FIVE PITFALLS TO AVOID WHEN INVESTING IN REAL ESTATE

Here are five common pitfalls to avoid when investing in real estate:

1. House Price Risk (up or down): what if the house goes down in value? That's why it's important to evaluate mortgage, cash flow, and debt planning strategies that won't put you in a bind if house prices stagnate or go down a little bit. On the other hand, what if the house goes up in value and you haven't pulled the trigger yet? That's why it's important to get yourself a solid mortgage approval BEFORE you go house shopping, and be prepared to act quickly if you find what you're looking for.

2. Higher Than Expected Carrying Costs: if you're fixing and flipping, have you factored in the costs of carrying the mortgage, and paying the property taxes, utilities and other expenses on the home?

3. Higher Than Expected Costs of Sale (8% +): do you realize that you'd have to sell the house for at least 8% - 10% more than what you paid for it just to break even and cover the real estate commissions and transfer taxes? That's why it's important to make sure that buying this property is part of a longer-term investment strategy.

4. Vacancy Risk & Eviction Costs: what if the tenant defaults on the rent and you have to hire a lawyer or go through a costly eviction process? Or, what if you can't find a tenant? That's why it's important to consider risk reduction techniques like non-refundable deposits, sale/leasebacks and/or rent-to-own strategies.

5. Lack of Liquidity: what if you need access to your capital and you can't sell the house? That's why you should never be 100% invested in real estate. This means that if your budget for real estate investments is $200,000, you should keep part of that cash in the bank, sitting on the sidelines. This way you won't get into trouble if the property sits vacant for a few months. Also, a cash cushion allows you to quickly take advantage of other investment opportunities when they arise.

I can help you avoid some of these pitfalls, calculate your internal rate of return and compare your options. Contact me so we can get started!

Source: CMPS Institute

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THREE QUESTIONS TO ASK BEFORE INVESTING IN REAL ESTATE

1. How can I increase my rate of return? The cornerstone of any smart investment strategy is to calculate your rate of return. With real estate this is done by running the numbers using an internal rate of return (IRR) formula that takes into account:

- Present Value (PV) - what am I paying out of pocket to get into this investment?
- Term (N) - what's my timeline and how long am I going to hold this investment?
- Periodic Cash Flow (PMT) - what's my monthly cash flow?
- Future Value (FV) - what are my net proceeds (after expenses) when I sell the investment?

2. How does my rate of return with real estate compare with other investment opportunities? When calculating your rate of return, make sure to account for:

- Carrying costs (mortgage, taxes, insurance, maintenance, etc.)
- Your time spent managing the property
- Vacancy loss if you don't find a tenant

3. How can I reduce my risk? You may want to consider these strategies to reduce your investment risk:

- Increase your liability insurance in case something goes wrong
- Consider a rent-to-own strategy where you find a tenant before you find a property
- Consider mortgage strategies that result in more cash flow and/or better liquidity

Contact me so we can get started on helping you answer these questions!

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