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Wealth Matters

There's Value in Real Estate, if You Find Your Florida

By [PAUL SULLIVAN](#)

THE last thing most people are thinking of investing in right now is real estate. The collapse of residential values stung almost all homeowners. And the commercial market, from offices to shopping malls, is full of uncertainty as unemployment rises and consumer spending continues to be weak.

Yet there are those who argue that this is a once-in-a-generation opportunity to buy property. Greg Rand, managing partner at Better Homes and Gardens Rand Realty, a brokerage in the suburbs north of New York, even has a theory to guide investors. He calls it "house rich."

Simply put, the days of buying almost anything and watching it appreciate are over. Those who want to make money in real estate now will have to do extensive research and expect to hold the property for at least a decade.

The crux of the idea is not buying a distressed property but "finding your [Florida](#)." By that he means investing in a piece of real estate, be it residential or commercial, in a hard-hit place that has to rebound.

"Florida is in a storm right now," Mr. Rand said. "It's overdeveloped, overspeculated and overleveraged."

Yet, with 78 million baby boomers expected to retire in the next two decades, the state's long-term prospects are solid: a good proportion of them will want to be someplace warm and sunny when they stop working.

Mr. Rand is not alone in this. Some of the biggest players in real estate see opportunity around the country.

"We are now looking at one of those rare opportunities to invest in commercial real estate," said Hessam Nadji, managing director at Marcus & Millichap, a commercial real estate [investment adviser](#) based in Encino, Calif. "There are plenty of properties in the \$5 million to \$20 million range, whether they're apartments or shopping centers, that are located in places where supply is constrained."

He added that these otherwise solid properties were for sale now because losses elsewhere were forcing their owners to raise money.

While many investors may not believe that real estate is returning as a steady, performing asset, the following criteria can guide those ready to re-enter the market.

DUE DILIGENCE Investing in real estate has always carried risk. But where many people went wrong was in taking a house vanity approach — they bought their dream home without knowing how its price compared to either historical levels or the prices in nearby neighborhoods.

Mr. Rand tells the story of the Trump Tower, in White Plains, which he represents. When the sales office opened during construction, buyers focused on the penthouse condominiums with views of Long Island and New York City. At that time in 2004, the going price for 2,200 square feet on a high floor was around \$1.8 million, he said. That would seem to be a deal for a buyer in Manhattan, 30 miles south, but in White Plains, few single-family homes had ever sold for that much.

He said investors who bought units on lower floors — priced closer to \$700,000 — did much better. The reason was that their fixed costs — [mortgage](#), fees and taxes — were lower, which meant they could attract a larger pool of renters to cover their [investment](#).

The lesson here was that anyone who really knew the White Plains market would have been more hesitant in buying a \$2 million apartment as an investment. “The key is due diligence over sex appeal,” he said.

THE COSTS What makes or breaks any real estate investment is fixed costs. Investors need to know how they are going to cover the amount they have to pay, whether the property is rented or not.

In Trump Tower, the monthly fixed costs for the penthouse apartment were \$11,100 with an expected rent in 2005 of \$8,000, Mr. Rand said. On the lower floors, the costs and expected rent were the same, both about \$5,000.

Any experienced real estate investor will tell you there are times when even the best properties, whether apartments or shopping centers, have vacancies and that means some of those costs fall on the investor.

This sounds obvious, but from 2005 until early last year, there were plenty of amateur investors who only realized this after their tenants left.

What signals a return to understanding that basic principle is a return of savvy investors.

“A lot of people who are coming back into the market that I’ve known for decades are saying the market is normalizing again,” said Harvey E. Green, president and chief executive at the commercial real estate brokerage Marcus & Millichap, and a 40-year veteran of the real estate market. The years “2005, 2006, and 2007 were the frothiest part of the marketplace, and these people stepped out on the sidelines.”

In other words, the smart money is back after years of watching.

YOUR GOALS Consider the [South Florida](#) market again. Many people who got caught had visions of renters covering all the costs on properties they bought. When renters became scarce and values plummeted, these investors did not have a backup plan. A better way is to set a goal for the

investment. Do you want to add to your cash flow immediately or can you afford to take a longer view of 10 to 15 years?

If your goal is to make money now, you will probably have to buy an older property and fix it up. This requires a more active role, and still, the return will not be what it was at the peak.

Mr. Nadji said investors in Class B commercial real estate — solid but not marquee properties — can expect returns in the high single digits. But most of those properties are not likely to appreciate in value for two or three years.

With a longer view, the options change. Ruth Trettis, a broker at Premier Properties in Naples, Fla., said one investor bought nine homes, worth more than \$32 million, in the last year in Port Royal, the town's most affluent neighborhood. Another investor bought three homes in Port Royal worth \$14 million over a single weekend in May and a fourth one last month for \$13.5 million (it was listed at \$19.9 million).

So far, she said, neither buyer has done anything with the properties. Even though both bought these houses at steep discounts, the costs of just holding them are immense. But they clearly have a long-term goal and a belief in the area.

THE RISKS Real estate is like every investment today. Experts and amateurs alike have strong opinions on what will work and what won't.

The message within the real estate market itself is mixed. Last week's report on flat home sales from April to May seemed to be heartening, but it was misleading. Homes sell better as the weather warms up. The better indicator of a bottom will come when year-on-year numbers are flat, and those have yet to appear.

The one upside is inflation, or at least the fear of inflation. Hard assets like real estate historically do well when there is inflation.

What this means is the longer your time horizon for investing in property, the better your chance of achieving real returns.

"Real estate was never a short-term investment," Mr. Green said. "It was just in that frothy market."

In this sense, the one certainty is that the age of the flipper is behind us.