. "But properties go up and down -- it's a very cyclical industry."

Accordingly, real estate investment strategies are also bound to change.

Patience is a virtue

Patience in finding profit opportunities will become ever-crucial, experts say.

"The most important thing is to set a realistic goal of how you want to invest," says real estate broker Mark B. Weiss, author of five books, including "Real Estate Flipping: Grow Rich Buying and Selling Property."

Weiss compares the process of finding an investment property to a fisherman waiting for his catch. "Sometimes you put the hook in the water and that fish will bite immediately. Sometimes it takes two days," he says. "People who are impatient -- spending money on books, CDs and tapes and falling into the seduction that, 'It's so easy, everyone's doing it' -- are people who won't be successful for the most part."

Can novices make a worthwhile catch in any kind of market?

"Yes, if they know what they're doing," says Lisa Moren, author of "Real Estate Investing for the Utterly Confused," an update on a seminar course she has been teaching for years. "I believe in real estate. I've bought property when interest rates were in double digits, and I've bought when interest rates were at a 40-year low."

But novices should avoid a relatively sinking market, says Moren, also marketing director of Entrust Administration Inc., a provider of self-directed retirement plans for which plan members can invest in nontraditional assets like real estate.

"Wait until it totally tanks," she says.

Still, rising interest rates and falling prices mean an investor is more likely to find less-expensive properties, Weiss says, adding that following the fundamentals of real estate helps breed success.

The value line

Seeking value properties is one of those fundamentals. "If you're new to the market, you have to spend a little bit of time, three to six months and maybe a year, shopping for something that's of value," Weiss says. Not quite the hit-while-it's-hot mentality that many investors tend to have in a booming market.

After all, "buy and hold" might be the right idea at a time where the market appears to be cooling off.

"Real estate makes a great investment for the long term," Moren says, pointing out that many people will invest in this area as retirement income.

Although, with a typical real-estate cycle lasting five to seven years, Worzala says, planning to hold a property for two to five years will likely be long enough to make it into the next cycle. That is, of course, if you don't buy in at the start. McClain says "Timing the Real Estate Market" by Robert Campbell can help in reading market cycles.

Finding the right location is crucial to spotting a value, as well. While areas such as Las Vegas and Phoenix have been hot for a while and the market's entry point may be too high for the average individual, other areas of the country have experienced stable growth, McClain says. "I think you're going to see the slow and steady growth in the markets that have been pretty much unchanged, even with the so-called bubble."

Getting down to the micro level of location is important, too. For example, says Worzala, "it's not what's happening in San Diego as a county but what's happening in XYZ neighborhood." As a generally safe bet for novices, she suggests buying an investment property that comes with a captive audience, such as something near a university campus.

Sellers in the hurry

Often lurking near real estate values is a motivated seller -- someone who needs to dispose of property. Divorcing couples and estate heirs are examples.

Realtors can sometimes assist in the hunt for these sellers. Depending on what state laws allow, Multiple Listings Service records may, for instance, include phrases like "divorce direct sale" or "estate direct sale," says Weiss. A more-direct "motivated seller" note is another possibility.

With the U.S. divorce rate hovering near 50 percent, he says, "you've got a huge volume of people who need to sell to satisfy a divorce agreement." In fact, one of his clients is currently buying a home for two-thirds of its value because of a divorce.

"People get nutty during divorces. They're more interested in hurting each other -- cutting off their spouse to save their face." says John T. Reed, publisher of the newsletter "Real Estate Investor's Monthly" and the author of more than 20 real-estate investment books. Not selling the home for market price is one way of hurting the other party.

Estates, meanwhile, often sell at good value because heirs would rather have the money from a sale than a property to care for.

Struggling real estate investors present another opportunity in a market that's headed south. "I've sometimes made more money in a down market because that means people have to get out," says Weiss. With stock investments, one can simply hold in a down market. But properties are expensive. From needing a new boiler to sitting on vacant apartments with no rent coming in, "It's expensive to hold a piece of property if all the cards are not lined up right."

Sure about foreclosures

Sometimes there's no saving a falling house of cards. Worzala points out that many people who got themselves into risky mortgages, like ARMs and no-money-down deals, can no longer afford their property when interest rates rise. It doesn't take long for them to fall behind on payments and go into default.

"A lot of people are sitting on the sidelines right now, waiting for properties to come down to a reasonable level," she says.

McClain agrees. "Foreclosures are rising every day in some markets. We will hear a whole lot more about them, especially with the amount of people who came in with ARMs."

Investing in foreclosures takes a true understanding of the strategy and a stomach for risk, though.

"You can't get title insurance on them," says Reed, who calls those who push foreclosures in their real estate seminars "criminal con men." And, investors who attend foreclosure auctions must have the cash to complete the transaction in pocket.

Some experts suggest forgoing the auctions and waiting until the bank takes the property back, then making an offer directly to the bank.

Rules of real estate

Real estate investors -- especially novices during a time of market change -- should keep these five considerations in mind:

1. Make sure it's a match. "Most people coming into real estate have never really asked themselves if they're suited for real estate," says Reed. Being comfortable with risk is a strong indication you are, experts say. "The kitchen can get too hot," Worzala says.

2. Limit your focus. There are dozens of possible strategies, from focusing on foreclosures or motivated sellers to seeking properties in need of cosmetic renovation. Pick what's best for you and stick with it.

3. Prep goes a long way. Learn all you can about strategies of interest. "Find people who have done it," says McClain, and ask what has and hasn't worked for them. "Sometimes you can learn more from horror stories than success stories." You might even find an experienced business partner. Arrange for financing in advance by approaching banks with a business plan, Moren says. "Know where you're going to get that money when opportunity knocks," says Weiss. Contracting with a real estate firm can also help.

4. New developments add risk. "When people write about a bubble, it's about pre-sold, new construction town homes and homes," Weiss says. So don't be seduced by developers.

5. Skepticism helps. Real estate investing gurus can be seductive in presenting their strategies, as well. "If it sounds too good to be true, it probably is," says Weiss.