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Four Key Risks Of Domestic Real Estate Investing

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While investing in domestic real estate is simple in theory, it is rarely easy in its execution. There is much involved—from banks' stringent requirements and the glut of paperwork to overriding labor, market, and macroeconomic conditions. Even beyond the predictable hardships associated with due process and protocols of purchasing domestic real estate, there are a myriad of "controllable risks" that, if ignored, can threaten, undermine, and even devastate an investment at large.

Here are four key risks every domestic real estate investor must know if they want to overcome the litany of hardships associated with today's real estate investment landscape:

Price Perception

Simply put: do not assume that a low price is a good deal. Beyond price, investors should focus on other key facets that determine property value—namely location. When vetting a residential real estate purchase, focus on where it is located, including what subdivision and school district it is in as well as research the overall demographics of those that live there. Find out if the residence is in a rental or multi-owner neighborhood, which is a good indicator of how neighbors will treat your property and theirs relative to curb appeal and otherwise... all, of course, factors that affect the value.

Another component is what the residence in question would rent for should you need to go that route as recourse or intention. With some time and effort applied to some simple research for information that is readily available, your price perception may be readjusted to understand whether that low price is actually the good deal that it appeared.

Contracts and Paperwork

It is imperative for you or a legal representative to actually read all of the language in any contract or piece of paper you sign, however copious that it may be. There can be terms that are not conducive to property investing, such as "deed restrictions," which actually limit the allowable percentage markup on resale. In fact, some stipulate that you cannot sell a house for 120% above what you bought it for during the time period. Rules such as these can be too restrictive for professional home "flippers."

Deed restrictions ride with the property, so even if the ownership name changes, you can not get around it. Deed restrictions are also problematic due to a three-month waiting period to sell, which makes valuation difficult and creates a painful delay when faced with a rapidly declining market.

Deal Structure

How a deal is structured directly impacts the required cash flow. Many make the mistake of calculating equity and translating that into a monthly cash flow, which can make the deal seem better than what reality delivers. Deal structure decisions should also involve property estimating property taxes and related due dates.

In this case, your only source of information should be county-driven facts and figures. Whether taxes seem high, low, or in-line, call the county and check to make sure because your scenario may differ from the prior owner's situation. For example, if the property you are going to be buying is a foreclosure and the person living in it was a senior citizen they may have had a homestead exemption whereby the county allowed a tax reduction. However, as an investor, you are going to pay top-dollar for your property taxes.

Other key deal structure considerations are insurance rates, management fees, vacancy rates and repair costs, which all have their own set of intricacies that you must investigate when considering the deal structure of your potential real estate investment.

Exit Strategy

In the realm of real estate investing, not having a clearly defined, pre-planned exit strategy even before purchasing a property can be a financial death knell. Knowing you will ultimately re-sell a property at the onset requires that you consider—and actually vet—all viable options and channels suited for the property at hand.

While many investors choose to rehab and flip properties themselves, another highly profitable strategy to consider is simply wholesaling it to another investor on an "as is" basis. This can reduce your financial exposure and liquidity to facilitate future investments.

The bottom line? If you properly vet each and every domestic real estate investing opportunity that may seem like a "no brainer" at surface level, then you are more likely to increase the viability, profitability and sustainability of your domestic real estate investment portfolio. ■

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