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## New rules of the real estate game

Real estate used to be one of the engines that drove the economy; now it's looking to the economy for a jump-start

**By Jeff Benjamin**

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With the U.S real estate market still struggling to get back on its feet, financial advisers continue to find themselves facing a barrage of questions from anxious clients about everything from depressed home values to whether now is the time to buy or sell property.

The answers to those questions, of course, depend on the state of the local real estate market and on the client's particular financial circumstances. But out of the downturn have emerged some new realities — or the re-emergence of old ones — that should at least be considered when advising clients on real estate matters.

First, the single biggest issue affecting the real estate market today is unemployment. With the jobless rate hovering around 10% and forecasted to stay above historic levels for several years, the housing sector's recovery could still be years away, experts said.

The jobless rate is critical because the initial stages of the recovery will be closely tied to the state of local economies, according to Gibran Nicholas, chairman of the CMPS Institute, which awards the certified mortgage planning specialist mark.


“Housing prices depend on the local markets, and right now, employment is the biggest driver of housing values,” he said.

Using that as a gauge, Mr. Nicholas cited Nevada's 14% unemployment rate and Michigan's 13.6% rate as reasons those states are home to some of the weakest housing markets in the country.

Conversely, Mr. Nicholas said, the housing market in New York, where unemployment stands at 8%, “has generally held up well.”

And then there is unusual North Dakota, where unemployment is at 3.6% and “housing

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values have not budged," Mr. Nicholas said. "It's like the whole country is in a recession except for North Dakota."

Another thing holding back a real estate recovery is a dearth of credit. Mortgage rates are at near-historic lows, but even straightforward strategies such as refinancing a residential loan for a better interest rate remain a major undertaking.

"Everybody is credit-challenged these days, because it's so hard to get financing even if you have good credit," said Lee Munson, chief investment officer at Portfolio LLC, an Albuquerque, N.M., firm with \$125 million under advisement.

Mr. Munson, who has leveraged his real estate expertise to help build his financial planning business, said the lack of available credit has made it more difficult to manage client portfolios.

"The lack of credit stops the flow of real estate investing, and that means we've had to adjust our planning process," he said. "Real estate, already an illiquid investment, has become even less liquid, and that's affecting the actual liquid part of the portfolios."

In Rapid City, S.D., veteran commercial-real-estate broker and financial adviser Richard Kahler has seen firsthand how the tight credit markets are muting any kind of real estate market activity.

Mr. Kahler, president of Kahler Financial Group, a firm which has \$120 million under advisement, spent five months working with a bank to refinance a loan in good standing on a fully occupied office building in which he has 50% equity.

"If a person has the cash, there are a lot of deals out there, but financing has dried up," he said.

Mr. Kahler said he advises clients to hold a 10% allocation in real estate and that about 25% of his clients own real estate directly in the form of office space, warehouses and rental properties.

In terms of re-balancing portfolios, he ignored the market bubble of the past few years as prices soared and then crashed.

"When you own real estate directly, you're not getting daily or even yearly valuations," he said. "That's one of the reasons I only recommend direct real estate ownership for those clients who have the tools and the understanding that it takes."

Extreme market bubbles notwithstanding, real estate historically has been considered a worthwhile long-term investment.

But even long-term investments need to be sold eventually, and that's where some advisers are facing challenges as they help clients adjust to recalibrated markets.

"The biggest thing is managing a client's expectations when it comes time to selling, especially if it's their primary residence," said Jorie Johnson, owner of Financial Futures LLC,

a Manasquan, N.J.-based firm that charges clients on a flat-fee or retainer fee basis.

“The problem is, people get an idea in their head of what the property was worth in 2007, and I have to explain to them that this is where the market is today,” Ms. Johnson said. “And usually they need to hear that from multiple sources.”

Selling after the bubble is the kind of pain Michigan-based adviser Bert Whitehead endured this year when he sold his home in tony Bloomfield Hills, which had been appraised for \$1.25 million in 2007, and got less than half that amount.

As president of Cambridge Connection Inc., Mr. Whitehead is among a rare class of advisers who calculate the primary residence into a client's overall financial plan.

When it came time to sell his house, Mr. Whitehead followed his own advice by starting with a low price of \$777,000 and then lowering it by 5% to 10% every six to eight weeks until the house sold.

Nine months later, he accepted his first — and only — offer for \$590,000. But even that price was trimmed when the appraised value of the house came in at \$540,000.

New rules since the housing market collapse have severed the cozy relationship between lenders and appraisers, so it has become more common for the appraisal price to come in below the agreed-upon sale price, according to Paul Walton, a mortgage broker with Cherry Creek Mortgage Co.

“There are two major flags that can stop somebody from buying a property these days,” Mr. Walton said. “Either a property won't appraise [for the agreed upon price], or somebody will come in with cash.”

Taking action, as Mr. Whitehead did, is one of only three options a real estate investor has, according to Mr. Munson.

“You can sit on it, be creative or take action,” he said.

In today's market, the first option is not really feasible, so Mr. Munson might advise a client to try to rent out a property with an option to buy, or just keep dropping the price.

“If you're in negative cash flow, you need to take action, because that's the No. 1 thing that can ruin you in real estate investing,” he said. “And even if you can only sell it for around what you paid for it, bye-bye.”

Even with the hard-luck stories and new challenges in the post--bubble real estate market, it is still difficult to dispute the unique opportunities of real estate investing, according to Sheryl Clark, the Tucson-based owner Sunrise Financial, an advisory firm that works with clients on a flat fee or retainer basis.

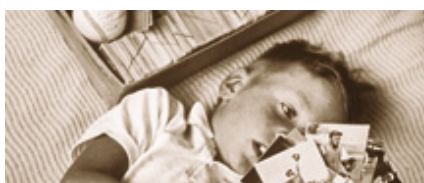
“It is easy to buy and hard to sell, but real estate is where you can get a lot of leverage, and that's the real power of real estate in this country,” she said. “A long-term fixed-rate mortgage is almost unheard of in the rest of the world.”

In terms of buying real estate at this point, Ms. Johnson said the combination of low interest rates and low housing values has her advising clients to “pull the trigger.”

“If you're buying and selling in the same market, price doesn't really matter,” said Ms. Johnson, who spent 10 years investing in real estate for institutional clients before transitioning into financial planning.

“And if you're going from one market to another, that can also work to your advantage,” she said. “I have clients that are two or three years from retirement who have already bought their Florida condo because the prices are so low.”

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