Navigating the "New" Real Estate Environment

As *A Tale of Two Cities* says, "It was the best of times, it was the worst of times…". Just like the novel, we are in a period of contradictory and competing opinions concerning the real estate market. What worked last year or even last month may not work now. The successful real estate investor must adapt in order to turn a profit in today's market.

Best of Times…Opportunities

Large Supply of Homes – According to RealtyTrac, foreclosures in the third quarter in 2007, increased 30 percent nationwide from the previous quarter. This is also an increase of nearly 100 percent from the third quarter of 2006. Investors have increased options and they should not be shy about making aggressive offers. Additionally, investors should be prepared to walk away from properties that do not meet their model for profitable projects.

Less Competition –During the "Real Estate" boom, many "newbies" entered the market looking for quick and easy riches in real estate. This resulted in prices for properties being driven upwards due to a large number of inexperienced investors. Now prices have lowered and savvy investors can take advantage.

Contractors – The slow down in the housing market, specifically new builds, has resulted in a large number of qualified trades people looking for work. This provides the rehab investor the ability to find good people at a reasonable price to complete the work.

Worst of Times… Challenges

Exit Strategy – This is the biggest challenge facing rehab investors, the culprit—the mortgage crisis. Many rehab investors have turned to a "lease option" or rental of completed projects. However, obtaining permanent financing can be a daunting task in this environment, especially for those with over 10 properties.

Declining Prices – Many of us have never experienced declining values in real estate. With many markets now in that period, the bottom line is that many of the "old" ratios, practices and models are now outdated. Greater research is required to make sure you will generate a profit.

Adaptation

What does all of this mean for the rehab investor? They must rethink their models and strategies to adapt to the new real estate realities. Several items to consider include, but are not limited to:

- Assume you will not be able to sell a property. Will you rent? Lease option? If you do end up selling, that will be a bonus.
- Have permanent financing sources lined up with the assumption that you will not be able to sell the property. Non-owner occupied financing solutions are more difficult to find in the environment.
- Do not list the property on the MLS prior to getting permanent financing in place. Listing the property for sale on the MLS may eliminate most, if not all, of your permanent financing sources.

- Get the permanent financing closed when the property is "appraisal" ready. This gives you the luxury of listing the property for a long period of time and/or using the rental or lease option strategy.
- Maintain your credit score. The ability to obtain any type of financing or credit is getting tougher. Old credit score guidelines are no longer being used. The requirements are getting higher. A program that previously required a 640 middle score will now require a 660 to 680.
- Be prepared for full documentation loans. There are very few non-owner occupied, stated programs available, even if they have stellar credit scores.
- Increase your liquidity. Lenders are now incorporating higher requirements for cash and marketable securities as part of the underwriting criteria.
- Think lower Loan-to-values, (LTVs). Lenders are looking for lower LTVs for financing programs due to the volatility of the real estate market. Conversely, investors should adjust their models to build in a higher profit margin to compensate for the volatility and the probability of a longer holding period.
- Sales Comparables: Closer proximity (at maximum one-half of one mile) to the subject property and more recent (less than 6 months) is a must in this environment. If necessary, have an appraisal completed prior to purchasing the property. You must be comfortable that the property will appraise for a purchaser or for you if a refinance is pursued.

In this new environment, we need to adapt in order to survive the changes.

Darwin said it best with this quote, "It is not the strongest of the species that survive, nor the most intelligent, but the one most adaptable to change".

Be a survivor by adapting your business practices and you will be a profitable real estate investor in the new real estate world!