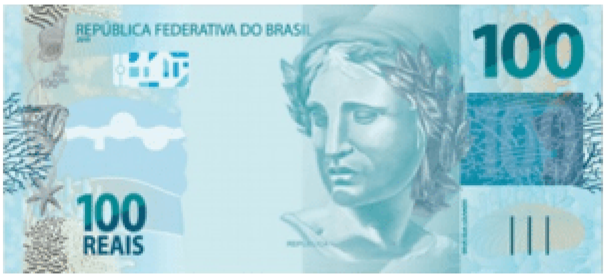
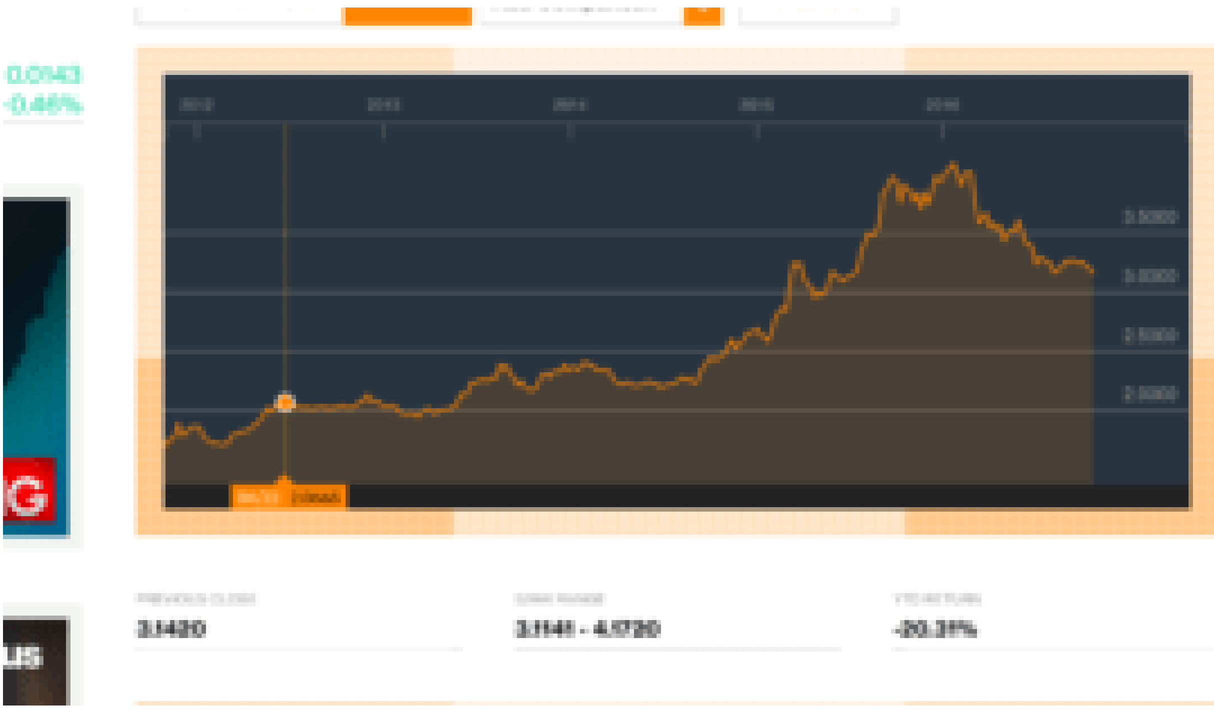
Real estate in Miami is about to go down again…

Time for real estate to go down again

Almost a year ago, I was writing about the Real Estate in Miami, and I was already aware that the time for good deals was gone. There were no longer any spaces available at a bargain price. As I had forecasted: things are now quite bad, markets are slow, realtors that were making millions a few years ago are now looking for different jobs, and cranes are still standing high, but some new buildings are starting to look deserted.

Let’s see what has happened:





Most of the price changes were due to a drop in demand due to external geopolitical factors (Brazil, Venezuela, and the immigration of the wealthy Latin Americans to Southern Florida—Miami in particular).

Now, Venezuela is in complete ruin, and the few that have money had already bought properties a few years ago and are now reselling try to cash out and have money to spend.

In Brazil, the currency is devastated. So Brazilians who can sell their assets in US Dollars now have a significant amount of cash available when exchanged for Reais.

So this means that even if they didn't have a lot of money (in USD), they could make up for it by converting to their currency. So basically, people are letting the deals go and lowering their price expectations.

Now, this does not mean that there is going to be a catastrophe (or at least not anytime soon), as interest rates are still very low, and banks are still lending. But inventory is high, and buyers have greater choices making the time to sell of increasing importance.

Also, most of the foreign buyers who have purchased a property in South Florida in the last few years were cash buyers. Therefore, even if the market continues to go down as it is doing slowly, we will never experience the same situation that we did in 2008 when prices were coming down due to the inability of landlords make their mortgage payments.

Who is buying again?

Well, as we know, people with bad credit are taking advantage of the readily-available bank money and low-interest rates. So they are working to return to a 600 credit score to be able to own property, thus lowering their monthly expenses.

Basically, in some blue-collar areas of Miami, or class C, rents are becoming pretty damn expensive. In Fort Lauderdale, Hallandale or Hollywood, you need, on average, $1700 a month for a three-bedroom residence.

The same goes for semi-ghetto areas such as Miami Gardens, where to rent a 1500 square feet house, you need at least $1500. So, with a less than 4% interest rate on a 30-year loan, mortgage payments will be much cheaper than rent. Mostly, buyers are buying because they are saving money by doing it rather than paying rent. Rents will likely start dropping a bit anytime soon.

> *If you saved your money, did your homework, worked hard, risked your money, bought when nobody was even touching real estate, and now you are enjoying the fruits of your work, why shouldn't you enjoy the rewards?*

My intuition a few years ago was right. Realtors were always trying to discourage you from class c areas, saying that they would not appreciate much. My math was saying, however, that this was bullshit.

Rent was more expensive—much more than buying a property. So, by the time six years had passed, all those landlords foreclosed upon could once again be eligible to purchase a property. Obviously, the first thing they would do was obtain a mortgage and buy a house—sometimes even more than one.

In Naples, Florida, I purchased assets that are now worth easily 5 times more. Those properties were in low-income areas. However, properties on the beach and inexpensive areas did not appreciate as much. Not even close.

Now, it’s time to sell—at least to unload the portfolio.

Why should we get rid of good cash flow properties if, regardless of their value, they are producing a good income?

> *I think there is a risk: politicians will subtly try to reduce investors’ profit through taxes.*

Most of the properties in southern Florida bought by investors and hedge fund managers.

They amassed properties, rehabbed them and rented them out. When they did the math, as we did, the simple real estate guys were not that bad, and they not only wanted to have a piece of the pie., they also wanted the entire pie. So they came from New York with millions of dollars, buying properties like people buy apples at the supermarket.

Property values have increased, and the government knows that most of the profit left in the hands of investors. Right now they can subtly take part of the profit, and at the end of the day, investors cannot complain much. So what are they doing?

In the meantime, cities are getting organized. With thousands of inspectors, they create the most stupid laws to charge you money, fees, and any kind of shit, for the most insignificant things. If your tenant parks the car a tiny bit off from the property lines, the landlord gets fined or issued a violation. They’re starting to check all of the old permits to evaluate if they are up to code. They are making new regulations to force new construction work, and along with those new codes, there are fines, permit fees, inspector fees, etc. levied.

They are doing it all on purpose. They are trying very hard everywhere to extract money from the landlord, even when it’s clear that the house is in good condition and no work is needed. In this scenario, it’s clear that taxes are also increasing, and they will increase more, forcing yields to decline and forcing investors to sell.

The crowds considered by politicians are not the lucky or good investors. The crowds are the poor that cannot afford rent, and they always make more noise. This is what really pissed me off.

If you saved your money, did your homework, worked hard, risked your money, bought when nobody was even touching real estate, and now you are enjoying the fruits of your work, why shouldn’t you enjoy the rewards?

But nobody will care about the meritocracy of some wise investors. We will be and always have been the easiest target to hit. When money is needed, the middle class are the ones that need to pay for it more than anybody, even more than the rich.

America will soon face an issue that cannot be solved anymore with quantitative easing. Taxes will need to increase. Real estate assets, mostly when paid for and belonging to investors, will be an easy target.

For this reason, I will not hold many more properties; it’s time to sell and look elsewhere. I will only keep one-quarter (¼) of my portfolio.

For more news on great investments stay tuned.

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Zillow’s App: a Real Estate App

Being in the Real Estate Industry, I downloaded Zillow’s app.

Zillow is the most prominent real estate portal in America. Through the Zillow app, there many options to find useful real estate information from decorating your home to renting an apartment or finding professional help.

Once I downloaded Zillow‘s app, I let the app find my location. It will suggest via the map real estate deals that were in my area. This works for both rentals and sales.

Now I am able to filter what I am looking for so this will narrow the search. This is a beneficial tool because by identifying the requirements, I will only spend time looking at deals that are within my criteria. The map feature is user-friendly, and you scroll through and pick out the areas where you prefer to live or invest.

Another feature that makes Zillow very successful is the possibility of inserting the address of virtually any house that has ever been in the MLS (Multiple Listings Service) and to be able to know the full story of the house. So I can check the pictures, how much it was sold for in previous years, how much tax it pays per year, and all the characteristics like the year it was built, lot size, etc.

It does have a system that can predict the value of the house and of the potential rent. The information is very reliable. Indeed many investors use it to identify the approximate value of the house based on Zillow’s price.

It does have a forum within the app where you can ask questions and get help or just get an opinion from a professional realtor.

The success of this app is also due to the review of realtors. Realtors engage with the clients by asking a question, and they can sell their professionalism with the answers they give. Clients can browse the forum and select an agent that inspires more trust. The latter reflects the concept learned in our first Lecture in which we spoke about the evolution of the expert friend and the importance of the new generation to rely on a specific review to choose to buy a particular product or service.

In Zillow's app, this is precisely what happens. Realtors engage with the customers and sell themselves, their ability, their capability, and professionalism. When they have made a positive impression, they will be chosen by potential clients. Their business model to create revenue is clear. They afford the possibility of realtors to introduce and advertise themselves so that all that interaction with the users earns potential rewards.

The revenue must be huge because they also advertise mortgages and rehabbing. So through the app, I can basically order a new kitchen or bathroom. I can choose the style and the color and have an instant quote.

I sit on my sofa while I get all this from my iPad.

The app does not have coupon or discount, so it leverages on the cognitive need of the users. Zillow provides all the information a user could wish to have instantaneously. People can use Zillow to study and evaluate and compare the rentals or the buying. Zillow's strategy has been to invest in the data collection of all the transactions in real estate in the USA and create a way to analyze the data and provide it free and in an easy to read format for everyone.

They created their power from sharing for free all the data collected, that's a fantastic innovation, what we learned until now proves how useful and valuable can be the analysis of data, analyzing data can help to develop a strategy for positioning for advertisement, etc.

The innovation of Zillow was to share for free those enormous amounts of data to become popular and visited and as happen eventually leverage this position to grow and start to create revenue.

I always thought that the apps or the socials or the video that are most successful are the ones that before charging try to give a proper contribution or advantage to the user. If you provide a free solution to a gap in the market and that solution has value, it’s only matter of time before users will come. Then you can produce a proper revenue late with aggregates services.

Internet population loves the word free, and they recognize value and power of proper content, and I find it so far, more than simple discount or coupon but an app with no substance.

The power of providing information and proper content will generate a real keen interest in the app. This is rather than just downloading an app with the intention of getting a discount coupon. I think the genuine keen interest in using an application that is beneficial for a business or a personal life will always be superior to the attempt to buy a client by offering a discount coupon.

The Dreadful Word: VACANCY

The concept of vacancy, which I touched on in the last post, is one of the most important factors when investing in real estate for cash flow/income purposes.

People lose money or make bad investments primarily because they do not understand how to calculate it correctly.

Obviously, calculating vacancy is terribly difficult. What most investors seem to do is simply discount 10%, sometimes even only 5% from the gross value of the rent that they are supposed to get…and then they just hope that it works.

It's pretty evident that such an approach is very shallow, although it probably does help to limit damages…sometimes. A lot of investors forget to even calculate it, so when someone actually considers some extra costs in the list of expenses, it's to limit possible damages, but it is probably not enough if you want to be professional.

Vacancy is a powerful tool to use to be able to understand the potential of an investment

What is a vacancy?

A vacancy is merely the money that you need to consider and take off from the gross rent because the unit is not rented. It is also a powerful indicator of how good an investment really is and what growth potential it may have. A vacancy is inversely proportional to the expected growth of a property.

I am not able to calculate the numbers precisely, but I am able to at least identify the relationship. The more the vacancy, the more you can expect the growth potential to diminish.

Why is this?

Well, let's think about it…

Neighborhoods that are really good usually have higher deposit requests to even get in the house. As a landlord, what that means is that you can get 2 months deposit, in some cases even 6 months deposit, which means that the prospective tenant will rent longer and always pay on time because they have more money and don’t want to risk ruining their credit. Also, the higher the deposit, the less risk that you, the landlord, will have to take on which will limit your damages and reduce the risk of vacancy.

Of course, we would all love to get 6 months deposit upfront or even 3 months for that matter, but it is usually not the case. People don’t always have this kind of money laying around, and you also need to compete with other property owners that are offering a more straightforward payment solution.

So this makes the relationship a little more clear. If you are in the right area, then you can get more money up front and limit the value of vacancy. The areas with the low vacancy will most likely be those with both high rental demand and income, as well as where there is a lot of competition.

For example, you can compare the vacancy rate in a Class D neighborhood in Miami-Dade county, let’s say, for instance, Liberty City, which is close to 40% vacancy, compared to another area like Miami Beach which can be calculated at 10% vacancy.

Can we derive a formula or an equation to predict a vacancy rate?

No. But we can have some fun and maybe try to work something out that will bring us as close as possible to a “formula” or market prediction.

What other values are there that can affect vacancy?

Well, it’s not only the neighborhood but what I noticed is that vacancy is directly proportional to the price of rent. The higher the rent, the fewer chances of the landlord being compromised by evictions and legal matters.

For example, regardless of the location of the house, a house

that rents for $700 will have a much higher vacancy rate than that of one that rents for $1400 in the same exact neighborhood.

I don’t have a lot of data available, but according to my database, even top class locations (income neighborhood of $125K+) where small studios or small 1 bedrooms rent for $800-900 experience 15-18% vacancy. Other data shows that a lot of people struggle to pay 3 months deposit up front.

In the same neighborhood, or even in one with a much lower income ($75-85K), I can basically say that according to my database, I am comfortable to estimate a vacancy of around 10% or less for homes that rent for $1400 or more. 10% vacancy means that there are very rarely evictions and that most of the vacancy depends on the changeover at the end of the contract. Also, the time that it takes to rent it out again is factored in as well.

Then I checked the low-income neighborhood below $50k, and I noticed the same relationship. The vacancy is low on properties that rent at $1400 or above. The $50k mark seems to make a big difference in the vacancy in Miami and Broward counties.

Actually, I noticed that the neighborhood does not make such a difference…what makes the most difference is one thing, the price of the rent! Property that is below $1000 per month in great areas will have a higher level of vacancy than that of properties in a Class C neighborhood, especially if the latter is a beautiful big house with a pool and the rent is above $1400.

I have owned about 100 properties in Broward and Miami-Dade County, so my data comes from plotting those results. And what I have found is that property with a higher rent value tends to have a much lower rate of vacancy.

So…hypothetically let’s say there is $150,000 available to invest in a Miami property for income purposes. Two options exist: 1) a studio in a desirable neighborhood that rents for $1000 per month, versus 2) a 4-bedroom house with a pool that rents for $1500 in a Class C neighborhood. Faced with these two options, I would definitely have to choose the second. The income would be better and more consistent on the second option.

I would also bet that appreciation is more likely with option 2…but that is for another post!

Talk Soon!

Antonio

Single Family Home Vs. Multi Family

Time and time again I have seen realtors pushing buyers around, mainly the property buyers who purchase multi-family investments. For some reason, many realtors seem to think that those investments are much more significant regarding a Single Family Home. Obviously it depends on the price, but in general, the costs of multi-family properties have been increasing so much that the numbers just don't make sense anymore.

As a general rule of thumb, I am firmly convinced that an SFH (single family home) is a much better investment than a multifamily. The only exception to this rule is if the multi-family is bought at such an "interesting" price, and with a much higher cap rate than the SFH.

Let’s analyze this:

1. Duplexes have a higher vacancy rate
    - The vacancy is one of the most critical concepts of real estate investing. If you are not aware of the right vacancy, you will end up entirely out-of-pocket and go into a real estate investment blind.
    - All salesmen will try to pitch you a great investment and will probably try to challenge your ability to interpret the vacancy rate.
    - When you’re dealing with a duplex, you are taking a higher risk, because the risk of an empty house is higher, at least double when compared to the single family home. Indeed, you will be dealing with two tenants and not only one.
    - You have another added risk; Assuming that you’re buying property below market value, you will most likely be dealing with a lower income tenant than the SFH.
    - Usually, the rent of a duplex unit is 25/30% lower than the SFH of a similar size. This means you are dealing with a more complicated tenant, your risk of not collecting the rent is higher.
    - So, you not only have double vacancy risk, but you also have a lower income tenant to deal with.
    - If you calculate a vacancy of 10% as a standard vacancy, a duplex in the same area should be at least 25/30%, considering double the risk and adding the extra percentage of risk dealing with a more troubled type of tenant.

- As you can see already, you need to have an amazing gross amount to still stand up with a reasonable cap rate after such a deduction.

2. Unfortunately, the above is not finished!

In the column of your maintenance cost, you will have to consider that now you have two kitchen's, two A/C's, two bathrooms, etc., etc. This means that you will have twice the chance that something may break and need to be repaired, and you will need to fix it.

Also, it's worth it to note that you will need more money when rehabbing the house; A/C is an essential part of the property and is usually a necessity in the summertime, especially in states like Florida, Texas, California and more…it breaks easily and always needs to be cared for. This will again increase your cost

Obviously, when it comes to a triplex or a four-plex, you need to apply the same criteria.

If you have units with a window A/C unit, you may get a lower rent, and therefore lower income tenants, but probably better in the long run, at least when it comes to any maintenance issues.

3. The exit strategy is much more complicated than the SFH.

You see, in SFH you will most likely be able to sell the house to a first time home buyer. If you have a lovely house in a decent location with a decent school, you will always find first home buyers that are willing to buy it.

People are slowly but surely fixing their credit and/or recovering their bad credit that they incurred during the financial crisis. Obviously, if you have a good cap you bought at a good price, there is a chance that the rent will cost more than the actual 30 years mortgage, at least if the interest rate stays below 6%, which is reasonable in the next 2/3 years.

It's even happening right now…tenants are becoming the "client" by calling the landlord and asking to buy the house that they are renting. With multi-family units, it is more complicated. You can still find first time home buyers for duplexes, but I can't lie…that is rare when compared to that of an SFH.

A family usually needs a bigger house, garden, etc.

It does happen for a duplex to have a first time home buyer that can rely on the other unit to help pay the mortgage but it's more difficult, and it's usually people with lower income, which means an increase of risk.

Now if an investor is leveraging, or even if they are not, why would they buy a unit with a lower cap rate then you in an environment where the interest rates are higher?

If you need to make a profit from the unit, the cap rate will be lower for the investor than the one that you have. And if you are selling in few years, we all assume the interest rate will be higher. So, leveraging will be more expensive, and it will make less sense investing to gain a spread.

Of course, a few things might have changed due to a rent increase and area improvement.

This can usually happen mainly IF THE INCOME OF THE PEOPLE IS INCREASING and inflation is high, the unemployment rate lowers, so basically everything that will have an impact on the Swifting of the demand curve. And therefore only, in that case, you may make some money, but you will still need to consider that a buyer leveraging will be impacted but at a higher cost of borrowing.

So then why is it that multi-family and bigger units have a lower cap rate than single-family homes???

This is the catch, I think the market does not appreciate enough, and the multi-family is more attractive to investors for the following reasons:

1. Bigger size, so it’s easier to place 1,2,3 million in one deal only

When realtors or asset allocation managers move money, they need to be concerned with how easy the deal can be achieved, and the need to allocate money. Usually, size is an issue. Any investor would prefer to deal with one building worth 5 million than with 40 single family homes.

2. Leveraging is easier on a building because a mortgage lender will work more on a loan of $1/2/3 million than on a $50,000 loan, small loans sometimes are a headache for the lenders and brokers because it is the same amount of work for a very small fee.

All of the above have a serious impact on multi-family prices. In Dade and Broward County you will see multi-family selling at a way overpriced amount.

This is a risky business because the vacancy considered is usually way underestimated, mainly in buildings that have many units and the cap rates are very low.

Multi-family prices are often times the effect of a realtor or asset manager that is desperate to allocate or find a good sized deal, but they don’t represent a great investment overall, nor in income or appreciation.

Nowadays, at least in the Miami area market, it is essential to keep your bearings with you, be aware and do your numbers before entering into any deal!

Until Next Time,

Antonio Velardo

Real Estate Investing: 101

I find it quite amusing that the Real Estate Market is one of the only areas of investment that you can find information on how to become rich quick. Or on how to buy a course that will teach you all of the tricks and “unrevealed secrets” that will make such a difference in people’s lives.

I have been in the industry for 15 years, and I have been tremendously successful, making millions of dollars, and I guess most of it was a combination of luck and knowledge. I wholeheartedly agree that the leverage you can get from specific knowledge will give you an edge over the others. But I think most of the Real Estate courses are focusing on the wrong subjects, and they try to make the job sound much easier than it really is. That, unfortunately, will bring a lot of discouragement, money lost and time wasted.

I have been a multimillionaire since 2007, and when I made my real estate fortune, I was not aware of courses and real estate “schemes.” I need to admit that the main reason why I made my real estate fortune was due to my dedication, hard work, and common sense.

I would like to clarify the word “*common sense*,” which is quite ambiguous if left like this in a conversation.

I guess for common sense I mean that sense of awareness of the investor’s point of view. If you know what the investor likes and their alternatives, then you can most easily understand if your Real Estate deal makes sense or not.

Comparing the Real Estate deal with other deals available is essential, not only in the same industry but also in other sectors will make a huge difference, because, at the end of the day, the person who invests money is not obliged to invest in only real estate.

I always compare my options to the bond market, the equity market, the commodity market, etc. Some Real Estate investor's fail to compare the deal, and they get a bad result from the investment. Firstly, comparing the market alternative will give you a feeling of how good the deal is at the moment, and whether you should put your resources, effort, and money in real estate.

I made quite a bit of money in the last 3 years acquiring distressed assets, fixing them, flipping them or making them perform as a positive cash flow asset, but I was not listening to the "news" on television or in the paper on how good that investment was at that moment.

I always do my own math. And as an investor, I was applying my "investors commons sense, " and the rules learned. I knew that my money, or at least a good portion of it, was better in the Real Estate market rather than in low-yield bonds, high-risk yield bonds or anywhere where the ratio risk/return was not remunerative.

What I would do is apply the same knowledge and same criteria, ignoring the "news" of the papers, where all these guru's that don't have a clue and would predict the market without a proper understanding of the subject.

I want to create a small space where people can learn from my experiences. And mostly that they can learn the criteria that I use and apply to each deal: how I became successful and it will be interesting to brainstorm with other people and investors, so to create a new way to analyze Real Estate deals in such a precise methodology that every deal will be a success.

In the last 3 years, I bought 250 houses, and I made money from practically all them. I tripled my money, and I guess we can say that it was easy to make money in the last 3 years, but to be honest, I saw experienced realtor's laughing at me because of a deal that I was buying. I sold that house 3 months later for double the money, even though I had friends and investors that bought houses 3 years ago that they still cannot sell.

So while I need to admit that finding deals were quite simple 3 years ago, I can tell you that not many people knew what they were doing.

I think anybody who masters Real Estate investments can make huge money when things go bad or when they go good, and the opposite, you can lose a lot even when things go well for everybody.

In the Real Estate business, there is a distinctiveness that does not apply to other fields, “everybody thinks they can become an investor, and it’s easy.” However, people will not apply the same simplicity when it comes to commodity trading, the stock market or any other field.

Most people have no clue, no knowledge and they feel that they are competent and intelligent when it comes to the Real Estate market. It’s utterly ridiculous, and I find that in real estate there is the highest number of charlatans and idiots that I have ever met in my whole life.

In other fields, you don’t really meet so many incompetent people as you do in real estate. I think 95% of all of the realtors have absolutely no clue about the rules that drive the prices up and down and will be mostly useless to help you to make money because they don’t understand the big pictures themselves.

I want to finish like this: Most of the courses and seminars from the “gurus” that I see online and that I participated in are extremely funny, because they teach you something obvious, that if you find a deal below the market value, you can resell making money, hahaha! Hello….we already know this!

So if you find a house worth $100,000 at $65,000, you can make cash. Even if you do not have a penny or even if you have just enough money for the deposit, you can still make the deal a success!

I guess it's the truth and it's quite apparent, but what they don't tell you is that the chances for you to get those deals are quite rare because you have millionaires like me that have a team of people always looking for deals. I have employees paid to spend all of their days, every day, searching for deals and making low ball offers to every single house that they come across…

I have cash on hand to buy, and like me, millions of investors always have an extra bonus for a friendly listing agent, so the chances for a random guy with no money to snap up deals from under me are rare. It does happen, but not so often that it's time to leave your job and become an overnight Real Estate multi-millionaire.

It's not easy to buy below market value, or at least the current market value. I think it's easier to predict the market movements with care so that you can get a deal wherein few months you will gain fantastic equity and good cash flow.

It's much more realistic to find a good deal for a house at half price, as opposed to limping in and needing much more money to make the deal a success.

If you want to follow my advice, I will very honestly tell you what I do and what principle I apply…and more importantly, where I apply them. I will not sell courses…I make my money in the field (in the real estate market), so I don't need to sell dreams. I do however want to be a part of the success of other people's dreams.

I will not tell and sell you BS…if you have no money and want to put a deposit on a property using a credit card with an APR of 15%, I will simply tell you the truth, "*you are crazy, and* *you very well may lose all of your money!"*

So, welcome to my blog, where a random unknown millionaire is willing to share the knowledge of the Real Estate market and how to identify and separate a good deal from a bad deal.

I hope you enjoy!

Ciao

Antonio Velardo