COVER STORY / DAVID WHARTON

BLAZING YOUR OWN INVESTMENT TRAIL

With interest rates on the rise, home price appreciation slowing, and the housing inventory crunch that defined many markets in 2018 beginning to ease, industry watchers anticipate a possible shift toward more of a buyer's market as we move through this year. But is there a possible market correction—or even a recession—on the horizon? While experts and thought leaders may differ on where the market is headed on the road to 2020, one thing is for sure: investors are paying close attention, and the landscape is filled with potential profit for those who know where to look and how best to craft their investment strategy.

Charles Sells, Founder and Managing Director, The PIP Group, told *DS News* that speculation about a possible recession is preoccupying some investors with "what if" scenarios spurred by uncertainty. "Investors have all talked about that 18-month window [for expecting a market correction]," Sells said. "'Alright, it's going to happen in 18 months.' Well, that was six months ago."

Sells observed, "People are just playing the wait-and-see game. They don't want to buy right now because they're afraid they'll end up in upside-down mortgages. They're just hanging tight, not wanting to make that move."

However, **Sean Miller,** President, PointCentral, told *DS News* that the market for single-family rentals (SFR) remains strong. "Owners and operators are trying to up their game as a way to serve that strong demand," Miller said, "whether that's combining portfolios or adding to their existing portfolios." Overall, Miller predicted that 2019 would be another strong year for SFR.

THE INVESTMENT OUTLOOK

"From a literalist perspective, it's just continuing from 2018, but if I was an investor I'd be cautious," said **Jay Tenenbaum,** VP, AZP

Property investment isn't for the faint of heart. DS News *takes a look at the trends and opportunities savvy investors should be pursuing.*

Capital. "I don't know that we'll be having the same conversations at the end of 2019. We know a correction is coming—we just don't know when."

However, many of those *DS News* spoke to for this piece don't foresee a widespread housing market correction to be as likely as more localized bubbles. "Not every metro behaves the same way," said **Dani Beit-Or,** Founder and CEO, Simply Do It. Nashville, he pointed out, is still facing low housing inventory supplies and a strong seller's market. "Some sellers are still living in the past, where you put a house on the market and it sells quickly. That is not what is going on in many metros."

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Tenenbaum said that he believes the market is simply behaving in a healthy and rational way. "People who are analyzing the numbers and the returns are excited to get in even at today's prices." He added that the housing shortage has helped spur the rental market, as even potential buyers who can afford to buy have not necessarily been able to find homes in their price range and desired locale—a boon for rental investors as those potential buyers find themselves renting for longer than they might have otherwise.

However, will the rental market take a hit when the market eventually corrects? Will renters have time to find a home before an investor buying frenzy in the event of a shift to a buyer's market?

"If we're buying the cheap properties and creating more rentals, we're just creating more rentals," Tenenbaum said. "Are we going to oversupply the rental market? Possibly."

There's certainly no shortage of interest in investing on the single-family rental (SFR) front. Kevin Ortner, CEO, Renters Warehouse, said, "Even the institutional capital has shifted their view on single-family rental to more of a long-term investment. There aren't a lot of people being spooked by talks of a potential recession in 2020."

With rents on the rise in many areas, Ortner said that SFR investors are seeing strong yields in markets where they can rehab properties into rentals. "We've seen both wholesalers and rehabbers beginning not just to buy and sell property but also start to build up a sizable rental portfolio as well."

Indeed, **Mark Gannaway,** CEO, Arcana Insurance Services, told *DS News* that single-family rental investment has become an easy entry point for many investors along the way toward diversifying into other areas. "These investors that have spent all this capital in learning how to do this are now trying to find a way to apply their new education in purchasing properties."

"Every market creates an opportunity to invest," Beit-Or said. "It's just a matter of how you will capture that opportunity."

THE CHANGING MARKET MAKEUP

So, who is investing in single-family properties in 2019? Gannaway said that the sector continues to attract many self-employed individuals who see investment as a chance to cement a secondary income. The fortysomething crowd is also well represented, according to Gannaway.

"Every once in a while, I'll have that young kid that has graduated from college and is entrepreneurial and has decided he's going to buy his first house," Gannaway said. "I don't a lot of people who are just married and have a bunch of children on the way. I see the very young or the over 40s who are thinking, 'What am I going to do if I lose my job?"

Whether it's the institutional money that entered the sector in the aftermath of the 2008 housing crash or smaller individual investors, Beit-Or said that the investment landscape is a much safer environment than it was in the days leading up to that crisis. "Investors today are working in a more constrained environment because the lending standards are tougher," Beit-Or said. "The appraisal process is different. So even those who just went and bought a house without doing their research, they're doing it in much safer environment than before the crash."

That's a good thing, because one trend mentioned by several of the people *DS News* spoke to is the influx of newbie investors with dreams of fixing and flipping their way to an easy fortune—and we can thank TV for that.

"Last I counted, there are 47 different reality TV shows based on fixing and flipping alone," Sells joked.

Yes, home flippers have become an easy punchline thanks to the popularity of shows glamorizing the process, but there seems to be no arguing with the fact that it's having a real impact on the sort of people who are entering the investment landscape for the first time. And unfortunately, the lessons of HGTV don't always translate well into the real world.

"Those shows make it look a lot easier than it is," Ortner said. "Every flip and rehab they do on those shows makes money. That's not the reality."

Tenenbaum told *DS News* that this influx of greenhorns has driven many more experienced investors away from fix-and-flip and into more long-term property investments.

"A lot of them are saying, 'If I'm not making 50 grand, it's not worth my time,'" Tenenbaum said. "The ones who can wash, rinse, repeat and get $10,000 a door, consistently, are still in the fix-and-flip game, however."

Sells said the "reality TV factor" has also impacted where more experienced investors are putting their money, with many bigger buyers shifting away from major metropolitan areas such as Atlanta or Charlotte, leaving those markets to the starry-eyed new arrivals. "There are a lot of what I call 'one and done' investors in those regions. Fortunately, the wholesalers usually aren't working with those guys. For big buyers like us, we're still dominating the markets that we're in."

PointCentral's Miller said that one sector seeing growth in the current market is the "build to rent" concept—properties being purpose-built to become rental homes.

"Builders are seeing high land costs, high labor costs, and high material costs. They're also seeing this continued demand for rental homes," Miller said. "While purpose-built rentals may still be expensive to build initially, it helps the operator and the owner see the return they need versus just buying an open home on the market."

These homes often don't require the same level of investment as far as amenities, since it's presumed they will see turnover and not become someone's "forever home," so items such as carpeting will likely have to be replaced multiple times over the years as new tenants cycle through.

WATCHING FOR LANDMINES

In spite of all the opportunities for profit property investment offers, there are of course just as many potential pitfalls. One frequent piece of advice: don't craft your investment strategy around price alone. Time and again, our experts warned, this approach will come back to bite you.

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> —**Dani Beit-Or,** Founder and CEO, Simply Do It

"If a property looks too good to be true, it often is," Ortner said. "A lot of times you see people get excited about property that's yielding 20 percent, but they forget it's a lower quality home that's going to need more routine maintenance and more preventative maintenance. Doing your diligence on the asset and understanding if you are going for those really high-yield properties, you have to know

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your risk and understand that."

Nor should this advice only extend to a property's initial purchase price. Gannaway cautioned that trying to cut corners when it comes to insuring a property can also prove disastrous. Cheaper prices may look like a bargain initially, but that will be cold comfort when the time comes to file a claim and you learn that the bargain policy has gaps in critical areas.

"Say an investor buys an insurance policy and finds out after the loss that it has a vacancy clause in it," Gannaway posited. "If I buy a policy and that property has been vacant more than 30 days, and then I have a fire loss or a vandalism loss after that, there's no coverage. They bought this house and now it's a total loss. How are they going to pay for it?"

Charles Sells also warned investors to be mindful of bankruptcy issues when considering properties to invest in. "Bankruptcy can come in and absolutely destroy your cash flow." He told *DS News* that The PIP Group has purchased properties at auction, only to lose the property "15 minutes after we won the bid" because a bankruptcy was filed. "It's definitely part of the business, and it's something that regardless of how good you are, it could happen."

Another factor to investigate is whether the auctioned property is still occupied or not. If it is, how long can you reasonably expect the eviction to take? Have you considered the worst-case scenario? Sells cited some Indiana investors he worked with who were having evictions take up to 18 months, a timeline that could easily bankrupt a beginning investor.

Beit-Or urged investors to also do their homework when it comes to selecting a property management company for their investments.

"Explore services. Explore how they work, what they do, and what kind of services they provide," Beit-Or said. "You've got to be very detailed." He said he typically speaks to between five and eight property management companies before he makes a decision, spending at least an hour talking to each during that process. "There's no such thing as a perfect property management company, but at least you learn to avoid the bad ones."

One tip Sells recommended is to always take for granted that the heating, ventilation, and air conditioning will be wrecked in any given property. It's a safe bet, he said, and even if it proves not to be the case, that can only mean good news. "We put that into our budget as far as what we're willing to spend for the property," Sells said. "Nine times out of 10, the HVAC is fine, so it just becomes money on top of the profit that we already built in."

Another often overlooked factor for investors purchasing properties is flood insurance—a lesson learned the hard way by many homeowners hit by hurricanes and flooding in recent years. Homes often are not required to have flood insurance if they aren't in a FEMA-designated flood plain, but those maps are not always up to date, and surprise uninsured flood damage can turn a property from a long-term investment into a long-term nightmare over the course of a single strong storm.

"Nobody in Houston thought they needed flood insurance," Sells said. "Panama City last year was the same situation. Even on the beach itself, people didn't have coverage."

Nor does a home need to ride out a flood in order for water damage to be a potential issue. PointCentral's Miller explained that one area of property management he's excited about is tech that allows for the automated monitoring of issues such as water leaks.

"Water damage doesn't just randomly happen," Miller said. "There is always some small hole or leak that starts, and then that grows and eventually ruptures." Miller explained that there are several companies working to develop products and tech that can automatically sense and map that sort of damage in the early stages, so it can be repaired before it becomes a full-blown disaster. "That allows you to avoid things like mold growth, remediation, and health claims," Miller added. "Anything that can help you be proactive, it helps the property manager keep a happier resident."

TAKING THE PLUNGE

Sells recommends that potential investors looking to dip their toes into the water start with one simple adage: start small, lose small.

"Start with something that isn't going to require you to leverage the pension that you worked 20 years for," Sells said. "I started in 1998, so I've been through the NASDAQ crash, the last housing crash, and when the market was strong. Distressed real estate is always there."

Sells recommended avoiding coaching programs, weekend workshops, and the advice of HGTV. Instead, he suggested that investors visit property auctions to meet the people who have been in this game for a long time. Auctions, Sells suggests, are also a chance for investors to play out a hypothetical investment to see what questions arise along the way.

"Do mock deals," Sells said. "Pretend that you're buying that three-bedroom, two-bath that's being sold on the auction steps in Augusta, Georgia next month. Go through the motions of what you think it would take to repair it, and all the steps involved."

Perhaps the most important advice, Beit-Or suggests, is to take the time to be strategic. What are you looking for? What sort of returns are you looking for? How long are you looking to be involved?

"A lot of people just jump in because they're following the herd," Beit-Or said. "They're not even spending a few minutes to ask themselves the important questions. Are you buying with cash or financing? What are your fears and concerns? If you have that conversation with yourself, it will be easier for you to come up and say, 'The right thing for me to do is lower-end, single-family homes,' or whatever strategy you come around to."

Single-family homes can prove to be an ideal entry point for investors, Beit-Or advised, but only if they take the time to do that initial self-examination and planning. "It's not about following the herd," he said, "it's about defining your path today, or tomorrow, or next year."

"There are so many different ways to go about it," Ortner said, "whether you're looking for higher home price appreciation over the long term or you want to invest in something that's higher yield. It's important to understand what you're trying to get out of it and how long your hold period is."

Thankfully, technological advances have made it easier than ever to be strategic, as the days of investors being hampered by geography have largely fallen by the wayside. Investors aren't limited to properties in their own backyards, and there are an abundance of tools and tech that streamline the process of finding the right properties in the right markets—even if that market is on the other side of the country.

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—**Sean Miller,** President, PointCentral

"It's always great to have the homes you can go see, touch, and feel, but if you are someone who wants to put money into the space and you're sitting in San Francisco or New York or in LA where really buying a home to rent doesn't make a lot of sense financially, that doesn't mean you can't play the game," Ortner said.

Be diverse and resourceful, Tenenbaum suggests. "You can't be distracted by shiny objects. You have to let things matriculate and filter and work. You can't say, 'I tried this for five minutes, it didn't work, I'm going to go on to something else.' You'll be a jack of all trades and a master of nothing."