Andrew 0:04

Hello, and welcome to the JGUA Financial Commentary Podcast. I'm your host Andrew Baron. And in this episode, I talk to Alex Ognenovski to discuss using real estate to diversify one's assets. We'll talk about a couple different approaches for exposure in the sector, and the advantages and consequences of each. But before we begin, a short disclaimer, the contents of this podcast are strictly for informational purposes only, and nothing said shall be taken as investment tax or legal advice. Any strategies discussed may not be suitable for the listener specifically, and JGUA encourages consulting with your individual advisor before implementing any strategies to ensure they meet your individual objectives. And with that out of the way, welcome to the podcast. Alex.

Alex 0:53

Thank you very much, Andrew, it's a pleasure to be here.

Andrew 0:56

And just for the audience. To clarify, we are discussing real estate as an investment and not your primary residence. To paraphrase George Carlin, your home is a place for your stuff. So why do people invest in real estate to begin with at all,

Alex 1:12

So real estate, Andrew is a, it's a different investment type than that of cash, stocks and bonds and will move differently. And as humans, there's something comforting about having an investment that is a physical property, it's tangible, you can go visit it. And broadly, the real estate market is also considered “safer,” in quotes than stocks, for example.

Andrew 1:35

There’s typically two way for investors to see return on their money, either through an income stream or appreciation in value, we'll see that in stocks as well, either through dividends or the stock price going up. But let's start with what people think about when they think about real estate investing, and becoming a landlord. So what's some of the appeal of rentals?

Alex 1:56

Let's begin by talking about three different types of rentals, you have the single family home, the multi unit apartment complex, and then royalties and rents from commercial operations. So with the first one, the single family home, very popular if you live in a college town, or another area with a lot of people that rent. A great example is Ithaca, New York, you have two colleges, one essentially on either side of the city, Ithaca College and Cornell huge rental opportunities there. There's other situations as well, maybe you already own a primary residence outright, and then you want to upgrade to another home. So you have your old house and your new house. And instead of selling the old house, you are now keeping that old house and you can use that as an income property, you know, the house well, you know, all of its kinks and quirks and things that may go awry with it, you're probably going to have a mortgage on the new home, renting can provide the cash flow to fund the new property, kind of a cool cash flow activity to have just because that's one less thing that's coming out of your paycheck. The single family home is more popular, if you're just looking for some rental income, and you're starting your real estate investment portfolio, that's how a lot of people get started. Unless you're pretty independently wealthy, you're probably not going out and looking for larger, sometimes zoned commercially, multi unit apartment building, the single family home is just less maintenance. In general, less work, utilities are a lot less complex as well, there's one electric box and things like that. And in the end, it's easier to sell. It's just because you can sell it as a rental, or you can sell it as a single family home.

The second type of property being the multi unit apartment complex, very popular because it has multiple tenants, and each of them provides rental income. The only thing with apartment complexes and multi unit apartment buildings is you need a lot of tenants to make it worth it, you have big parking lots, usually in apartments, and you have to maintain that parking lot. That's just one example of many, you have common areas that you have to maintain, you know, just certain codes. And then, you know, seasonally, you have to make sure that it's not slippery in the wintertime or when it rains or things like that. It's a lot more maintenance in general.

And with respect to the royalties and rental income from commercial operations, there's often a high initial payout, which is great. And then there's usually the reduced income comes after that over time. You still own the land, so you still have that, hopefully appreciating parcel of land as well that you can always sell. Examples of this are oil and gas companies, cell phone towers, it can be very lucrative, but it's also very situationally specific as well.

Andrew 4:31

If you did have an apartment complex, you also might have to act as a mediator between your tenants. If you have 15-20 units, if they have issues, you might have to actually become part of that.

Alex 4:42

That's right. There is some babysitting to that and you just took me back to my Resident Advisor days at the University of Buffalo. You know, there's a lot of babysitting, which you can also get with a single family home not to say that, you know, it's one or the other, but it's usually less so. People that rent a single family home, they're living there, that is their home. And they're usually treating it like their home, right? They'll do things that they probably wouldn't do if they lived in an apartment building, they'll shovel the driveway or they'll shovel the sidewalk and things like that. A lot of different considerations between the two. But that's a great point.

Andrew 5:17

Let's talk about the other side: purchasing for appreciation.

Alex 5:20

This is one of my favorite topics. This is what you see on television all the time, all these shows about flipping houses, it's all over HGTV, Bravo wherever you look. What this usually means when people say flipping houses, you're buying a property as inexpensively as you can, like buying a foreclosure or public auction, and then you renovate the property itself to bring up the value and make a profit on it.

Additionally, some people also purchase a second home, in a very hot market. Whether it's a lake house, or a vacation property or something like that, a condo in Florida, a ton of people I know up here, upstate New York have one of those, so they'll purchase it. And then after a couple of years after they've used and enjoyed it, not renting it out or anything like that, maybe not even making a lot of improvements to it. But just you know, over time, with the popularity of the area, they'll plan to sell it when the price starts to creep up like real estate market has here in upstate New York. It's very low inventory demand is very high, a lot of people have been selling their vacation properties, or their secondary homes for this very reason. Just because they know that they can get a lot more than what they paid for just to make a profit flipping houses doesn't necessarily mean you have to make a ton of improvements and pour blood, sweat, and tears and a ton of money into it and work it just essentially means that you're buying low selling high just like you do in the stock market, except this is with real property instead of an investment vehicle.

Andrew 6:52

You made these scenarios sound pretty good. What are some of the drawbacks or risks that our audience might not be thinking about, before they go off and quit their day jobs?

Alex 7:00

This is why we have disclaimers like the lovely one that you read earlier in the podcast. Real estate is often times a leveraged purchase, you usually have 20% down payment, and then you have an ongoing mortgage. Are you getting a good rate? How much can you put down? What's your payment going to be like? How much liquid cash do you have to spend towards the improvements that you're going to make?

You really have to have a plan, you really have to know exactly what you're going to do, how you're going to do it, how much it's going to cost you. And what timeframe are you working in as well. You'll see this on all of these shows. There's always a time constraint. And I remember I was watching one with my mother one time and she was like, “Why? Why do they have to do this in three weeks?” It's all about timing.

There's multiple reasons why somebody would have to do that in three weeks. You have to time the market correctly. There's way more sales, especially here in the northeast, in the spring, summer, and even in the fall, you typically want to get everything done for the springtime. In Florida, for example, you obviously are not going to put a house up for sale during hurricane season, because it's not going to be great. You want to put your home up for sale when people out of state are coming into the state. So you want to do it at peak tourist times and you want to be able to market it. Marketing is huge. Marketing is something that a lot of people don't think about when they first get into real estate investing. How are you going to make your property a) stand out? and b) in what mediums because there's so many nowadays, it's not just a newspaper ad, you know, there's but there's so many options out there. And not that that's a bad thing. But you have to know who is your target market? Are you going after young professionals? Are you going after college students? Are you going after single families? Are you going after people that are retired? Really knowing your target audience and where and how you're going to advertise?

Andrew 9:00

What about the importance of building relationships with contractors?

Alex 9:04

You really want good contractors really want dependable people to help you through this journey. And you have to take care of them as well. It's very mutual, they're happy with your work and you're happy with their work because you're going to need these people in your back pocket when something does go awry and things do go awry. Nothing ever goes to plan.

Andrew 9:24

We've all heard the phrase location, location, location, but dig in a little bit about why that's actually important.

Alex 9:30

It has to match the community that the property is in and this is why location is so important. If you're in a college town, you're probably going to get college students. You're probably not going to get elderly, retired people things like that. And it's more than just looking at comps. Any real estate agent can give you sheets and sheets and sheets of comps. What is this house go for? What is this house rent for? You're probably not going to go all out for a rental or even if you're flipping the home, you have to look at physically what is your competitive advantage? How is your home going to stand out versus the competition, and you have to capitalize on that when you're thinking about redoing a home. Whether you're flipping it, or whether you're flipping it on renting it, there's a lot of aspects to really look into before you list the home on the market for either being a rental or flipping it for sale.

Andrew 10:20

You're also really constrained by the neighborhood you choose to invest in, there's not unlimited upside. Typically, you can't just go to a really low cost part of town and build the most expensive house in the whole city, it's gonna be hard to actually get the return on your money for that. You were actually telling me a story about one of your clients who maybe spent a little too much on the property.

Alex 10:44

Sure, I had clients. And, you know, he lived in this home for probably about 20 years. And year after year, they would upgrade everything, essentially. So they completely gutted the home, him and his wife, and they have great tastes. So of course, everything was very high end, and everything was luxury and opulence. But the houses around them were not nearly as large. They were not nearly as valued in terms of the money that they had put into this home. They had a second house, it was a vacation home, that they wound up moving to. And they were thinking going to be very tough to sell, just because they knew that they wouldn't be able to get anything near what they have put into it—in terms of a sale price—in that neighborhood.

We were thinking of options, and I threw it out there. And I said, “Well, what about renting it? It's very family oriented community. This is a single family home, decently sized. And it's in a great school district area.” We talked about it and he said, “You know what, that's a really good point!” Five or six spreadsheets later, we wound up going through and finding the sweet spot where he would charge X amount of rent per month versus all the projects he's done to the home plus what he would be able to sell it for. So he essentially rented it for about three and a half years and made all of that rental income. And it was on the higher end side in terms of rental, just a normal rental. But rightfully so it was in that category, right? It was definitely a higher end rental. After that they wound up selling it and they wound up getting way more for it because the market is super hot right now. They wound up making a profit with all things considered. You know, even with all the work that they put into it with a rental income and what they're selling it for wind up being a great deal. But they had a lot of patience and they were never landlords previously, they had a lot of learning get into it. And that's a learning curve. And it never ends. It was kind of the perfect storm. Does that always happen? Absolutely not.

We've all seen the movie, *The Money Pit,* great film starring Tom Hanks. You know, from the 80s, they get into this huge older home, try to redo it. They're just throwing all kinds of money into this home that they never know that they can recoup, ever. Moral of that story there is, know your limits on making such updates, and these construction projects. It's not just financially. It's time. It's effort. If you're swamped with everyday life, and you have children at home, and you have a very time consuming career. These house flippers usually are either real estate agents or brokers. Or they do this for a living just because it's so time consuming. So that's definitely something to keep in mind with the time aspect.

Monetarily speaking, you will probably end up over budget. Like you see in all these shows. Everybody's like. “Oh my gosh! This is my budget. I'm way over budget!” Of course, things change. But definitely try and set your budget lower to begin with. And then if you have to add on to it a little by little within reason, you know, keep it as tightly wound as possible. So you just have to be as frugal and as smart about it as possible. But know that you have options with real estate that you don't necessarily have with that have stocks and bonds and such.

Andrew 13:57

You'll hear a lot about diversifying when it comes to your stock portfolios. But can you talk about why it's equally important to diversify in real estate?

Alex 14:07

You know, we really liken that to investing in multiple stocks in the same sector. So if you're investing in a ton of tech companies, and you only have all of your eggs in that basket. And a correction happens of some kind and everything gets devalued, you're really going to strike out. It's not going to do you any favors. You're going to do multiple homes and you have multiple homes, make sure that you geographically diversify these homes. If the market changes—which fluctuates all the time, and all of your properties are in the same location. You know, you don't want all of your eggs in that one neighborhood. If something unfortunate happens to that neighborhood, you know, they put a highway through it or something like that.

Things go from residential to commercial which can be good sometimes—sometimes it's not so good. Things like that. Definitely know your neighborhood. Know your geography. Know your target market. Have a plan, but make it fluid, keep it elastic, and make sure that you can absolutely shift gears if need to, and be as involved as possible. You have to be ready for some sort of mini disaster.

Andrew 15:16

We should probably take a moment to at least mention the risks involved in real estate investing. Besides protecting against physical catastrophes, what risks are investors facing and how can they protect themselves?

Alex 15:30

It opens you up to liability, like any investment vehicle really does. It's a big liability. You know, I don't care if you're just flipping a house, or flipping it and renting it or just renting it and you're not doing anything to it. It opens you up to even more liability, though, because this is a physical, tangible, real property. So you're having people on the property. Whether it's workers doing construction projects, whether it's actual tenants, whether it's the tenants’ guests, you know, if you're not living there, you really don't know who's there. And even if you are living there, say you live in, you know, half of a duplex and rent the other side, you can still be sued, it's happening on your property.

I urge anybody that has rental properties to take a look at is the umbrella policy. Generally, it's pretty inexpensive coverage for what you're getting. And that will all depend on how much you should get depends on your overall insurance portfolio. How many other homes? Do you have? Even things like what's your income, because heaven forbid, you get into an accident, you live in a million dollar house, you know, they're going to see dollar signs and cha-ching. I mean, it's true! You can literally find any information on the internet about anybody. You're already exposed in that sense as it is. So with that in mind, you have to make sure you're cushioning that blow even more, which is super important. And I don't think that a lot of people really take that into consideration at the outset. Unfortunately, until something happens, or it's too late.

Andrew 16:57

One last risk I was thinking about is in the current low interest rate environment we have if you are kind of banking on your tenants paying $2,500- $3,000 a month, they actually might look and say instead of taking this money in rents, why would I just buy something? So I think that there's also the headwind of actually being able to fill your units, not just being able to cash flow it on an Excel sheet. Did you have any closing thoughts, Alex?

Alex 17:26

Absolutely. Like I said before, definitely do your research before jumping into anything. And lastly, definitely explore real estate investing with your head and not your heart. Take emotion out of the equation. And you can keep your heart where it belongs at your home, the place that you live—your primary residence. With real estate investing, you have to think of it with the bottom line always in mind, what is this going to cost me? What am I going to get out of it? And what kind of parameters am I looking at with any situation?

Andrew 17:59

Really great points. Alex, thank you so much for being part of the podcast.

Alex 18:03

Absolutely anytime. Thank you for having me, Andrew.

Andrew 18:06

And thank you to all of our listeners went through quite a bit of information on this. So for our audience if they do have any questions, please send an email to info@jgua.com and visit our website for additional content. Stay smart, everyone