Berkeley Investment Advisors

Real Estate Brokerage/Retirement Planning

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Investing in Single Family Homes

Current market conditions in several fast growing states are very favorable for investing in single family homes. Investors can jump into the market with relatively little capital, and, with the right investing strategy and risk management, earn very good returns for the level of risk taken on. As with any real estate investment you must do your homework on the markets and pay attention to details in your due diligence to maximize returns and minimize risks. Rick Rife has joined Berkeley Investment Advisors to provide his expertise to investors looking to take advantage of the opportunities in this market.

Why Invest in Single Family Homes

Perhaps the most compelling reason to invest in single family homes is the extremely favorable financing terms currently available. For example, it's possible to fix your interest rate for 5 years at less than 5% and pay interest only. This has two effects: it keeps your costs of holding the investment low – thus allowing the rent to cover the expenses of holding the property, and it makes houses more affordable which drives demand for your house when it comes time to sell. The leverage available is much higher than with apartment buildings. Thus the capital requirements are very low which makes it a good real estate investment for those who don't have the capital to buy multi-unit properties. The icing on the cake is tax benefits. A house leveraged with 90% financing will generate tax losses. If you participate in the management of the property (which you should), you can use these losses to shelter other income – saving you money at tax time.

Where to Invest

The single most important factor for investing in a single family home (SFH), as with all real estate, is choosing the right market to invest in. A promising economic outlook is vital. Look for a metropolitan area with good job and population growth such as Phoenix and Las Vegas. You want a real estate market where there is growing demand from users: people who are buying to live in the houses. Beware of markets driven more by investor demand than users: this can lead to a sharp downturn if they dump holdings and there are no "end users" ready to buy. The other half of choosing the right real estate market is valuation. It doesn't matter how great demand is relative to supply; if property values have run too far ahead of users' incomes, local real estate will not have the same appreciation potential as a more reasonably priced market.

New Construction is Best

Once you've picked the right real estate market, look for opportunities to buy houses not yet built in new developments. This allows you to control a house with a very small (non-refundable) deposit – sometimes it can be less than 1% of the purchase price. This lets you leverage your capital even more than normal for a SFH. Yet it lets you own the house for a 5 to 6 month period and you will reap the benefits of real estate appreciation over that period.

New construction means minimal maintenance costs in the first 5 years as well as extended warranties on the house and all appliances. New construction will also command top rental income.

Finally, with new construction you can benefit from the normal price increases that developers build into their project plans. They tend to price the early homes lower to ensure low risk cash flow for building later homes and to create buzz and excitement among buyers.

Maximize Appreciation Potential

The key to maximizing your potential returns is to find an excellent subdivision in the heart of growth. The subdivision needs to be close to shopping, schools, highways, and have above average amenities. In the case of common amenities, make sure that the homeowners' association is well managed, and that dues are reasonable - but not so low that the association can't pay its bills. As mentioned above, buying into a subdivision early in its growth cycle is generally preferable because of the expectation of price increases for later phases.

Property features also affect appreciation potential. The floor plan is the heart of the product. It must provide enough total space and the configuration must allow a family to operate efficiently in the house. You must evaluate the number and placement of bedrooms and bathrooms as well as the impact of a two story design versus a single level. Desirableness of lot orientation with respect to the sun and geographic features should be evaluated as should the rental and resale value of interior finishes.

Financing

If your stated intention is to occupy the property as a second home you will be eligible for the most favorable financing (i.e. higher leverage, lower rates). If you later decide to rent the property instead, it generally will not affect the financing already in place. If you already own a second home you will not be able to receive the most favorable financing. Still, with a little homework even investment properties can be financed on very good terms.

Selling at Delivery

Buyers of new construction can also flip the investment after final completion. If price momentum is strong enough this strategy can yield big returns because you may be able to avoid putting up more than the initial deposit. Hence you would buy and flip several properties at a time even though you may not want to fully commit enough capital to close on all properties under contract. Note that this is a risky strategy and should not be attempted without very thorough analysis of the economics of the subdivision. Generally we recommend holding the property (at least) until the builder completes the subdivision, and sells the models. This is because the developer will usually push prices up throughout the life of the subdivision and will push the model home prices as high as they possibly can when they exit the project. When the models sell with their full menu of upgrades, they should provide very high comparable sales figures that can push up pricing for all subsequent re-sales. Therefore selling after the models are sold is likely to maximize appreciation. Which strategy maximizes return on equity will depend on the specifics of the situation. We analyze each situation and explain the risk versus return trade offs of the timing choices.

Managing the Risk

With regard to builders, there are two sources of risk: product quality and failure to deliver. A thorough investigation of the builder of your new home or existing home is a must: evaluate the builder's track record and financial condition.

All investments involve uncertainty and while we all expect price momentum to carry housing prices ever upward, there is always some risk that prices may pause or even decline in the face of rising interest rates or recession. Therefore the prudent investor should have the ability to hold the investment long enough to ride out any downturn. Do your homework to make sure that the property can support its leverage without requiring a subsidy from you to cover the mortgage. I.e. buy a house that will breakeven or, at worst, have minimal negative cash flow.

Poor management can turn even a good real estate investment into a bad one. If you intend to hold the property for rental, make sure you find an effective and cost efficient management company.

Legal risk also needs to be addressed by reviewing and understanding the following documents that govern the transaction:

- Purchase agreement
- Construction order
- Subdivision public report
- Recorded covenants, conditions, and restrictions (CC&R's)

Get Expert Help

Berkeley Investment Advisors starts by giving you the big picture on metropolitan area markets in fast growing states. We provide detailed analysis of the targeted market, including the dynamics of the job market and property valuations in the market. Our analysis also includes a look at infrastructure development and growth patterns.

Berkeley Investment Advisors does the due diligence on the builder, the subdivision, and the homeowners association. We review public subdivision reports, CC&Rs, purchase agreements, disclosures and construction orders. We help the buyer value the lot orientation, the elevation plan, and most importantly, the floor plan. We also advise on the value of interior and exterior upgrades.

When you work with us you get access to our expertise on all facets of real estate investing, including taxation and financing. If you plan to hold the real estate (rather than flipping at completion), we will provide projected cash flow analysis and recommend a good management company. Our evaluation of property management companies includes interviews and cost comparisons.

Conclusion

Current market conditions are ripe for investing in single family homes. Berkeley Investment Advisors can help you participate in the best housing markets from afar. We explain all facets of the single family home investment process and help in all aspects of the actual transaction, including taxation, management and financing. Let us provide the expertise to ensure you get the best deal possible.

Featured Investment Opportunity

The last phase of the Richmond American Homes subdivision in Goodyear Arizona is being absorbed rather quickly. This is an excellent subdivision with above average amenities; included are a baseball field and a todler park.

The Opal model is a very functional 4 bedroom 2 bath single family home with a base price of $151,990. We estimate this is 11 times annual potential rental income and thus allows breakeven or better cash flow with 90% leverage. Investors put down a $5,000 deposit and delivery is scheduled in 5-6 months. Interstate 10 is approximately 1.5 miles north of the property. Schools are less than a mile away, as is the new Safeway, scheduled for completion this summer. There is a great deal of growth planned for the area, including the Anaheim Angels' new $30 million Spring training facility, the largest mall in Arizona (3 miles away) and the city center development with a mixture of government and commercial uses.

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